

## Unemployment

### 1. There are two main methods of measuring unemployment in the UK:

- a) the claimant count
  - b) the labour force survey
- a) This method was used for the whole of the 1980s and most of the 1990s. It simply involves taking a count of the number of people unemployed and claiming benefit. These are: the Jobseeker's Allowance (JSA) and National Insurance credits, claimed at Employment Service local offices. People claiming JSA (formerly Unemployment Benefit) must declare that they are out of work, capable of, available for and actively seeking work during the week in which the claim is made. They enter into a Jobseeker's agreement agreeing to take action to find work and to improve their prospects of finding employment. However, this method has many imperfections and so the incoming Labour government in 1997 changed to the second method of calculating unemployment.

This measure has been seen as inaccurate because it omits many people who are unemployed but are not actually claiming benefit. There have been thirty changes to the way in which this measure is counted over the last twenty years. For example: in the late 80s, it was decided that those aged between 16-17 years old should not count, because they could either stay in education or engage in government training. Also, more recently, it was decided that one could only claim Jobseekers Allowance for six months, rather than twelve. Many unemployed women do not collect Jobseekers Allowance; because they then cannot claim other important benefits.

Figures are seasonably adjusted to allow for changes in unemployment that can occur naturally over the year. There tends to be seasonal employment in the summer at tourist resorts and at Christmas.

Unemployment is commonly supplied as a percentage, because this takes into account changes in demographics. As one can imagine, an arbitrary figure of 2 million unemployed in a country means very little – the population could be 50M, which means that unemployment is low, or the population could be 20M, where it is very high. However, an unemployment rate of 5% means that unemployment is very low regardless of the total population.

- b) The alternative and, now more popular method is a survey: a sample of addresses is extracted from the Postcode Address File. Also, small cross-section of addresses of NHS and Health trust accommodation is included in the survey and anyone aged 16 or over and at boarding school or living in a hall of residence is included in their parent's household. A stratified random sample is included and within any continuous thirteen week period, every postcode sector is sampled. From April 1998 the Labour Force Survey figures are the headline UK statistics for unemployment and employment figures each month for the prior quarter.

A panel design in the survey interviews sampled addresses for five 'waves'. Interviews are placed in three month intervals with the fifth interview at an address occurring a year after the first. Each 'quarter interview' is achieved at about 59,000 addresses with about 138,000 respondents. During this year a response rate of 79% was achieved for the first wave of the survey.

This is linked to the “ILO” measure - this is the **International Labour Organisation** measure. It is based on a survey, so all those that are effectively unemployed, but do not claim the highly specific Jobseekers Allowance can be included.

Those who are part of this measure but not included in the claimant count include the young unemployed who are not always eligible to claim, married women who can't claim if their husband is earning enough, and those who claim sickness and invalidity benefits. Many (only slightly inconvenienced) unemployed workers are paid these benefits rather than having the claimant count of unemployment increased. This method can be used for international comparisons, as this survey is taken in most developed countries.

## 2. January figures for the:

**Claimant count:** 951,300 (a rate of 3.2 per cent), a decrease of 10,600.

**Labour Force Survey:** 1,546,000

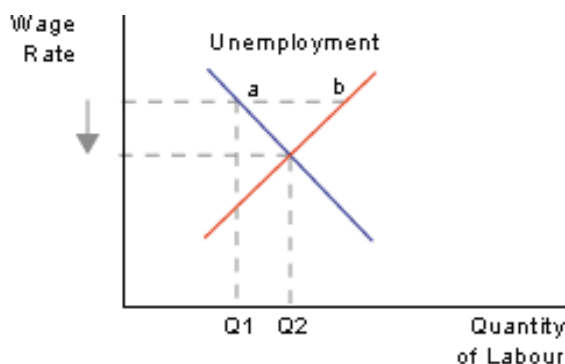
3. There are two main and one fringe types of unemployment: cyclical, demand-deficient and Keynesian. There are two major categories that unemployment factors fall into:

- a) demand side
- b) supply side

a) Demand side economics cause unemployment because there is a lack of aggregate demand. This should be fairly obvious: if there isn't sufficient demand, employers will need less workers – this is called ‘demand-deficient unemployment’; this is a major Keynesian interest.

b) Labour side economics influence unemployment by imperfection in the labour market. For example, a perfect market (practically impossible) would have 100% employment and all those who would normally be seeking employment will have jobs. This is when the market clears – supply equals demand. If, however, as practice shows, the market does not clear, there is unemployment. One of the reasons for this is that incomes/wages/salaries fail to fall adequately to clear the market.

