



Edexcel A - AS Level Economics

Theme 2 – The UK economy – performance and policies

2.1 Measures of economic performance

Revision Notes

Contents

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2.1.1 Economic growth

Gross Domestic Product (GDP)

What is Economic Growth and GDP

Let's think of GDP as your country's scoreboard. It tells us how much *stuff* (goods and services) a country is producing over a year. The more the country produces, the higher the score. It's a keyway to measure **economic growth**, which is just a fancy way of saying how much the country's output is growing over time.

- **Definition: Economic growth - A long-term rise in an economy's productive capacity, leading to higher production of goods and services, typically measured by growth in real GDP.**

What is GDP?

GDP is the **value of all the goods and services** made in a country in one year. Imagine everything sold in shops, all the services like healthcare and teaching, and even the exports sent abroad – its all counted. It's also a way to compare how different countries are doing.

- **Total GDP:** This is the overall value of all the goods and services produced.
- **GDP per capita:** This is the value divided by the number of people in the country. Think of it as how much stuff each person gets, on average. If this grows, it means people are likely better off.



2.1.1 Economic growth

There are **two ways** to measure GDP:

1. The Income Approach:

This adds up all the income earned from making the goods and services:

- **Wages:** From workers' salaries.
- **Rent:** From land or property.
- **Interest:** From capital like loans or savings.
- **Profits:** From businesses.

2. The Expenditure Approach:

This adds up all the money spent in the economy:

- **Consumption:** What households spend on things like groceries, clothes, Netflix subscriptions, etc.
- **Government Spending:** Money spent on things like schools, roads, and hospitals.
- **Investment:** What businesses spend on machinery, buildings, or tools.
- **Net Exports:** Exports (stuff sold abroad) minus imports (stuff bought from abroad).

Both approaches should give the same number because one person's **spending** is another person's **income**. It's all connected.

2.1.1 Economic growth

Gross Domestic Product (GDP)

Real GDP vs Nominal GDP

- **Nominal GDP:** Includes inflation, so prices might look bigger just because things are more expensive, not because there's more stuff.
- **Real GDP:** Strips away inflation to show the true growth in goods and services. It's like comparing apples to apples, not apples to super-expensive golden apples.

Value vs Volume of GDP

- **Value of GDP:** The actual monetary worth of all the goods and services produced.
- **Volume of GDP:** The total number of goods and services produced, stripped of price changes like inflation. It's the real stuff, not just the inflated cost.

So, if prices go up, the value of GDP may rise, but the volume might stay the same if the same amount of goods is produced.



2.1.1 Economic growth

Example: Cakes and Cookies Over Two Years

Year	Price per Cake (£)	Cakes sold	Prices per Cookies (£)	Cookies sold	Nominal GDP (£)	Real GDP (£)
2022	10	100	2	200	1,400	1,400
2023	12	120	2.5	220	2,010	1,780

1. **Nominal GDP:** Multiply the price of each product by the quantity sold and sum them up.
 - **For 2022:** $(£10 \times 100 \text{ cakes}) + (£2 \times 200 \text{ cookies}) = £1,400$.
 - **For 2023:** $(£12 \times 120 \text{ cakes}) + (£2.50 \times 220 \text{ cookies}) = £2,010$.
2. **Real GDP:** Use the first year's prices to calculate GDP for both years.
 - For 2023, adjust prices to 2022 levels: $(£10 \times 120 \text{ cakes}) + (£2 \times 220 \text{ cookies}) = £1,780$.

2.1.1 Economic growth

Other national income measures

Let's talk about GDP (Gross Domestic Product). It's great for showing how much a country makes *within its borders*, but it doesn't tell the full story. Why? Because it ignores money made by citizens *outside* the country. Imagine your friend works abroad, sends money back home, but that cash doesn't show up in GDP.

That's where **Gross national income (GNI)** comes in. It's like GDP but cooler because it **includes income from citizens working abroad**. So, if someone from the UK is earning in Australia and sending money home, GNI counts that too.

Now, **GNP (Gross National Product)** takes things one step further. It's like saying, "Alright, let's include money sent **to** the UK by its citizens abroad and take away money sent **out** of the UK by non-residents." Clearer picture, right?

Finally, **GNP per capita** is even better because it divides GNP by the population. It's a more **realistic measure of wealth** – because it considers how much each person, on average, actually benefits from the country's income.

