

OCR A2 Economics Module 3 Revision Notes – Market Failure and the Role of the Government and Unions in the Labour Market

Labour Market Failure

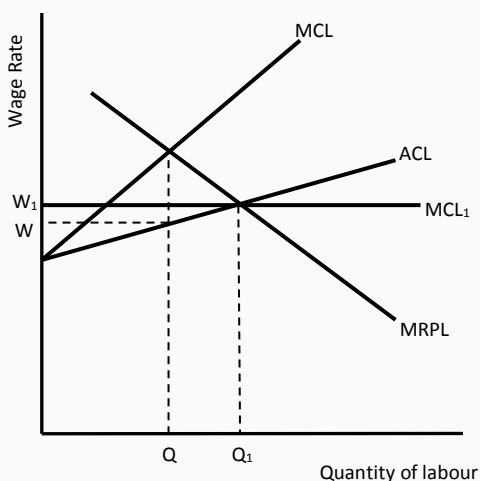
- Labour Market Failure occurs when supply and demand don't result in an efficient allocation of labour resources
 - This can be seen in instances where there is either a surplus or a shortage of labour, as well as cases where workers are in the wrong jobs, workers are poorly/aren't trained, and where wage rates are low
- The causes of labour market failure are:
 - Abuse of labour market power
 - Imperfect information
 - Skill shortages
 - Economic inactivity
 - Unemployment
 - Discrimination
 - Occupational immobility of labour

Abuse of Market Power

- Trade Unions are a source of power in the sale of labour services, and they may abuse their market power by pushing the wage rate above its equilibrium level, and thereby cause unemployment
- Unions may also engage in job demarcation, which is where workers will only perform tasks outlined in their job description, and hence, labour flexibility will decrease.
- Market power is also present on the demand side
 - Monopsonists and Oligopsonists are buyers of labour who have the power to determine the wage rate, which is likely to be lower than it would be in a perfectly competitive market.

The Determination of Wages and Employment

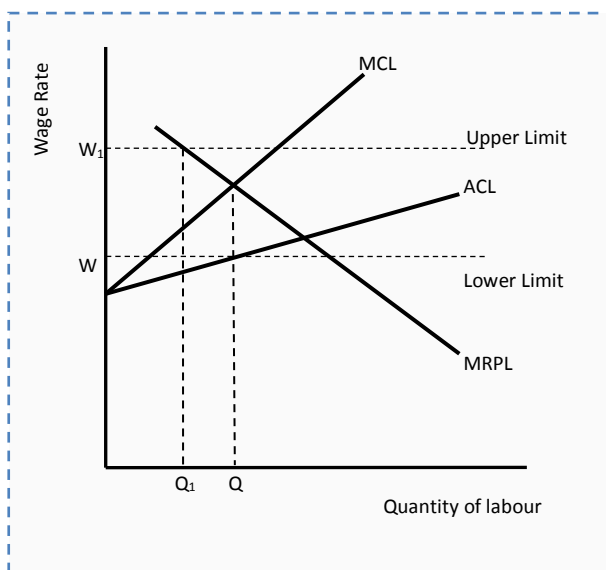
- For monopsonists and oligopsonists to employ more workers, they have to increase the wage rate



- Equilibrium point is where $MRPL (D) = MCL (S)$, and this is where the firm will employ, WR is ACL at this point
- A Union can raise the wage rate (ACL) without reducing unemployment
- In the absence of a union, the wage-rate is MCL, and hence, the number of workers employed will be Q , and wage rate will be W ($MRPL = MCL$)
- A union can raise the wage rate to W_1 , which then becomes the new MCL
- Employment will therefore rise to Q_1
- It also means, however, that once the wage rate has been settled by negotiation, the monopsonists will not have to increase the wage rate to attract labour

Bilateral Monopoly

- When a trade union negotiates with a monopsonist's employer, the situation is referred to as a bilateral monopoly
 - A bilateral monopoly is a market with a single buyer and seller
- In this case, the wage rate will be determined by the relative bargaining strength of the two sides
 - If the monopsonist is very powerful, the outcome will be a wage rate close to that which the monopsonist would have chosen to pay without any union intervention (low rate)
 - The stronger the union is, the closer the wage rate is likely to be to the upper limit
 - However, the union must take into account the adverse effect that pushing up the wage may have on the quantity of labour demanded



- The lower-limit for wage-rate is W , which is derived the same way as in the previous diagram
- The upper limit is the maximum the monopolist can pay without threatening the existence of the firm.
- This is W_1 , and it is roughly any point above $MCL=MRPL$

Factors Influencing an Employer's Bargaining Strength

- An employer will be stronger:
 - The greater the financial reserves it has with which it can last out any dispute
 - The lower the proportion of its workers who are in a union or professional body
 - The greater the degree of substitution between capital and labour
 - The higher the rate of unemployment, since this will mean it can substitute existing workers with unemployed workers
 - The lower the support workers have from the public
 - The lower the disruption any industrial action would cause to the productive process
 - The more branches the firm has which employ non-union labour or labour in different unions, so that production can be moved in the case of a dispute
 - The more legislation favours employers