### Diagram showing the wage/quantity division:

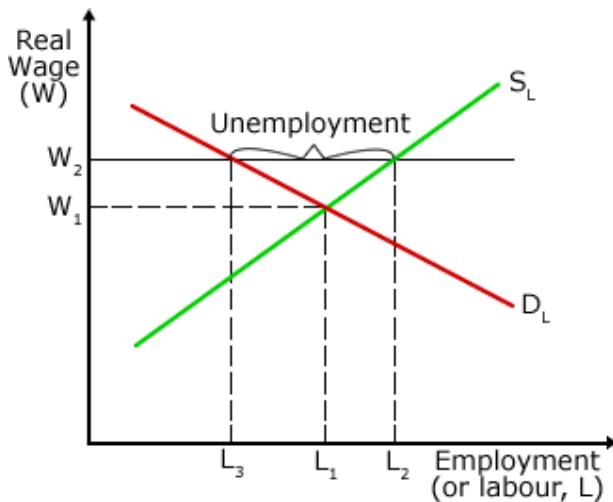


Wages are, initially, too high, so the result is the unemployment of ‘ab’ (supply is greater than demand). In order to ameliorate this unemployment and clear the market, wages have to drop.

If wages are 'sticky-downwards', this may not occur and unemployment may persist. Here, the supply of labour is greater than its demand.

Unemployment from the supply-side may also occur due to occupational/geographical immobility. Another reason is poor information concerning job opportunities. This will lead to inefficient job seeking, thus increasing the level of ‘frictional’ or ‘search’ unemployment (‘between-jobs’).

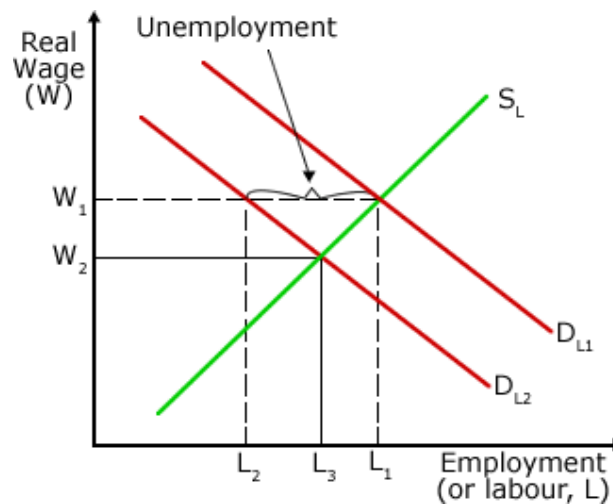
**Diagram: Classical unemployment**



This is unemployment that is caused by the real wage being higher than the equilibrium real wage.

The supply curve in the diagram only indicates the number of people who are willing and able to work at any given wage. Some people may be unemployed simply because they are looking for a better job (frictional unemployment - see later). These people are voluntarily unemployed.

Keynesian unemployment (or demand deficient unemployment) - Keynesian economists, however, believed that unemployment was not just about the labour market being in disequilibria. Labour is derived demand, derived from the demand for the good that is being produced. If there is a big fall in the demand for products in the goods market (during a recession, for example) then the demand for labour will fall causing unemployment.



Using the same diagram as before, one can see that the equilibrium wage is  $W_1$  giving a level of employment of  $L_1$ . Keynesians now argue that in times of recession, the **aggregate demand** curve for the economy as a whole will shift to the left. This will cause the demand for labour curve to shift to the left as well (from  $D_{L1}$  to  $D_{L2}$ ). If the real wage rate stays at  $W_1$  then there will be  $L_1 - L_2$  workers involuntarily unemployed.

Classical economists would argue that the real wage rate would fall to the new equilibrium (wage  $W_2$ , employment  $L_3$ ). The level of employment would fall (from  $L_1$  to  $L_3$ ) but there would be no involuntary unemployment. Even if the real wage rate did fall, the lower incomes of the workers would lead to lower spending in the economy, a further reduction in

aggregate demand and a further reduction in the demand for labour. When would it all end?

Frictional unemployment is voluntary unemployment for workers who are looking for a better job. Previously, the monthly figures for this had been as high as 300,000. The bigger the imperfections in the labour market, the longer will be this period of unemployment for each worker, and the higher the 'search' costs for the individual. The worker could take the first job that he/she is offered, but it is probably better, for the individual and the economy as a whole, if he/she takes some time to find the right job, so that he/she is more productive in that job.

