

Unemployment: The situation that exists when the number of people who are actively looking for work exceeds the number of jobs available.

The number unemployed: Those of working age who are without work, but who are available for work at the current wage rates.

The labour force: Those in employment plus those unemployed.

The unemployment rate: The number unemployed divided by the labour force, times 100.

Flow concept: Unemployment is a flow. The number of people unemployed may stay the same, but the actual people involved will always be changing as some people gain jobs and others lose them.

Equilibrium unemployment: Unemployment that exists when there is no general disequilibrium in the economy. It consists of frictional unemployment, structural unemployment and seasonal unemployment.

Disequilibrium unemployment: Unemployment resulting from real wages in the economy being above the equilibrium level.

Demand deficient unemployment: Unemployment that exists as a result of a cyclical downturn in the economy, where the aggregate demand for labour falls.

Real-wage unemployment: Unemployment that exists if a government minimum wage or trade unions prevent the wage from falling to equilibrium, and so there is excess supply of labour.

Supply-side policies: Policies designed to shift the long-run aggregate supply (LRAS) curve to the right. There are two types, interventionist policies and market-oriented policies. Main weakness of supply-side policies is that they take time to have effect. Main weakness of interventionist policies is that they are expensive. Main weakness of market-oriented policies is that they create greater income inequality.

Demand-side policies: Policies designed to shift the aggregate demand (AD) curve in order to expand or contract economic activity. There are two types, fiscal policies, which alter the levels of direct taxation and government expenditure, and monetary policies, which alter the levels of interest rates and money supply.

Why do we worry about unemployment?

There are a number of costs caused by unemployment.

Costs to the economy

- The most obvious is the loss of output to the economy. The actual output of the economy is below the potential output and the output lost can never be regained.
- The longer people remain unemployed, the more deskilled they become. This reduces potential output.

Costs to the government

- The government loses tax revenues.
- The government incurs extra costs of supporting the unemployed, even if it is only in terms of administrative costs.

Costs to society

- There is some evidence that higher unemployment leads to increased crime and vandalism.

Costs to individuals

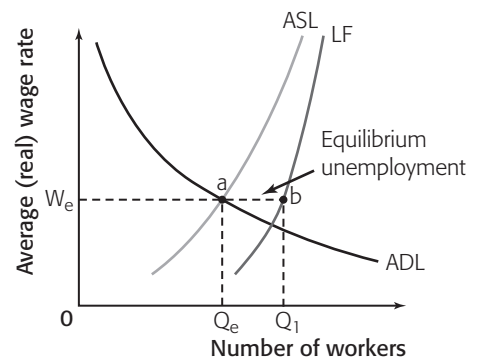
- There is a direct financial cost to the unemployed themselves, measured as the difference between their previous wage and any unemployment benefit received.
- There are personal costs for the unemployed in terms of stress-related illness and family problems caused by the strain of being unemployed.

What causes unemployment?

Equilibrium unemployment

There are three types of equilibrium unemployment.

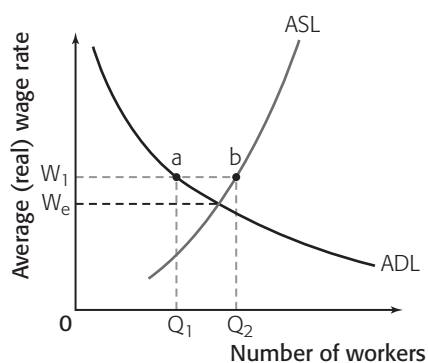
1. **Frictional unemployment** occurs when people leave their jobs and are unemployed while they are looking for a new job, or just having a break from working.
2. **Structural unemployment** is where unemployment occurs because the structure of the economy has changed. This may be a change in the pattern of demand, or a change in the methods of production. If the changes cause unemployment in a specific geographical region, then this is known as **regional structural unemployment**.
3. **Seasonal unemployment** occurs when the demand for labour fluctuates with the seasons of the year.



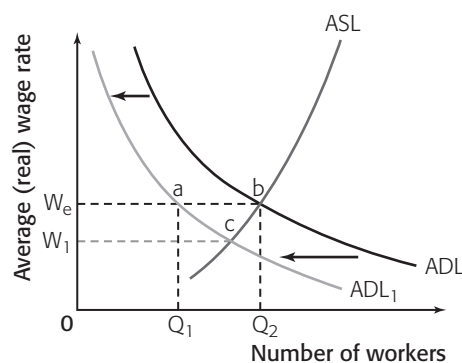
What causes unemployment?

Disequilibrium unemployment

Real-wage unemployment



Demand-deficient unemployment



There are two main types of disequilibrium unemployment.

1. **Real-wage (classical) unemployment** occurs when trade unions push wages above the market-clearing level, or when the government introduces a minimum wage that is above the market-clearing level. This is **ab** in the diagram above.
2. **Demand-deficient (cyclical/Keynesian) unemployment** is where unemployment occurs because AD in the economy has fallen (recession), and so the demand for labour has also fallen. The unemployment is longer if wages are 'sticky downwards' and so do not adjust. This is **ab** in the diagram above.

How do we cure unemployment?

EQUILIBRIUM UNEMPLOYMENT – CAN ONLY BE CURED BY SUPPLY-SIDE POLICIES, WHICH SHIFT THE LONG-RUN AGGREGATE SUPPLY (LRAS) CURVE TO THE RIGHT.

Frictional unemployment – Improve information flows about available jobs (interventionist policy) or lower unemployment benefits (market-based policy).

Structural unemployment – Provide education that makes people more occupationally flexible, provide retraining for workers, give subsidies to firms to provide training, give subsidies to firms to employ the long-term unemployed, give subsidies to encourage firms to go to certain areas of the country (interventionist policies) or reduce unemployment benefits, deregulate labour markets to make them more flexible (market-based policies).

Seasonal unemployment – Improve information flows so that people can find jobs in the off-season, give grants to encourage the growth of industries that work in different seasons (interventionist policies)/lower unemployment benefits (market-based policy).

DISEQUILIBRIUM UNEMPLOYMENT

Real-wage (classical) unemployment – If trade unions are preventing the labour market from clearing, then the government should pass laws to reduce the power of the trade unions (market-based policy). If the government is preventing the labour market from clearing, then the minimum wage should be reduced or removed (market-based policy).

This may also be cured by an expansionary demand-side policy, but this does not really cure the actual cause of the ‘problem’.

Demand-deficient (cyclical) unemployment – The government can intervene to bring about an increase in AD through the use of an expansionary fiscal or monetary policy.

Which are the most effective policies?

Remember that it depends upon the type of unemployment involved. However, the types of equilibrium unemployment (frictional, structural and seasonal) may ONLY be cured by supply-side policies.

Real-wage unemployment may be cured by supply-side or expansionary demand-side policies, but the demand-side policies do not cure the actual cause of the unemployment.

Demand-deficient unemployment may be cured by expansionary demand-side policies.

The use of demand-side policies may have bad effects elsewhere in the economy. For example, if interest rates are lowered, this may lead to inflation and a fall in the external value of the currency (the exchange rate). Furthermore, there is no guarantee that expansionary monetary policy will be effective in raising AD. If consumer and business expectations about the future are pessimistic, then lower interest rates may not necessarily lead to increased AD.