Unemployment

AQA A-Level Economics

Measures · Types · Causes · Consequences · Policies · Phillips Curve · Natural Rate

Defining & Measuring Unemployment

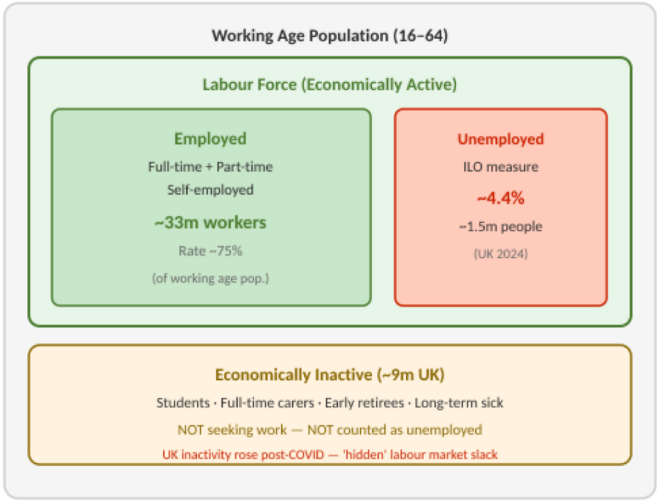
Definition:
Unemployment occurs when people who are willing and able to work, and are actively seeking work, cannot find employment. It represents wasted productive potential — lost output that can never be recovered.

Unemployment Rate = (Unemployed ÷ Labour Force) × 100

Two main UK measures:
ILO / Labour Force Survey (LFS): those without a job who have actively sought work in the past 4 weeks and are available to start within 2 weeks. Based on quarterly household survey of ~95,000 people. The internationally comparable standard.
Claimant Count: number of people claiming Universal Credit as unemployed. Monthly administrative data — faster but narrower. Generally lower than ILO as not all unemployed people claim, and some part-time workers may claim.

Economic inactivity:
People not in work and not seeking work — e.g. students, full-time carers, early retirees, long-term sick. NOT counted as unemployed. UK inactivity rose sharply post-COVID (~9m people) due to long-term sickness.

Underemployment: people working fewer hours than they would like, or in roles below their skill level. Not captured by headline unemployment statistics — may significantly understate true labour market slack.



Real-World Example

UK 2022: ILO unemployment fell to a 50-year low of 3.5% — yet the claimant count was much lower still. Meanwhile ~2.5m people were inactive due to long-term illness, a post-COVID surge. The headline rate understated true labour market slack considerably.

Types of Unemployment (1/2)

Unemployment has multiple causes — the policy response depends critically on identifying the correct type:

Cyclical (Demand-Deficient)

Caused by insufficient aggregate demand — the most common type in recessions. Firms cut output and lay off workers as sales fall. Rises sharply during downturns.

e.g. UK 2009: ILO unemployment hit 2.68m (8.5%) as the financial crisis collapsed demand. GDP fell 6% — classic cyclical unemployment from AD collapse.

Structural

Skills mismatch — workers' skills no longer match the jobs available as industries decline or technology changes. The most persistent type; does not disappear in a boom.

e.g. UK coalminers (1980s–90s): pit closures left communities without work. Skills not transferable to new service sector jobs — structural unemployment persisted for decades in former mining areas.

Frictional

Between jobs — workers searching for new employment. Inevitable in a dynamic economy as people voluntarily move between jobs. Short-term in nature.

e.g. A marketing manager who leaves one job and takes 4–6 weeks to find another is frictionally unemployed. A healthy level of frictional unemployment signals labour market dynamism.

Types of Unemployment (2/2)

Further types of unemployment:

Seasonal

Demand for labour varies with the seasons — some industries (tourism, agriculture, retail) need far fewer workers at certain times of year.

e.g. UK agricultural workers in winter; seaside resort workers in September–March; temporary retail staff after Christmas. Statistics are often seasonally adjusted to remove this effect.

