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Economics *for* IGCSE

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Sample pages

Nelson Thornes

Introduction

Nelson Thornes are proud to present you with a sample section of our new title, *Economics for IGCSE*. *Economics for IGCSE* has been endorsed by **University of Cambridge International Examinations**.

This completely new text follows on from our Cambridge endorsed *Business Studies for IGCSE* and the Science series, using all of the best features while catering for the specific requirements of international schools following the Cambridge 0455 Economics syllabus. Having been planned and reviewed by Cambridge IGCSE Principal and Senior Examiners, the content is presented in a clear, concise visual manner.

Key features of Nelson Thornes *Economics for IGCSE*

Double-page spread features

- Learning outcomes are clearly stated at the start of each spread.
- Exam Tips – notes written by Cambridge IGCSE Principal and Senior Examiners to help students overcome common errors and misconceptions.
- Did you know? – features that use contexts relevant to international school students.
- Practical Activities allow students to take an active approach to the study of Economics.
- Case Studies – accompanied by questions, these short contextualised scenarios are directly linked to topics in the text to improve understanding. Additional, longer case studies are also provided at the end of the book.
- Summary questions – test and consolidate students' learning.
- Key points at the end of the spread relate directly to the learning objectives and highlight the key information students need to understand.
- Content is supplemented by tables and diagrams that present information in a visual manner.

Additional book features

- End-of-unit question spreads – Each chapter concludes with a double page spread of questions, consisting of a balance exam-style questions from each paper. These have been written by Cambridge IGCSE Principal and Senior Examiners.
- Glossary of command terms to help students familiarise themselves with terms they will meet in the exams.
- Glossary of terms provides clear definitions for students.
- Fully indexed to help navigate the text

Author credentials

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Jane King has over 16 years' experience as a teacher of Business Studies and Economics and is currently head of Business Studies and Economics at an independent girls' school. She is a Senior Examiner with extensive experience on both the Cambridge IGCSE and A Level Business Studies papers. Jane has travelled worldwide undertaking consultancy work for Cambridge. Experiences in countries as diverse as Zambia, Pakistan and the Maldives, have contributed to the materials for Business Studies for IGCSE.

Contents

Contents

6 Economic indicators

Unit 6 explains how economic indicators provide good measures of major changes taking place in economies, showing how quickly an economy is growing and indicating possible problems, such as rising prices and unemployment.

The unit explains how indicators such as the Retail Price Index are used to decide policies, such as setting the rate of interest, and points out that businesses and trade unions use these as a basis for setting wage increases. Reference is made to charts that show how governments use indicators, such as numbers employed, as a basis for devising policies that will attempt to create jobs.

The material in Unit 6 also shows how some indicators, such as Gross Domestic Product and the Human Development Index, move in the same direction as the economy, while others, such as unemployment, move in the opposite direction to the economy.

LEARNING OUTCOMES

With regard to **prices**, candidates should be able to:

- describe how the Retail Price Index is calculated
- discuss causes and consequences of inflation.

With regard to **employment**, candidates should be able to:

- describe changing patterns and levels of employment
- discuss causes and consequences of unemployment.

With regard to **output**, candidates should be able to:

- define Gross Domestic Product (GDP)
- describe simple measures and indicators of comparative living standards, such as GDP per head, and the Human Development Index (HDI).

6.1 The Retail Price Index

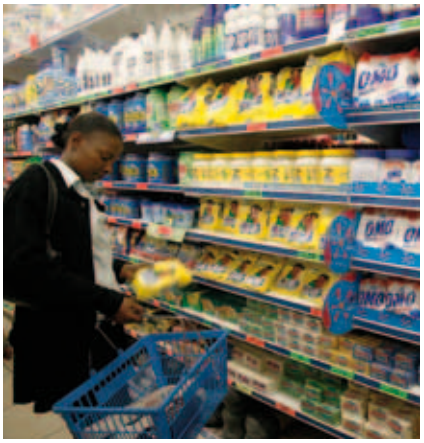
LEARNING OUTCOMES

With regard to **prices**, candidates should be able to:

- describe how the Retail Price Index is calculated.

Average prices are measured by governments using the **Retail Price Index (RPI)** or the **Consumer Price Index (CPI)**. This index measures changes in average prices over a year. Measurements are made by recording prices of goods and services that most people will be expected to buy, or put in an imaginary shopping basket. Government statisticians decide what goods to include in this basket. This list should be updated to take account of changing spending patterns.

Most governments measure prices in similar ways. This unit uses the example of Kenya. The examples show some of the difficulties involved in accurately measuring average price changes.



Shopping in a supermarket in Kenya. The Consumer Price Index (CPI) measures general increases in the prices of a basket of goods. Changes in food prices are particularly important in Kenya as this is the largest item of household expenditure (and how these prices change over time).

A basket of goods

The imaginary shopping basket for a typical family in Kenya contains, for example, milk, bottled water, sugar, tea, meat, cooking fuel, school books and mobile phone charges. The contents included in the basket are fixed in the short term, but the prices of individual goods change.

Figure 6.1.1 A helpful way of thinking about the price index is to imagine the contents of a shopping basket bought by a typical household

DID YOU KNOW?

Food prices (especially for rice, maize, flour and coffee) have a prominent weighting in the price index in Kenya. When they rise, this will have a major impact on inflation as measured by the price index.