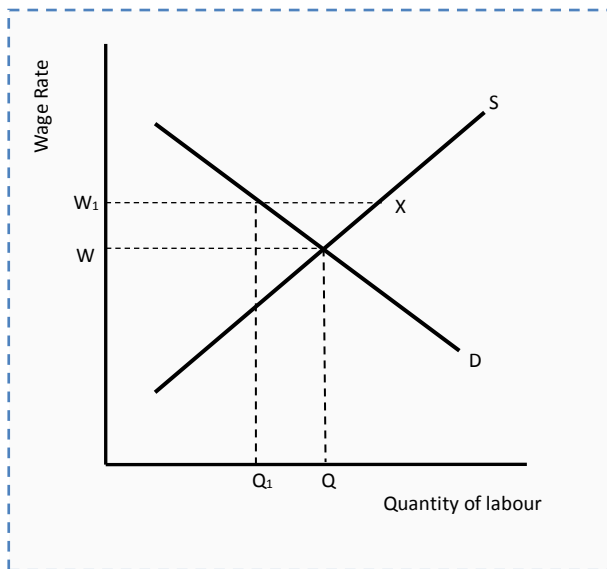
Trade Unions

- Trade Unions are labour organisations that seek to promote the interests of their members

- Their main function is to negotiate the wage rate and conditions of employment for their members
- Trade unions may also
 - Serve as a channel for communication between workers and employers
 - tend to reduce labour turnover
 - Raise the level of training
 - Reduce income inequality.
- Pay scales in unionised firms tend to be flatter than in non-unionised ones

The Effect of Trade Unions on Wages and Employment

- If all the workers in a labour market are members of a trade union, the union will act as a monopoly seller
 - This will alter the supply curve of labour



- This diagram shows a union increasing the wage-rate to W_1
- The union members will now work for W_1 or above, so their supply curve becomes W_1XS
- The diagram also shows employment falling from Q to Q_1

- A union may also raise the wage rate by pressing for employers to raise the qualifications or skills required to do the job
 - Such an approach would shift the supply curve of labour to the left, which would increase the wage rate
- The effect that a trade union will have on employment will depend upon the market structure in which the employers sell their products
- If under conditions of perfect or monopolistic competition a union increased the wage rate, it would likely have an adverse effect on the firm
 - This is due to the firm only making normal profit in the long run, so a rise in their costs will cause marginal firms to leave the industry, causing output and employment to fall
- In any market structure, a union may both increase employment of its members and wage rate by either increasing the labour productivity (e.g. training) or by increasing demand for the product (e.g. aiding advertising)
 - In both cases, the demand curve would shift to the right

Factors Influencing Trade Union's Bargaining Power

- A trade union will be stronger:
 - The greater the financial reserves of the organisation
 - The higher the proportion of workers in the organisation
 - The more inelastic the demand for the firm's product
 - The lower the degree of substitution between capital and labour
 - The lower the proportion of labour costs in total costs
 - The lower the rate of unemployment
 - The greater the support the workers have from the general public
 - The more legislation favours the rights of workers
 - The more disruption any industrial action would cause.

Imperfect Information

- Workers may be in jobs that are less well paid and aren't fully suited to them, or one could be unemployed because one doesn't know of the suitable job vacancies available.
- Likewise, an employer may not have the *most* productive workforce simply because they are not in touch with all of the potential workers.
- Both groups have to consider the benefits of searching for a better employment situation against the costs of searching
 - For an employer, these costs could be interviews, advertising job vacancies, inducting new staff etc.
 - For a worker, this could be filling out application form, attending interviews, looking for new jobs, etc.

Skill Shortages

- Skill shortages occur when firms have difficulties recruiting people with the required skills
 - This usually results in an increase in the costs of production
 - This is because due to the scarce resource that is skilled labour, firms may bid up the wage rate of staff, whilst others may try to fill the vacancies with less efficient, unskilled workers.
- One cause of skill shortages is a lack of training, which is a merit good – it has greater private benefits than consumers realised, and has positive externalities
 - If left to market forces, training would be under-consumed, as some firms and works underestimate the benefits of training
 - Some firms are also afraid of other firms 'poaching' their staff.

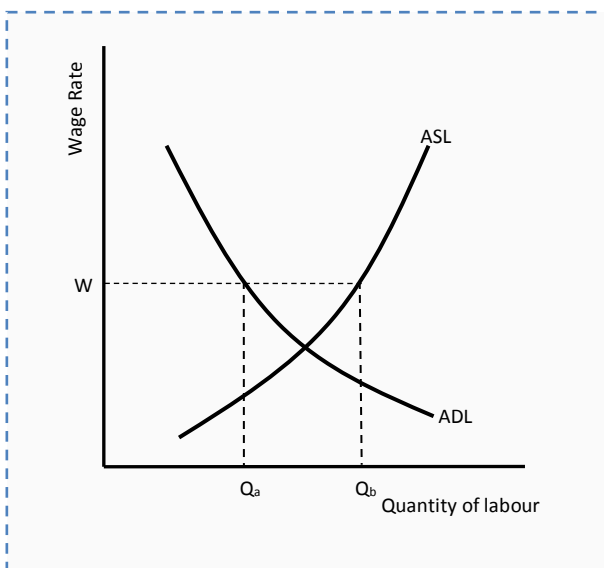
Economic Inactivity

- Most forms of economic inactivity are not labour market failure
 - E.g. people looking after family and home have chosen to do so and are providing a key service, and a rise in the number of full-time students will likely help the economy in the long run

- Discouraged workers and people classified as long-term sick or disabled, but are still capable to do some work, represent a waste of resources and a burden to tax payers
 - Getting these people into the labour force would increase aggregate supply, and increase their income.