In summary

Think of it like pizza slices:

- **Nominal GDP** is the total pizza size.
- **Real GDP** is the same pizza without the "inflation toppings" you didn't ask for.
- **GDP per capita**? That's how many slices each person gets.
- **GNI/GNP per capita**? That's making sure you're counting the slices people earned, whether they baked the pizza at home or worked in a neighbour's pizzeria! 🍕



2.1.1 Economic growth

Comparing growth between countries

National income stats are like a global report card. They show us how countries are doing when it comes to **wealth, standard of living**, and whether governments are making good decisions. Here's how they help:

- You can compare countries across different eras or events. *Example:* Compare the rapid tech growth in South Korea over the last decade to the industrial boom in the UK during the 1800s.
- **Real GDP** - It's way better than nominal GDP because it removes inflation. *Example:* Imagine one country's economy is growing, but only because the price of bananas tripled. Real GDP looks past that banana inflation and tells the real story. 🍌💰
- **Real GDP per person (GDP/capita)** - It's like dividing the country's wealth among its people to see how much each individual benefits. *Example:* A small country with 1 million people and a high GDP might be better off than a larger one with 100 million people and the same GDP.
- **Real GNI per person (GNI/capita)** - It checks how much money citizens are earning, even if they're working abroad. *Example:* If a lot of workers from India earn money in the Gulf and send it home, GNI shows how much income the country's citizens actually get.
- **Real GNP per person (GNP/capita)** zooms in on money earned **within the country**. *Example:* In Switzerland, you'd see the wealth generated from chocolate factories and banks staying in the country's economy. 🇨🇭🏦

2.1.1 Economic growth

Purchasing Power Parities (PPP)

Imagine PPP as your travel guide for money, it helps you compare what your currency can buy in different countries. It's like finding out how much of your currency is needed to buy the same good in different places, whether it's **GDP, GNI, or GNP** we're talking about.

- **Definition: PPP – The exchange rate between two currencies that reflects the cost of living in different countries by comparing the price of a standard basket of goods.**

How Does PPP Work?

PPP shows how much money you'd need in one country to buy the same things as in another.

Example:

- A pair of trainers' costs **£50 in the UK**, but the same pair might cost **\$150 in Australia**.
- PPP here would be **1:3**, meaning it costs 3 times as much in Australia in currency terms.



2.1.1 Economic growth

Purchasing Power Parities (PPP)

Why is PPP Useful?

It's the best tool to compare the **standard of living** between countries where prices for goods and services can be wildly different.

- A basket of groceries that costs **£110 in Thailand** might cost **£330 in the UK**. Here, PPP = 1:3.
 - This tells us the UK is more expensive.
 - BUT, if British workers earn more than 3 times what people in Thailand earn, their standard of living might still be better.
 - On the flip side, if incomes in Thailand stretch further, it could mean they're living it up on less.

Breaking It Down:

- **High PPP** (like 1:3): Goods cost much more in one country compared to another.
- **Low PPP** (like 1:1): Things cost about the same, no matter where you are.

2.1.1 Economic growth

Problems with comparing GDP between countries

Imagine if the economy grows by 8% in India, 4% in Nigeria, and 1% in France. At first glance, it might seem straightforward, but there's more to the story. These figures can hide significant differences because of several factors:

1. Subsistence, Barter, and the Informal Economy

In many rural areas, people may grow their own food or trade goods and services without money. This activity isn't recorded in GDP. Similarly, informal work, like unregistered street vendors, flies under the radar. For example:

- 10% of GDP in Germany may come from informal work.
- 40% in Mexico.
- Over 50% in Kenya.

This means GDP misses a big chunk of economic activity in some countries.

2. Currency Values

How do we compare the real value of money? Should we use the official exchange rate or consider how far a currency stretches in each country? For example, \$10 might buy a simple meal in Canada but a week's worth of food in Cambodia. Using measures like purchasing power parity (PPP) can provide a fairer comparison.

3. Income Distribution

GDP per capita might look good, but is the wealth shared evenly? For instance, a tech billionaire in the USA skews the average, even if millions struggle to afford healthcare. A high GDP doesn't always reflect the reality for most citizens.



2.1.1 Economic growth

Problems with comparing GDP between countries

4. Size of the Public Sector

Some economies rely heavily on government spending, like Norway's public-funded healthcare and education. Meanwhile, in places like the Philippines, the public sector is much smaller, and most spending comes from individuals. Whether this spending improves welfare is not always clear.

5. Consumer vs. Capital Spending

If a country pours money into building high-speed rail networks (capital spending), it might boost future growth but won't immediately improve people's day-to-day lives. On the other hand, if the focus is on consumer spending (like buying cars or gadgets) GDP might grow, but long-term benefits could be limited.

6. Quality Issues

Spending on infrastructure like roads might be high, but are the roads actually usable? For instance, a country may build ten new hospitals, but if they lack staff or equipment, the quality of healthcare doesn't improve. Numbers alone don't tell the whole story.

