GCSE Economics: Theme 2.7 The Labour Market

Why do people do the jobs they do?

What is the labour market?

The labour market consists of the supply of labour from households and the demand for labour by firms. The interaction of these will give the price for labour (wages).

Wages provide an income to households but are a cost to firms.

In a free market the forces of supply and demand would set the wage level but governments and trade unions will influence the wage level.

What main labour markets exist?

Local	Within a short commuting distance of a worker's home
National	This covers the whole of the UK
International	The whole world or a large section (EU)

What is the role of the labour market?

To enable workers who are willing and able to sell their labour to meet employers who are willing and able to give them a job.

To determine the wage rate for this work.

What smaller interacting markets exist within each labour market?

- Qualifications
- Skills
- Geographical locations

What information exchange do labour markets rely on?

- Wage rates
- Conditions of employment
- Level of competition
- Location of the job

What might prevent the perfect operation of the labour market?

There is not perfect mobility in the labour market. Labour cannot move freely from one job to another. Possible reasons:

- Lack of skills
- Unwillingness to relocate
- Personal factors
- Lack of information about available jobs (information failure)

You will learn more about information failure in Topic 2.8

What is meant by the interaction of workers and employers?

- Individual workers can deal directly with their employer to establish wages, working conditions etc
- Many workers belong to a trade union. The trade union will interact with employers on behalf of its members to establish wages, working conditions etc. This is known as collective bargaining.

How are wages determined? (a)

What is the supply of labour?

The working population; those who are both willing and able to supply their labour. A potential additional supply of people who are currently inactive.

Active labour supply	Inactive labour supply
Employed consisting of:	Unemployed consisting of:
Employees	Looking after family
Self-employed	Short term sick
Those on government schemes	Long term sick
Unpaid workers	Discouraged workers
Unemployed	Students
	Retired

What factors affect the supply of labour?

- ***Wage rate*** – higher wages will attract more workers
- ***Other money payments*** – overtime, bonus payments etc
- ***Size of working population*** – affected by retirement and school leaving ages, migration etc
- ***Non-monetary factors*** – working conditions, job security etc
- ***Barriers to entry*** – necessary qualifications, trade unions, discrimination etc
- ***Education and training*** – will increase the number of skilled workers

Exam Criteria

- **Explain** the role and operation of the labour market
- **Explain** the interaction between workers and employers
- **Analyse** the factors affecting the supply of labour
- **Analyse** the factors affecting the demand for labour
- **Analyse** the determination of wages through supply and demand
- **Explain** and **calculate** gross pay
- **Explain** and **calculate** net pay
- **Explain** deductions involved in moving from gross to net pay including income tax, national insurance and pension contributions

Key Vocab

Word Wall

Pension- A fixed amount paid at regular intervals to a person or their surviving

Gross - Total amount of pay earns before deductions

Net – Pay after deductions have been made.

Levy – Impose a tax

Key Terms

Labour market – Where workers sell their labour and employers buy the labour: it consists of households' supply of labour and firms' demand for labour

Supply of labour – The total number of people who are willing and eligible to supply their labour, including the unemployed

Gross pay – The amount of money an employee earns before any deductions are made

Income tax – A tax levied directly on a personal income (a wage)

National Insurance – A contribution paid by workers and their employers towards the cost of state benefits

Net pay – The amount of money that an employee is left with after deductions are made from gross pay

Trade Union – An organisation of workers who act to protect and further their rights and interests

How are wages determined? (b)

What is the demand for labour?

A derived demand as it depends on the demand for the product that the labour helps to produce. If consumers want more of a product, firms will demand more labour.

Study Tips

Remember that the price of labour is wages. Wages, not price should therefore be used on labour market diagrams.

How are wages calculated?

What is gross pay?

The amount of money an employee actually earns before any deductions are made. It includes overtime payments, bonuses and allowances. It is gross pay that is quoted when advertising jobs

What is net pay?

Net pay is also known as 'take-home pay'. It is the actual amount of money an employee has to spend or save after all deductions have been made.

Deductions include:

- Income tax
- National Insurance
- Pension contributions

How do we calculate gross and net pay?

Gross Pay **–** Take your base pay (stated on contract) and add any extra payments:

Payments per month	£
Wage	2,500
Bonus	300
Total	2,800

Net Pay – Depends on which deductions are made

Gross pay and deductions per annum	£
Gross pay	24,000
Income tax	2,512
National insurance	1,925
Pension contribution	1,440
Net pay	18,123

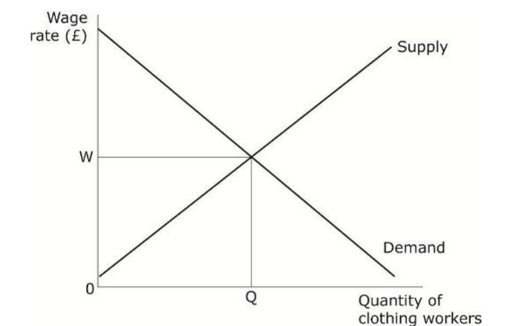
n.b. Pension contributions are the monies a worker pays into a workplace pension scheme which the employer also pays into. Student loan repayments are also classed as a deduction.

What factors affect the demand for labour?

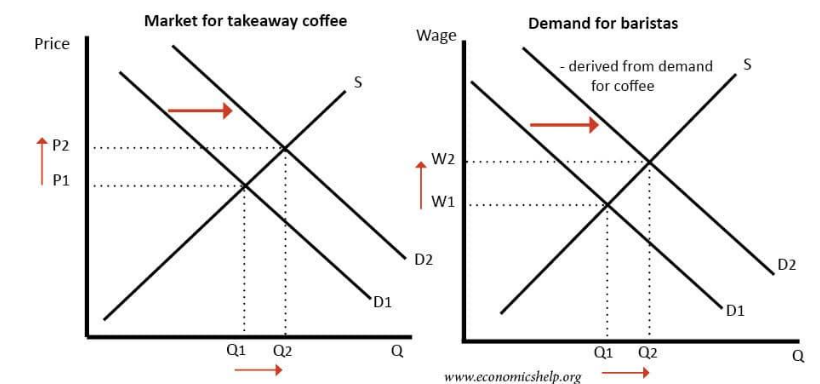
- ***The state of the economy*** – more labour is demanded as the economy grows
- ***Demand for goods*** – If demand in a particular market is growing fast then the demand for labour in the market will increase
- ***Wage rates*** – there is an inverse relationship between ware rates and the demand for labour; less labour will be demanded at higher wages
- ***Real wages*** – a fall in real wages may encourage producers to employ more rather than invest in capital
- ***Productivity of labour*** – If this rises, labour may become cheaper than capital investment
- ***Profitability of firms*** – firms making large profits are likely to expand and therefore need more workers.

How does supply and demand determine wages?

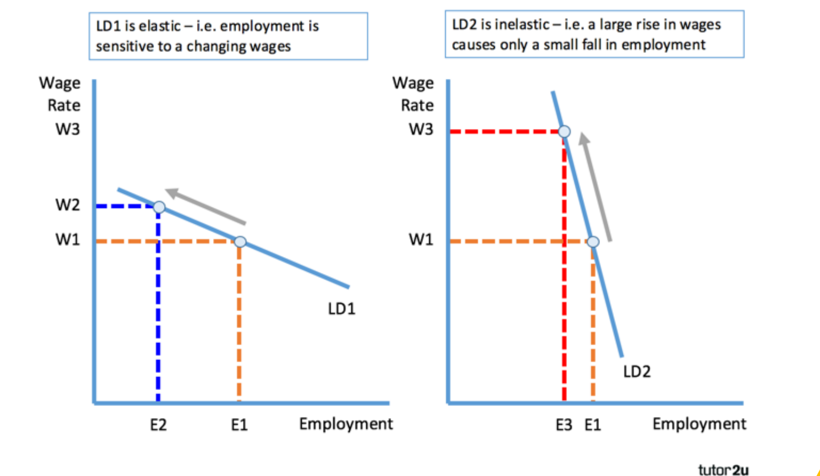
The labour market works in exactly the same way as the markets for goods and services in topic 2.4; where supply and demand meet is the equilibrium price for labour (the wage).



The demand for labour is dervived from the demand for the product or service being produce:



The size of any change will depend on the PED and PES of labour. Supply of labour will be inelastic if there are limited people who could fulil the role and more elastic if many people could fulfil it.



GCSE Economics: Theme 2.8 The Role of Money and Financial Markets

Why is money important?

What is money?

Anything that is accepted as a means of payment for goods and services. Consists of notes and coins (legal tender) and bank deposits in current accounts and savings.

Cheques, debit cards and credit cards are NOT money but they allow money to be transferred between buyers and sellers.

What is a debit card?

Transfers money from your current account to the seller.

If you do not have enough money in your current account you cannot buy the product.