Some may argue that this 'search' can become rather prolonged: if (for example) the Jobseekers Allowance is too high. If out of work benefits are high, the unemployed worker might be tempted to not work at all.

Structural unemployment is so named because it is unemployment caused by changes in the structure of the economy. The huge shift away from manufacturing to the service sector over the last twenty to thirty years (often referred to as de-industrialisation) has caused structural unemployment to be the largest component of the total unemployment figures.

Technical unemployment is where technology has forced people to redundancy. A good recent example is the banking sector, where the introduction of phone and Internet banking has caused the large banks to close many of their (traditional) high street branches. If the improved technology reduces an industry's costs, and therefore prices, by a substantial amount, the increased demand for their product might involve an increase in employment. A substantial increase in output will require extra workers.

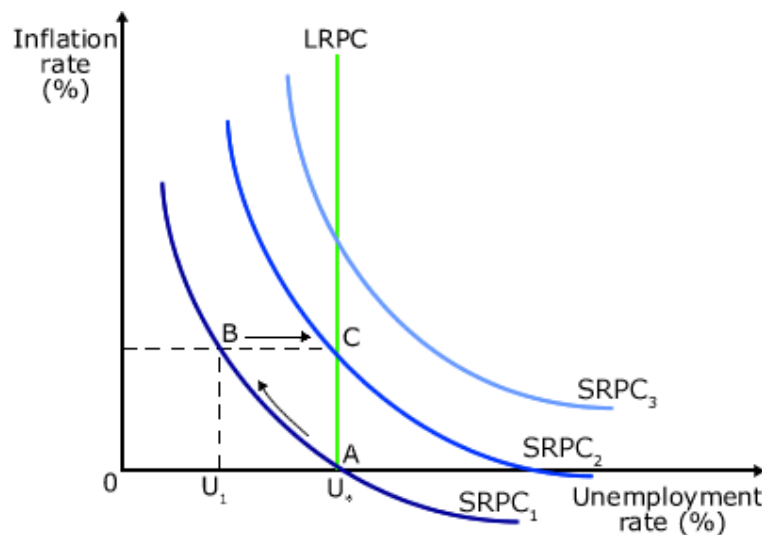
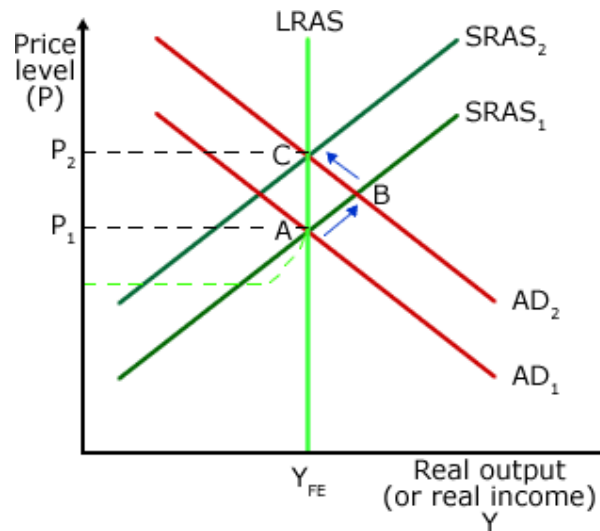
An exchange emerges: if, following improved technology, the increase in workers required (technicians for the new technology, for example) outweighs the losses due to the more efficient capital employed, then there will be a net increase in employment. Otherwise, unemployment will rise. A major factor will be the point to which new technology increases the productivity of capital involved relative to the improved labour productivity. If all the reduction in costs is down to a new 'super machine', then the amount of labour required will probably fall.

One final cause of unemployment is permutations of the workforce. It is constituted by people who are of working age and not currently in full-time education. Their number will change as demographic (age) structures (of the population) change. For example, a baby-boom (a rapid increase in the birth rate) will mean that these people will only join the workforce between 16 and 21 years later. If there are the same number of people retiring from the work-force, then unemployment will stay constant. However, following a baby boom there are often more joining the work-force than leaving. This would increase unemployment, unless there are sufficient jobs created to employ the extra people in the work-force. This was one of the causes of unemployment in the early 1980s when people born in the baby-boom of the 1960s joined the work-force.