Unemployment

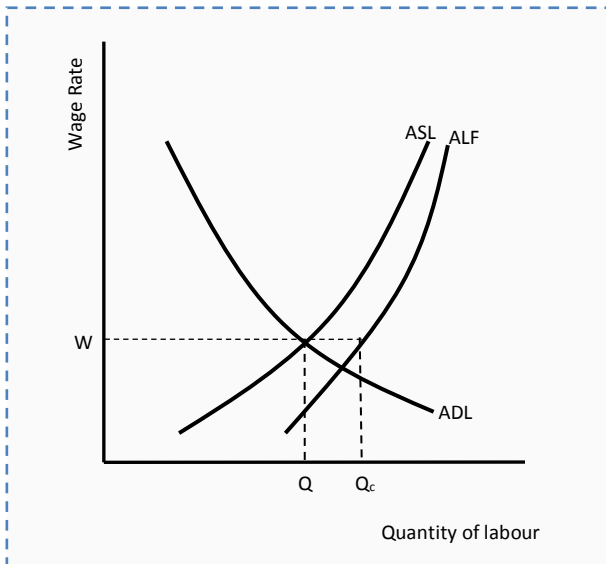
- Unemployment means that labour markets aren't clearing ($S=D$)
 - Some of those willing and able to work cannot obtain a job
- This means that a country is not producing all that it's capable of; it's not producing on its PPC, and hence it won't be achieving productive efficiency.
- The extent to which unemployment causes labour market failure depends on the number of people unemployed, and how long they've been out of work
 - The longer someone is unemployed, the more they get out of touch with the skills required, and the chance of them getting a job decreases.
- Unemployment can arise as a result of a lack of aggregate demand for labour
 - This is known as disequilibrium unemployment, and occurs when aggregate supply of labour at the going wage rate is greater than aggregate demand for labour



- ASL exceeds ADL at the given wage rate, and hence, unemployment of $Q_b - Q_a$ is a result.

- It might appear that a way to reduce unemployment would be to decrease the wage rate
 - This might not only be difficult, but with workers wanting to resist a cut in their wages, a deflationary spiral could occur
 - The cut in wages would reduce aggregate demand, which in turn would lower ADL (derived demand, etc.), which would lead to a further cut in wages, which would..., etc.
- Conversely, unemployment can arise due to problems related to the supply of labour
 - Some people may be unemployed due to them: not knowing about job vacancies; not being suited to the vacancies, or are unwilling to take up certain vacancies.
- In other words, they are experiencing voluntary, frictional and structural unemployment.

- In such a situation, there will be a gap between the aggregate labour force (ALF) and the aggregate supply of labour (those that are prepared to work at the going wage rate)
 - The gap between ALF and ASL narrows as the wage rate rises, as more of the labour force would be prepared to work at the required wage rate.



- The difference between employment is $Q - Q_c$

- The unemployment that exists where $ASL = ADL$ at the going wage rate is sometimes referred to as the equilibrium unemployment or the non-accelerating inflation rate of unemployment (NAIRU)
 - These both exist when the labour market is in equilibrium
- NAIRU is the level of unemployment at which there is no upward pressure on the wage rate and inflation
 - If, for example, the government raises aggregate demand to increase employment, the rate of inflation would increase.
 - To contrast, if unemployment rises above NAIRU, the wage rate and rate of inflation will fall.

Discrimination

- Discrimination results in an inefficient allocation of resources and inequitable wage differentials
- The group that's discriminated against are likely to be paid less for doing the same job, and are likely to find it harder to gain employment.
 - They may be overlooked for promotion, have to do less demanding jobs, may not go on selected training courses, etc.
- The producers who discriminate will have a smaller pool of labour to select from, and may not make the best use of black workers they do employ
 - As a result, their costs of production will increase which will make them less competitive
- Consumers will experience higher prices if producers discriminate (if the producers pass their costs onto the consumer (elasticity?))

- If consumers themselves discriminate, they will find themselves with less choice to buy from, and so higher prices.
- The government may have to pay out more money to groups that are discriminated against in terms of welfare, and they may have to spend money on anti-discrimination legislation.
- Overall, the economy will lose out as a result of the misallocation of resources
 - Output will be below the potential output that could be achieved if the groups were not discriminated against in terms of employment, pay, promotion and training.