A price index uses a single number to indicate changes in prices of a number of different goods. This is calculated by comparing the price of buying the basket of goods with a starting period, called the **base year**. The base year is given a figure of 100. So if the average price of goods in the basket today is 10 per cent higher than the base year, the price index will be 110. Changes in average prices (the cost of the basket of goods) can be measured on a monthly, quarterly or annual basis.

EXAM TIP

The examination may require you to define inflation, so make sure you are able to give a full and accurate definition.

Inflation

Inflation is a persistent or sustained rise in the general level of prices over a period of time. So not every price will rise, but average prices will. The effect of this rise on ordinary people will vary, depending on what they buy.

Price inflation in Kenya is measured by the Kenya National Bureau of Statistics (KNBS). One of its responsibilities is to decide on the 221 goods and services to be included in the price index, or 'basket'. The selection is made after carrying out a survey of spending patterns – that is, what most people in Kenya are buying. From time to time the items in the basket will change: in 2010 the basket was 'widened' to include internet charges, computers and primary and secondary school transport fees.

Statistics covering the prices of all items in the CPI are gathered each month in 10 areas of the capital, Nairobi, and 15 other price collection zones across Kenya selected for their high expenditure levels.

DID YOU KNOW?

The 'average annual' rate of inflation is computed as a percentage change of a twelve-month average of the CPI. The 'year-on-year' inflation rate is calculated as a percentage change of the CPI between the current month (e.g. April 2011) and the same month a year ago (e.g. April 2010).

Weighting

The weighting is a figure given to a category of goods according to the percentage of a typical household's income that is spent on it. Statisticians have found that typical families in Kenya spend 40 per cent of their income on food, so this is given a weighting of 40 per cent in the price index.

CASE STUDY Rising inflation in Kenya

In 2008, inflation rose sharply in Kenya, largely as a result of rising food prices. The overall annual average inflation was 26.2 per cent, compared to 9.8 per cent in 2007. The main causes of this were:

- an increase in average food prices of 37.5 per cent
- an increase in average oil prices of 18 per cent.

Questions

1 What effect do you think that a rate of inflation of 26.2 per cent is likely to have on people in Kenya?

2 Why do you think that changes in food prices are so important to people living in Kenya?

3 Are some Kenyans likely to have been more affected than others by the high inflation figure? Explain how.

4 Suggest a way of measuring inflation in Kenya.

DID YOU KNOW?

From time to time, weighting of items in the basket needs to be adjusted. For example, more frequent use of mobile phones in Kenya between 1993–4 and 2005–6 meant that the weight attached to spending on mobile phone use was increased from 5.75 to 12.7 per cent.

Calculating average price changes

Calculating average price changes will give the rate of inflation. The calculation involves two sets of data:

- The price data (collected each month).
- The weights (representing patterns of spending, updated each year).

Category	Percentage spend	Weight
Food	40	4
Clothing	20	2
Transport	10	1
Other household goods	30	3
Total	100	10

The weighting for food is twice that for clothing because typical households spend twice as much on food as on clothes

With this data it is possible to construct a weighted price index. A consumer spending survey has been carried out that shows the percentage spend of typical households in an imaginary country. The table on the left shows how the percentage spend forms the basis of the weighting given to the categories.

The next stage is to identify price changes in each of these product categories. Let us suppose that surveys carried out in supermarkets, shops and other retail outlets across the country show the following changes since the base year:

- Food prices have increased by 20 per cent.
- Clothing has increased by 10 per cent.
- Transport has fallen by 10 per cent.
- Other household goods have increased by 30 per cent.

To find out the **average change in price** we need to take account of each of these price changes in terms of how much consumers spend on that item (the weight). For example, the increase in food prices of 20 per cent will have a major impact on average prices because 40 per cent of household income is spent on food. In contrast, even though transport prices have fallen by 10 per cent, this will have a smaller impact on average prices because consumers only spend a tenth of their income on transport.

To create a **weighted price index** we need to multiply the weight for each item by the price index for that item. This is shown in the table below.

Product category	Weight price index	Weighted price index
Food	4 × 120	= 480
Clothing	2 × 110	= 220
Transport	1 × 90	= 90
Other goods	3 × 130	= 390
Total		**1180**

Finally, divide the weighted price index by the total number of weights:

$$\frac{1180}{10} = 118$$

This shows that prices have risen on average by 18 per cent (i.e. from the base year figure of 100 to 118 in the new year).

EXAM TIP

Make sure you understand this difference: the price index shows how much the price of that item has risen by compared with a base year of 100; the weighted price index shows the price index times the weight attached to the product category.

Problems involved in using a price index

The price index is designed to show general increases in prices and how they affect consumers. There can be some problems, however, with its use as an indicator:

- The index does not necessarily show how price changes affect typical consumers. For example, in Kenya the weighting attached to food in the index was reduced from 50 per cent to 40 per cent. However, food purchases for a poor person in Kenya may make up 80 per cent or more of their spending.
- The index makes comparisons with a base year. However, if prices were low at the base year, the comparison may exaggerate the price rise. If prices were high at the base year, the index comparison may suggest that subsequent price changes have been low (especially if the base year is at the top or bottom of the trade cycle fluctuation).
- Some items, for example fuel and food, are subject to quite a lot of variation.

For indicators to provide useful information, it is essential that the statistics gathered are accurate.