What is a credit card?

Enables you to buy goods and services whether or not you have money in your account. If you cannot pay this short term loan back within 30 days you are charged interest on it.

Retailers are charged for allowing you to use credit cards as a form of payment.

What is meant by medium of exchange?

Anything that sets the standard of value of goods and services to all parties in a transaction. Money is the common form of medium of exchange.

What organisations operate in the financial sector?

What is the financial sector?

Consists of financial organisations and involves the flow of capital.

It helps markets to function and consumers/households, firms and governments to economic activities all within a regulatory framework.

This normally involves the lending and borrowing of money between those who have it but do not need to use it immediately (savers) and those who want to use it now (borrowers).

What is the role of the central bank?

- Issue bank notes and control the supply of money to the economy
- Control monetary policy by setting the bank rate
- Provide financial stability
- Manage the country's foreign reserves
- Act as a bank for commercial banks
- Be the bank for the government

What is the role of commercial banks?

Take deposits (savings) from customers and turn them into assets for the bank. Generally changer interest rates higher than the bank rate.

- Accept deposits and pay interest on them
- Make payments on behalf of their customers
- Issue loans to individuals and firms and issue overdraft facilities
- Offer safe deposit boxes for very expensive items

What is the role of insurance companies?

A financial institution that provides compensation for specified loss, damage, illness, death in return for an agreed payment.

- Life Insurance
- General insurance

What is the role of building societies?

Not companies but mutual institutions. Their members (the people who have money deposited) own them. Provide saving products and mortgages for their members.

Different to banks as banks are often listed on the stock exchange. Many building societies have now converted to banks following changes in the law.

Exam Criteria

- **Explain** what is meant by money
- **Explain** the role of money as a medium of exchange
- **Explain** what is meant by the financial sector
- **Explain** the role of banks
- **Explain** the role of building societies
- **Explain** the role of insurance companies
- **Explain** the role of the financial sector for the economy
- **Evaluate** the importance of the financial sector for consumers
- **Evaluate** the importance of the financial sector for producers
- **Evaluate** the importance of the financial sector for the government
- **Analyse** how different interest rates affect the levels of saving
- **Analyse** how different interest rates affect the levels of borrowing
- **Analyse** how different interest rates affect the levels of investment
- **Calculate** the effects on savings of changes in the rate of interest
- **Calculate** the effects on borrowings of changes in the rate of interest

Key Vocab

Word Wall

Money- Anything that is generally accepted as a means of payment for goods and services

Investment - The purchase of capital goods that are used to produce future goods and services. Also an asset purchased to provide an income in the future and/or to be sold at a profit

Annum – By the year, in or for each year, annually

Mortgage – An agreement with a financial institution to borrow money to purchase a property

Key Terms

Medium of exchange - Anything that sets the standard of value of goods and services to all parties in a transaction.
Financial sector - Consists of financial organisations and involves the flow of capital
Insurance company - A financial institution that provides compensation for specified loss, damage, illness, death in return for an agreed premium.
Building society - A mutual financial institution that is owned by its members. Its primary objectives are to receive deposits from its members and to lend money for members to purchase property.
Rate of interest/interest rate – The cost of borrowing money
Bank rate - The interest rate set by the central bank; all other interest rates are calculated from this.

Why is the financial sector important?

Why is credit provision important?

Without credit the level of activity in the economy would be greatly limited. Credit cards increase consumption by allowing consumers to buy now and pay later; this has encouraged some people to live beyond their means.

Producers can borrow money to enable them to grow without first having to save the money.

Governments use credit to enable them to spend before tax revenue is raised or even allowing them to spend more than they plan to raise in tax revenue (fiscal policy).

You will learn more about Fiscal Policy in Topic 3.5

Why is liquidity provision important?

Liquidity refers to hov quickly assets can be turned into cash. Banks provide the facility to do this to households and firms and this allows them to function when receiving unexpected bills.

Why is risk management important?

Financial institutions allow individuals and businesses to pool their risks from exposure to financial markets.

By taking savings from a range of customers and investing in a number of companies, the risk of a customer losing all of their money is lowered as even if one investment fails, another might be doing well.

Study Tips

Be careful how you use the words 'saving' and 'investment'. In economics saving is done largely by individuals and investment mainly by firms. However, in finance, investment has another meaning (see key terms).

Remember that when reading the news or looking information up on the internet, you may come across 'rate of interest' and 'interest rate'. These are basically the same thing.

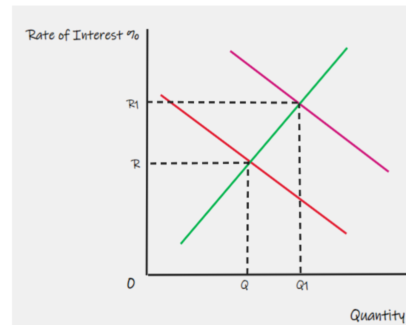
Be careful not to say that commercial banks issue notes and coins. The Bank of England and Wales issues them through the commercial banks.

Why are interest rates important?

How do interest rates affect the level of saving?

In general, higher interest rates will attract savers and falls in interest rates will result in people reducing their level of saving. Individuals are compensated for not spending their money immediately with the interest they gain from saving. The ***opportunity cost*** of receiving interest is not spending money immediately.

If the interest rate rises from R to R1 this results in an increase in demand for savings from D to D1resulting in an increase in savings from Q to Q1.



How do interest rates affect the level of borrowing?

Higher interest rates increase the cost of borrowing. New borrowing is more expensive and people have to pay more for any existing borrowing. Both firms and households tend to borrow less at higher rates of interest.

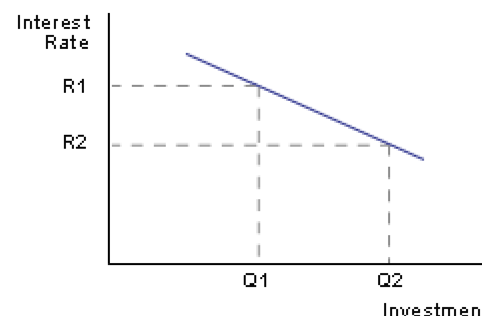
Also, rising interest rates may encourage people to save rather than spend which means less goods and services are purchased which could further deter firms from borrowing as their revenue falls.

Higher interest rates are likely to lead to an increase in the foreign exchange value of the pound making exports more expensive and less competitive; firms will sell less and reduce borrowing.

How do interest rates affect the level of investment?

The level of investment is inversely related to the rate of interest. A fall in the rate of interest means the cost of borrowing will fall and also there is lower opportunity involved in sacrificing saving. Also, lower interest rates will encourage consumer spending and firms will want to expand to meet demand.

If firms and consumers lack confidence in the economy firms might not increase investment.



How do you calculate the effect of changes in the interest rate?

Interest on saving:

$$\frac{\text{Amount saved} \times \text{Interest rate}}{100}$$

Interest on borrowing:

$$\frac{\text{Amount borrowed} \times \text{Interest rate}}{100}$$

In both situations, you need to calculate the original interest payments and the new interest payments so that you can calculate the effect of the rate changes.

e.g. Nikki has borrowed £100,000 for one year and is being charged an interest rate of 5%.

$100{,}000 \times \frac{5}{100}$ *= £5,000 interest is being paid on the loan*

If the interest rate was 5.5%

$100{,}000 \times \frac{5.5}{100}$ *= £5,500 interest is being paid on the loan*

This method enables you to calculate and draw conclusions about the effect of a change.

GCSE Economics: Theme 3.1 Economic Growth

What is the meaning of Economic Growth?

Economic Growth

Economic growth is the increase in the economic activity in a country. It is shown by the growth in the value of output. The value of output is called **GDP**.

GDP

The total value of output produced in an economy is GDP. It is also equal to the total of incomes in an economy and the total amount spent in an economy.

For example, if a student purchased a textbook for £20, the bookseller's output would be £20, their income from the sale would be £20 and the student wold have spent £20. So when there is economic growth, output, incomes and spending are rising.

Total Output = Total Income = Total Spending

Exam Criteria

- **Explain** what is meant by economic growth
- **Calculate** and explain how economic growth is measured with reference to Gross Domestic Product (GDP) and GDP per capita
- **Analyse** recent and historical GDP data
- **Analyse** the determinants of economic growth, including investment, changes in technology, size of workforce, education and training, availability of natural resources and government policies
- **Evaluate** the costs and benefits of economic growth, including the impact on economic, social and environmental sustainability

How do we Calculate Economic Growth?

