

UNEMPLOYMENT

INTRODUCTION

High employment means that the economy is throwing away output by failing to put its people to work. It also means misery, social unrest, and hopelessness for the unemployed. Over the following 40 years, macroeconomic policy was geared to avoiding a return of the 1930s.

In the 1970s views about unemployment began to change. People began to reject the Keynesian pessimism about the capacity of the economy to respond to shocks but quickly restoring full employment. The classical model began to be more widely accepted as a description of the way the economy works even in the short run. Since in the classical model unemployment is voluntary, there is less presumption that unemployment means extreme human suffering. Moreover, research by labour economists has shown that in the early 1950s and 1960s most of the unemployed quickly found jobs. Unemployment might therefore be considered a stepping stone to a better job.

By the 1970s, not only was it felt that the cost of unemployment might have been overstated; in addition, governments in many countries began to perceive an even greater danger to economic and social stability, the danger of high and rising inflation. Thus by the end of the 1970s many governments had embarked on tight monetary and fiscal policies to try to keep inflation under control. The combination of restrictive demand policies and the adverse supply shock of the second major OPEC oil price increase in 1979-80 has led to a dramatic increase in unemployment in most of the industrial countries in the early 1980s.

High unemployment is one of the major problems of the 1980s. Will it continue? Is it a drain on society or a signal that at last people are getting out of dead-end jobs into something better? What can and should the government be doing? These are the questions we set out to answer in this chapter.

The suggested outline for this course is:

1. The facts
2. The framework
3. Why is Unemployment so high?
4. Supply-Side Economics
5. Eliminating Keynesian Unemployment
6. The Private and Social Cost of Unemployment
7. International Comparisons

Summary

Problems

SUMMARY

1. People are either employed, unemployed, or out of the labour force. The level of unemployment rises when inflows to the pool of the unemployed exceed outflows. Inflows and outflows are large relative to the level of unemployment.
2. As the level of unemployment has risen, the average duration of unemployment has increased.
3. Women face lower unemployment rates than men in developed countries (emerging countries? Work on it). The unemployment rates for older workers, and especially for young workers, are well above the national average.
4. Unemployment can be classified as frictional, structural, classical, and demand-deficient. In modern terminology, the first three types are voluntary unemployment and the last is involuntary, or Keynesian, unemployment. The natural rate of unemployment is the equilibrium level of voluntary unemployment.
5. Roughly half the UK unemployment in the early 1980s is explained by a rise in the natural rate. Structural unemployment caused by the decline of heavy engineering industries, and an increase in classical unemployment caused by a rise in real wages relative to value-added per worker, seem to be the most important explanations for the increase in the natural rate.
6. Supply-side economics aims to increase equilibrium employment and potential output, and to reduce to natural rate of unemployment, by operating on incentives at a microeconomic level. Supply-side policies include income tax cuts, reductions in unemployment benefit, retraining and relocation grants, investment subsidies, and policies such as lower interest rates coupled with lower government spending, aimed at 'crowding in' investment's share of full-employment aggregate demand.
7. At 1 per cent increase in output is likely to lead to a much smaller reduction in Keynesian unemployment. Some of the extra output will be met by longer hours. And as unemployment falls some people, effectively in the labour force but not registered, will start looking for work again.
8. Although people who are voluntary unemployed reveal that the private benefits from unemployment exceed the private cost in wages forgone, society derives no direct return from the payment of employment benefit which individuals regard as a private benefit from being unemployed. Nevertheless, society would not benefit by driving the natural rate of unemployment to zero. Some social gains in higher productivity are derived from the improved matching of people and jobs that temporary spells of unemployment allow.
9. Keynesian unemployment is involuntary and therefore disadvantage to private individuals who would prefer to be employed. Socially it represents wasted output. Society may also care about the human misery inflicted by involuntary unemployment.
10. In most countries, unemployment was high and rising in the early 1980s. However, Japan and Sweden have managed to retain very low rates of unemployment. **(What is the situation now? Analyse and discuss)**

KEY TERMS

Labour force	Natural rate of unemployment
Registered unemployed	Replacement ratio
Long-term unemployed	Unemployment and supplementary benefit
Discouraged workers	Supply-side economics
Frictional workers	Income and substitution effects
Classical and Keynesian unemployment	Incomes policy
Voluntary and involuntary unemployment	Private and social cost of unemployment

PROBLEMS

1. What is the discouraged-worker effect? Suggest two reasons why it occurs.
2. ‘The average duration of an individual’s unemployment rises in a slump. This suggests that the problem is a lower outflow from the pool of unemployment, not a higher inflow’ do you agree? (Analyse and discuss).
3. Why is teenage unemployment so high?
4. ‘The microchip will inevitably cause a permanent increase in the level of unemployment’. Carefully examine this assertion.
5. How would the rise in unemployment between 1978 and 1981 be explained by (a) a Keynesian (b) a classical or monetarist economist?
6. Shouldn’t we pay the unemployment an amount equal to the after-tax wage they earned in their last job, thereby eliminating the disadvantage they suffer on becoming unemployed?
7. **Common Fallacies** Show why each of the following statements is incorrect. (a) Unemployment is always a bad thing. (b) So long as there is unemployment, there should be pressure on wages to fall. (c) Unemployment arises only because greedy workers are pricing themselves out of a job.

FURTHER READING

D. Begg, S. Fischer, @ R. Dornbusch, “Economics”, British Edition, Chapter 27.

R.G. Lipsey, “Positive economics”.

E.V. Morgan, “Economics”.

G.F. Stanlake, “Introductory Economics”, fourth Edition.