DID YOU KNOW?

In Kenya separate indexes are calculated for low-income households and medium- to high-income households in recognition of the way that they purchase different baskets of goods each week.

ACTIVITY

Working in a group, find out the monthly inflation rate of your country, or a large country in your part of the world. You should find this information published each month by your national statistical office. With your teacher's help, try to find the rate on the internet or in a national newspaper. Plot the current rate on a large chart and display this in your classroom to monitor ongoing changes. Then try to find the inflation rate of another country and compare it with your own.

SUMMARY QUESTIONS

1 What items are likely to be included in a basket of goods bought by a typical consumer in your country? Which categories of items should be given the greatest weights?

2 What two sets of data are required to calculate a CPI?

3 Why is it necessary periodically to alter the list of items included in a country's 'shopping basket' of items included in the CPI?

KEY POINTS

1 Inflation is a persistent or sustained rise in the general level of prices over a period of time.

2 A price index can be used to measure price increases by reducing prices to a single number starting at 100 in a base year.

3 The price index measures changes in an average basket of goods bought by a typical consumer or family.

4 Weighting items in the basket makes it possible to take account of the relative importance of spending on different items when measuring average price changes.

6.2 Causes of inflation

LEARNING OUTCOMES

With regard to **prices**, candidates should be able to:

- discuss causes of inflation.

Rising oil and energy costs are a major cause of cost-push inflation that affects many businesses across an economy

Causes of inflation

A cause is a factor that has an effect on something else. For example, a cause of inflation might be that people increase the amount of money they spend. The effect might be an increase in prices.

Inflation is usually the result of a number of causes. It may occur when a number of prices rise at the same time, say for oil, food and housing or rented accommodation.

In examining inflation, economists distinguish between **cost-push** and **demand-pull** factors. These are explained below.

Cost-push factors

Cost-push refers to the costs that a business has to meet, such as wages and raw materials. As costs rise, the business will often pass these on to consumers by increasing the prices for the product they are selling.

Food costs

In the previous Unit we saw that 40 per cent of the weighting in Kenya's Consumer Price Index (CPI) is allocated to food. In the years 2000–10 the food supply in Kenya has been badly affected by droughts in the north of the country.

At the same time, the price of basic foodstuffs, including the price of cereal crops on global markets, has been increasing. There is increased competition for cereal crops as a result of the growth of huge economies like China and India, and also as a result of cereals being used as alternative **biofuels**. Whatever the cause, high food prices lead to higher costs for other businesses.

Raw material costs

Despite the world recession in 2008 and 2009, the costs of raw materials such as steel, copper, oil and gas have risen. These raw materials are at the centre of modern economies, so as their prices rise, there is an effect on many other prices.

Wage costs

Wage costs are another major cause of cost-push inflation. If food and fuel prices rise for workers in Kenya, they will press their employers for higher wages. If, however, the wage increase is not matched by higher labour productivity, in other words, if the workers do not produce more goods to sell, production costs will rise.

Land costs

Land prices in many countries have risen as land is used more intensively. For example, the Ethiopian government has granted

EXAM TIP

In the examination, you need to show that you understand that inflation can be the result of more than one cause.

long-term leases to overseas companies to use land for large-scale agricultural production of grain and other crops. Land is also increasingly being used for housing as the world population increases. This leads to land price inflation.

Exchange rate costs

Changes in the exchange rate between currencies can have a major impact on business costs. For example, if the Kenyan Shilling (KES) loses value against the South African Rand (ZAR), people will have to pay more for imported goods, oil and food from South Africa.

Demand-pull inflation

Demand-pull inflation occurs when rising demand pushes up the price of goods. This happens when people have more to spend. This is most likely when an economy is near to full employment. Businesses compete for resources and this will lead to a rise in prices.

CASE STUDY Monetary inflation

Monetary inflation provides a good explanation of demand-pull inflation. It illustrates clearly the impact of economic indicators on the economy.

The idea of monetary inflation is not new. One of the best explanations was provided by the American economist Milton Friedman in the book he wrote with Anna Schwartz, *A Monetary History of the United States, 1867–1960,* published in 1971.

Friedman and Schwartz argued that if governments increase the quantity of money, there is more to spend on new goods. If, however, there are not enough goods being produced for the people who want to buy them, manufacturers will be able to put up prices. The authors concluded that price levels are linked to the quantity of money available. In their words, 'inflation is always and everywhere a monetary phenomenon.'

This work was published in 1971 and became a model of good practice in using detailed statistical analysis over a long period (in this case in the US) to make the link between prices and the quantity of money.

Questions

1. What connection did Friedman and Schwartz identify between the quantity of money and the level of prices?
2. What statistics did the authors study and use to make their claim?
3. How can monetary inflation also be described as demand-pull inflation?
4. With what economic indicators was Milton Friedman primarily concerned?

KEY POINTS

1. Causes of inflation can be split into cost-push and demand-pull factors.
2. Rising costs include agricultural prices, raw material costs, labour costs and weakening exchange rates.
3. Demand-pull occurs when demand increases and is usually associated with monetary inflation.

SUMMARY QUESTIONS

1. Define cost-push inflation, explaining one type of cost-push inflation.
2. How is an increase in the quantity of money in the economy likely to affect price levels?
3. When the exchange value of a country's currency falls, how is this likely to impact on import prices?