To **calculate** economic growth, the government measures the value of output and calculates the rate at which it has changed. It is measured by the percentage change in GDP and the formula is:

$$\frac{\text{Change in GDP}}{\text{Original GDP}} \times 100$$

Example:
If a country has a GDP in 2021 of £500 billion and the next year it has risen to £510 billion, the rate of growth is:

$$\frac{\text{£10 billion}}{\text{£500 billion}} \times 100 = 2\%$$

Total **GDP** figures are useful to show the size of an economy as a whole and is calculated by adding together the value of all output of goods and=d services in an economy

GDP Per Capita is GP divided by the population and therefore output per head of population. It is also average income of each person in the country. In the UK GDP per capita grew by 0.8% between 2018 and 2019 but then fell by 10.3% in 2020. REMEMBER GDP per capita is an average and the actual GDP will be distributed unevenly.

The **standard of living** is often measured by GDP per capita and is used as a comparison between countries of how well off people are.

Key Vocab

Key Terms

Economic growth - Growth in GDP (value of output)

Gross Domestic Product (GDP) - Total value of goods and services (output) produced in an economy in a year.

GDP per capita - GDP divided by the population.

Determinants of economic growth – Things that make the economy grow - achieved through an increase in the quantity or quality of factors of production

Investment – Spending on capital goods.

Changes in technology - Better technology leads to better quality of capital.

Size of workforce - A larger workforce means there is more labour (a factor of production).

Education and training - An increase in the skills of the workforce will improve the quality of labour.

Availability of natural resources - If there is the discovery of more natural resources, it enables an economy to grow.

Government policies - Government investment in infrastructure; management of the macro economy and having adopted a mixed economy.

Mixed Economy – A mixed economy means that part of the economy is left to the free market, and part of it is managed by the government.

Macro Economy - deals with performance, structure, behaviour, and decision-making of an economy as a whole. For example, using interest rates, taxes, and government spending to regulate an economy's growth and stability.

Standard of living – how well off people are, often measured by GDP per capita

How Useful is recent and Historical GDP Data?

What is a Boom?

A boom is a period of high economic activity and high levels of employment

What is a recession?

A recession is a period of time when a country's GDP falls for two or more consecutive quarters

Economists use the terms BOOM and RECESSION when analysing a country's GDP

Analysing the Data

The figure above shows that economic growth rates are not the same every year. For all years above growth was positive except 2020 which was negative. A period of negative growth is known as a recession. During such times GDP falls so the economy is producing less than it was previously. Economists say that a recession is technically when GDP falls for two or more consecutive quarters of a year. If economic growth is positive and high over a period of time it is called a boom.

Between 2011 and 2019 there was a positive annual growth rate. In 2020 the pandemic happened and the UK went into recession with output falling (red bar). Output fell as firms closed and government spending reached its highest to fund the vaccine roll out and the furlough system. Consumer spending fell overall further affecting output.

What are the Determinants of Economic Growth?

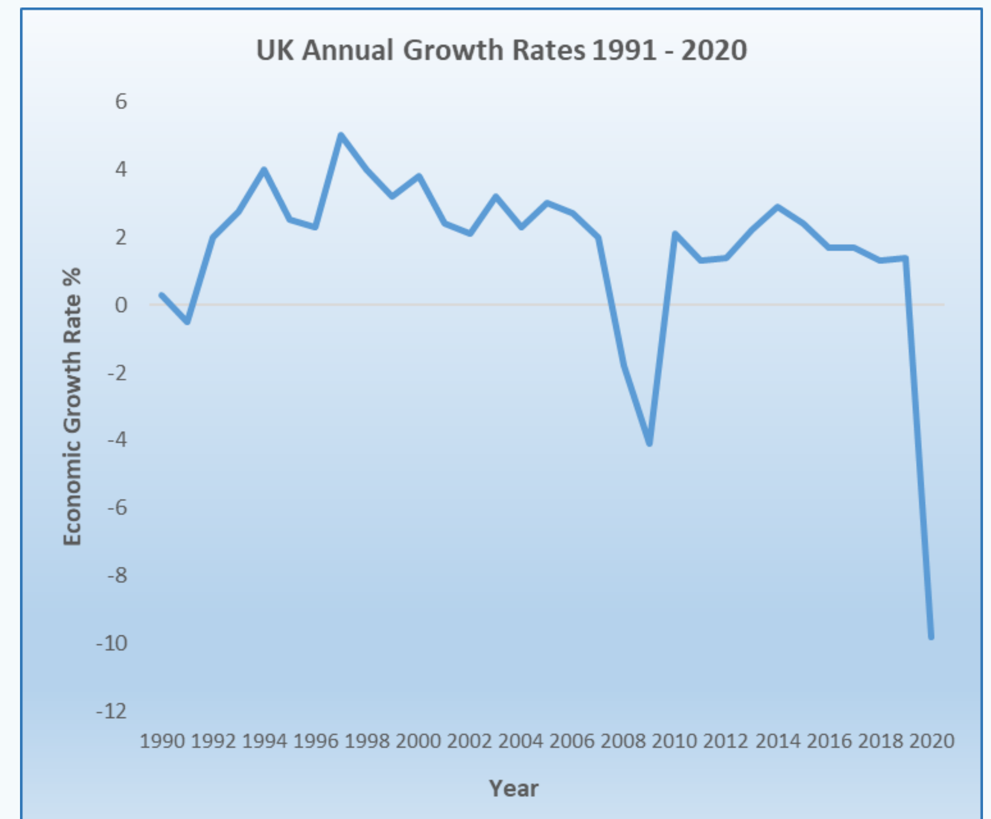
- Economic growth can be caused by an increased ability of an economy to produce goods and services
- The quality or quantity of factors of production affect an economy's potential to make goods or services
- Determinants of economic growth change the quality or quantity of these factors of production

Study Tip

To analyse these determinants of economic growth, you need to be able to explain how they might cause economic growth using logical chains of reasoning

Study Tip

Don't confuse GDP and GDP per capita. While GDP is the value of the output and incomes for the whole economy, GDP per capita is the average income of each person.



Analysing the Data

The graph above shows that when the UK economy entered recession in 2008, output fell. Less labour was needed to produce fewer goods so unemployment rose and thus incomes fell leading to a fall in demand. This led to a deeper recession in 2009.

However the graph shows that by 2010 the economy had come out of recession, output was rising so more workers were required to produce goods and services and employment rose. This meant higher incomes and more demand until 2020 with the impact of the pandemic caused output to fall steeply.

Analysing the Determinants of Economic Growth

Investment

Investment is spending on capital goods by firms

- Capital goods are man made aids to production such as delivery vehicles and computers
- They can be faster and more efficient than workers doing a job
- They might also be used by workers to help them work more efficiently
- This can lead to the economy being able to make more in the future .

Changes in Technology

- Advances in technology can improve the quality of capital goods
- This means the same amount of capital can make more goods and services
- E.g. if a restaurant's oven is replaced with one that heats up faster, customers are now served more efficiently
- Improved capital may mean a country can use all its factors of production more efficiently.

Size of Workforce

- The size of the labour force is the quantity of people willing and able to work in an economy
- This is the number of people who either have jobs or who are looking for them
- An increase in the number of potential workers means more can be made
- This is because there is an increase in the factors of production
- E.g. and increase in immigration may increase the quantity of labour available to work

Education and Training

- Affects the quality and quantity of the labour factor of production
- An increase in spending on education may lead to a more skilled future workforce
- These workers are more productive and can increase the number of goods and services produced
- This increase in output could mean an increase in GDP and economic growth

Study Tip

To analyse these determinants of economic growth, you need to be able to explain how they might cause economic growth using logical chains of reasoning

Natural Resources

- The quantity affects the land factor of production
- If a country finds new natural resources such as oil, it can either sell to other countries or use them to make more goods and services
- Both of these could lead to an increase in output, GDP and economic growth
- A country may also face a decrease in natural resources such as losing land due to rising sea levels
- This can mean it's less able to make as much output and economic growth may decrease or become negative

Government Policies

- The amount of government intervention in a country will depend on the type of economy – mixed, command or market
- Policies may be ones that affect specific markets or the whole economy
- A supply side example maybe providing more roads or broadband
- Improved infrastructure could make it easier to supply goods and services therefore increasing efficiency and lowering costs
- This can lead to increased output GDP and economic growth
- Policies can also affect total demand within an economy and economic growth e.g. income tax levels

Evaluating the Costs and Benefits of Economic Growth

Benefits

- More output created
- Greater supply of goods and services leading to a reduction in prices and increase in standard of living
- More workers needed leading to more jobs and lower unemployment
- More tax revenue e.g. through income tax which could be used to improve welfare
- Increase in tax revenue along with reduction in unemployment benefit would improve the budget balance

Costs

- More pollution affecting quality of life
- More pollution affecting the environment
- Depletion of non renewable resources due to increased use of raw materials
- More pressure on workers leading to workplace stress and affecting mental health
- Increase in inflation if demand increases faster than supply
- Increased inflation makes goods more expensive for export, leading to decreased competitiveness
- Inequality of incomes if increases are not spread evenly

Study Tip

To work out whether there is a positive or negative impact on supply and economic growth, think about whether the intervention makes it easier/harder or more costly/cheaper to produce

Economic, Social and Environmental Sustainability

- Economic growth should improve quality of life now without reducing it in the future
- Costs and benefits of growth can impact factors of production both now and into the future
- Increased production could lead to more pollution causing global warming therefore harming economic stability:
  - Reduced factors of production such as land reducing future production
  - If homes are lost due to flooding reducing the quality of life
  - Areas of the world may experience more extreme weather leading to damage

GCSE Economics: Theme 3.2 Low Unemployment

What is the meaning of Employment and Unemployment?