Links with aggregate demand and supply analysis:

The first diagram shows the 'long run' Aggregate Supply/Aggregate Demand diagram. It is assumed that the economy is at equilibrium (full employment),  $Y_{FE}$ , providing a price level of  $P_1$  (pt. A). In the full employment level of income, any increase in aggregate demand will lead only to a rise in the price level in the long run. The economy will move to point B temporarily, but the subsequent rise in real wage claims that follow a rise in the price level

will shift the short run aggregate supply curve to the left (from  $SRAS_1$  to  $SRAS_2$ ) and the economy will end up at point C, back at  $Y_{FE}$  but with a much higher price level ( $P_2$ ).



The second diagram: it is assumed that the economy is operating at point A, with unemployment equivalent to NAIRU,  $U_*$ , and 0% inflation. If aggregate demand is increased, unemployment is assumed to fall **only** in the short run (a move to point B). The economy will end up at point C with a permanently higher rate of inflation.

These two diagrams describe **one** economy. The rising price level in the first diagram is shown by the increased inflation rate in the second diagram. The temporary rise in the level of real output in the first diagram is illustrated by the temporary fall in unemployment in the second diagram. The long-run equilibrium level of national income ( $Y_{FE}$ ) in the diagram on the left is illustrated by the natural rate of unemployment in the diagram on the right. Even at full employment there will be some unemployment in the economy (see Q5).

**4. The Costs Of Unemployment**

There is a personal effect on those that are unemployed. Individuals may become dispirited (i.e. lose their motivation to work) and the longer they are unemployed, the more skills, confidence and self esteem they lose. It is a fact that death rates are higher in those that are unemployed. They also suffer from mental illnesses, stress etc. more than those employed. The fact that their income is negligible means that they contract health problems – the NHS pays the bill. Also, the longer one is unemployed, the lower his/her chances of being re-employed because employers fear a certain “deskilling” – loss of skill due to employment hiatus.

However, these are micro effects. There are macro effects also:

a) The economy – microeconomic factors have knock-on ramifications on the economy: if workers lose skills and motivation, the entire economy suffers. For example:

a) loss of output to the economy: the unemployed could be producing goods and services, but because they aren't, the GDP isn't as high as it could be.

b) implications for government spending and taxation - high unemployment is expensive for the government and because the cost is passed on, to the taxpayer also. For one unemployed worker, there are two costs to the government: first, the unemployed worker will be entitled to benefit, and if he/she is young, (or older but remains unemployed for a long period of time) he/she will be offered training under the 'New Deal'. Secondly, there is the more implicit cost of the loss of income tax revenues the worker would have paid in work. These workers would have been paying VAT as well through their purchases. Put together, some economists have estimated that the cost to taxpayers of each unemployed person is up to £9,000 a year. There is a loss of tax revenue; the unemployed are not earning, so they are not paying tax: this limits the government's revenue from taxes.

c) increase in government expenditure: it has to pay benefits to support the unemployed. With the loss of potential tax, this is double the loss. This is linked to (b).

d) loss of profits: higher employment firms will probably perform better. If they make less profit due to unemployment, they have less funds to invest.

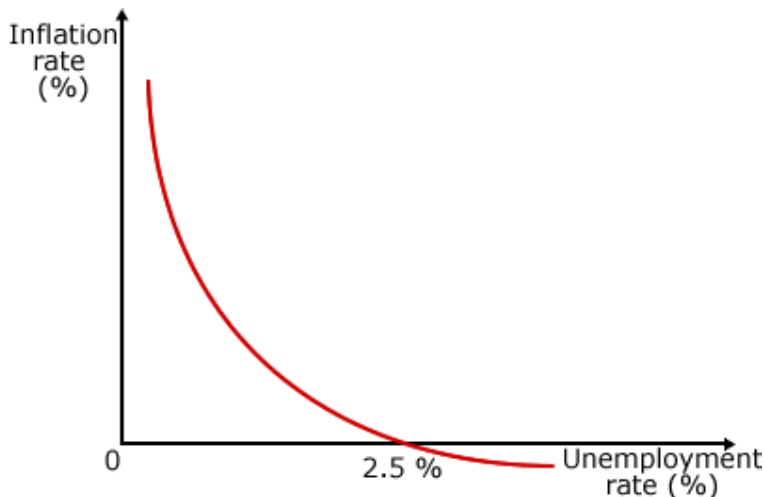
e) social cost: unemployed workers (particularly young men) can create external costs in the economy, like crime for example. The governments of the 80s dismissed the coincidence of rising crime figures and rising unemployment. Could it really have been a coincidence, with many of new unemployed workers being young school leavers without experience in work?

