Unemployment

Peter Smith highlights key aspects of unemployment, which is one of the key macroeconomic indicators used to monitor the economic performance of an economy

Measuring unemployment

In line with the **International Labour Office (ILO) guidelines**, unemployment in the UK is measured as the number of people who are without a job, have actively sought work in the last 4 weeks and are available to start work in the next 2 weeks, or are out of work, have found a job and are waiting to start it in the next 2 weeks. This definition is used internationally, making it possible to compare unemployment rates across countries.

In the UK, the number of people who are unemployed can also be measured by the **claimant count**, which counts the number of people claiming benefits principally for the reason of being unemployed. Note that not everyone who is unemployed is eligible for Jobseeker's Allowance, which helps to explain why the two measures — the ILO guidelines and the claimant count — diverge in Figure 1.

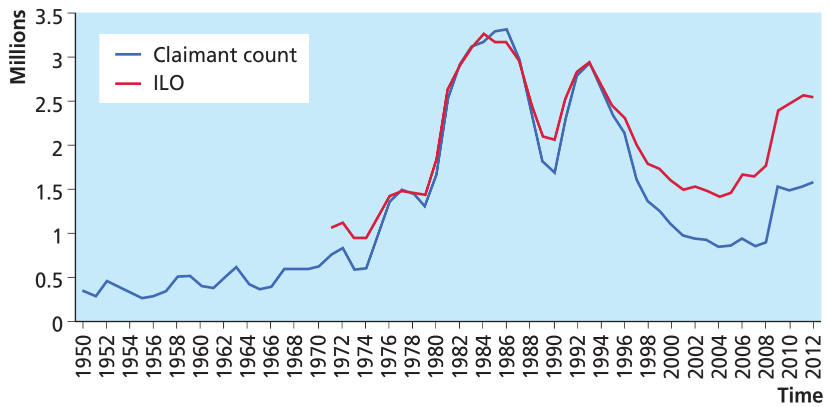

Figure 1 Unemployment, 1950–2012

What are the costs of unemployment?

The existence of unemployment in an economy means that the economy is producing less real output than it could because the factors of production are not being fully utilised. One way of viewing this is that when there is unemployment, an economy is operating inside its production possibility frontier.

Unemployment is also costly at an individual level, as people who are not in work and unable to find a job are unable to earn an income, and may feel socially excluded.

For some people, unemployment may be seen as being voluntary, in the sense that they choose not to accept jobs at the going wage rate — perhaps because they believe that they can do better by waiting and searching. In some cases, individuals may perceive that taking a low-paid job may not leave them better off than if they claim Jobseeker's Allowance. The government needs to monitor the balance between providing protection for unemployed workers and giving appropriate incentives for people to accept jobs.

Frictional and structural unemployment

There will always be some unemployment in an economy, even when the labour market is in equilibrium. It is important that a dynamic economy can adapt to changing patterns of demand. This means that at any moment in time workers will be moving between jobs, leaving sectors that are in decline and going into those that are booming. The more flexible the labour market is, the shorter the periods of job searching for individuals. Indeed, some workers may change jobs simply to improve themselves. The unemployment that results from such periods of job searching is known as **frictional unemployment**.

Longer-term unemployment may result when the expanding activities in an economy call for different skills than the activities that are in decline. This can give rise to **structural unemployment**, which reflects this sort of skills mismatch. Training schemes may be needed to overcome this.

Trade unions

Unemployment can arise from trade union activity in a labour market. Figure 2 illustrates how this may happen. With no intervention from the trade union, the equilibrium wage in this market would be at W_e, where labour demand equals labour supply and employment would be at L_e. However, if the union was able to negotiate a higher wage for its workers at W^*, employers would employ only L^* workers and more workers would wish to accept jobs at the higher wage. The result would be unemployment shown in the figure by the distance $N^* - L^*$.

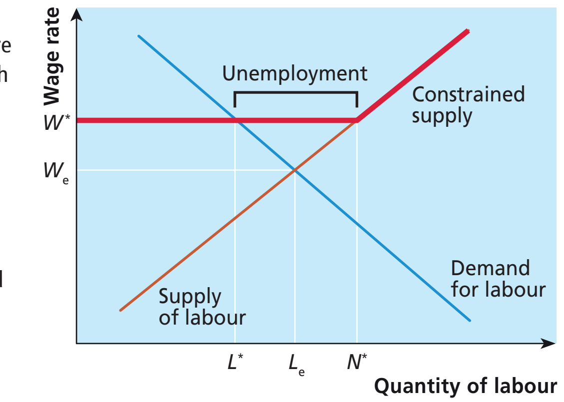

Figure 2 A trade union fixes the wage

The effects of a minimum wage

Imposing a minimum wage that is above the competitive equilibrium wage rate can give rise to unemployment, as shown in Figure 3. Assuming that the labour market is perfectly competitive, the free market equilibrium would be with a wage at W^* and employment at L^*. In an attempt to protect low-paid workers, suppose that the government impose a minimum wage of W_{min}, so that employers are not permitted to charge a wage below that level. Firms will reduce their demand for labour to D_{min} and the supply of labour will be at S_{min} at that wage. Unemployment will be given by the distance $S_{min} - D_{min}$. In this case, well-intentioned government action has allowed some workers to receive higher wages but at the cost of pushing others into unemployment.

Note that not all markets will be affected in this way. Labour markets in which the equilibrium wage is higher than the minimum wage will not be affected by the policy. Furthermore, in some markets where there is a monopsony firm, employment may actually rise as a result of firms being forced to pay higher wages to their workers.

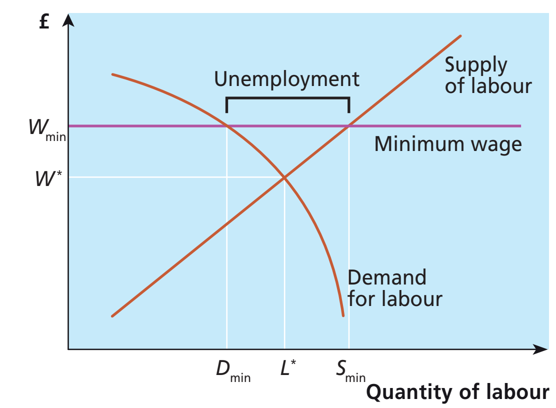

Figure 3 The effect of a minimum wage in a perfectly competitive labour market

Regional unemployment

Unemployment may arise because of the immobility of labour. This may be important when economic activities concentrated in some regions are in decline and where expanding sectors are located in different regions. Unemployed individuals may not be prepared to move house in order to find work, or may not be aware that there are job opportunities available in other areas. This is known as **regional unemployment**. Differences in house prices can reinforce the immobility of labour but people may also be reluctant to move because of family and other social ties, or because of schooling for their children.

Demand-deficient unemployment

John Maynard Keynes argued that unemployment could arise when there is a fall in aggregate demand. The core argument here is that following a decrease in aggregate demand, real wages may fail to adjust downwards in order to restore equilibrium because of inherent rigidities in the market, thus giving rise to unemployment.

Some macroeconomists have argued that there is a **natural rate of unemployment** for an economy and that equilibrium would rapidly be restored. However, attempts by the authorities to reduce unemployment below this natural rate would lead to an acceleration in the rate of inflation.

EconomicReviewExtras
Go online for a printable pdf of this centre spread (see back cover).