

OCR Economics A-level

Macroeconomics

Topic 2: Economic Policy Objectives


2.3 Employment

Notes

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Unemployment, employment and the government macroeconomic objective

-  The **unemployed** are those able and willing to work, but are not employed. They are actively seeking work and usually looking to start within the next two weeks. Those in **employment** are those with a job.

Governments aim to have as near to full employment as possible. They account for frictional unemployment by aiming for an unemployment rate of around 3%. The labour force should also be employed in productive work. When this employment rate is met, the economy is said to have full employment.

Measures of unemployment

It is usually difficult to accurately measure unemployment. Some of those in employment might claim unemployment related benefits, whilst some of the unemployed might not reveal this in a survey.


The two main measures of unemployment in the UK are:

The Claimant Count

This counts the number of people claiming unemployment related benefits, such as Job Seeker's Allowance (JSA). They have to prove they are actively looking for work.

Evaluating the Claimant Count:

Not every unemployed person is eligible for, or bothers claiming JSA. Those with partners on high incomes will not be eligible for the benefit, even if they are unemployed. Although there may be instances of people claiming the benefit whilst they are employed, the method generally underestimated the level of unemployment.

-  **The International Labour Organisation (ILO) and the UK Labour Force Survey (LFS)** The LFS is taken on by the ILO. It directly asks people if they meet the following criteria:
- Been out of work for 4 weeks
 - Able and willing to start working within 2 weeks



- Workers should be available for 1 hour per week. Part time unemployment is included.

Since the part time unemployed are less likely to claim unemployment benefit, this method gives a higher unemployment figure than the Claimant Count.

The causes of unemployment:

Structural unemployment

This occurs with a long term decline in demand for the goods and services in an industry, which costs jobs. This is especially true of jobs in industries such as car manufacturing, where labour is replaced by capital (this is also called **technological unemployment**). Moreover, the decline of the coal and ship building industries in the UK, led to a great deal of structural unemployment.

This type of unemployment is worsened by the geographical and occupational immobility of labour. If workers do not have the transferable skills to move to another industry, or if it is not easy to move somewhere jobs are available, then those facing structural unemployment are likely to remain unemployed in the long run.

Globalisation also contributes to structural unemployment, since production in the manufacturing sectors, such as in clothing or motor cars, moves abroad to countries with lower labour costs. This means that workers trained for these jobs will become unemployed, because the industry has declined in size or has been removed from the economy.

Frictional unemployment

This is the time between leaving a job and looking for another job. It is common for there to always be some frictional unemployment, and it is not particularly damaging since it is only temporary.

For example, it could be the time between graduating from university and finding a job.

This is why it is rare to get 100% employment: there will always be people moving between jobs.



Seasonal unemployment

This occurs during certain points in the year, usually around summer and winter. During the summer, more people will be employed in the tourist industry, when demand increases.

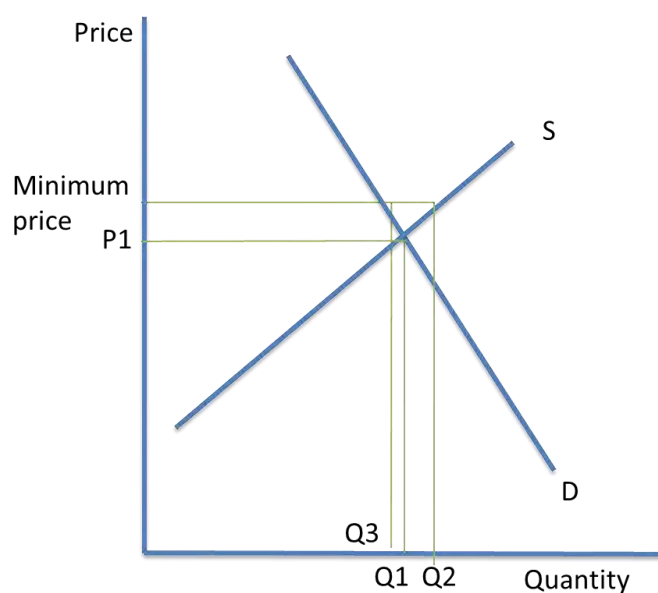
Demand deficiency (cyclical unemployment)

This is caused by a lack of demand for goods and services, and it usually occurs during periods of economic decline or recessions. Firms are either forced to close or make workers redundant, because their profits are falling due to decreased consumer spending, and they need to reduce their costs. This then causes output to fall in several industries.

This type of unemployment could actually be caused by increases in productivity, which means each worker can produce a higher output, and therefore fewer workers are needed to produce the same quantity of goods and services.

Real wage inflexibility

Wages above the market equilibrium may cause unemployment. Classical economists argue that by letting wages fall to the equilibrium level, there would be no unemployment.



In the diagram, the point at 'minimum price' reflects the NMW. This causes unemployment of $Q1 - Q3$.



If demand then shifts to the left, due to a fall in consumer spending for example, there would be more unemployment since wages are not able to adjust.

Classical economists would argue that by letting wages be flexible, by removing trade union power and removing the NMW, wages could fall and unemployment would fall to 0.

However, cutting wages during times of weak consumer spending would cause further falls in consumer spending, and there would be even lower economic growth. Moreover, the classical economist argument is made on the assumption of a perfectly competitive market, which is not true in reality.

The consequences of unemployment:

○ **Consumers**

If consumers are unemployed, they have less disposable income and their standard of living may fall as a result.

There are also psychological consequences of losing a job, which could affect the mental health of workers.

○ **Firms**

With a higher rate of unemployment, firms have a larger supply of labour to employ from. This causes wages to fall, which would help firms reduce their costs.

However, with higher rates of unemployment, since consumers have less disposable income, consumer spending falls so firms may lose profits. Producers which sell inferior goods might see a rise in sales.

It might cost firms to retrain workers, especially if they have been out of work for a long time.

○ **Workers**

With unemployment, there is a waste of workers' resources. They could also lose their existing skills if they are not fully utilised.



- **The government**

If the unemployment rate increases, the government may have to spend more on JSA, which incurs an opportunity cost because the money could have been invested elsewhere.







The government would also receive less revenue from income tax, and from indirect taxes on expenditure, since the unemployed have less disposable income to spend.

- **Society**

There is an opportunity cost to society, since workers could have produced goods and services if they were employed.

There could be negative externalities in the form of crime and vandalism, if the unemployment rate increases.

The effects of full employment:

-  This is the state when all factors of production are used to their productive potential. It maximises the output of the economy.
-  This could put up upward pressure on the price level, since consumer demand in the economy is high which will lead to demand-pull inflation.
-  There could also be wage inflation, which can push up the price of production for firms. This is since labour is in shortage.
-  There are social benefits of having full employment. Crime rates might fall if more people are in employment, and standards of living might increase if people have more disposable income. Inequality and poverty might fall if fewer people are unemployed.
-  Consumers and firms might have more confidence in an economy where resources are used to their full potential. This should encourage long term sustainable growth.
-  With full employment, government budgets might improve since tax revenues increase and spending on welfare benefits falls.

