

tutor2u™

Supporting Teachers: Inspiring Students

Economics Revision Focus: 2004

AS Economics

Unemployment

tutor2u™(www.tutor2u.net) is the leading free online resource for Economics, Business Studies, ICT and Politics.

Don't forget to visit our [discussion boards](#) too as part of your Economics revision.



Revision Focus on Unemployment (AS)

AS Syllabus Requirements

Employment and Unemployment

Candidates should understand how employment and unemployment may be influenced by both **aggregate demand and supply-side factors**. They should be able to use a **production possibility** diagram to illustrate unemployed resources. They should understand that, at least in the short run, if the growth of aggregate demand is less than the underlying trend rate of growth of output unemployment is likely to occur. They should understand the concept of the **'output gap'** and its significance for both inflation and unemployment.

Definition of unemployment

Officially, the unemployed are people who are registered as able, available and willing to work at the going wage rate but who cannot find work despite an active search for work.

The **Claimant Count** measure of unemployment includes those people who are eligible to claim the Job Seeker's Allowance. Claimants who satisfy the criteria receive the JSA for six months before moving onto special employment measures.

The **Labour Force Survey** covers those who have looked for work in the past month and are able to start work in the next two weeks. On average, the labour force survey measure has exceeded the claimant count by about 400,000 in recent years

Since 1993 there has been a sustained fall in the number of people out of work. In May 2004, unemployment according to the claimant count measure was 951,000 – or 3.1% of the labour force. The labour force survey measure found unemployment to be 1.5 million of 5.1% of the labour force. On either measure, this is the lowest rate of unemployment in the UK for over twenty-five years. Our unemployment rate compares favourably with many other industrialised economies.

	Labour Force Survey			Claimant Count Unemployment		
	Level 000s	Change on previous year 000s	Rate %	Level 000s	Change on previous year 000s	Rate %
1995	2,470	-281	8.8	2,290	-309	7.6
2000	1,633	-121	5.6	1,088	-160	3.6
2003	1,485	-54	5.2	933	-14	3.1

International unemployment rates (as a % of the labour force)

	Euro Zone	UK	USA	Japan	Germany	France
2000	8.5	5.6	4.0	4.7	7.8	9.3
2001	8.0	4.9	4.8	5.0	7.8	8.5
2002	8.4	5.2	5.8	5.4	8.6	8.8
2003	8.8	5.0	6.0	5.3	9.3	9.4

Frictional Unemployment

Frictional unemployment is **transitional unemployment** due to people moving between jobs: For example, redundant workers or workers entering the labour market for the first time (such as university graduates) may take time to find appropriate jobs at wage rates they are prepared to accept. Many are unemployed for a short time whilst involved in job search. Imperfect information in the labour market may make frictional unemployment worse if the jobless are unaware of the available jobs. Some of the frictionally unemployed may opt not to accept jobs if they believe the tax and benefit system will reduce the net increase in income from taking paid work. When this happens there are **disincentives** for the unemployed to accept work.