Theories of Discrimination

- Becker's theory states that some people may be prepared to experience higher costs rather than to come into contact with members from a particular group
 - For example, a firm may have lower profits due to not employing women workers, and higher costs due to not buying from firms employing women workers.
- Statistical discrimination states that firms make generalisations about specific groups
 - E.g. a firm may not employ over 50s, as it believes that they're less productive than younger workers. The same may apply when over 50s lose out on promotions, or get made redundant over younger workers.

Segmented Labour Markets

- There are barriers that exist to the free movement of workers between different sections of the labour market
 - In reality, there are also a number of different labour markets
- If there were no barriers to entry or exit in labour markets, workers would move from low-wage jobs to high-wage jobs, which would equalise wages.
- However, some barriers to entry increase efficiency of labour markets
 - For example, one would want a surgeon to be fully qualified, and one would want a taxi driver to have a license.
- Some barriers, however, may be unnecessary and could be used to just push up particular workers' wages.

Immobility of Labour

There are two kinds of immobility of labour

- Geographical immobility of labour is barriers to the movement of workers between different areas
 - When this occurs, shortages of workers in one area and surpluses in others are not corrected, leading to regional unemployment and geographical wage differentials continue to exist.
 - Geographical immobility occurs for a number of reasons, most notably are things like house prices or personal/family ties to the area.
- Occupational immobility is the barriers to workers changing occupations
 - These obstacles can come in the form of the skills and qualifications required to do particular jobs

- These barriers contribute to occupational wage differentials and structural unemployment.

Other Causes of Labour Market Failure

- Attachment between workers and employment
 - Some workers may stay in less paid jobs because they like working for their employers (transfer earnings?)
 - This attachment reduces the mobility of labour and makes supply more inelastic
 - It may, however, increase productivity.
- Inertia
 - Workers may not move to higher paid jobs and employers may not seek for more productive staff simply because they can't be persuaded.

The Economic Effects of Labour Market Failures

- Labour market failures can result in unemployment, skill shortages, and workers in the wrong jobs
 - This increases a firm's costs of production and reduces consumer surplus
- On a macro scale, it reduces the firm's international competitiveness and has an adverse effect on the country's trade position.
- Inefficient labour markets also raise governmental costs in terms of state benefits, legislation, and spending on education, training and regional policy

The Trends in Trade Union Membership in the UK

- The general trend is downwards
 - This is thought to be because of the decline in union power, mainly due to Thatcher's supply side policies
 - Also because of firms not recognising unions, and hence the union does not have the right to negotiate on behalf of its members
- Within professional organisations, such as accountancy and teaching, membership of trade unions is stronger
- A higher proportion of female workers are members of trade unions than men – 30% to 28%
- The last four decades have seen a decline in labour disputes
 - As well as working days lost, there are two other measures of labour disputes:
 - Number of stoppages
 - Number of workers involved in stoppages

Forms of Bargaining

- Unions favour national collective bargaining, as this gives them greater power and enables them to take advantage of economies of scale in negotiations.
 - It would be expensive for a union to negotiate separate agreements with a large number of employers

- In most of the EU collective bargaining is undertaken where unions will negotiate with associations of employers on industry-wide agreements.
- In the USA and Japan (and sometimes UK), local agreements are more common; especially in the private sector
 - For local agreements, there is a single employer bargaining, with agreements being made at the company level.

Types of Labour Market Flexibility

- A flexible labour market is one that adjusts quickly and smoothly to changes in demand and supply
- Types of flexibility include:
 - Numerical flexibility – the ability to change the number of workers, or ease of hiring and firing
 - Temporal flexibility – the ability to change the hours people work
 - Locational flexibility – the ability to change where people work – at home, somewhere else or at the man place of work
 - Functional flexibility – the ability to change the tasks workers perform
 - Wage flexibility – the ability to change the amount paid to workers

The Consequences of Flexibility

- A flexible labour market allows firms to match their production closely to demand
 - This should keep their average costs low, as they won't be overstaffed during periods of low demand, and will be able to raise output when demand rises
- For workers, labour flexibility can a good thing
 - It can create more employment, as firms are likely to want to recruit more workers at times of rising demand if they know they can get rid of them when they're not needed
 - A flexible labour market can attract foreign investment that is likely to boost employment
- It can also be a bad thing
 - Because you can be employed quickly in a flexible labour market, you can also be out of work quickly – less job security
 - This would mean that a worker would need to be more occupationally and geographically mobile, which can put stress on workers
 - Greater wage flexibility tends to result in a greater wage inequality.