Suppose a shipbuilder had been employed all his life, and then, at the age of, say, 53 his dock closed and everyone was rendered redundant. He has been trained, thoroughly, for one job, but what else can he do? Some of the skills may be transferable, but retraining will be required. Employers would prefer to employ an 18 year old - young, fresh and open to new ideas - rather than a 53 year old with pre-conceived ideas. This was common in the 1980s. A 53 year old man would often not get a job for a couple of years, and then it would be impossible to find work at the age of 55 with two years out of the market. He would spend the rest of his days up to retirement age (65) unemployed and practically unemployable.

The problem of de-industrialisation would not be so potent if the expansion of the service sector created sufficient jobs to employ those who lose theirs in the manufacturing sector. To a certain extent, this IS what has happened. However, the skills required in the service sector are usually different to those required in the manufacturing sector. Occupational mobility has been improved through government training programmes, in particular, the 'New Deal' which helps the long term unemployed get back to work. Geographical mobility needs to be improved as well, through

increased low cost housing for those who need to move to a more expensive area to get a job. Recent governments have not been quite so forthcoming with money to eradicate this problem. This may be because many people are reluctant to move from the area from which they came, regardless of financial inducements.

**The Phillips Curve** (this is linked to Q3 also)– this showed the interaction between inflation and unemployment:



This eponymous curve predicts the effect of changing inflation on unemployment and vice versa.

Q3: This graph illustrates that if inflation rises, unemployment decreases; and if inflation falls, unemployment increases. The change in one element is proportionate to the change in the other.

Q4: This graph shows that a consequence of changing unemployment is varying inflation.

If unemployment increases, inflation decreases (and may move below the target 2.5%), or if unemployment decreases, inflation increases (and may increase above the 2.5% target). A lower inflation level is detrimental to the economy, as is one too high. However, this graph does not hold universally true, for unemployment AND inflation can rise. However, this curve is no longer used and is a simplified version of an “expectations-augmented Phillips curve”. In reference to Q3, NAIRU is the ‘non-accelerating inflation rate of unemployment’. This is the point where inflation is non-accelerating, stationary.

5. In order to achieve full employment, the government would have to augment a perfect market in which the market is cleared. To eliminate unemployment, the government would have to maintain 100% employment. Historically, this has proven impossible, and the closest the UK has come to it has been 2%. In order to achieve this 0% unemployment (100% employment), the government can take the following action:

a) Decrease corporation tax – not only does this encourage more industries/businesses/entrepreneurs to develop and thus create jobs, it also means that businesses have more wealth after taxation, so can afford to pay higher wages; attracting more workers. However, this has disadvantages: unscrupulous corporations may decide to use the extra wealth for other (more personal) purposes. Also, this would mean that the government loses out. The way it will balance this is by increasing other taxes, for example, income tax. This would affect those with well paying jobs as well as those with menial jobs (to varying degrees, admittedly). This would lead to decreased spending and perhaps recession.

b) Decrease interest and business rates – this would encourage entrepreneurs to borrow money for setting up a business(es) and thus creating jobs. This leads to the same consequences as (a): more jobs are created, but less money is saved despite higher confidence, which is linked to mortgages.

As mentioned before, in order to achieve full employment, the government would have to implement a perfect market. Perfect competition, however, is very difficult to forge and therefore, so is full employment.

Another factor related to this is the thriving technological boom that we are currently living in and will continue to do so. Throughout the all-encompassing industry of technology, the aim is to make jobs easier and/or automated. Automation inevitably leads to a machine doing the equivalent work of several employees with more precision and lower costs. The main point here is this: more and more technology is being developed in every industry, and eventually (and progressively), it may replace human labour, thus causing more unemployment. However, as mentioned before, this forced unemployment can be offset if they are employed in another sector, possibly in the maintenance of the new technology(ies) that made them obsolete in the first place. The disadvantage here is that not many technicians are needed, and, if a company 'lays off' 10,000 workers and replaces them with 25 machines, only, say, 3 technicians per machine may be needed and so 9925 workers will still be unemployed.

There is a **natural rate of unemployment** around which the unemployment rate hovers. The government can change the rate to below or above this level, but it will return to the natural rate of unemployment. Therefore, 0% unemployment, even if possible, would be temporary. A ramification of this is that the long run Phillips curve is vertical. Success would lie in reducing this natural state of unemployment, and this can only be done by increasing the growth rate of the economy, which is a difficult task..

In conclusion, I do not believe that the government can achieve full employment, but the matter is highly subjective, as all the different classes of economists have proven.