2.1.1 Economic growth

National happiness

Let's talk about happiness, on a national scale. In the UK, the **Office for National Statistics (ONS)** measures how people feel about their lives, going beyond numbers like GDP.

While GDP is all about numbers, **national happiness** looks at the bigger picture, like **health, relationship status, employment status, the quality of housing, access to green spaces**, and how people feel about their daily commute.

Here's a twist: **GDP stats often paint a more positive picture**, but happiness surveys dive into how people *actually feel*. This makes happiness data more **normative** (focusing on what *should* be, not just what *is*).

There's also a famous idea called the **Easterlin Paradox** that explains how happiness links to income:

- More money *does* make people happier *but only up to a point*.
- Beyond that, extra cash doesn't always bring extra joy.
- In short, happiness isn't just about earning more, it's about living better.



2.1.1 Economic growth

National happiness

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2.1.2 Inflation

Inflation, deflation and disinflation

Inflation

This is when prices **keep going up** across the economy, it's not just one or two things getting more expensive. Imagine a "basket of goods" filled with things you buy every month, like bread, milk, and shampoo. The average price of this basket is tracked using something fancy called the **Consumer Price Index (CPI)**.

For example, last year, a bread cost £1.04, and now it's £1.40. That's inflation in action. In the UK, the government tries to keep inflation steady at around **2% per year**, because a little inflation means the economy is growing.

Deflation

This is the opposite: prices **fall** across the economy. Sounds good, right? Not always. If prices drop too much, people might stop spending because they expect things to get even cheaper, which can harm businesses and jobs. Deflation happens when the **percentage change in prices goes below zero**.

Disinflation

Don't confuse this with deflation! Disinflation means prices are **still rising**, just **not as fast as before**.

For example:

- Year 1: Gym memberships go up by 10%.
- Year 2: They increase by 6%.
- Year 3: The rise slows to 3%.

Prices are still climbing, but the pace is relaxing, like a jog slowing down to a brisk walk.

2.1.2 Inflation

Inflation, deflation and disinflation

Understanding inflation is like solving a fun little puzzle using percentages, here's how it works:

Example 1:

If inflation is 20%, what will £300 worth of goods in Year 1 cost in Year 2?

Here's the process:

1. Add the 20% inflation to the original price.
2. So, 120% of £300 = **£360**.

By Year 2, those £300 goods will cost **£360**. 🛒

Example 2:

If inflation is 25%, what will £800 worth of goods in Year 2 have cost in Year 1?

Let's work backwards this time:

1. £800 is 125% of the original price (because $100\% + 25\%$ inflation = 125%).
2. To find 1%, divide £800 by 125.
3. Then multiply by 100 to find 100%:
4. Therefore, $£800 \div 125 = £6.40$. Multiply by 100 = **£640**.

So, in Year 1, those goods would have cost **£640**.



2.1.2 Inflation

Consumer Price Index (CPI)

Inflation is when the **average price** of goods and services goes up over time. Imagine buying a cinema ticket and some snacks for £10 one year, but next year it costs £11. That's inflation creeping up! The **inflation rate** tells us how much those prices have risen compared to last year.

How Do We Measure Inflation?

We use something called the **Consumer Price Index (CPI)**. It's a tool that calculates inflation by comparing the prices of a 'basket' of goods and services that most households buy.

The Consumer Price Index (CPI) – Explained Simply

- **The 'Basket of Goods':** Imagine a virtual shopping basket with 700 everyday items like bread, clothes, transport, and more. These are products an average family would buy.
- **How It's Updated:** Each year, some items are swapped out (e.g., DVD players are out, streaming services are in) based on what people actually spend their money on.
- **Weighting Items:** Items in the basket are weighted depending on their importance in household spending. For example, more money is spent on food than on cinema tickets, so food has a higher weight.

How Do Prices Get Tracked?

- Prices are collected every month from shops, online stores, and services across the UK.
- All those prices are averaged out to create a total cost for the basket.

The CPI Formula Simplified:

Here's how inflation is worked out:

$$CPI = \left(\frac{\text{Cost of basket this year}}{\text{Cost of basket in base year}} \right) \times 100$$

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2.1.2 Inflation

Consumer Price Index (CPI)

Example: Working Out the Index of Spending



Let's say the base year is **2010**, and we want to calculate the index of spending for the following data:

Year	Spending on Pizza (£)	Index
2005	500	$(500 \div 600) \times 100 = 83.33$
2010	600	100 (it's the base year)
2015	660	$(660 \div 600) \times 100 = 110$
2020	720	$(720 \div 600) \times 100 = 120$

Explanation:

1. **Base Year (2010):**
The spending in 2010 is **£600**, and this becomes our benchmark, so the index is **100**.
2. **2005 (Before the Base Year):**
Spending is **£500**. The index is 83.33.
This shows that spending was lower in 2005 compared to 2010.
3. **2015 (After the Base Year):**
Spending rises to **£660**. The index is 110
A 10% increase in spending since the base year.