The Flexibility of the UK's Labour Market

- The UK's labour market is more flexible than most of the EU's
 - The least four decades have seen an increase in temporary employment, part-time employment, flexible hours, job sharing, career breaks and homeworking
- In the 80s, the government introduce legislation so that hiring and firing people became easier, making the labour market more flexible

Government Measures to Achieve Labour Market Flexibility

- Government can intervene and increase the flexibility of the labour market in several ways:
 - Increase labour market information, training and education should make workers more mobile, and hence make labour more responsive to demand
 - Cutting the unemployment benefit or link it more closely to the search for employment
- If the supply of labour becomes more wage-elastic, firms will be able to respond to changes in demand faster
- Reducing income tax will encourage workers to work more hours, and the unemployed to look for work, and for those looking to retire to stay in the workforce
 - This will work if the overall effect of the substitution effect is greater than the overall effect of the income effect (i.e. more people choose to work more hours than choose to work fewer)
 - Studies have shown, however, that changes in tax rates don't really alter the hours worked
- Cutting job seeker's allowance may reduce the time that the unemployed spend searching for a job, as it makes it less attractive, but this would only work if there are jobs available.
- Removing protective employment legislation can make the labour market more responsive
 - E.g. maternity leave laws increase the cost of employing workers, and allowing workers to appeal against dismissals makes the process more expensive
 - Employment protection benefits those who have jobs but makes it more difficult for the unemployed to gain work

Government Intervention in Labour Markets

- A government may intervene in the labour market to correct market failure and so raise efficiency, and also promote equity and social cohesion
- Government intervention affects wages in a number of ways:
 - Employment of public sector workers
 - The provision of information
 - Regional policy
 - Training
 - Education
 - National minimum wage
 - Anti-discrimination legislation
 - Trade union legislation

The Government as an Employer

- Government employs a lot of people (e.g. NHS, teachers), and the decisions on its workers' wage rate will affect private-sector wage rates
 - E.g. raising the pay of public sector teachers will put pressure for the pay of private school teachers to increase.

Labour Market Information

- The government provides informative services such as careers advice, information about pay and working conditions, and job centres that inform workers of vacancies

Regional Policy

- Regional policy seeks to influence the distribution of firms and people
- To reduce the problem of geographical immobility of labour and regional unemployment, the government usually takes the action of 'bringing the work to the worker', by giving financial assistance to firms willing to relocate to areas of high unemployment

Training

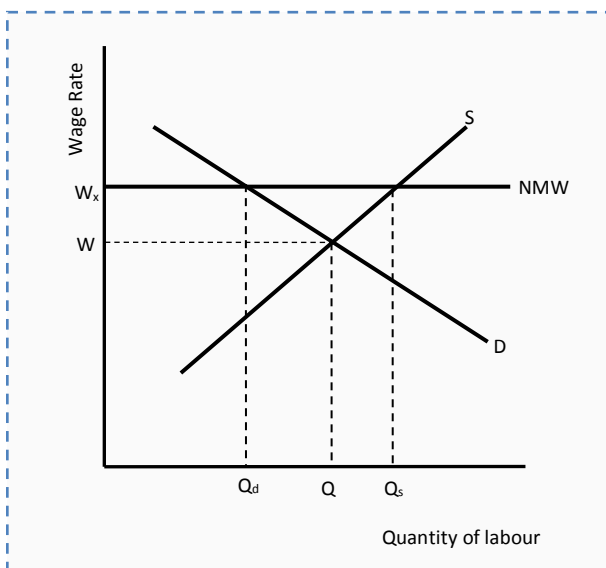
- The government can seek to raise the level of training to the allocatively efficient level in a variety of ways
 - It can subsidise individuals to engage in training and/or firms to provide training
 - It can pass legislation requiring firms to provide training
 - It can directly train its own employees and the unemployed.

Education

- Providing education to youths should increase the occupational mobility of labour, reduce the shortage of skilled labour and raise the productivity of labour
- Measures to raise qualifications and skills in workers are known as investments in human capital

Minimum Wage Legislation

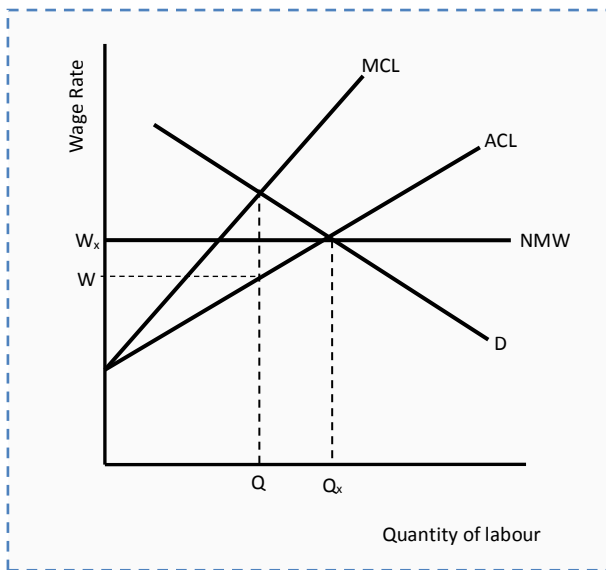
- Minimum wage legislation is introduced to help raise the pay of low paid workers
- To have any effect, the minimum wage has to be set above the market equilibrium wage rate



- Some economists say that intervention in the operation of free market forces raises firms' costs of production, and so causes higher unemployment
- W_x (NMW) is above the equilibrium wage rate of W , and causes an extension in supply of labour, but a contraction in demand, causing a shortfall of employment from $Q_s - Q_d$
- Before the intervention, employment was Q , but after, it's Q_d