Full Employment
This occurs when an economy is using most of its workers to produce output. It is when everyone willing to work is able to get a job.

- **Employment** means people have a job
- People who are willing and able to work make up the labour force or workforce
- The labour factor of production is used or employed to make goods and services
- Wages incentivise and motivate people to work
- As demand and supply change for goods and services so will the need for workers within these different markets so there will always be some people looking for new jobs

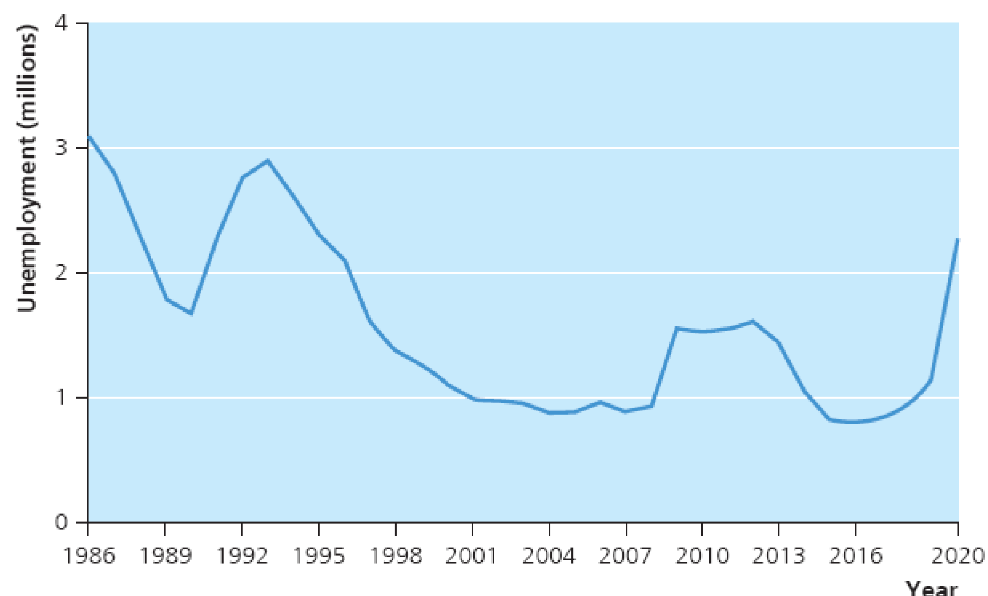
- **Unemployment** means people who are of working age and are looking for work at the current wage rate are unable to find a job (Usually above 16)
- Economically inactive people are not included e.g. pensioners, full time students, sick, family care
- Low unemployment is a key govt. objective
- Low unemployment means less money needed for unemployment benefits
- Wages are a main source of income and can help people out of poverty

How is unemployment measured?

The Claimant Count is a method of measuring unemployment and includes people who are claiming unemployment related benefits such as jobseekers allowance or universal credit.
The unemployed register for these benefits so it is a method the govt. can use to measure.

Extension
Labour Force Survey

The LFS is a sample of households and counts people as unemployed if they are willing to work, actively seeking work could soon start work but currently do not have a job. It uses standard international labour organisation methods and is therefore useful for comparing unemployment between countries



Exam Criteria

- **Explain** what is meant by employment and unemployment
- **Explain** how unemployment is measured using the claimant count
- **Calculate** the unemployment rate
- **Analyse** recent and historical unemployment figures
- **Explain** the types of unemployment, including cyclical, frictional, seasonal and structural unemployment
- **Evaluate** the causes and consequences of unemployment for individuals, regions and government

Key Vocab

Key Terms

Employment The use of labour in the economy to produce goods and services and when people who are willing and able to work can find a job.

Unemployment Occurs when workers able and willing to work at the current wage rates are unable to find employment

Claimant Count The method of measuring unemployment according to the number of people who are claiming unemployment related benefits

Level of unemployment The number of people in the working population who are unemployed

Rate of unemployment The percentage of the country's workforce that is unemployed

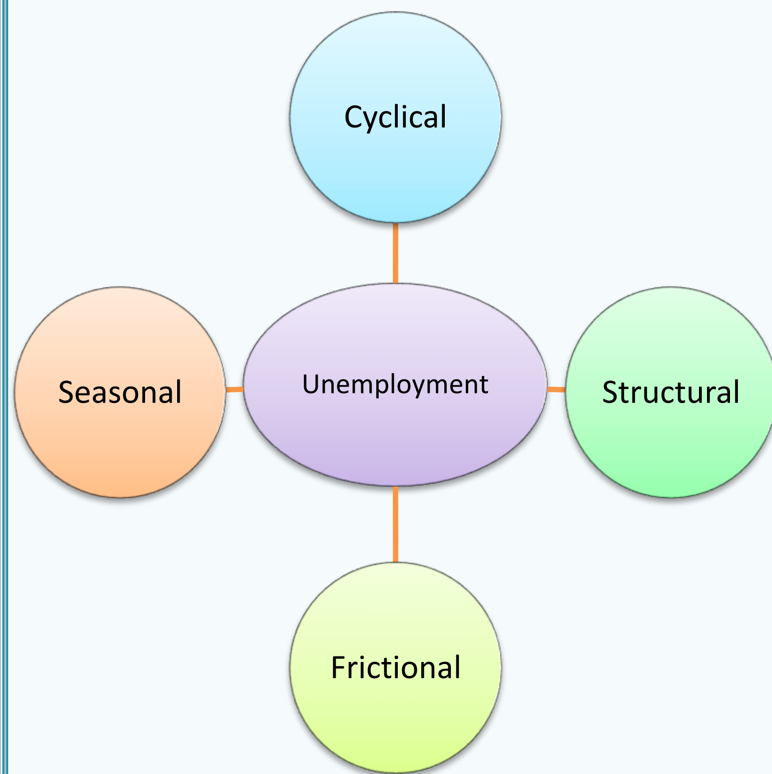
Seasonal unemployment Lack of employment caused by a fall in demand during a particular season

Frictional Unemployment Lack of employment caused by time lags when workers move between jobs

Structural Unemployment Unemployment caused by a permanent decline of an industry or industries

Cyclical unemployment Lack of employment caused by a lack of demand in the economy

What are the causes and types of unemployment?



- Unemployment may be affected by or worsened by a range of causes that are referred to as types of unemployment.
- These may vary between individuals and regions
- If a govt. identifies the causes of unemployment, it can change its policies.

- **Cyclical** Unemployment is caused by problems in the economy, so total demand falls therefore fewer workers are needed to make less output
- **Frictional** Unemployment is caused when people are 'between jobs' for a short time
- **Seasonal** Unemployment is caused when labour is only demanded at certain times of the year such as Christmas workers or ice cream sellers
- **Structural** unemployment is caused due to changes in demand and supply. Certain industries decline and jobs are reduced e.g. steel production

How do we Calculate The Unemployment Rate?

To **calculate** unemployment rate we use the following formula:

$$\text{Unemployment rate} = \frac{\text{Number of unemployed}}{\text{workforce}} \times 100$$

The unemployment rate is the **percentage** of a country's workforce that is unemployed whereas the unemployment level is the **number** of a working population that are unemployed.

Study Tip

If you are asked to identify the **level** of unemployment from some data, your answer must be a number e.g. 1.4 million. If you are asked to identify the **rate** of unemployment, your answer must be a percentage e.g. 6.4%

Calculation Points

- The level of unemployment and unemployment rate can move in different directions. For example, the level of unemployment can increase in a country, but if the size of its workforce increases by proportionately more, then the unemployment rate falls
- A rising unemployment rate over time can mean economic growth is slowing down or has become negative, so fewer workers are needed to produce less output
- A falling unemployment rate over time can mean there is economic growth so more workers are needed to produce more output.

How do we Analyse Recent and Historic Data?