Why Should You Care?

CPI helps governments set policies, workers demand fair wages, and you plan your finances. For example, if your favourite coffee shop suddenly charges £4 instead of £3, CPI will reveal if it's inflation or just overpriced lattes.  

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2.1.2 Inflation

Limitations of CPI

The **Consumer Price Index (CPI)** is a useful tool, but it has its limitations when it comes to measuring the rate of inflation. Here's why:

- **Not Fully Representative**
CPI uses an average "basket" of goods, which doesn't reflect everyone's spending habits. For example, someone who spends more on technology versus groceries won't see their personal inflation rate reflected accurately.
- **Excludes Housing Costs**
Big expenses like house prices are left out, so CPI often underestimates inflation. If rent or property prices skyrocket, it won't show in the data.
- **Regional Differences Ignored**
CPI averages inflation nationwide, missing variations like higher living costs in cities like London compared to rural areas.
- **Doesn't Account for Quality Changes**
Product improvements aren't captured. A laptop in 2023 is far superior to one from 2000, but CPI treats them as the same if the prices match.
- **Survey Limitations**
CPI relies on small sample surveys, which can be inaccurate. People might underreport or overreport their spending, leading to unreliable results.



2.1.2 Inflation

The Retail Price Index (RPI)

Definition: The Retail Prices Index (RPI) is a measure of inflation that calculates the average change in prices of goods and services over time.

It's similar to the Consumer Prices Index (CPI) but includes extra costs related to housing and personal finance.

1) What Makes RPI Special?

RPI covers costs that CPI doesn't. For example, **train season tickets** (commuter costs), **home insurance** (keeping your house safe), or **mortgage interest payments** (if your loan payments rise, RPI will catch it).

2) Extra Costs = Higher Inflation

Because RPI includes these extra expenses, it tends to show a higher inflation rate than CPI. For instance, if housing costs skyrocket, RPI will reflect that increase more accurately than CPI.

3) Real-Life Impact

Imagine two families: one rents a flat, and the other has a mortgage. The mortgage family's costs go up if interest rates increase, which RPI takes into account. CPI, on the other hand, wouldn't reflect this.

4) Is RPI Better?

Some say RPI gives a clearer picture of household spending, especially for costs like housing and travel. For instance, it might be better for estimating the real cost of living in big cities like Manchester or Birmingham.

RPI is great for tracking costs like rail fares and homeowner inflation, but it's sensitive to interest rates and not relevant to everyone.

2.1.2 Inflation

The causes of inflation

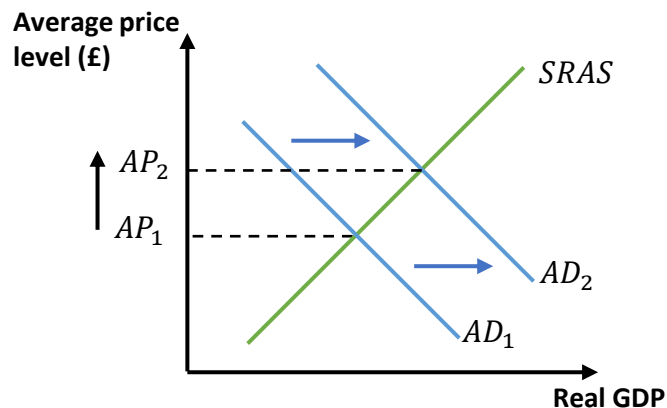
Demand-Pull Inflation

This type of inflation happens when there's too much demand in the economy – like everyone trying to grab the last PlayStation in stock.

- **Aggregate Demand (AD):** This is the total spending in an economy, made up of:
 - **C: Consumers spending** on goods/services.
 - **I: Businesses Investing** in things like factories or tech.
 - **G: Government spending** on roads, schools, etc.
 - **(X-M): Exports minus imports** (basically what we sell abroad versus what we buy from other countries).

When AD increases (like during a shopping spree), it pushes up prices.

- **Short-Run Aggregate Supply (SRAS):** This is how much the economy can supply at current price levels. If supply can't keep up with demand, prices increase, as shown in the diagram where **AD shifts right from AD1 to AD2**.