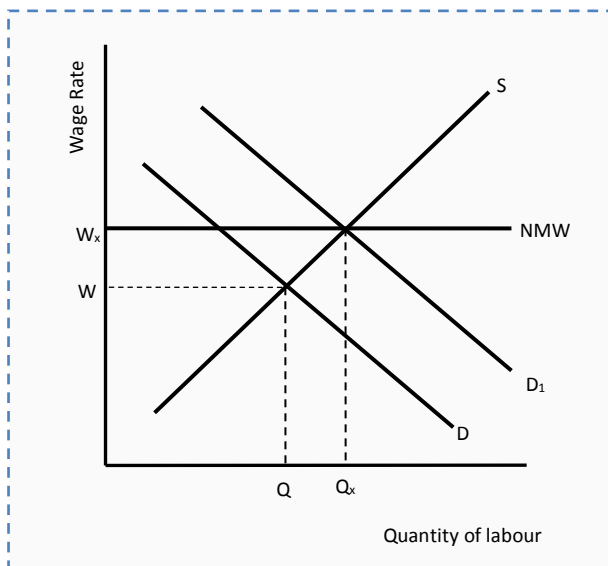
- If a minimum wage is established, firms may seek to cut the cost of employing low skilled workers by decreasing fringe benefits

- It may also encourage workers who earned near the new minimum wage to press for a wage rise



- Other economist argue that introducing a minimum wage will decrease unemployment
- Low-paid workers often have low bargaining power relative to their employers, who are often oligo/monopsonists
- In such a case, the introduction of a NMQ would raise both the wage rate and employment
- NMW of W_x becomes the new marginal cost of labour and raises employment from Q to Q_x

- There are other reasons why a NMQ may not cause unemployment
 - A NMW increases wages, and this, in turn, will increase aggregate demand for goods and services, which, due to the derivation of demand for labour, would increase demand for labour
 - The higher wages may also encourage people to not miss out (by being sick) and raise morale, and hence increase productivity



- A rise in the wage rate (via the NMW) may cause a rise in demand for goods and services
 - This is represented by D moving to D_1
- This will then create a new equilibrium point, where both quantity of labour supplied and wage rate is higher than before the NMW

- As most low wage earners are women who work part-time, a NMW may reduce the gender gap in pay
 - It may, therefore, not have much of an impact on income inequality if a relatively high proportion of these women are from middle to high income households.

Discrimination Legislation

- Legislation has made it illegal for employers to discriminate on the grounds of gender, race, marital status and age
- As a result employers may find that a group which had previously been discriminated against is more productive than they first thought
- However, some employers may still discriminate, and in practise, such legislation is hard to legally enforce

Trade Union Legislation

- If a government thinks trade unions have been weakened too much by previously legislation, and so they have little bargaining power in relation to employers, then a government may repeal some legislation
- If the opposite is true, then the government can introduce new legislation that reduces the industrial action unions can take, and weakens them.

Income Distribution

- Both income and wealth are distributed unevenly in the UK
- Wealth is more unevenly distributed
 - While one can survive without owning any assets (e.g. renting a house), one couldn't survive without any income
- Within an economy, distribution of income can be considered in terms of how income is shared out between:
 - The factors of production (functional distribution of income)
 - Between households (size distribution of income)
 - Between different regions (geographical distribution of income)

The Functional Distribution of Income

- Income is the flow of money over a period of time
 - It can be earned by labour in the form of wages, by capital in the form of interest, by land in the form of rent and by entrepreneurs in the form of profit
 - Out of these, it is often wages that account for the largest percentage of total income.
- People can also receive income in the form of state benefits

The Size Distribution of Income

- This has become more unevenly distributed over time

The Geographical Distribution of Income

- Income is unevenly distributed between regions of the UK
- Causes of differences in the geographical distribution of income include the variation in:
 - Unemployment rates
 - The proportion of the population claiming benefits
 - The qualifications and the skills of the labour force

- Industrial structure
- Occupational structure
- Living costs that give rise to differences in pay
- There are also variations within regions
 - E.g. London on the whole has a high income per capital, but it also has some of the most deprived districts in the UK

Causes of Income Inequality Between Households

- Unequal holdings of wealth
 - Wealth can generate income in the form of profit and interest, and so differentials in wealth cause differences in income
- Differences in the composition of households
 - Some households have 2 adults in full-time employment, whereas others have no-one in employment
- Differences in skills and qualifications
 - Those with high skills and qualifications are likely to be able to earn high incomes
- Differences in educational opportunities
 - Those who have the opportunity to stay in education for longer are likely to increase their earning potential
- Discrimination
 - The income of some groups is adversely affected by discrimination in the form of employment opportunities, promotion chances and pay
- Differences in hours worked
 - Most full-time workers earn more than part-time workers, and those who work overtime earn more than those who work standard hours.