Structural Unemployment

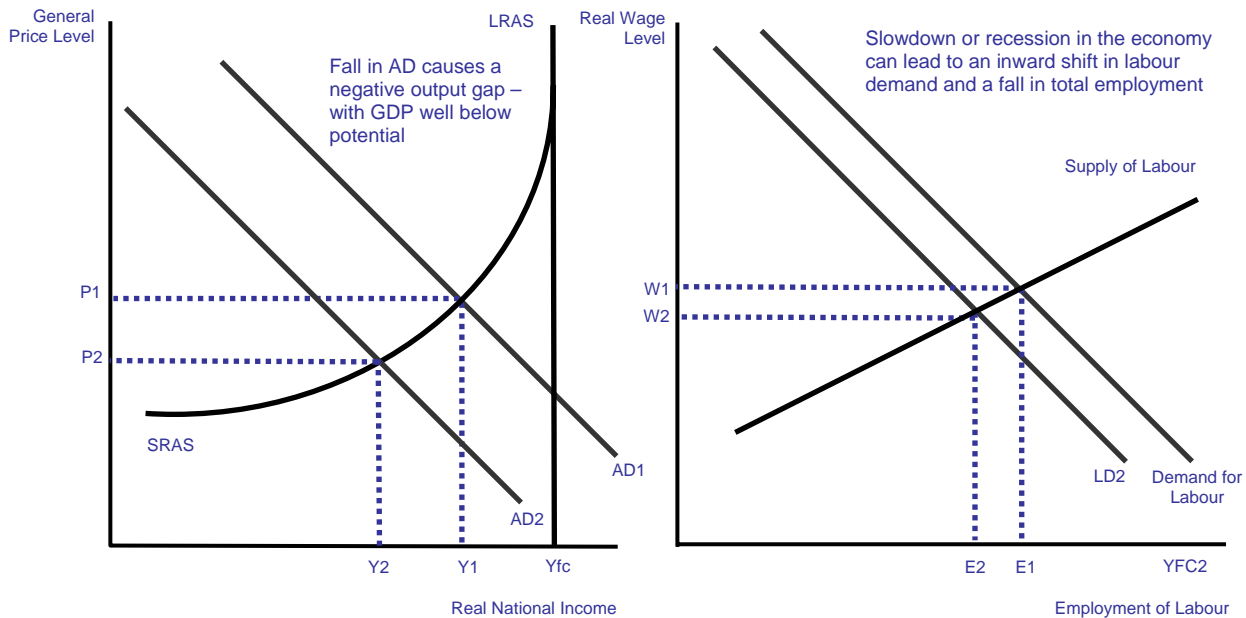
Structural unemployment occurs because of **capital-labour substitution** (which reduces the demand for labour) or when there is a **long run decline in demand in an industry** leading to a reduction in employment perhaps because of increasing international competition. **Globalisation** is a fact of life – and inevitably it leads to changes in the patterns of trade between countries over time. Britain for example has probably now lost for good, its cost advantage in manufacturing many goods such as motor cars, household goods and audio-visual equipment. Manufacturing industry has lost over 400,000 jobs in the last five years alone. Many of these workers may suffer from a period of structural unemployment, particularly if they are in regions of above-average unemployment rates where job opportunities are scarce.

Structural unemployment exists where there is a **mismatch** between their skills and the requirements of the new job opportunities. Many of the unemployed from manufacturing industry (e.g. in coal, steel and engineering) have found it difficult to find new work without an investment in re-training. This problem is one of occupational immobility of labour

Cyclical Unemployment:

Cyclical unemployment is involuntary unemployment due to a lack of AD for goods and services. This is also known as Keynesian "demand deficient" unemployment. When there is a recession we see a rising unemployment because of plant closures, business failures and an increase in worker lay-offs and redundancies. This is due to a fall in demand leading to a contraction in output across many industries. A downturn in demand is often the stimulus for businesses to rationalise their operations by cutting employment in order to control costs and restore some of their lost profitability.