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2.1.2 Inflation

The causes of inflation

Demand-Pull Inflation

Diagram Analysis:

- If any of the 4 factors of AD increases, the curve shifts **right** ($AD_1 \rightarrow AD_2$), showing higher demand.
- At the original price (AP_1), there's suddenly too much demand in the economy.
- Therefore, prices rise, causing less spending (**contraction of AD**) and more production (**extension of SRAS**).
- Prices move up from AP_1 to AP_2 , resulting in **demand-pull inflation**.

Example: Imagine a concert with only 100 tickets and 1,000 fans show up. People start offering more and more money for the tickets – that's like AD increasing and causing prices (aka ticket costs) to rise. 🎫

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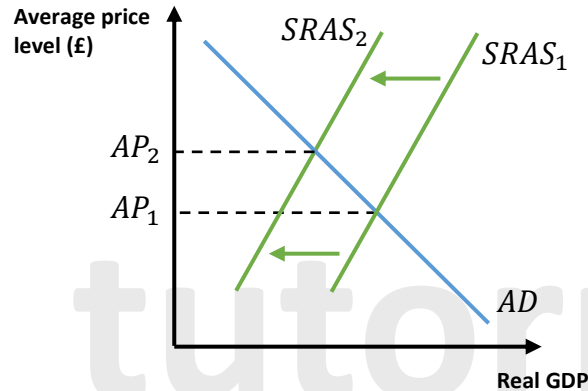


2.1.2 Inflation

The causes of inflation

Cost-push Inflation

Definition: Cost-push inflation happens when **the cost of making stuff goes up**, like higher wages, expensive raw materials, or rising fuel costs. Businesses pass these costs on to customers by **raising prices**.



What the Diagram Shows:

1. When production costs rise (e.g., oil becomes pricier), the **supply decreases**, shifting the supply curve **left** ($SRAS_1 \rightarrow SRAS_2$).
2. At the original price level (AP_1), there isn't enough supply to meet demand, leading to shortages.
3. Prices go up ($AP_1 \rightarrow AP_2$) as goods become harder (and costlier) to produce.
4. As prices increase, people buy less (**contraction of AD**), and businesses can't supply enough.
5. This is called **cost-push inflation**, it's when higher costs push prices up for everyone.



2.1.2 Inflation

The causes of inflation

Cost-push Inflation

Example: Chocolate bars need cocoa, and if cocoa prices skyrocket due to bad weather. Chocolate companies now spend more to produce each bar, so they **charge you extra**. Suddenly, your favourite £1 treat is now £1.50.

2.1.2 Inflation

Growth of the money supply

Definition: The money supply refers to the total amount of money circulating in an economy. When the **Central Bank** adjusts the money supply, it can influence borrowing, spending, and inflation.

How It Works:

1. Lowering the Base Rate:

- The Central Bank reduces the **base rate** (the interest rate it charges banks).
- This makes borrowing cheaper for firms and consumers.
- People start spending and investing more, which boosts **demand**.
- Result? **Demand-pull inflation** occurs as too much demand pushes prices up.

Example: Imagine your bank cuts interest rates on loans, so you decide to take a loan and buy a new car 🚗. When everyone does this, demand increases, and prices climb.

2. Quantitative Easing (QE) – printing new money:

- The Central Bank **creates new money** and injects it into the economy.
- More money means **lower interest rates** and more cash available to spend.
- Again, this fuels **demand-pull inflation**.

Example: Think of it like a big money tap being turned on 💧. With more money flowing, people are eager to spend, but with demand rising faster than supply, prices increase.

Cheaper loans and more cash sound great, but if demand grows too much and supply can't keep up, you end up paying more for everything, like that coffee suddenly costing £5 ☕.

2.1.2 Inflation

The effects of inflation

For Firms:

- **Uncertainty:** Inflation makes it hard for businesses to plan because they can't predict future costs and revenues.
- **Menu Costs:** Constant price changes mean businesses have to update their price lists, menus, or catalogues frequently. It's not just annoying, it's expensive.

For Consumers:

- **Less Spending Power:** As prices rise, your money buys you less. The weekly shop feels like it costs a fortune!
- **Fixed Income Hit:** Retirees relying on pensions or others on fixed incomes feel the pinch most as their income doesn't stretch as far.
- **Savings Lose Value:** Got cash in the bank? It's worth less in real terms if inflation is higher than interest rates.

For the Government:

- **Harder Exports:** Inflation makes a country's goods more expensive abroad, reducing international competitiveness.
- **Difficult Choices:** Tackling inflation often means tough trade-offs, like potentially increasing unemployment or slowing economic growth.