Wealth

- Wealth is a stock of assets that have a financial value
- There is marketable wealth and non-marketable wealth
 - The former is wealth that can be transferred to another person, e.g. a house or shares
 - The latter is specific to a person and cannot be transferred, e.g. pension rights.
- The distribution of wealth can be considered in terms of:
 - How it's distributed amongst the population (size distribution)
 - The forms in which it is held
 - The characteristics of those holding wealth

The Size Distribution of Wealth

- Wealth is very unevenly distributed amongst the UK's population

Wealth Distribution Between Assets

- Wealth can be held in forms such as life insurance, pension funds, shares, etc.

- Some forms of wealth, such as life insurance and pension funds are more evenly distributed than things like shares and land

Wealth Distribution Between Different Groups

- People can become wealthy through inheritance, saving, and using their entrepreneurial skills
- Wealth is unevenly distributed between age categories, but it is to be expected; people in their 40s and 50s have had more time to accumulate savings than younger people, and so have greater wealth
- Wealth also varies between ethnic groups; men have more wealth than women, etc.

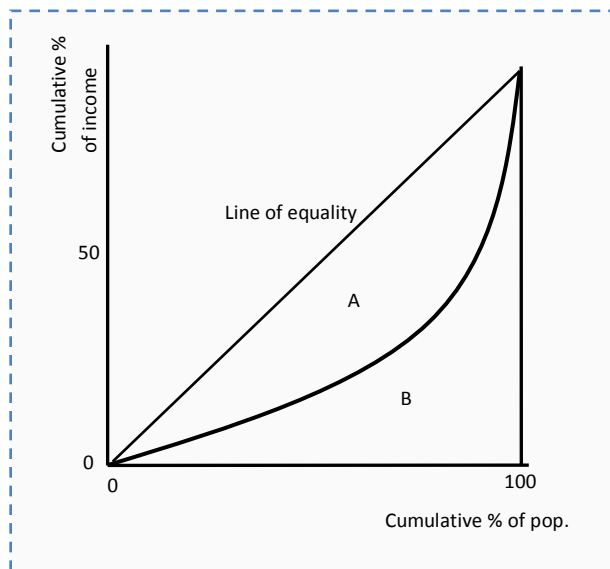
Causes of Wealth Inequality

- Inequality of income
 - Work overtook inheritance as a source of wealth in the UK
 - Having a high income makes it easier for people to save, and so gain higher interest rates on their savings.
- Differences in entrepreneurial skills
 - Some people are self-made millionaires as a result of building up a business
- The pattern of inheritance
 - In the UK, wealth has traditionally passed down to the eldest son, and hence kept wealth in the hands of the few
 - In other countries where the property and other assets are distributed amongst the children, wealth is more evenly distributed over time.
- Marriage patterns of the wealthy
 - The wealthy tend to marry other wealthy people, and this further concentrates wealth in the hands of the few.

Measuring Inequality

- Wealth and income inequality can be measured in a number of ways
 - The distribution of wealth owned or income earned by a given percentage can be compared
 - It can also be compared in percentage groups, e.g. the bottom quartile shows the share of income of the poorest 25% of households
 - Another way is the 90:10 ratio, which takes the incomes of people 10% from the top and 10% of the bottom
 - This method eliminates the extremes that you get at either end
 - This ratio was 4:1 in 2006 and 1996
 - A further measure is the Gini coefficient, which can be used to make international comparisons of income inequality.
 - It is found by using a Lorenz curve

Lorenz Curve



- Line of equality – 50% of population earn 50% of income
- The greater the extent of inequality, the greater the curve will be from the line of equality
- The Gini coefficient is the ratio of the area between the Lorenz curve and the line of equality to the total area below the line ($A/A + B$)
- The higher the Gini coefficient, the more inequality there is

Government Intervention to Affect Distribution Between Income and Wealth

- The extent to which a government intervenes to affect the distribution of income and wealth depends on:
 - The extent to which it believes that the free market distribution would be inequitable
 - The effects that such inequality will have on society
 - The effects it believes any intervention will have on incentives and efficiency
- Economists who believe in the efficiency of markets do so because they believe that the differences in income act as signals which encourage workers to change jobs, and differences in wealth promote savings and investment
- The contrast, other economists believe that intervention is justified, as market forces won't ensure an efficient allocation of income and wealth
 - They believe low levels of income can affect the household a significant amount, like affecting the educational performance of the children
 - Differences in wealth and income can also cause social division, as the poor may feel socially excluded.

Ways in Which Government Affect the Distribution of Income and Wealth

- Taxation
 - The overall effect of the tax system is to reduce inequality
 - Progressive taxes such as income tax make distribution more equal
 - Regressive taxes such as VAT make distribution more unequal
- Provision of state benefits
 - Means tested benefits reduce inequality and universal benefits form a larger percentage of the income of the poor
 - Means tested benefits are provided to those whose income is below a certain level, and can come in the form as things like working tax credit

- Universal benefits are applied to everyone in a particular group, regardless of their income; all pensioners get a winter fuel allowance.
- Provision of benefits in kind
 - These come in the form of health care, education, school meals, etc.
 - The take-up of these benefits depends on the age of the household – a household with no children isn't going to take up education and schooling, whereas an older household is likely to use the NHS more.
- Labour market policy
 - NMW, anti-discrimination legislation, subsidising training – all of these reduce income inequality
- Macroeconomic policy
 - Measures to reduce unemployment may benefit low-income households, and regional policy may reduce geographical inequalities of income and wealth