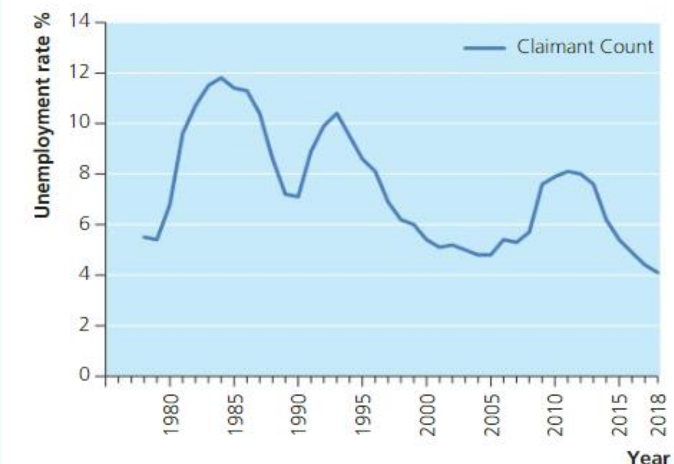


Figure 12.1 UK unemployment rates, 1978–2018

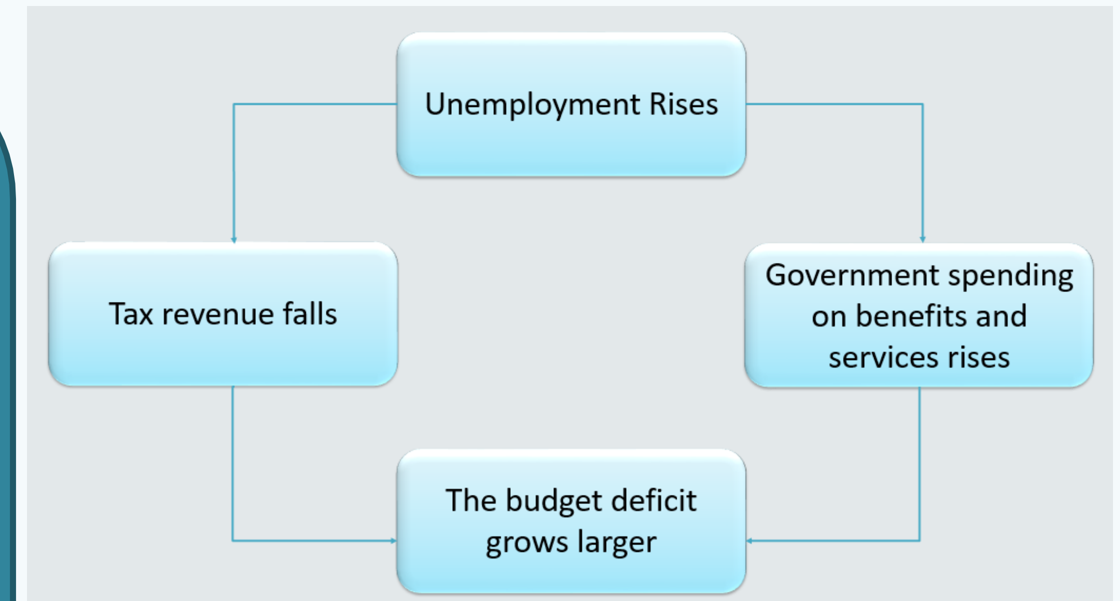
Analysing the Data

- Over time in the UK the unemployment rate has both risen and fallen
- Figure 12.1 was produced by the ONS using data from the Labour Force Survey (LFS) and could have been plotted using the claimant count
- The unemployment rate rose at points in the 1980s, 1990s and from 2007 to 2011
- This often linked to points in the economy where output fell and fewer workers were needed to make this lower level of goods and services
- Since 2011 the unemployment rate in the UK has fallen
- Some of these new jobs have been in low paid, low skilled areas e.g. warehouse staff
- Employing workers may be a cheaper option than buying new machinery
- There has been an increase in self employment e.g. Uber drivers, which reduces risks and costs for firms but leavers individuals with fewer employment rights

Evaluating the Causes and Consequences of Unemployment

Benefits of Unemployment

- Easier to recruit: if there are more workers looking for employment, it is easier for firms to find new workers and expand output
- Dynamic economy: unemployed workers help and economy to be responsive if they can move from one industry to another as demand patterns change
- International competitiveness: workers may have to accept a lower wage rate to get a job, which reduces the costs for firms, meaning they can lower prices and be more price competitive against overseas firms
- Inflation: lower wages means individuals could buy less, so there is less demand for goods, resulting in less demand for goods, resulting in lower general price level



Consequences of unemployment on the budge deficit

Costs to individuals

- Lower standard of living: individuals have less income so can afford fewer goods and services that contribute to their wellbeing
- Lower income: unemployment benefit is relatively low and wages are pushed down due to a surplus of workers
- Excluded workers: firms may not want to employ the long term unemployed, e.g. due to outdated training
- Lower standard of living: due to less income tax revenue, the government may cut spending on services
- Tax increases: income tax may increase for those employed if a government needs to raise more money to pay increased benefits

Costs for Regions

- Differing level of problems: depends on the level of employment in an area e.g. due to the decline of a specific industry a region may have higher costs and need more help from the government
- Regional standard of living: a cycle of increasing negative impacts due to high local unemployment e.g. shops closing

Costs for Government

- Lower output than potential: one of the factors of production not being used (labour) so there is a waste of scarce resources
- Budget deficit: the government may spend more than it receives in tax revenue due to increasing costs such as unemployment benefit and falling revenue due to reduced income tax
- Costs linked to social problems: e.g. less money to spend on healthy food resulting in health problems
- Cycle of increasing unemployment: lower incomes lead to lower consumption leads to less total demand leads to fewer workers needed to make less output, leads to increased unemployment …

GCSE Economics: Theme 3.3 Fair Distribution of Income

What is the meaning of distribution of income?

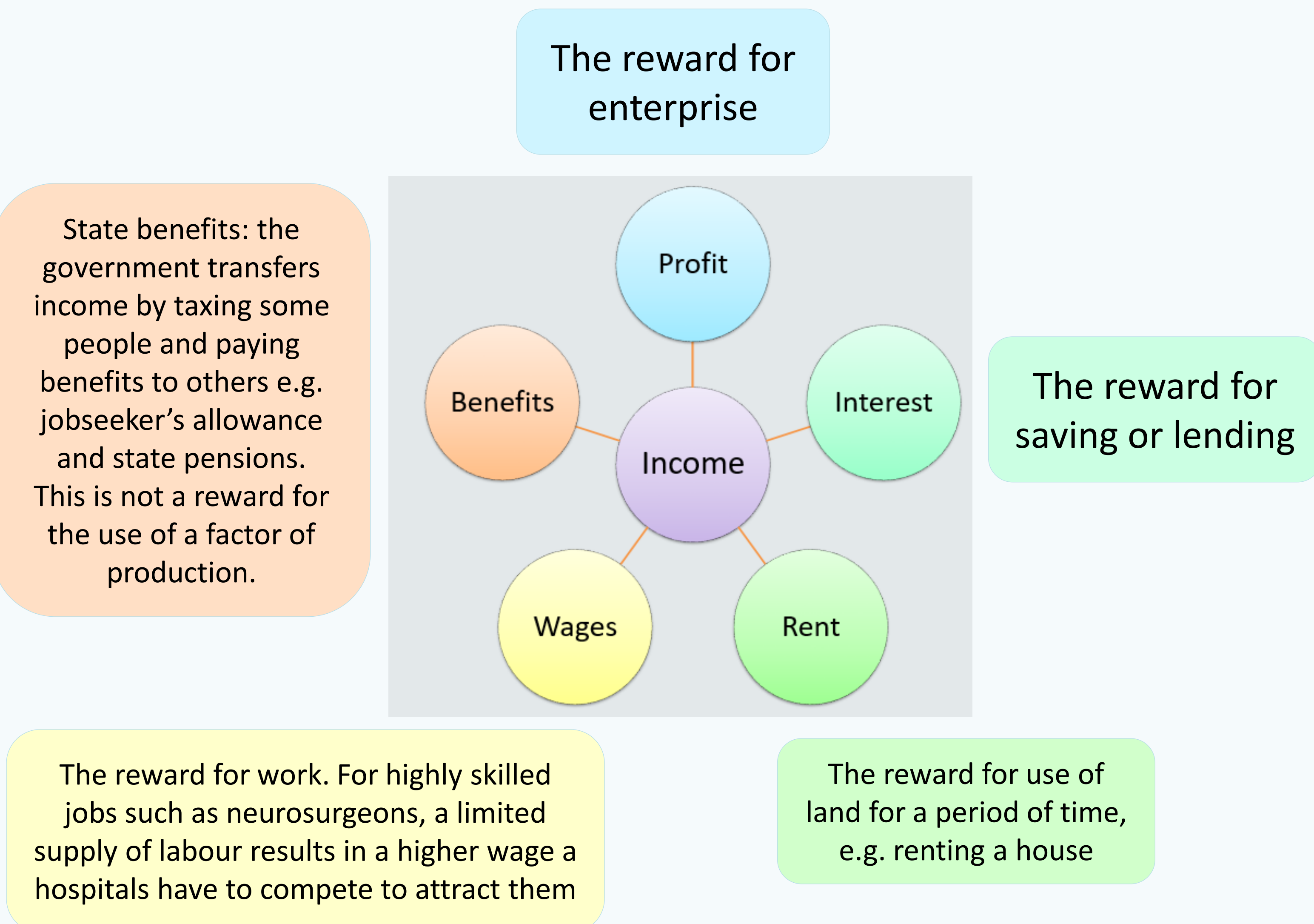
Distribution of Income

This refers to how the total incomes of the economy are shared out among its people. As it is not shared out equally, there is an uneven distribution of income. Some individuals and households have low incomes while others have much higher incomes. This is called inequality of income.