For Workers:

- **Demand for Higher Wages:** To keep up with rising prices, workers push for better pay. Fair enough, right?
- **Productivity Dip:** If wages don't keep up with inflation, motivation falls and so does productivity.



2.1.3 Employment and unemployment

Unemployment: This is the **number of people** who *want* a job, are **able to work**, but currently **don't have one**.

- **Level of unemployment:** The **total number** of unemployed people.
- **Rate of unemployment:** This shows the **percentage** of the workforce that's unemployed.

Employment: This is the **proportion of people** in work compared to the **total workforce**.

The Workforce: Everyone of **working age** who is either **working or ready and able to work** (so it includes both the employed and unemployed).

Measures of unemployment

In the UK, **unemployment** is measured in two main ways:

1) The Claimant Count

What is it? A count of people claiming **Jobseeker's Allowance (JSA)** or **Universal Credit** because they're unemployed.

How does it work?

- Only includes those **eligible** for benefits.
- Claimants must meet **strict requirements**, like attending meetings with a **work coach**.



2.1.3 Employment and unemployment

Measures of unemployment

2) The International Labour Organisation (ILO) and the UK Labour Force Survey

The **International Labour Organisation (ILO)**, used by the **Office of National Statistics (ONS)**, defines people over the age of 16 as either **employed, unemployed, or inactive**. Let's break it down:

a) Employed

- You're **working at least 1 hour a week** for pay or profit.
- Includes people on **holiday**, in **training schemes**, or doing **unpaid family work** (15+ hours).

b) Unemployed

- You're not working but are:
 - **Actively looking for work** in the past 4 weeks.
 - Available to **start work within 2 weeks**.

c) Inactive

- You're not working and **not looking for work**.
- Includes students, carers, retirees, those with health issues, or people **discouraged from applying**.

Labour Force Survey (LFS)

- A **sample survey** of households to classify people as employed, unemployed, or inactive.
- It's used in every EU country and gives an **estimate** of unemployment since it relies on a representative **sample**.

2.1.3 Employment and unemployment

The distinction between unemployment and under-employment

Unemployment refers to people who are not working but are actively looking for a job and are ready to work. **Underemployment**, on the other hand, means people have jobs but aren't working to their full potential. Let's break it down:

Underemployment:

What does it mean?

You're underemployed if:

- You **want more hours** than you're currently working (e.g., doing part-time work when you want a full-time role).
- You're **overqualified** for your job (e.g., a trained accountant working as a cashier).

Why Does Underemployment Happen?

- During **economic downturns (recession)** when jobs are scarce. People may settle for part-time jobs or roles outside their usual skill set just to make ends meet.
- When industries change or technology evolves, and workers' **skills become outdated**. Without retraining or gaining **new skills**, it's tough to find a job that matches their qualifications.

Impact on the Economy:

While underemployment isn't as bad as full unemployment, it still hurts. With less money to spend, the underemployed reduce their consumption, which leads to lower **aggregate demand** (the total demand in the economy) and slower economic growth.



2.1.3 Employment and unemployment

Changes in employment, unemployment and inactivity rates

1. Unemployment Rate

- This shows the percentage of people who are actively looking for work but aren't currently employed.

$$\text{Unemployment rate} = \frac{\text{No. actively seeking work}}{\text{Total labour force}} \times 100$$

2. Employment Rate

- This measures the percentage of working-age people who are currently employed.

$$\text{Employment rate} = \frac{\text{No. in employment}}{\text{Population of working age}} \times 100$$

3. Inactivity Rate

- This measures the percentage of working-age people who are not working and not looking for work (e.g., students, carers, retirees).

$$\text{Inactivity rate} = \frac{\text{Inactive people of working age}}{\text{Working - age population}} \times 100$$

4. Labour Force Participation Rate

- This shows how many people of working age are actively involved in the labour force, either employed or looking for work.

$$\text{Participation rate} = \frac{\text{Labour force}}{\text{Total population}} \times 100$$

2.1.3 Employment and unemployment

Changes in employment, unemployment and inactivity rates

How These Rates Work Together

The **employment rate** might rise while the **unemployment rate** also increases.

- Example: A city attracts more tech workers, increasing the working-age population, but not all of them find jobs immediately.

Unemployment rates don't show everything, like **hidden unemployment**.

- Example: A freelance artist stops looking for new clients during a slow period. They're no longer counted as unemployed but aren't working either, which lowers the unemployment rate even though the situation hasn't improved.



2.1.3 Employment and unemployment

The causes of unemployment

1. Frictional Unemployment

This happens when people are **between jobs**-maybe they've left a job to find a better one or are fresh graduates entering the workforce. It's a **short-term problem**.