6.3 Consequences of inflation

LEARNING OUTCOMES

With regard to **prices**, candidates should be able to:

- discuss consequences of inflation.

Maize grain is a major staple food in many countries. An increase in the price of maize and other food staples can have a major impact on the livelihoods of the poorer members of society

Inflation is a sustained rise in the general level of prices. Mild inflation of one or two per cent is not particularly harmful because it encourages producers to supply more to the market. When inflation rises more quickly it can disrupt economic decision-making because it becomes difficult for businesses, governments and even ordinary people to make plans. Inflation results in a loss of value of units of currency. The reverse of inflation is **deflation**, when prices start to fall. Deflation (negative inflation) discourages businesses, who may restrict supply to markets.

There are many historical examples of rapid inflation. When prices rise rapidly governments are often tempted to print more money. Where the quantity of money increases, people lose confidence in it and businesses push up prices because they see money as being less valuable. The government is forced to print more money, but it becomes worthless. In the first decade of the 21st century, the government of Zimbabwe printed so much money that citizens started exchanging goods and services rather than use money to make payments.

The table below shows how inflation affects people in different circumstances.

Income level	Effect of inflation
Low income	They can afford fewer goods, including basic necessities. People resort to buying the lowest-priced products available.
Fixed income	There is a fall in real income (what can be afforded with money coming in). Because money loses value, people on fixed incomes save less and spend more.
High income	There is less income to spend on some luxury items. People may, therefore, switch to cheaper alternatives and cut back on some extravagant purchases. They may save less and spend more.

DID YOU KNOW?

Deflation can be as harmful as rapidly rising prices. When prices are falling business income from sales falls. Businesses become reluctant to invest and they reduce the numbers of employees.

Who loses out in a period of inflation?

The poor

Poor people are the first to suffer in times of inflation. For example, in Kenya, an important part of people's diet is maize grain. In recent years there have been several droughts, reducing the supply, and so raising the price of maize. Drought has hit Kenya every two or three years and this has forced the country to buy expensive imports to meet its people's needs. This has pushed up inflation.

People on fixed incomes

People on fixed incomes are those whose incomes remain the same, or nearly the same, during periods of inflation. They may be poorly paid workers who are not in a trade union, or pensioners. Workers who are unskilled and so have less bargaining power, such as office cleaners and car park attendants, also suffer in times of inflation. Skilled workers in well-paid jobs may be able to bargain with their employers to receive wage increases. This is often the case for people who work for the government: civil servants, teachers, the police and armed forces.

Savers

Many people like to save some money each month for future needs. Their savings may be deposited in a bank or kept in a safe place. However, during a period of inflation savings lose their value. When the money comes to be spent it is not worth as much as when it was first saved. Similarly, money saved in a pension scheme can lose value by the time the saver becomes old enough to draw on it.

Businesses

A lot of business activity involves supplying goods on credit, perhaps to other businesses. Payment may be required one month, three months or six months later. When money starts to lose value quickly, businesses become reluctant to supply on credit. Therefore, inflation is very harmful to business activity.

In contrast, people who borrow money in a period of inflation are likely to gain. When they come to pay back the sum they have borrowed, the value of their repayment will have fallen.

Mild inflation

As mentioned above, a small level of inflation is not necessarily a bad thing. Gently rising prices encourage businesses to supply more to the market and help to increase profits. In fact Milton Friedman argued that the government should increase the quantity of money. However, this should be done in a planned way that anticipates growth in production in the economy.

Deflation

Deflation refers to a general fall in the level of prices. Typically, this will occur when there is a general fall in demand for goods – for example, if people are spending less through uncertainties over rising unemployment. This is likely to be harmful to the economy as businesses will start to lay off workers and reduce levels of production.

ACTIVITY

Argentina and Turkey have both experienced rapid inflation. Carry out some internet research to find out when these periods of inflation occurred and how the governments in the two countries managed to stabilise prices. Try to find out what caused the inflation in these countries.

EXAM TIP

Make it clear in the examination that you understand that inflation can have varying effects on different groups of people in an economy.

KEY POINTS

1. In a period of inflation the economy becomes less stable. Groups such as the poor and those on fixed incomes suffer most.
2. Rapidly rising prices can quickly destroy business confidence and the willingness of business people to supply goods on credit.
3. A mild level of inflation can have a positive effect on business confidence.

SUMMARY QUESTIONS

1. Which two of the following groups would suffer least in a period of high inflation? Savers, pensioners, poor households, employees whose skills are in great demand, borrowers, or the government? Explain your answers.
2. Explain why a period of very mild inflation may not be harmful for an economy.
3. Explain why high inflation can be damaging for long-term business planning.

6.4 Patterns and levels of employment

LEARNING OUTCOMES

With regard to **employment**, candidates should be able to:

- describe changing patterns and levels of employment.

Employment

Employment is the work that people do in an economy. Over time, patterns of employment change: some industries go into decline and jobs disappear while new types of industries and jobs develop.

Government statistics provide indicators showing what jobs people do and how many are employed. These are important for governments. (Ideally everyone who wants a job should be able to find work that meets their own needs, as well as the needs of the economy as a whole.)

Skilled full-time workers producing modern products are best placed to earn high wages and to help an economy to grow

CASE STUDY Labour force indicators in the UK

The table below presents a picture of employment in the UK from May to July 2009.