The UK has a high level of inequality of income: the top fifth of the population received 40% of total income in 2015.

Total income is measured by GDP in a country

What are the different types of income?



Exam Criteria

- **explain** what is meant by the distribution of income, including different types of income and the difference between income and wealth
- **calculate** income and wealth
- **evaluate** the causes of differences in the distribution of income and wealth and the consequences for an economy

Key Vocab

Key Terms

Distribution of Income How incomes are shared between individuals and households

Income The reward for the service provided by a factor of production, including labour – a flow of money over time

Wealth The market value of all the assets owned by a person, group or country at a specific point in time. Wealth is a stock of assets e.g. money, houses and land, whereas income is a flow over time

Gross Income Income received before any taxes are taken or benefits given

Net Income Income available after the effect of direct taxes and benefits, often called **disposable income**

Distribution of Wealth How wealth is shared out between individuals and households

What is the difference between income and wealth?

- **Income** is a flow of money over time e.g. the amount of money an individual earns in a year.
- **Wealth** is the monetary value of assets owned at a specific time e.g. the total value of all properties owned by a landlord at a point in time
- Examples of assets that could be valued and contribute to an individual's wealth include houses, cars, antiques, jewellery, savings and shares
- Income and wealth can be linked e.g. more income enables individuals to buy more assets, which in turn may lead to greater rewards and income

Study Tip

Remember to use the words 'income' and 'wealth' correctly in your answers. Wealth is a stock and income is a flow. So an individual may have savings that are a stock and count as wealth but if they generate interest that is income.

How do we Calculate Income and Wealth?

To **calculate income and wealth:**

1. Identify whether the items are income or wealth
2. Split the items into two lists – income and wealth
3. Add together all the current monetary values of income to give total income
4. Add together all the current monetary values of wealth to total wealth

- Gross income or pay is income before tax
- Net income is income after tax plus benefits

What are the Consequences of Differences in Wealth and Income Distribution?

Costs of inequality

- Poverty: in some countries without jobs or benefits people may be in absolute poverty unable to buy necessities and having less than the minimum standard of living. In others inequality leads to relative poverty where people earn less than 60% of average income so have a lower standard of living
- Housing: low incomes mean inability to afford a house or poor quality housing
- Health: low incomes mean inablility to buy healthy food or medicines leading to health problems and lower life expectancy
- Education: in countries with no state education, low incomes my result in the inability to afford education, leading to fewer skills resulting in a lower wage and a poverty cycle
- Social problems: combination of poverty, poor housing, health and education may lead to unhappiness with the unfairness and social unrest
- Lower economic growth: less – educated, unhealthy, unhappy workers are less productive so there is less output in an economy

What are the causes of differences in distribution of income and wealth?

Income:

- Assets distributed unevenly: no land, capital or shares means no income from rent, interest or profits
- Wage differences: wage rated are based on demand and supply for specific jobs so the equilibrium price varies. E.g. minimum wage jobs vs jobs with a high demand and low supply with a high wage rate
- Benefit reliance: state benefits are usually lower than wages and may be the only source of income e.g. pensioners, unemployed or disabled
- Age: Young and old are likely to have a lower share of income. People under 25 have a lower level of minimum wage and less experience so are paid less. Older people who are retired will have pensions likely to be lower than wage
- Gender: in the UK average wage for a woman is less than a man. Legally they are supposed to be paid the same for the same work however time taken out for families or gender bias are cited as reasons for lower pay for women.

Wealth:

- Inheritance: some families own more possessions like property to be passed down
- Savings: people with enough income choose to save some and savings receive interest increasing wealth over time
- Property: people with enough income may buy property or shares which can generate rent or increase in value and therefore increase wealth
- Enterprise: entrepreneurs may invest income or borrowings and if successful, the business would increase in worth and the increase would be a for of wealth.

Benefits of inequality

* Incentives: possibility of higher income may motivate hard work leading to greater productivity and its benefits
* Trickle down effect: if some individuals are on higher incomes, they may spend more in an economy or set up businesses which may lead to more income for others

GCSE Economics: Theme 3.4 Price Stability

What are price stability and inflation?

The general price level is the measure of overall prices of goods and services in an economy at a particular point in time, often expressed as an index.

Price Stability
This is when the general price level is fairly constant over time

Inflation
This is when the general price level increases over time

- Inflation can lead to a fall in purchasing power where consumers can buy less with the same amount of money
- Inflation means the cost of living has increased
- The rate of inflation is shown as a percentage and is a positive number
- A negative number would mean that the general price level has fallen over time.

What is the rate of inflation?

The Rate of Inflation is the percentage rise in the general level of prices over time. It is usually expressed as an annual rate of inflation. For example, if an economy has had a 4% increase in the general level of prices over time, then the rate of inflation is 4%.

What are real and nominal values?

- Economists take inflation into account when comparing information over time.
- A real value takes into account inflation whereas a nominal value does not. E.g. a saver earning 2% interest with a 5% inflation rate would have a real rate of interest of -3%.
- A worker would need to have a wage increase of 5% to maintain the same buying power so if the wage increase was only 2%, then wages would fall by 3% in real terms.

Study Tip

When the rate of inflation falls, the price level is still rising so long as the inflation rate is positive. Don't make the error of stating that prices fall when inflation falls unless the inflation rate is negative.

Exam Criteria

- **explain** what is meant by price stability and inflation, including the difference between real and nominal values
- **explain** how inflation is measured using the Consumer Price Index (CPI)
- **calculate** the effect of inflation on prices
- **analyse** recent and historical inflation figures
- **evaluate** the causes of inflation and the consequences for consumers, producers, savers and the government

Key Vocab

Key Terms

Price Stability When the general level of price stays constant over time, or grows at an acceptably low rate

Inflation A sustained rise in the general price level over time

Cost of living The price level of goods and services bought (by the average family)

Rate of Inflation The percentage rise in the general price level over time

Consumer Price Index (CPI) Method used to calculate the rate of inflation

Nominal Value The monetary value of something

Real Value is the **nominal value** adjusted for inflation

Cost push inflation Occurs when firms respond to the rising costs of production by increasing prices

Demand pull inflation This is caused by excessive demand for goods and services. There is too much money chasing too few goods.

How is inflation measured?

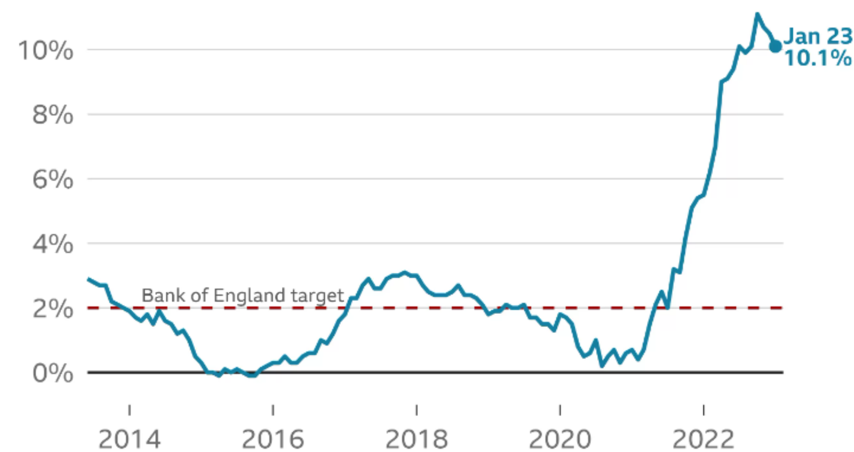
- Inflation is measured using the CPI – Consumer price index.
  - Consumers are surveyed to create a basket of goods and services that they are buying
  - The amount they buy of these goods and services is tracked so they can be given more importance in the basket – known as weighting
  - Prices are checked every month
  - Index numbers show the overall change in the general price level compared to a base year
- The CPI is set to 100 in the base year
- Numbers above 100 show inflation has risen

How do we analyse inflation?

We look at recent and historical data

Inflation at 10.1% in January 2023

Consumer Prices Index



Source: Office for National Statistics BBC

https://www.bbc.co.uk/news/business-12196322

Very recently inflation has shot up with energy prices being a key factor. Oil and gas were in greater demand as life got back to normal after Covid and at the same time, the war in Ukraine meant that less was available from Russia increasing pressure. The war has also reduced the amount of grain available pushing up food prices. Food inflation was 16.7% in January 2023.