2. Structural Unemployment

This is more serious and long-term. It happens when industries decline, or new technology makes some jobs obsolete.

Key types include:

- **Technological Unemployment:** Robots and machines replace workers (e.g., self-checkout tills). Workers often need retraining to get back into the game.
- **Regional Unemployment:** Certain areas are hit harder, like when a factory closes in a small town.
- **Sectoral Unemployment:** Entire sectors (e.g., coal mining) lose jobs as demand falls.

3. Seasonal Unemployment

- Some jobs are tied to seasons-like tourism or farming. For example, a strawberry picker is busy during the summer harvest but out of work the rest of the year.

4. Cyclical Unemployment

- This happens when the **economy slows down**. For example, during a recession, a furniture company may close shops because fewer people can afford new sofas. With falling demand, jobs are cut, leading to unemployment. It's also called **demand-deficient unemployment** because less spending = fewer jobs.

2.1.3 Employment and unemployment

The causes of unemployment

5. Real wage inflexibility

Real wage unemployment occurs when wages are set too high above what the market naturally wants (equilibrium wage), often due to minimum wage laws.

This creates a mismatch: more people want to work because of the higher pay, but employers can't afford to hire as many workers, leading to an excess supply of labour. In simple terms, too many workers are chasing too few jobs at those high wages.

2.1.3 Employment and unemployment

Migration and skills

Labour is one of the essential ingredients for production in an economy, like eggs in a cake recipe. To boost output, you often need more workers, and one way to do this is by encouraging **immigration**, bringing in people from other countries to work.

The **UK** has seen a wave of immigration since the 1990s, especially from places like Eastern Europe. But what is **net migration**? It's the balance of people coming into the country (immigration) and leaving the country (emigration).

- In **less developed countries**, more people leave than arrive (*net outward migration*).
- In **developed economies**, the reverse happens, more people come in (*net inward migration*).
- Skilled workers often leave **wealthy countries** for opportunities abroad.

Impact on Employment

- **Plugging Job Shortages:** Immigrants often take jobs locals avoid, such as seasonal fruit picking on farms or night shifts in factories. This keeps industries running smoothly.
- **Lowering Wages but Increasing Jobs:** An influx of workers may reduce wages in certain fields, like retail or hospitality, but it makes it cheaper for businesses to hire more people, boosting employment overall.
- **Growing the Economy:** Picture a bigger population buying groceries, clothes, and gadgets. This increased demand encourages businesses to expand, creating more jobs in everything from supermarkets to delivery services.

Impact on Unemployment

- **Local Job Displacement:** If an immigrant chef starts working in a small town, a local chef might lose opportunities, raising unemployment in that sector.
- **Family Struggles:** An immigrant's spouse may face challenges getting a job, especially if they lack language skills or qualifications recognised locally, adding to unemployment figures.



2.1.3 Employment and unemployment

The effects of unemployment

Unemployment, especially when it lasts a long time, can be incredibly harmful, not just for individuals, but for businesses, the government, and the economy as a whole.

Impact on Individuals

- **Loss of income:** No job means no paycheck, which can make life really tough.
- **Mental and physical health issues:** Stress from unemployment can lead to anxiety, depression, and even physical health problems.
- **Family strain:** Relationships can suffer due to financial pressure, leading to marital problems.
- **Low self-esteem:** People may feel a sense of failure or lose confidence in their abilities.

Impact on Businesses (Firms)

- **Loss of sales:** If people don't have jobs, they spend less, which means lower revenue for businesses.
- **Less production:** Without enough workers, firms can't produce as much, slowing the economy.
- **Skills drain:** Over time, workers lose their skills, making it harder for businesses to find qualified staff.



2.1.3 Employment and unemployment

The effects of unemployment

Impact on the Government

- **Higher costs:** The government spends more on unemployment benefits and retraining schemes.
- **Lower tax revenue:** With fewer people earning wages, there's less income tax coming in.
- **Budget pressure:** The government has to juggle spending while dealing with a weaker economy.

Impact on Society/Economy

- **Homelessness:** Without income, more people lose their homes, putting pressure on social services.
- **Increased crime:** Financial struggles can lead to higher crime rates and vandalism.
- **Antisocial behaviour:** Communities can feel the strain as unemployment rises.

2.1.4 Balance of payments

Components of the balance of payments

The **Balance of Payments (BOP)** is like a country's bank statement. It records all the money flowing in and out of the country over a certain period.

- **Imports:** Goods/services we buy from other countries, money flows out.
- **Exports:** Goods/services we sell to other countries, money flows in.