	All aged 16 and over (thousands)	Total in employment (thousands)	Employment rate (%)
Men	24,109	15,461	64.1
Women	25,340	13,430	53.0

Source: Labour Force Survey

The table is extracted from data in the Labour Force Survey. It shows that out of a possible 50 million people in the UK over 16, about 29 million are in work. The employment rate among men is higher than among women.

The survey also shows the breakdown of employment by age structure. For example, almost 11 million jobs are held by people in the age category 35–49. Over 80 per cent of people in this age category are employed, compared with only 25 per cent for the age category 16–17.

There are over 18 million people in full-time jobs, 6.5 million doing part-time jobs and almost 4 million people who are self-employed (i.e. working for themselves, perhaps running a small enterprise).

There are 23 million people working in the private sector, while just over 6 million people work in the public sector.

Questions

1. What reasons would you put forward to explain why only 29 million people aged over 16 are working in the UK? What will the others be doing?
2. What is meant by the employment rate? Why do you think that the employment rate is higher among men than among women?

DID YOU KNOW?

Core workers are at the heart of an organisation. They have full-time well paid jobs. Their work is supported by a more flexible labour force of part-time and temporary contract workers. Terms of employment, such as wage rates and job security, are less good for contract workers.

3 What is the difference between the public and private sectors? Who pays employees in these two sectors?

4 Why is the self-employed sector of the economy likely to be important for the future development of the UK economy?

The table (right) shows the different status of employees in a workforce.

Participation rates

The number of people available to work in an economy depends on:

- the number within the working age range
- the number within that age range who are prepared to participate in work. This is the **participation** rate.

$$\text{participation rate} = \frac{\text{number who are prepared to work}}{\text{number within working age range}}$$

Participation rates vary from country to country, depending on various factors:

- Social attitudes: in some countries it is acceptable for women to go out to work. In others they may be expected to stay at home and focus on looking after their children and the home.
- Number going to school and university.
- Age at which people stop work and **retire**.
- Facilities available to enable groups to work. In some countries, shops, offices and industrial premises are adapted to enable people with disabilities to participate in work.

The industrial structure

Another way of examining patterns of employment is to look at the industrial structure of the economy.

The table below gives some statistics from the UK, from June 2009: jobs are divided into 14 categories (A–O), using a classification known as the Standard Industrial Classification.

Job	Category	Number
All jobs	(A–O)	30,997
Agriculture, forestry and fishing	A–B	488
Mining, energy and water supply	C–E	191
Manufacturing	D	2,885
Construction	F	2,170
Distribution, hotels and restaurants	G–H	6,816
Transport and communications	I	1,854
Finance and business services	J–K	6,409
Education, health and public administration	L–N	8,193
Other services	O	1,991
Total services	G–O	25,263

Type of employee	
Full time (core workers)	Very important to the economy. They may work for the same employer for a number of years and develop increased knowledge and skills, enabling them to produce high-quality products for the economy.
Part time	Able to combine work with other commitments, such as bringing up a family.
Self-employed	Work for themselves. The businesses they set up may take on others and grow to become major employers in the future.
Employed workers	Work for someone else (e.g. large businesses or the government).
Private sector workers	Work for businesses. Most employees in developed economies, such as the US, UK or Germany, work for large companies, some of which employ thousands of workers.
Public sector workers	Employed by the government, for example, in the Civil Service. In India the biggest employer is the government-run Indian Railways.
Skilled employees	Have developed skills through training and practice. Typically, they are relatively well paid compared with **unskilled** workers.

DID YOU KNOW?

In many countries, tourism is a major provider of employment that swells the size of the tertiary industry. Hotel work, excursions and trips are all 'services'.

By studying the chart opposite, you should be able to see that most jobs in the UK are in service occupations.

The industrial structure is split into three main areas:

- Extractive (primary industry)
- Manufacturing and construction (secondary industry)
- Services (tertiary industry)

These areas are outlined below.

Extractive industries

Extractive industries use natural resources. Examples include farming, mining and drilling for sources of oil. Farmers grow and harvest crops and farm livestock, miners take out, or extract, fuel and minerals from the ground. Extractive industries sometimes produce raw materials like iron ore (for making steel) and oil (for making petrol, plastics, fibres, and so on). Some primary products can be sold direct to consumers, for example fish and oranges sold by a grower at the farm gate.

Manufacturing and construction industries

Manufacturing and construction industries use raw materials and parts from other industries to make and assemble new products, such as chocolate, furniture, cars and oil rigs. House, factory and bridge building are examples of construction industries. **Semi-manufactured** refers to goods that are partly made and will need further processing by manufacturing industries.

ACTIVITY

Societies have developed in three stages, sometimes also called 'waves'. Group the following activities under the headings of primary, secondary and tertiary industry.

Service industries

Service industries are particularly important in the modern world. **Services** give something of value to people, but are not physical goods. Examples of services are being served in a restaurant, or having a bank look after your money for you. Society has gone through three waves of development. In modern third wave societies services dominate employment in advanced economies.

In the **first stage**, countries are dominated by agriculture and farming. This is still the case for many developing countries, such as such as Côte D'Ivoire and Ghana in West Africa, where over 90 per cent of the population live in rural areas.

In the **second stage**, countries are dominated by manufacturing, when industries such as coal, steel, car manufacture and engineering become important.

