

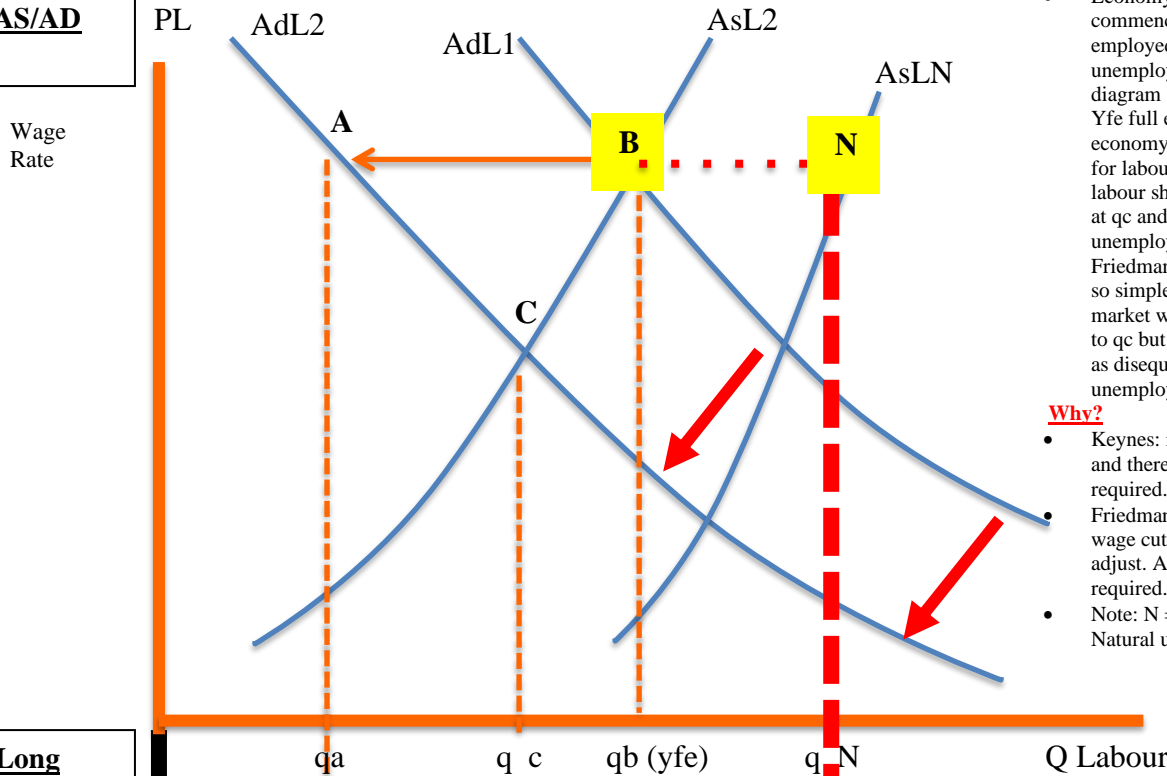
Best Uses:

- Cyclical (demand deficient) unemployment is a Keynesian concept
- Use the diagram below for a labour market to show how a contraction in AD for final goods and services affects the labour market by shifting the point A or C in diagram a.

Syllabus Reference 3.3: Unemployment : using AS+AD for Labour + The Phillips Curve (HL)

**ED 18
Unemployment**

Diagram a: AS/AD for Labour



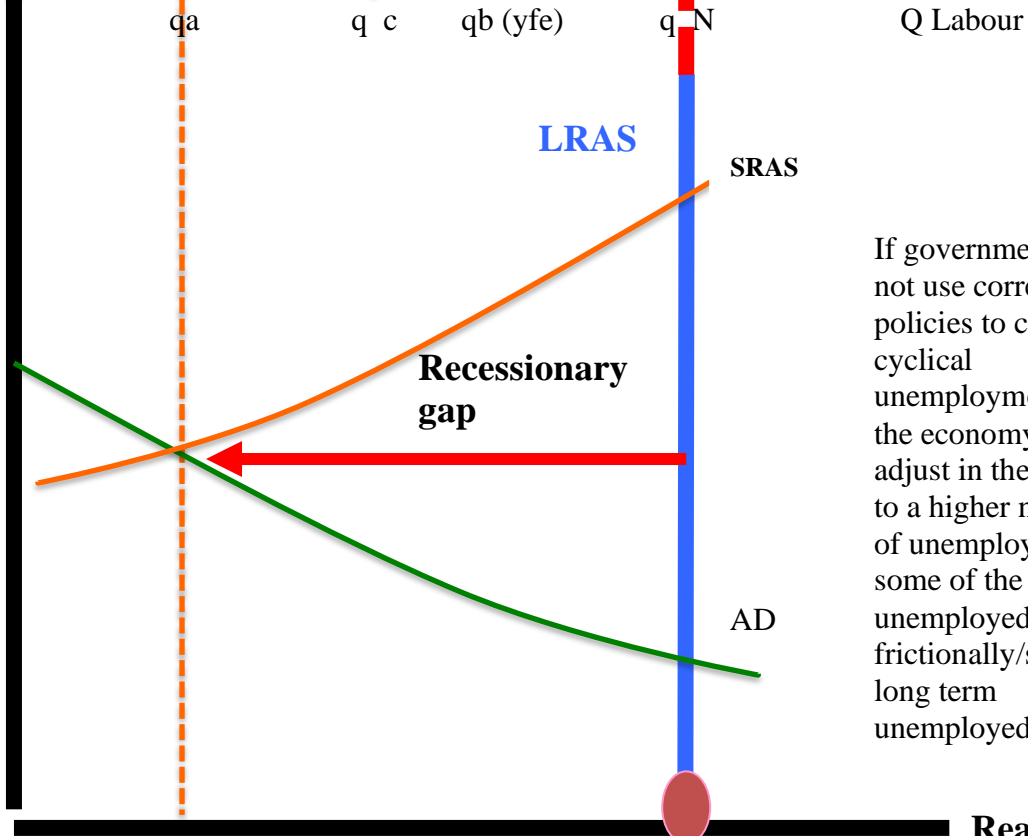
- Economy and labour market commences at q_b labour employed. Natural rate of unemployment is 6% or BN in diagram 1. q_b is equivalent to Y_{fe} full employment. If economy contracts and demand for labour shifts to AdL_2 then labour should reach equilibrium at q_c and we have cyclical unemployment. Keynes and Friedman noted that it was not so simple and the labour market was likely not to adjust to q_c but to q_a . This is known as disequilibrium unemployment (AB).

Why?

- Keynes: markets not efficient and therefore AD intervention required.
- Friedman: trade unions resist wage cuts and market cannot adjust. AS intervention required.
- Note: $N =$ to full labour force. Natural unemployment = $q_b q_N$

Diagram b: Long Run Phillips Curve

Inflation



If government does not use corrective policies to correct the cyclical unemployment then the economy could adjust in the long run to a higher natural rate of unemployment as some of the cyclically unemployed become frictionally/structurally long term unemployed.

At this GDP
Natural unemployment (6%)