Main Parts of the Balance of Payments

1. Current Account:

- Tracks the buying and selling of goods, services, and income flows.
- **Trade in Goods (Visibles):** Physical items like cars, food, and clothes. For example, a German car sold in the UK is a visible import.
- **Trade in Services (Invisibles):** Non-physical transactions like tourism or financial services. A British tourist spending in Spain is an invisible import.
- **Income and Current Transfers:** Money flowing into or out of the country, such as wages, profits, or government transfers. Example: A British person earning dividends from a French company (income coming in) or sending money to family abroad (transfer going out).

2. Capital and Financial Account:

Tracks investments, loans, and asset transfers. Think of it as big money moves:

- A Chinese firm buying a factory in Manchester = money coming into the UK.
- A British investor buying property in Spain = money flowing out.



2.1.4 Balance of payments

Components of the balance of payments

Key terms

- **Balance of Trade in Goods:** Exported goods minus imported goods (how much stuff we sell vs buy).
- **Balance of Trade in Goods and Services:** Combines physical goods (visibles) and non-physical services (invisibles) to give the full picture.

Examples:

- A British architect designs a skyscraper in Dubai = UK invisible export (money coming in).
- A London restaurant importing Italian truffles = UK visible import (money going out).

Why It Matters

- The BOP shows whether a country is borrowing or earning more from the rest of the world. A surplus means more money coming in than going out, while a deficit means the opposite.

2.1.4 Balance of payments

Current account deficits and surpluses

The **current balance** is like your financial health check. It's calculated as:

Current balance = Balance of trade (goods) + Balance of invisibles (services) + Net income and current transfers.

Current Account Surplus:

This is when a country is earning more than it spends. How? **Exports > Imports**. Think of it as having more money coming in than going out. For example:

- A UK company exporting jet engines to Australia (money in).

Current Account Deficit:

This happens when a country spends more than it earns. How? **Imports > Exports**. It's like your spending outweighing your income. For example:

- A UK retailer importing luxury Italian handbags (money out).

Why It Matters:

- A **surplus** means the economy is bringing in cash, while a **deficit** shows the opposite. Neither is always good or bad, it depends on the context. A deficit could mean we're importing great stuff, while a surplus could mean we're saving rather than spending. It's all about balance, like managing your own bank account! 😊



2.1.4 Balance of payments

Macroeconomic objectives and current account imbalances

Governments aim to manage the economy with four main goals:

1. **Economic Growth:** Growing the economy at a steady pace, similar to other countries.
2. **Low Unemployment:** Making sure most people who want to work can find jobs.
3. **Stable Inflation:** Keeping price rises steady so that money holds its value.
4. **Balance of Payments:** Ensuring the money coming in (from exports) equals money going out (from imports).

Challenges of Balancing Objectives

Achieving these goals can get tricky because they often conflict:

- **High Economic Growth:** When the economy grows quickly, people buy more imported goods, which can lead to a **current account deficit** (more money leaving the country than coming in). Oddly, during tough times, when unemployment is high, deficits might shrink because people spend less overall.
- **Export-Led Growth:** Governments love the idea of boosting exports. This can drive economic growth, create jobs, and fix current account issues. But there's a catch: exporting too much can cause **inflation** (prices rising too quickly).
 - Export-led growth can cause inflation because it increases demand in the economy. Higher exports mean businesses produce more, which raises demand for resources like labour and materials. Rising demand for workers can also push wages higher, increasing production costs that businesses pass on to consumers. Additionally, higher incomes from export growth boost domestic spending, further fuelling inflation as demand outpaces supply.

2.1.4 Balance of payments

The Interconnectedness of economies through international trade

Over time, countries around the world have become more connected, this is what we call **globalisation**. Here's how it happens:

- **International Trade:** More goods and services produced in one country are being sold internationally. Think of your smartphone, it's designed in one country, manufactured in another, and sold globally.
- **Global Investments:** Individuals and companies now own things like shares, loans, or even businesses in other countries. For example, a British company might own factories in India or China.
- **Migration:** People are moving between countries more than ever, either for work or better living opportunities. This brings cultures and labour markets closer.
- **Technology Sharing:** Advances in tech now spread faster across borders. A breakthrough in medicine in the US could quickly benefit people in Europe or Asia.

Countries are now **interdependent**, meaning what happens in one economy impacts others. For example, if a global chip shortage affects Taiwan, car manufacturers in the US could halt production. In theory, trade balances between countries should cancel each other out (one's exports are another's imports). But in reality, things don't always add up neatly.



2.1.4 Balance of payments

The Interconnectedness of economies through international trade

Continue to the next page...

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