In the **third stage**, services become the most important sector of the economy, with many people working in insurance, banking, leisure entertainment, tourism and hotels. This can lead to countries being highly developed in some areas, while still having districts where people live in considerable poverty.

In modern, third-wave societies, computers and robotised machinery have replaced many manufacturing jobs.

CASE STUDY Employment by major industry sector in the US

The US is frequently given as an example of a third-wave society. The following data is drawn from information provided by the US Bureau of Labour Statistics. It shows percentages of people employed in the three sectors. The table includes a prediction for the future.

	1996 (%)	2006 (%)	2016 (%)
Primary industry	2.4	1.8	1.6
Secondary industry	16.9	14.5	12.7
Tertiary industry	81.7	83.7	85.7

Source: US Bureau of Labour Statistics

Questions

1 Describe the key trends that are taking place in the data.

2 Why do you think that the figures for primary and secondary industries show a decrease?

3 Do you think that the patterns of change from 1996 to 2016 are likely to continue?

ACTIVITY

Find statistics for your own economy to find out how the working population (i.e. people who are of working age) is distributed between primary, secondary and tertiary occupations. You will need to examine statistics from the government department responsible for collecting employment statistics. Obtain some information from the past five years so that you can see the trends in the three sectors.

The data shown for the US is very different from **Newly Industrialised Countries** (NICs). Brazil is a NIC and roughly 20 per cent of the working population there is still engaged in agriculture and other primary industries, and a further 15 per cent in manufacturing, with the remainder working in services. In Ghana in West Africa, over half the working population still works in primary industries, including cocoa growing and other forms of small-scale agriculture. About 25 per cent of Ghana's population is engaged in services.

In all countries, the percentage of people employed in tertiary industries tends to be higher in urban than in rural areas.

KEY POINTS

1 The structure of employment refers to the employment rate, proportions of men and women working, differences between public and private sector employment and other structural differences.

2 The structure of employment in an economy changes over time.

3 As economies develop, the main change is an increasing proportion of jobs in the service sector.

SUMMARY QUESTIONS

1 Explain the difference between the primary, secondary and tertiary sectors of an economy. Give examples of industries that would fit into each sector.

2 What is meant by the 'participation rate'? What are the key factors influencing rates of participation?

3 Between 1990 and 2005 the employee percentage working in manufacturing fell in these countries: Australia, Barbados, China, Colombia, Finland, France, Iceland, Ireland, Japan, Poland, Republic of Korea and the UK. Give four reasons why you think this may have occurred.

6.5 Causes of unemployment

LEARNING OUTCOMES

With regard to **employment**, candidates should be able to:

- discuss causes of unemployment.

Machines taking jobs away from humans is an example of technological unemployment

What is unemployment?

As we have seen, employment usually refers to the use and payment of labour. Unemployment typically occurs when people who want to work are not able to find jobs.

Measuring unemployment

The International Labour Organization (ILO), an agency of the United Nations, defines unemployed people as those who are:

- without a job, but who want a job and have actively sought work in the last four weeks and are available to start work in the next two weeks
- out of work, have found a job and are waiting to start it in the next two weeks.

There are two major statistics to look at when examining unemployment:

1 The total number of unemployed people in an economy. Is this rising or falling over time?

2 The unemployment rate. This rate measures the percentage of the working population who are unemployed. Note that the 'working population' consists of those with jobs as well as those who are unemployed. Is this rate rising or falling over time?

What causes unemployment?

Unemployment and inflation are two of the most serious economic problems. It is not surprising that governments pay so much attention to indicators that measure unemployment.

Unemployment is caused by a range of factors, some of which are more harmful than others in that they affect more people and have a longer-term impact on the economy. Figure 6.5.1 shows the range of unemployment types: the factors that cause them are explained in the next paragraphs.

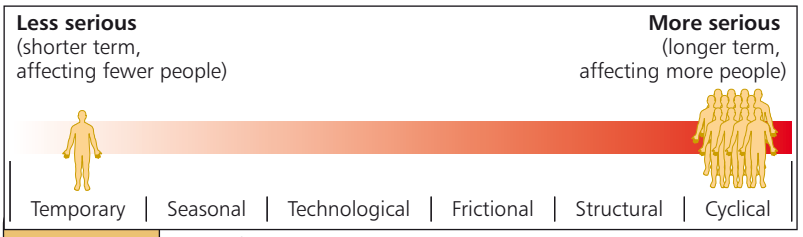


Figure 6.5.1 Types of unemployment

ACTIVITY

Identify the current rate of unemployment in your country. How does this compare with figures for your region and for the world? Study news reports to get the figures for your country. Do newspaper reports suggest any of the causes for unemployment? As a group, collect monthly statistics for unemployment in your country and display these on a poster in your classroom.

Temporary unemployment

Temporary unemployment is short term, occurring usually while people are leaving one job to go to another, or perhaps when they are leaving school or university before going on to work.

Seasonal unemployment

Seasonal unemployment occurs in countries where there are distinct seasons and harvest times. For part of the year there will be plenty of jobs, such as harvesting sugar cane or picking fruit and vegetables. In the rainy season or winter, fewer jobs will be available.

