ECONOMICS DEMYSTIFIED

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Brilliant

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economics demystified

permanent or temporary basis; according to their gender; and finally by age group. Statisticians also seek to divide employees according to the sectors that they work in. The employment rate – the percentage of the labour force in work – allows changes in the labour market to be interpreted in a wider context by allowing for changes in the population. The headline measure of employment for the UK is the employment rate for those aged 16 to 64.

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In the United States, the federal government classifies all employers according to their primary business activity. The North American Industrial Classification System (NAICS) includes 1,170 industries. For example, code 331513 (Steel Foundries) includes the traditional US job of manufacturing steel castings. Code 711510 is for Independent Artists, Writers, and Performers, which comprises 'independent (i.e. freelance) individuals primarily engaged in performing in artistic productions, in creating artistic and cultural works or productions, or in providing technical expertise necessary for these productions'.

Gizzajob!

The internationally accepted definition of unemployment (from the Organisation for Economic Co-operation and Development) is of someone who does not have a job, has actively looked for work in the previous four weeks, and is currently available for work. The ways of looking at whether someone is actively looking for work and also their 'availability' means there is scope for differences between countries. There are also different ways of doing the measuring. The two main options are carrying out surveys of a representative group of households and counting the number of people claiming jobless benefits. For example, in the UK, the unemployment figure is based on the Labour Force Survey while the claimant count is the number of people claiming unemployment benefits, currently known as Jobseeker's Allowance. Unemployment figures tend to be higher than measures of claimants. This is because the latter excludes many people who want to find a job and have searched for work but do not pass the test for claiming benefit and so are not counted.

Like employment, unemployment can be broken down although here the most used classifications are according to gender, age group and between long-term or short-term unemployment. Another way of looking at this is to identify what is creating unemployment. In any economy people will find themselves out of work for short periods of time perhaps, such as after leaving college or while they are in between jobs. This is known as frictional unemployment. Some industries tend to employ more people, perhaps on a temporary basis at certain times of the year. For instance December will see the shops of London's Oxford Street take on extra workers while the tourist trade in Cornwall will need only a skeleton staff. This is known as seasonal unemployment. People who choose not to be in work make up what is known as voluntary unemployment.

None of these is immediately worrisome as they reflect short-term, largely predictable patterns. However, when people talk about unemployment they tend to think of longer-term more unpredictable worklessness. When an economy slows, businesses will make job cuts to survive, the unemployment rate will rise. As the economy recovers firms will take on more staff and unemployment will fall. This is known as cyclical unemployment. If we remember the idea of trend growth rates from Chapter 2, when the economy is growing below trend, unemployment will rise, and will then fall when the economic growth exceeds the trend rate.

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Despite its name, full employment does not mean that every single person is in work. The mainstream economic view is that it means that unemployment is as close to zero as possible, taking into account people who are cyclically unemployed. However, the late Nobel laureate economist James Tobin insisted that full employment meant 0% unemployed.

The most worrying is structural unemployment, which takes place when people find they no longer have the skills that employers want and are unable or unwilling to retrain. This can be driven by shifts in technologies that make certain skills obsolete. In extreme circumstances where a region is dependent on a redundant skill, intergenerational worklessness occurs where no one in the household is in work and younger members have never been in employment. While this involves terrible social costs to those affected, it has costs to the wider economy as well. The loss of skills and rise in unemployment can become a permanent feature of the economy even after the initial causes of it have disappeared. This is known as hysteresis, after the ancient Greek word for 'later'.

brilliant example

Losing their job is obviously a personal blow to that person, in terms of earnings, prestige and future job employment prospects. But research has shown that there are wider costs to society in the form of higher divorce rates, increased levels of crime and worse health, which all come on top of the costs the state pays in the form of unemployment benefit. One academic study in the US in November 2012 published in a journal called the *Archives of Internal Medicine* found that repeated job losses may be as damaging to the heath of that person's heart as smoking, high blood pressure or diabetes.

