1. What is the best way for a government can reduce unemployment? Justify your answer.

*Answers may include:*

Unemployment measures the number of people actively seeking work who are not employed at a given moment. There are numerous causes of unemployment:
- A lack of demand
- A lack of skills
- A lack of information
- Seasonal factors

The best way to reduce unemployment depends on the underlying cause. For example, if unemployment is due to a lack of demand the government would want to boost demand – this may be through expansionist fiscal or monetary policies. If, however, unemployment is due to supply side factors the government may be better focusing on issues such as training, benefit payments, the provision of advice and information and income tax rates.

2. To what extent do high levels of unemployment matter?

*Answers may include:*

High levels of unemployment:
- Represent a waste of resources in the economy; this means the economy is producing within the Production Possibility Frontier
- May lead to less demand in the economy
- May lead to social unrest

However it is important to analyse the nature of unemployment- for example, are people quickly passing through the unemployment pool? Or are they stuck unemployed for long periods of time.

3. What is the best way for a government can reduce inflation? Justify your answer.

*Answers may include:*

Inflation measures a sustained increase in the general price level. If inflation is 3% this means that the price level is 3% higher than the year before. Inflation in the UK is measure by the Retail Price Index or Consumer Price Index. There are various causes of inflation, such as:
- Demand pull inflation- this is caused by high levels of demand
- Cost push inflation- this is caused by higher levels of costs leading to higher prices.

To reduce inflation a government might:
- Reduce demand e.g. through tighter fiscal policy, control of the money supply or higher interest rates
• Control costs e.g. through wages and incomes policies, pushing the exchange rate up

The best way for a government to reduce inflation depends on the underlying cause. If it is demand pull inflation then the best way to solve this is a deflationary policy. If it is cost push inflation then the best solution is to focus on controlling costs.