Technological unemployment

New technology frequently replaces older methods that might have required more labour. For example, the use of tractors and giant harvesting equipment on modern farms has reduced the demand for agricultural labour. Automatic bottling, canning and packaging equipment has reduced the need for factory labour. However, new technology also helps to create new jobs by leading to economic growth. Computer technology has taken away the need for many factory workers, but it has created new opportunities for office workers and people setting up small businesses from home.

Frictional unemployment

Frictional unemployment occurs when the market system does not work as smoothly as it should – as its name suggests, there are *frictions* in it. This sort of unemployment occurs when there is a mismatch between the demand for, and supply of, labour. This might occur when employers are trying to recruit highly skilled construction workers but too few workers have been trained with the skills required.

Another cause of frictional unemployment might be **search** unemployment. This occurs when workers who have lost their previous jobs are searching for new ones, but are unable to find them because there is too little information about availability.

Structural unemployment

Structural unemployment arises when there are longer-term changes in the economy, affecting specific industries, regions and occupations. In the previous Unit we saw that one of the main structural changes in economies has been the move away from primary and secondary industry to services. This has led to rural and urban poverty in areas where agriculture and manufacturing industry are in decline.

Cyclical unemployment

On a larger scale, a major cause of unemployment across the globe is cyclical unemployment, also called **demand-deficient** unemployment. This is unemployment resulting from a substantial fall in demand that affects the economy as a whole.

Dealing with unemployment

Because there are many causes of unemployment, governments need to identify cures, that is, policies to deal with them. These are shown in Figure 6.5.1. The more serious the type of unemployment, the more it will cost the government to provide a cure.

DID YOU KNOW?

In Mauritius the sugar cane harvest depends on weather conditions. Once the hurricane season starts (usually in December) there are fewer available jobs in this industry.

KEY POINTS

1. 'Unemployment' refers to people seeking work who are unable to find a job.
2. Some of the causes of unemployment are more serious and long term than others.
3. Structural and cyclical unemployment are the most deep-seated causes of long-term unemployment.

SUMMARY QUESTIONS

1. What type of unemployment is caused by:
   - a the decline of an industry
   - b the end of the agricultural harvest?
2. What is the difference between the level of unemployment and the rate of unemployment?
3. Why is structural unemployment likely to have long-term consequences?

Please see the full text for the remainder of this chapter.

Practice exam questions

SECTION 1: Multiple-choice questions

Each question has ONE correct answer.

1 Which of the following is NOT usually used as an indicator of the overall health of the whole economy?

- **a** The level of unemployment
- **b** The level of economic growth
- **c** The level of retail sales
- **d** The level of inflation

2 What is inflation?

- **a** An increase in the population of a country
- **b** An increase in the value of a country's currency
- **c** An increase in a country's interest rate
- **d** An increase in a country's general level of prices

3 If the Retail Price Index at the start of 2006 is 100 and increases to 130 by the end of 2009, what is the average yearly inflation rate for the time period?

- **a** 10 per cent
- **b** 11 per cent
- **c** 15 per cent
- **d** 30 per cent

4 Which of the following may be an advantage of an increasing rate of inflation for the population of a country?

- **a** People who borrow money find that the real value of repayments falls
- **b** People on fixed incomes find that their spending power decreases
- **c** Poor people must pay higher prices for basic foodstuffs
- **d** People who save money find that the real value of their savings have fallen

5 Unemployment may cause a negative 'multiplier effect' because:

- **a** People spend less so businesses close down
- **b** People may claim welfare benefits
- **c** People have out-of-date skills
- **d** People suffer from low self-esteem

6 What does the participation rate for workers in an economy measure?

- **a** The total number of people of working age
- **b** The percentage of people of working age who are prepared to work
- **c** The percentage of workers who are in full-time jobs
- **d** The number of retired people who continue working

7 Which of the following works in a secondary industry?

- **a** A school teacher
- **b** A restaurant chef
- **c** A car factory worker
- **d** A mobile phone salesman

8 Which of the following is a disadvantage of increasing rates of employment for the population of a country?

- **a** Rising prices for goods and services
- **b** Rising wage rates
- **c** Rising levels of income
- **d** Falling level of benefit payments

9 Which economic indicator measures the total output of an economy?

- **a** Gross Domestic Product
- **b** Human Development Index
- **c** Gross Domestic Product per head
- **d** Retail Price Index

10 Which of the following is a problem with using GDP to measure the total output of a country?

- **a** Workers' incomes are not equal
- **b** Prices are different in different areas
- **c** Some incomes are not reported
- **d** Higher earners pay more income tax

SECTION 2: Structured questions

Country A is a developing nation, whose population, due to better health care, is now growing at 10 per cent per year. There are two major cities and several large towns, but the majority of the population live in rural areas and farm small areas of land. There is an increasing trend for people to move to the cities, but there are not enough jobs, so many people end up living in poverty. The increasing population is also putting pressure on resources. Gross Domestic Product (GDP) is only increasing at 2 per cent yearly, causing average prices to rise by an average of 12 per cent per year.