The link between unemployment and inflation

Given the negative consequences of unemployment, it is no surprise that politicians will aim for full employment. However, to most economists full employment does not mean getting the jobless rate to 0% although some have seen that as a desirable target. As the previous section shows there will always be some people out of work at some point in time, whether due to the economic cycle, the season of the year, the cycle of people's careers or because of more long-term shocks.

One common definition of full employment is that everyone in the labour force who is willing and able to work has a job other than those in transit from one job to another. Many definitions add in 'at the market rate' on the basis that anyone not willing to work for the rate of pay on offer is voluntarily unemployed. This raises the whole question of the link between unemployment and wages and inflation more generally.

there will always be some people out of work at some point in time

Under the so-called 'classical' view, unemployment is the result of people demanding wages above the level at which supply and demand says they should be set for a particular job. Advocates of this theory believe that any interference in the market for labour, such as a national minimum wage, collective bargaining through a trade union or restrictions on the ability of employers to make workers redundant, simply create higher unemployment by protecting the conditions of those in work.

Keynesian economists disagree, saying that unemployment is due to a deficiency in demand that the government should intervene to rectify. They say that the cuts in wages that classical economists believe should happen would simply sap demand further. Another criticism of the classical school of thought is that it treats workers like a commodity or raw material that can be bought and sold. They point to the fact that the supply of labour cannot be separated from the actual person (as oranges and lemons can be separated from the market stallholder). This implies a direct, personal relationship between the employee and employer. That relationship tends to be long-term and involve ongoing subordination between the two. Unlike most goods and services, individual workers are very different from each other.

Either way, economists agree that there is some long-term link between unemployment and inflation. Initially there was thought to be a trade-off between unemployment and inflation.

A British-based economist from New Zealand, A.W.H. Phillips, said that the greater the fall in unemployment, the greater the rise in wage increases. This was based on an analysis of almost 100 years of UK data up to the 1950s. This implied that there was a 'natural' rate of unemployment that was consistent with a level of inflation. As a result governments felt that if unemployment was too high, they could intervene with measures to stimulate job creation at a cost of higher inflation. Similarly, high inflation could be combated, albeit with measures that led to higher employment. He gave his name to the Phillips curve that shows unemployment falling as inflation rises and vice versa.

there is some long-term link between unemployment and inflation

However, the experience of the 1970s, which saw both high unemployment and high inflation (which became known as stagflation), undermined people's faith in any trade-off. Instead, attempts to stoke up the economy did achieve short-term falls in unemployment and rises in inflation. But as workers saw the buying power of their wages eaten up by inflation they demanded higher wages, which firms could not meet before laying off staff.

Economists came up with an alternative concept, which was that there was a level of unemployment which could not be further reduced without fuelling rises in inflation. This was called the non-accelerating inflation rate of unemployment or the NAIRU for short. As there was no direct relationship between the two, there was no simple number. In fact the NAIRU can be different for different economies. Modern policymakers have seen the challenge as reducing the NAIRU by making the labour market more efficient and so able to employ more people without causing inflation to accelerate.

A productive workforce

The measure of the efficiency of a country's or company's workforce is known as its productivity. Economists calculate this by dividing the total amount produced by the number of workers or by the number of hours worked. This tells you much about each worker or how much each worker hour produces which makes it easy to compare different industries, companies and economies. Productivity is often called the holy grail of economic prosperity.

Labour productivity has historically been higher in the US than in most European countries. There are many suggested explanations for this but according to economists the measures needed to boost productivity are called supply-side reforms. This is because they aim to improve the way that workers work and to increase their willingness to work – which is how the concept of supply applies to the labour market – rather than boost demand among employers for staff. In economic terms it is about improving the quality of the 'human capital' that we encountered in Chapter 2.

There are many reforms and initiatives that come under this heading and most require some involvement from the workers, employers and the government. Some of the measures have proved controversial. Perhaps the one that excites the least controversy is the need for better training and education of workers.