



## Notes – Topic 7

### Topic 7: Unemployment

- I. Definition
  - a. Percentage of labor force not currently holding jobs, but actively seeking them.
  - b. Labor force → Adult population (over age 16) that's both willing and able to work, and actively seeking employment.
    - i. Doesn't include children, full-time students, house producers, "lazy bums" etc.
    - ii. Doesn't include those not able to work (severely handicapped, prison inmates)
  - c. If you're not in the labor force, you can't be considered unemployed.
    - i. Doesn't include people who *want* to work, but have given up actively seeking employment ("discouraged workers")
    - ii. Doesn't include "Underemployed"
      1. Part-time workers who'd prefer full-time work but can't get it.
      2. Temporary workers who'd prefer permanent work but can't get it.
      3. These people counted as fully employed.
    - iii. Doesn't include institutionalized population (over 2 million people in prisons – highest rate in the world)
    - iv. Figures may thus be underestimated.
  - d. Questionable implications as a straight number, but good for observing trends from year to year.
- II. Types of Unemployment
  - a. Structural Unemployment
    - i. Arises when not enough available jobs to go around.
    - ii. Two general causes
      1. Major changes in markets or technologies that cause jobs to disappear
        - a. Coalmine closing down after many years of being worked.
        - b. Typewriter repairmen with no work after technological shift to using computers
      2. Laws, institutions, and regulations that raise cost of hiring workers
        - a. Minimum wages
        - b. Workplace safety regulations
        - c. Fringe benefits (pensions, healthcare, insurance, family leave)
        - d. Company not wanting to setup in a particular region due to unions being notoriously difficult there.
  - b. Frictional Unemployment
    - i. Even with enough jobs for *everyone* there would still be unemployment.
    - ii. Takes time to match workers with jobs.
    - iii. Depends on how well labor markets function, and how quickly information on available jobs spreads.
    - iv. Internet had very significant effect – became very easy to find information.
  - c. Not considered as "bad" ("social scourge") as structural unemployment. Better to be frictionally unemployed for a while than to take a worse / "unfit" job.
  - d. Includes people newly entering the workforce (college graduates, spouses returning to the labor force after raising children, etc)
- III. Cyclical Unemployment
  - a. Arises from slumps in economy.
  - b. Rises and falls with business cycles.
  - c. When economy is at normal potential for output, cyclical unemployment is zero.
  - d. Cyclical vs. Structural
    - i. Unemployment due to a factory closing due to being unable to compete is structural unemployment.
    - ii. Unemployment due to people being fired from the factory because the economy isn't doing well is cyclical. Those workers may or may not get hired back when the economy improves.

- IV. The “Natural Rate” of Unemployment
  - a. Most (not all) economists believe in a natural rate of unemployment.
  - b. Defined several ways.
  - c. Sum of structural and frictional unemployment.
  - d. Rate of unemployment that remains in the economy even when operating at normal level of potential output.
  - e. Depends on many technical / market / institutional factors (all the factors affecting frictional and structural unemployment)
  - f. Differs from nation to nation and even among regions in a nation.
  - g. Differs over time.
  - h. Identified as lowest rate of unemployment that can be sustained without causing inflation to rise.
    - i. Labor huge part of production of essentially everything.
    - ii. If there's less labor, employers will have to pay more for the labor they need.
    - iii. The higher cost of production will be passed to consumers, equating to inflation.
  - i. Identifying actual number as natural rate has been problematic.
    - i. Until 1980s, economists thought U.S. Natural Rate was 6%.
    - ii. By mid 1990s unemployment dropped to as low as 4% and inflation was still under control.
    - iii. We *can* make comparisons over time and between nations.
      - 1. Higher rate in Europe than U.S.
        - a. Structural unemployment higher because labor markets are over-regulated.
        - b. Frictional unemployment higher due to high unemployment benefits. Less incentive to seek work.
      - 2. Can determine whether the rate is trending up or trending down in the United States over time.
  - j. Natural Rate defined in three ways
    - i. Sum of Structural and Frictional unemployment.
    - ii. Level of unemployment remaining when cyclical unemployment equals zero.
    - iii. Lowest rate of unemployment consistent with price-level stability.
  - k. Also called
    - i. NAIRU: Non-Accelerating Inflation Rate of Unemployment
    - ii. “Full Employment” rate of employment.
- V. Unemployment in the United States
  - a. In post-WWII period, unemployment peaked at 10% in the early 1980s and dipped to 3% during the Korean war.
  - b. In period including WWII and the Great Depression, dipped under 1% during WWII and peaked near 25% during the depression.
  - c. Prolonged wars associated with low rates of unemployment.
    - i. Reduce size of labor force by sending away troops.
    - ii. Increase demand for labor for war production.
    - iii. Thus lowest rate since WWII was during Korean and Vietnam wars.
  - d. Not *all* unemployment dips are associated with wars. 1990s was a period of posterity during a period of unusual peace.
  - e. Until late 190s, long-term NAIRU trend was thought to be rising. Now appears to be falling. Much more stable than measured rate, but still drifting.