1 a Explain why 'better health care' may lead to an increase in population. *(4)*

b Country A's government measures price changes using a Retail Price Index. Explain how this is constructed. *(6)*

c Using the information given, explain how you would expect the measure of 'GDP per head' to have changed. *(4)*

d Discuss whether GDP might be an accurate way to measure living standards in Country A. *(6)*

2 The government of Country A is worried about the rising prices. The Minister of Finance is quoted as saying '12 per cent inflation per year is far too high'.

a Explain why the increasing population of Country A is causing prices to rise at 12 per cent per year. (A suitable diagram may be used here.) *(4)*

b Why are some types of products, such as basic foodstuffs, given a 'prominent weighting' in the Retail Price Index in Country A? *(4)*

c Explain the effects of 12 per cent inflation on the different population groups of Country A. *(6)*

d Discuss why the RPI may not provide an accurate measure of the level of price rises suffered by all citizens in Country A. *(6)*

3 In the capital city of Country A, 30 per cent of people are estimated as being unemployed. There are increasing numbers of jobs in secondary employment in new factories, but people moving into the city do not have appropriate skills, as they only have experience in primary farming occupations.

a Why might it be difficult to measure the unemployment rate in the capital city of Country A? *(4)*

b Explain the economic causes of unemployment of the people moving into the capital city of Country A. *(6)*

c Describe likely changes in the structure of industry and types of occupation that will be available to Country A's population as it becomes more developed. *(4)*

d How might the government of Country A decrease the level of unemployment in its capital city? *(6)*

4 The President of Country A has been quoted as saying 'this increase in our population can only be good for living standards in the long run, as we will have more workers'.

a Explain what is meant by 'living standards'. *(3)*

b Explain the president's view that 'more workers will lead to better living standards'. *(3)*

c Apart from using GDP to measure output, how might living standards in a country be measured? *(6)*

d Discuss which will be the most important factors that will determine whether the President will be proved correct in his assumption. *(8)*

Total: 80 marks

SECTION 3: Analysis and critical evaluation

Country B is a developed nation, whose working population are mainly employed in jobs in the tertiary sector. The country has been suffering from an economic recession and the government has reported the following indicators for the third quarter (three-month period) of 2009:

- A fall in GDP of 0.2 per cent for this quarter, which is the sixth successive quarter of falling GDP.
- A population which has increased by 408,000 to 61,383,000 from the previous year. This is noted to be due to 'increase in births, decrease in deaths and changing patterns of international migration'.
- An unemployment rate of 7.8 per cent, having increased by 0.1 per cent over the quarter, indicating that unemployment is still increasing but at a slower rate than in previous quarters. However, there are 'over one million employed and self-employed people working part-time, as they are unable to find a full-time job'.
- An inflation rate of 0.3 per cent as measured by the Retail Price Index, or 1.9 per cent as measured by the Consumer Price Index, the government's preferred measure. It is noted that the largest upward pressure on inflation is due to the rising price of oil leading to increasing transport costs for businesses and individuals.

1 a Explain what 'A fall in GDP' means. *[2]*

b Why might the government of Country B be worried by 'six successive quarters of falling GDP'? *[2]*

2 a 'Most of the working population in Country B are employed in the tertiary sector'. Give examples of one occupation in each of the industrial sectors. *[2]*

b Explain ONE likely reason for the increase in employment in the tertiary sector. *[2]*

3 Discuss whether 'over one million people working part-time' may benefit the economy of Country B. *[5]*

4 a Explain what is measured by the 'HDI' or Human Development Index. *[2]*

b Discuss the benefits to an economist of using the HDI to compare Country B with another country. *[5]*

5 Using a diagram and written explanation, show how 'the rising price of oil causes transport costs to increase'. *[5]*

6 Using all the information in the text, write an assessment of the health of the economy of Country B. *[7]*

Total: 32 marks

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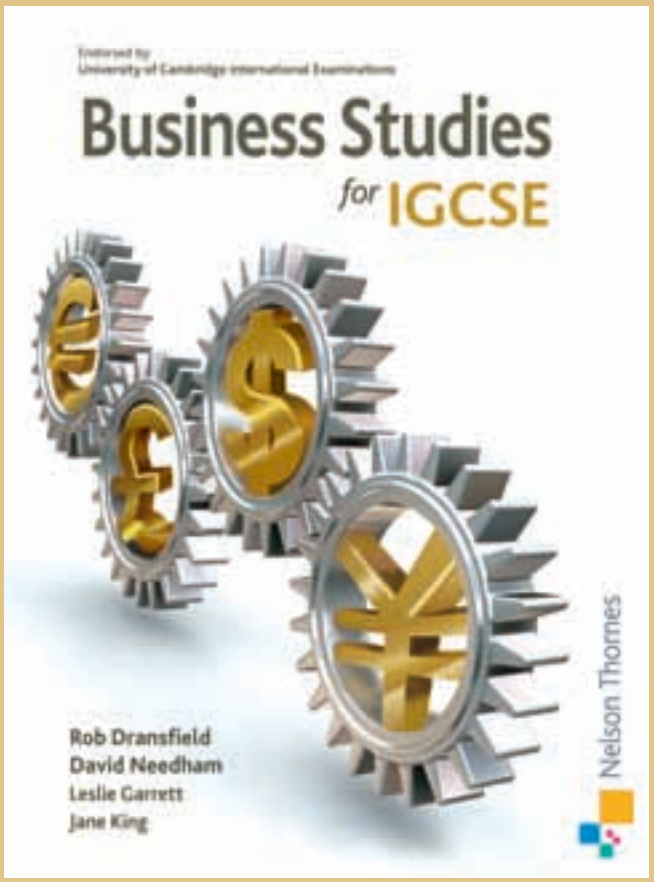

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