Poverty

Absolute Poverty

- People are said to be in absolute poverty when their income is insufficient for them to be able to afford adequate shelter, food and clothing
 - In rich countries such as the UK, relatively few people are in situations of absolute poverty – around 500 (think tramps)
 - In other countries, such as Nigeria, 70% of the population was living on less than \$1 a day

Relative Poverty

- Someone in the UK may see themselves as poor if they live in poor accommodation and can only afford to go out once a week
 - The same standard of living could be for a rich person in a country like Mali
- This is relative poverty – a situation of being poor relative to others – they are unable to participate in the usual activities of the society they live in
- Economists often define poor as those people living in households with income below that of 60% of average disposable income

Causes of Poverty

- Unemployment
- Low Wages
 -
- Sickness and disability
- Old age
- The poverty trap
 - The poor find it difficult to raise disposable income as if they get a job, they'd have to pay more in taxes whilst receiving less state benefits.
- Being a lone parent

- Reluctance to claim benefits

The Effects of Poverty

- The poor tend to suffer worse physical and mental health and have lower life expectancy
- The poor tend to have less education, e.g. they can't buy books for their kids or won't have a computer at home
- The poor can feel cut-off from the rest of society
- It imposes a burden on the government, as they have to spend more

Government Policy Measures to Reduce Poverty

- Government may seek to reduce absolute poverty by introducing measures that raise the income of the poorest groups
- They may reduce relative poverty by introducing measures that narrow the gap between the rich and the poor
- Amongst the measures they might use are:
 - Operating a NMW
 - This will help the low paid who stay in employment
 - However, most people earning minimum wage are secondary earners from middle and high income households
 - Cutting the bottom rate of income tax
 - May reduce the poverty trap and provide a greater incentive for people to work
 - Increasing employment opportunities
 - A major cause of poverty is unemployment
 - There is no easy way of increasing the number of jobs on offer
 - Improving the quantity and quality of training and education
 - This is a long term measure but will increase productivity
 - Making use of trickle-down effect
 - Controversial, but basically means cutting taxes like corporation and inheritance tax so that rich entrepreneurs will take business ventures that will hopefully mean a greater aggregate demand for jobs
 - Increasing benefits for the unemployed
 - Some economists argue that this could raise aggregate demand in the economy, as the unemployed will spend more, thus creating more jobs
 - Others, however, believe it can increase voluntary unemployment
 - Increasing the provision of affordable childcare
 - This would enable more lone parents to undertake full-time employment and raise them out of poverty.

An Ageing Population

- Older workers have experience and tend to stay with existing employers and lose fewer days through illness.

- On the other hand, they tend to be less geographically and occupationally mobile and their skills may need to be updated
- DIY stores and supermarkets tend to employ over 50s, as they realise that these workers have a lot to offer and thus it increases the pool of workers they can draw upon
- With the population aging, that means a higher proportion of citizens are likely to be economically inactive and claiming a pension, thus decreasing the revenue the state gets via taxation, and yet increasing the overall costs of state benefits
 - This is known as the dependency ratio (proportion of the population that are reliant on the output of other workers), and puts pressure on government spending
 - This is also known as the 'demographic time bomb'

Pensions

- The government is considering a number of ways to try and maintain pensioners' living standards, while reducing the fiscal pressure of an ageing population. Some methods include:
 - Raising the retirement age
 - This reduces the number of pensioners and increases the number of workers, thus reducing the dependency ratio
 - Discouraging early retirement
 - Increasing the labour force by other means
 - This could include increasing the economic activity rate of lone parents and the disabled, and permitting more immigration
 - Promoting occupational and personal pension scheme
 - Relying on private funding of pension scheme reduces the fiscal burden on the government
 - Encouraging a change in salary structures

EU Directives

- These are instructions to member countries to achieve particular outcomes
- They usually allow member countries some flexibility in terms of the laws they draw up to achieve the desired result
- These directives often protect workers' rights and may correct some forms of labour market failure, including discrimination
- There is, however, a risk that excessive protection for those in work may depress economic growth and job creation.

Migration

- The supply of labour for an economy is influenced by the net immigration
 - If more people come into the country than leave, the labour force will increase in size
 - This increase can:
 - Overcome skill shortages
 - Reduce the dependency ratio

- Increase government tax revenue
 - Help the economy to expand without encountering inflation
 - However, emigration can cause problems, as the labour force will suffer a contraction in supply (e.g. in Ghana, 3/4s of trained doctors emigrate)
- Immigration can disadvantage low paid workers, as some of the immigrants will be prepared to work for lower wages
 - Immigration can therefore put downwards pressure on wages
- Immigration may also put pressure on public services such as the NHS, especially if they're concentrated in a specific area.
- It is said that a lot of immigrants that work in low-skilled jobs are over-skilled for these, and may move onto more demanding occupations in the future
 - They could, however, be working in the UK whilst they wait for economic prospects in their original country to improve.