Study Tip

Inflation rate figures can be compared between countries but do not show the actual current general price level. So, although one country may have a higher inflation rate than another, its actual prices may still be lower

Fig 3.4.2 shows inflation has fluctuated over time although has been relatively stable up to 2020. This is likely because the Govt. has been more successful in meeting its 2% target.

If inflation rate is +ve then prices are rising. E.g. if it was 4% in 2012 and 1% in 2015 there is a fall in the inflation rate of 3%, however the price level has still risen in 2015 – 1% higher than 2012.

It is only when the inflation rate falls below zero that the price level actually falls. The price level has not been negative during the time period shown.

If one country has a higher inflation rate than another it does not mean the prices are higher. It is possible that prices are lower but the rate is higher.

How are the effects of inflation calculated?

If inflation is positive, it means prices are higher (on average) than they were a year ago.

- To calculate the change in price due to inflation:

  $$\frac{\text{Original price}}{100} \times \text{inflation rate}$$

  - For example, the effect of a 10% inflation rate on a price of £5 would be to increase it by 50p.

  $$\frac{500}{100} \text{ X } 10 = 50\text{p}$$

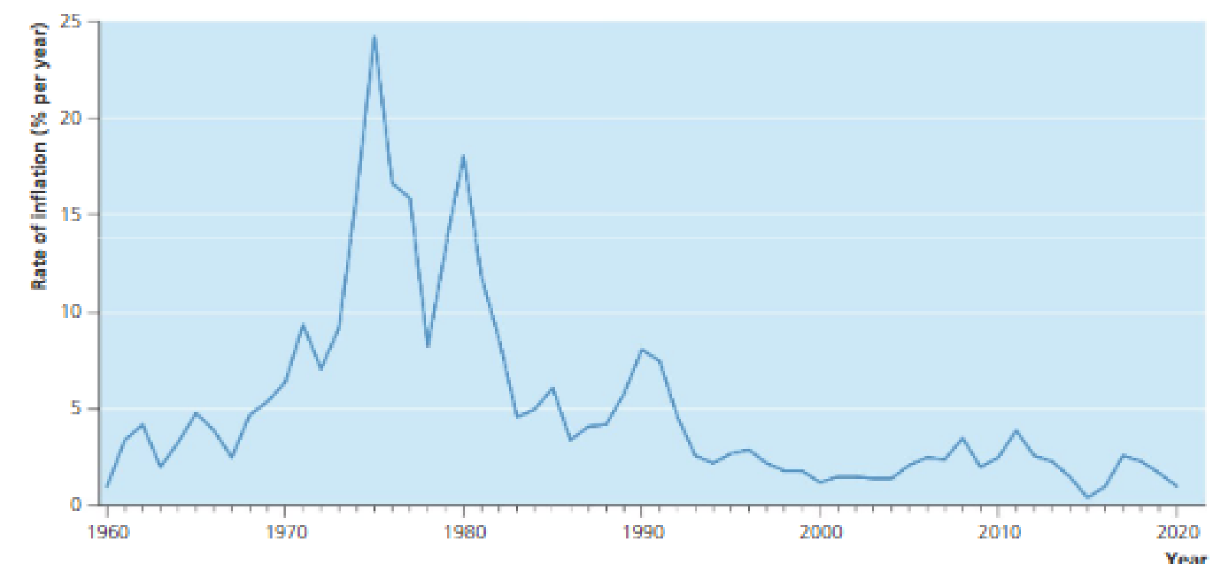
- To calculate a new price after inflation:

  $$\text{Original price x } \left(1 + \frac{\text{inflation rate}}{100}\right)$$

  - For example, if inflation is 10% and the original price is £5.00, this would give a new price of £5.50

  $$£5.00 \text{ x } \left(1+ \frac{10}{100}\right) = £5.00 \text{ x } 1.01 = £5.50$$

Comparisons over time



Source: International Monetary Fund

Figure 3.4.2 UK inflation rates, 1960–2020

What are the causes of inflation?

Demand Pull inflation occurs when total demand rises faster than total supply in a country

- Increased incomes as more goods and services can be afforded
- Leads to increased competition for these goods and services pushing prices up
- More likely where an economy is working close to capacity and firms are less able to respond quickly to increase supply to meet the demand increase
- The economy is close to full employment so hard to find unemployed workers to increase output
- Rises in investment by firms
- Rises in government spending
- Increased demand for exports or decreased demand for imports
- Excess printing of money

Cost push inflation is caused by a rise in the costs of production which firms try to pass on to consumers to maintain profits. This leads to a general rise in prices

- Costs of production include wages and salaries, raw materials, fuel, tax and NI and interest on borrowing.
- A fall in the exchange rate could increase the cost of inputs to production if imported
- A fall in productivity can lead to higher average costs which can be passed on to consumers in higher prices
- An increase in trade union power can lead to higher wages
- A wage price spiral can worsen inflation

Figure 14.2 The wage-price spiral

What are the consequences of inflation for savers?

- Reduced purchasing power of money meaning a fixed amount can buy fewer goods
- Inflation reduces the impact of interest and reduces the real value of money saved e.g. price of item being saved for rises faster than money can be saved
- The real rate of interest is calculated by:

nominal rate of interest minus inflation rate

What are the consequences of inflation for consumers?

- Loss of consumer confidence – uncertainty with rising prices can stop consumers buying goods and services
- Shoe leather costs: as prices change consumers and firms have to keep comparing prices of different goods from different suppliers. This costs time and effort
- Fall in real income: if income rises at a slower rate than inflation , consumers will have less purchasing power
- Income redistribution: some workers e.g. with strong trade unions can negotiate higher wages so they can maintain their standard of living whilst others can't.
- Consumers as debtors: if consumers have borrowed money e.g. mortgages, the real value of the debt falls if there is inflation .

What are the Consequences of inflation for producers?

- Increased production costs: inflation may increase the price of inputs, increasing costs and possibly reducing profits
- Menu costs: firms may need to update pricing information which can increase printing and distribution costs
- Labour market disputes: wage negotiations may take time and result in possible pay increases for workers
- Lower exports: is UK inflation is higher than other countries then UK goods may seem relatively more expensive to overseas consumers who could then buy less
- Producers as creditors: this includes banks who are owed money. If there is inflation, the real value of their loans to borrowers may fall.
- Producers as debtors: firms with debts may gain as the real value of their debt falls.
- Loss of business confidence: if firms are uncertain about the prices of their input costs and the selling price for their goods, this may make them reluctant to invest, which can lead to lower productivity.

What are the consequences of inflation for government?

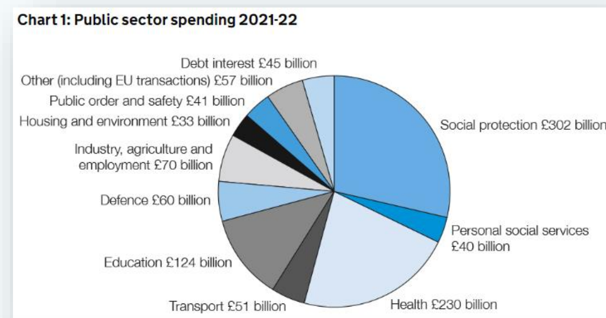
- Government as employer: inflation leads to pressure on the government to increase wages for its employees, such as NHS and state school staff. This can lead to costly industrial disputes and, if wage rises are agreed, increased government spending.
- Government as benefits provider: benefits, such as state pensions and unemployment benefits, may be linked to rise in line with inflation. This means an increase in government transfer payments.
- Tax revenue: if there is inflation, some tax revenue may increase, e.g. VAT and income tax. VAT may increase because it is a percentage of higher prices. Income tax may increase if it is a percentage of higher incomes and people may be dragged into higher tax brackets. However, taxes that are fixed as a specific amount, e.g. tax on alcohol may fall in real terms.
- Government as debtor: the government borrows money to cover a fiscal deficit. The real value of the national debt can fall if there is inflation, so this may be a benefit for government.

GCSE Economics: Theme 3.5 Fiscal Policy

What are the purposes of government spending?

A government needs to raise revenue, largely through taxation, to be able to spend money, mainly on services.
The purposes of government spending:

- to supply goods and services that the private sector would fail to do, e.g. defence
- to supply goods and services that would be too costly for many people, e.g. healthcare
- to reduce poverty through welfare payments and benefits, e.g. unemployment benefit
- to support the economy when there is insufficient private sector investment/spending.