Cyclical unemployment and the output gap

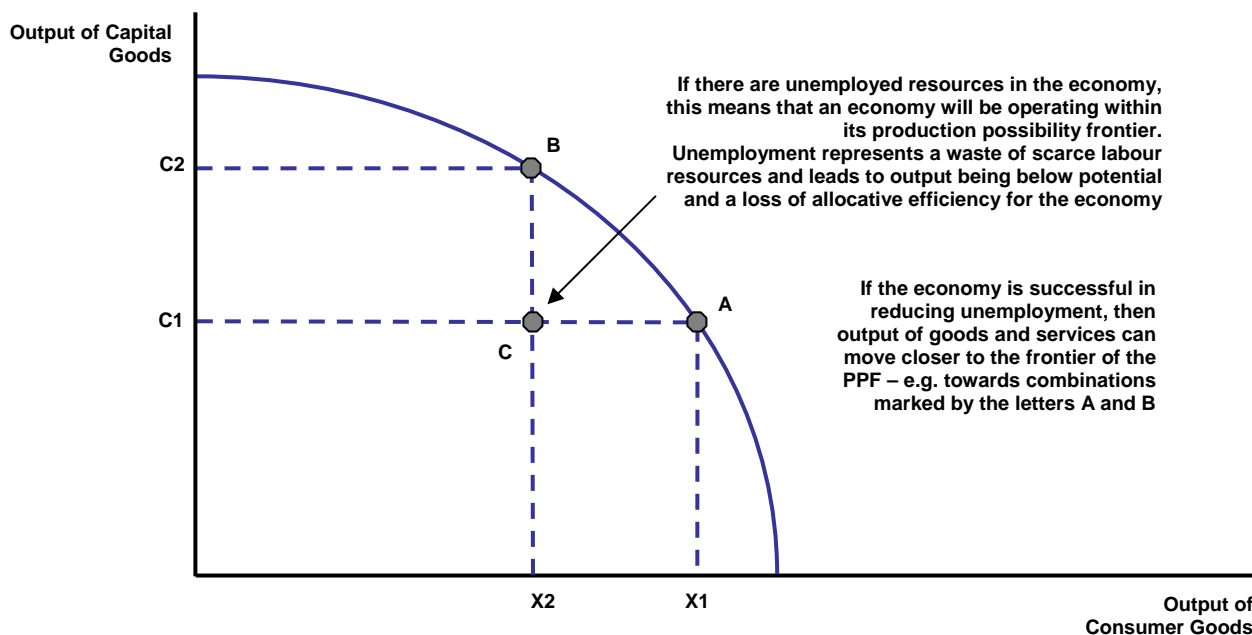


Real wage unemployment: This is considered to be the result of real wages being above their market clearing level leading to an excess supply of labour. Some economists believe that the minimum wage risks creating unemployment in industries where international competition from low-labour cost producers is severe. As yet, there is relatively little evidence that the minimum wage has created rising unemployment on the scale that was feared.

Hidden unemployment

No measure of unemployment can ever give us a truly accurate indication of the true size of the unemployment problem. But undoubtedly there are thousands of people who by any reasonable definition are unemployed, but who are not picked up by the official unemployment statistics. Many have become **discouraged workers** and have stopped actively searching for work.

Unemployment and the production possibility frontier



The economic and social costs of unemployment

1. **Loss of income:** Unemployment normally results in a loss of income. The majority of the unemployed experience a decline in their living standards and are worse off out of work
2. **Loss of national output:** Unemployment involves a loss of potential output (i.e. GDP operating below potential) and represents an inefficient use of scarce resources. If some people choose to leave the labour market permanently because they have lost the motivation to search for work, this can have a negative effect on long run aggregate supply (LRAS) and the economy's growth potential
3. **Fiscal costs:** The government loses out because of a fall in tax revenues and higher spending on welfare payments for families with people out of work. The result can be an increase in the budget deficit which then increases the risk that the government will have to raise taxation or scale back plans for public spending on public and merit goods
4. **Social costs:** Rising unemployment is linked to economic and social deprivation. There is a relationship with crime, and social dislocation (increased divorce rates, worsening health and lower life expectancy). Areas of high unemployment see falling real incomes and a worsening in inequalities of income and wealth

Government policies to reduce unemployment

Some countries are more successful than others in reducing the scale of unemployment. In the long term, effective policies are required for both the demand and the supply side of the economy so that enough new jobs are created and that people possess the **skills** and **incentives** to take those jobs.

In general effective policies are those that:

1. **Stimulate an improvement in the human capital of the workforce** – so that more of the unemployed have the skills to take up the available jobs. Policies normally concentrate on improving the occupational mobility of labour. The pattern of employment in any modern economy is always changing, so people need to have sufficient flexibility to adapt to structural changes in industries over the years
2. **Improve incentives for people to search and then accept paid work** – this may require reforms of the tax and benefits system for example a reduction in the starting rate of income tax (an incentive for people in lower paid jobs). Or perhaps a change in welfare benefits such that people who find work do not experience a sharp withdrawal of benefits because they are now earning more
3. **Allow a sustained period of economic growth** – this requires that AD is sufficiently high for businesses to be looking to expand their workforce. The Keynesian theory of unemployment emphasises the argument that if monetary and fiscal policy does not keep demand at a high enough level, then the economy is less likely to be able to sustain a high rate of employment

Policies used in the UK to reduce unemployment in recent years

Demand side policies	Supply-side policies
Employment subsidies for employers who take on the long-term unemployed (New Deal)	Welfare reforms – including lower starting rates of income tax and the introduction of tax credits
Financial assistance for inward investment from overseas	Policies to promote entrepreneurship and the growth of small-medium size enterprises
Monetary policy – low interest rates has allowed aggregate demand to grow despite a global economic slowdown. Fiscal policy is also boosting AD as the budget deficit increases (2003-04)	Increased spending on education and attempts to increase private sector spending on training

Key evaluation points

1. There are always cyclical fluctuations in employment. If growth can be sustained and monetary and fiscal policy can avoid a large negative output gap then it should be possible to create a steady flow of new jobs
2. Demand and supply-side policies need to work in tandem for unemployment to fall in the long term. Simply boosting demand if the root cause of unemployment is structural is an ineffective way of tackling the problem. If demand is stimulated too much, the main risk becomes one of rising inflation (i.e. the trade-off between these two objectives may worsen)
3. Full-employment does not mean zero unemployment! There will always be some frictional unemployment – it may be useful to have a small surplus pool of labour available

4. UK unemployment is currently low by recent historical standards. It is among the lowest of the countries inside the European Union.
5. There are still large regional differences in unemployment levels and pockets of deep-rooted long-term unemployment in many areas, which causes significant economic and external costs