Evaluate the effects of demand side and supply side policies on the natural rate of unemployment?

The natural rate of unemployment is the percentage of people of working age who are voluntarily unemployed. Milton Friedman was a monetarist and he believed that the natural rate of unemployment fluctuated in the short run with changes in demand but in the long run, the long run Philips curve was vertical.

Monetarists believe that in a competitive market economy the level of unemployment will remain at an equilibrium level made up of frictional and possible structural unemployment. It is the level of unemployment that exists when the demand for labour is equal to the supply of labour thus clearing the market. The result is all classical unemployment is removed.

Keynesians believe in demand management to decrease the natural rate of unemployment. They believe that markets don't clear and are slow to adjust. This means the economy can settle in equilibrium below full employment and therefore involuntary and voluntary unemployment may exist. The only solution to decrease unemployment is to expand AD through government intervention with fiscal policy and monetary policy.

However, Monetarists believe by expanding the demand side to try and reduce unemployment will not affect the natural rate of unemployment. The monetarist approach suggests that if demand falls and inflation falls, then money wage growth falls and the real wage rate remains unchanged and the economy stays at full employment or the natural rate of unemployment. The only way to decrease the natural rate of unemployment is through the use of supply side policies.

In the long run the supply side policies that can be employed to decrease the natural rate of unemployment have to be focused on the frictional and structural unemployment. Therefore a policy to reduce the occupational immobility of labour through improvements in education and training which will increase the human capital of workers. The switch away from traditional primary and secondary sectors of the economy to the tertiary services sector has caused structural long term unemployment in the manufacturing sector. In order to solve this problem the unemployed need to become re-skilled and be more flexible to allow them to be more mobile in the work force. The supply side policy of the New Deal and employer subsidies to train workers are being put into place. Additionally, the supply side policy of reducing the real value of benefits will increase the incentive to take a job. Furthermore, policies to increase the LRAS of the economy will increase the number of jobs available and the economy will experience growth. The natural rate of unemployment will be lower due to boom that may exist cyclically and the high investment in both human and physical capital.

But will these policies be sufficient to have an affect on the vertical Philips curve or will we need to expand demand instead. Many demand policies exist to push the economy to full employment and decrease the natural rate of unemployment. According Keynesians government intervention is needed. Demand side policies such as decrease the rate of interest will increase the incentive to borrow and consume on credit. This money will be an injection into the circular flow of income and thus increasing the number of jobs available to through the multiplier effect. Workers will be more willing to take up a job as they can then have the ability to borrow and increase their standards of living by consuming more. Fiscal policy of tax reform will have the same effects on the economy as monetary policy. Another demand side policy is employment subsidies which help the long term unemployed by allowing firms to take on more workers to expand as they can fund this investment through government subsidies. This will result in the number of involuntary unemployed to decrease and also decrease the natural rate of unemployment.

To evaluate further both views are valid and both types of policy will have an effect on the natural rate of unemployment. However, in the case of Keynesians the natural rate of unemployment may decrease but the rate of inflation may increase vastly. For the monetarists the fact that we are assuming the economy will clear in the long run and that we are operating today with only voluntarily unemployed is a myth. If we are below full employment of even above due to a boom and markets haven't adjusted yet, it makes it difficult to know whether to expand supply. As always in economics it all depends upon a number of factors but some intervention through demand and supply side policies need to be used. One doesn't prevail over the other. In some situation demand may be better but in other supply side policies so in the long run both need to be used.