Type of spending	Purpose of this spending
Social protection	To provide everyone with a basic minimum living standard To reduce inequality in income distribution (see Chapter 13)
Education	To provide everyone with education whatever their income To ensure that everyone is equipped with basic skills, e.g. reading
Healthcare	To provide everyone with healthcare whatever their income To increase the welfare of all, e.g. by preventing diseases
Defence, law and order	To provide essential services the private sector could not do
Debt interest	To repay the money government has borrowed

What are the sources of government revenue?

Government revenue is the amount of money a government receives from taxes and other sources such as privatisation and is used to finance government spending.

Direct Taxes

Direct tax	Explanation
Income tax	Paid on all incomes including wages, pensions, dividends etc. Each person gets an income tax allowance before tax is paid
National insurance contributions (NIC)	Paid by both employer and employee
Capital gains tax	Paid on the profit when an asset is sold
Inheritance tax	Paid on the transfer of wealth to relatives when someone dies
Corporation tax	Paid by firms on the profits they have made

Indirect Taxes

Indirect tax	Explanation
Value-added tax (VAT)	Paid on most goods and services at three different rates: • 20% standard rate applied to the majority of goods and services • 5% reduced rate on, for example, children's car seats and fuel for the home • 0% zero rates on most food and children's clothes
Excise duties	Taxes on specific goods such as alcohol, petrol, tobacco
Customs duties	Taxes on imports of goods into the country

In addition there are other indirect taxes such as: insurance premium tax, landfill tax and air passenger duties

Exam Criteria

explain purposes of government spending and sources of government revenue, including direct taxes and indirect taxes
explain what is meant by a balanced government budget, budget surplus and budget deficit
explain what is meant by fiscal policy and how it can be used to achieve economic objectives
calculate and analyse how taxes and government spending can affect markets as well as the overall economy
evaluate the costs, including opportunity cost, and the benefits of fiscal policy on the economy to achieve economic objectives
evaluate economic consequences of measures to redistribute income and wealth, including progressive taxes

Key Vocab

Government revenue The amount of money the government receives.
Government spending The total amount of money spent by the government in a given time period.
Direct tax A tax on income and wealth.
Indirect tax A tax on spending which is imposed on the producer but may then be passed on to consumers through an increase In price.
Balanced budget is when revenue is equal to government spending.
Budget surplus Is when revenue is greater than government spending.
Budget deficit Is when revenue is less than government spending.
Fiscal Policy is a policy that aims to control the economy through the use of government revenue and spending
Progressive Tax – taxes that take a greater % of tax the higher the income

Local Taxes
In addition there are two taxes that provide revenue for local authorities:

- Council tax which is a tax on the value of a person's home
- Business rates which are a tax on the value of the property of a business

What is meant by a balanced government budget, budget surplus and budget deficit?

Government budgets
The budget shows the revenue and expenditure of the government for the tax year (6 April to 5 April). The budget can be of three different types:
I. **Balanced budget** where the total amount the government is expected to receive in the tax year equals the expected expenditure.
2. **Budget surplus** where the expected revenue is greater than the expected expenditure for the year. The surplus is added to reserves or used to pay off debt.
3. **Budget deficit** where the expected expenditure is likely to be greater than the expected revenue so the government has to use reserves, borrow money (both sensible) or print more money.

What are economic objectives?

Fiscal policy/economic objectives - Government objectives consist of:

- economic growth
- low unemployment
- price stability
- improved balance of payments
- fair distribution of income

What is Fiscal Policy?

Fiscal policy is the use of taxation and government spending to affect the level of economic activity:
Budget surplus will reduce economic growth and inflation.
Budget deficit will increase economic growth and employment.

Study Tip
When doing calculations it is important to show your workings. There is 1 mark for workings and 1 mark fro the correct answer so failing to do this will result in a loss of the mark.
Always make sure you have used the unit symbol in an answer e.g. £

How can fiscal policy be used to achieve economic objectives?

Objective	Type of budget	Taxation	Spending	Outcome
Rise in economic growth	Deficit	Reduced	Increased	Greater output and employment, perhaps higher inflation and possibly more exports
Lower unemployment	Deficit	Reduced	Increased	More employment and output, perhaps higher inflation/more imports
Price stability, or lower inflation	Surplus	Increased	Reduced	Prices are stable or rise more slowly, balance of payments improves, but growth may fall
Improved balance of payments	Surplus	Increased	Reduced	Imports fall, economic growth may rise as exports exceed imports
Fair distribution of income	Deficit	Increased	Increased	The rich lose income while the poor become better off, both financially and in terms of more services

The opposite will be true if deficit and surplus are swapped around

How do we calculate tax payments?

Calculations could be for either direct or indirect taxes. Below is an example for each.

Direct: Sian pays tax at the standard rate (20%) on her income of £40,000. If her personal allowance is £112,500, how much tax will she have to pay?

£40,000 - £12,500 = £27,500 which is her taxable pay.
£127,500 X 20% = £5,500. She will have to pay £5,500 in tax.

Indirect: John has been quoted £5,000 excluding VAT for repairs to the drive of his house. If VAT will be charged at the standard rate, how much will the repair cost him?

£5,000 X 20% = £1,000. Total cost is £5,000 + £1,000 = £6,000.

Taxes can be either direct (imposed on people) or indirect (imposed on goods and services)

How do taxes affect markets and the economy ?

Tax change	Affect on markets	Affect on the economy
Rise in income tax and NIC	Workers' disposable income falls so they may decide not to work resulting in fall in supply in the labour market Lower income leads to fall in demand especially for non-essential goods and services	Lower demand leads to lower output and economic growth and thus more unemployment. Lower demand leads to lower inflation
Fall in corporation tax	Firms keep more profits so invest more, leading to better quality goods/ inventions so demand for those products rise. More people may be needed so the labour market expands	Investment leads to economic growth and more employment. Inventions leads to improved balance of payments

Type of tax/good	Affect on markets	Affect on the economy
Rise in VAT on TVs	• Fall in demand for TVs • Consumers switch to buying goods with lower VAT	• If produced in UK then employment in the industry will fall. If produced abroad imports may fall • Could be offset by whatever is bought instead of TVs
Rise in excise duty on a good with negative externalities	• Fall in demand for the product, the extent depending on the price elasticity of demand • Could lead to switching, e.g. from petrol cars to electric cars	• Could improve the environment • Could reduce imports, e.g. fall in demand for petrol

How does spending affect markets and the economy ?

Government spending is likely to increase economic growth, increase employment, increase inflation and possibly worsen the balance of payments if there are more imports

Market	Analysis
Labour market	The government is a major employer so any change in spending will have a major effect on: civil servants, teachers, doctors and nurses, etc.
Construction market	Governments are directly responsible for: roads, hospitals and schools. They can also encourage housebuilding by cutting interest rates
Private sector	By building new schools there is more demand for computers, tables etc. so the profits of firms rise. The same will be true if the Royal Navy orders a new ship etc.
Specific markets	Subsidies may be given to specific areas of the economy, e.g.: • renewable energy to replace use of fossil fuels and thus negative externalities • grants for small businesses to encourage new firms in many product markets • grants for firms setting up in areas with high unemployment

What are the costs and benefits of fiscal policy?

The costs of fiscal policy

This means not just the actual monetary cost of the policy, but also the unfavourable consequences:

- Consumers may save rather than spend their extra income so the economy does not grow as much as expected.
- Firms and consumers might spend the extra money on imports making the balance of payments worse.
- Inflation may rise if supply cannot keep up with demand in either the factor or product markets

Opportunity cost

- If the government spends more on one area, e.g. education, then it will spend less on another area, e.g. healthcare.
- If the government spends more it could pay for it by higher taxes. This means consumers have less income so they spend less meaning VAT receipts fall.
- If a government cuts taxes then it must either spend less or accept a higher budget deficit.

Benefit - Government can cut taxes/increase spending. There is more demand for labour. Consumers can spend more, so again more labour is demanded

Economic growth increase - Cutting taxes and increasing spending both lead to greater output as consumers purchase more and firms increase investment

Faster acting - Compared with monetary policy and supply-side policy, changes in fiscal policy act more directly and faster on the economy

What are the economic consequences of measures to redistribute income and wealth?

Redistribution involves either direct taxes as they are progressive, or spending.

Consequence	Evaluation
Reduce inequalities of income	Poorer people are better off and those with higher incomes receive less money
More services available to less well off, e.g. education/health	This increases equality of opportunity so people are in a position to earn more in the future
People may not seek work	If benefits are such that working would not bring in more money, people may opt not to find jobs
Reduces incentives	For those in work getting promoted may mean they have to pay higher taxes so that it is not worth the extra effort
People leave the country	High taxes can lead people to go abroad to where tax rates are lower
Lack of investment	High corporation tax rate can deter firms from investing or they may prefer to invest abroad
Lower savings	If the interest on savings is heavily taxed people may prefer to spend rather than save
Tax avoidance or tax evasion	People may seek ways to avoid paying tax (legal) or try to evade taxes (illegal)