Technological

A form of structural unemployment caused specifically by automation and new technology replacing workers. Jobs are permanently destroyed rather than merely relocated.

e.g. Amazon warehouse automation: robots handle picking and packing. Self-checkout tills replacing retail cashiers. AI potentially displacing white-collar roles — a growing 21st-century concern.

Real Wage (Classical)

Occurs when wages are held above the market-clearing equilibrium — e.g. by minimum wage legislation or strong union bargaining. Qs of labour exceeds Qd at the artificially high wage.

e.g. Controversial in practice — evidence on whether minimum wages cause real-wage unemployment is mixed. Most studies find small or negligible employment effects, especially in monopsonistic markets.

Consequences of Unemployment

Unemployment imposes costs on individuals, government, and the wider economy:

Costs to Individuals

Loss of income: immediate fall in living standards. Benefits replace only a fraction of previous earnings — poverty risk rises sharply.

Skills erosion (hysteresis): prolonged unemployment causes skills to atrophy, making workers harder to re-employ. Long-term unemployed face discrimination from employers.

Mental and physical health: unemployment is strongly associated with depression, anxiety, higher rates of substance abuse, and reduced life expectancy.

Social exclusion: loss of identity, status, and social networks built through work. Social cohesion weakens in high-unemployment communities.

e.g. Bevan/Beveridge research: unemployment is the most significant predictor of subjective wellbeing — more than income loss alone suggests.

Costs to Government and Economy

Lost output: unemployed workers produce nothing — real GDP is below potential. This output gap is permanently lost and cannot be recovered.

Fiscal costs: government spending on benefits rises automatically (Universal Credit, housing benefit) while tax revenues fall. Budget deficit widens.

Deflation risk: high unemployment reduces wage growth and consumer spending → falling AD → deflationary pressure → potential debt-deflation spiral.

Social costs: higher crime rates, family breakdown, increased demand for NHS and social services — all costly to government beyond benefits spending.

e.g. UK 2009: unemployment cost ~£50bn in lost output, ~£8bn in extra benefits, and caused lasting regional scarring in areas like South Yorkshire.

The Natural Rate of Unemployment (NRU)

Definition:

The rate of unemployment that exists when the labour market is in equilibrium — when the economy is at full employment. It is made up entirely of frictional and structural unemployment. It cannot be reduced by demand-side policies.

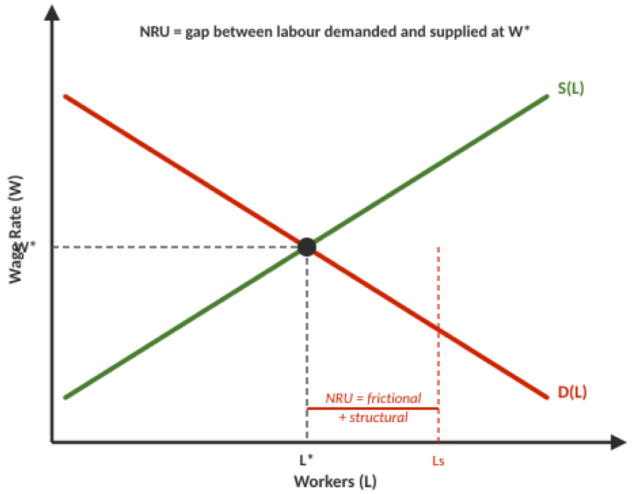
Also known as NAIRU:

Non-Accelerating Inflation Rate of Unemployment — the level of unemployment consistent with stable (non-accelerating) inflation. If unemployment is pushed below NAIRU, inflation begins to rise.

What determines the NRU?

Generosity of unemployment benefits — higher benefits increase the duration of job search, raising frictional unemployment.
Geographical and occupational mobility — low mobility raises structural unemployment.
Quality of job matching (information) — better job centres and digital platforms reduce frictional unemployment.
Education and skills — poor education raises structural unemployment as workers cannot adapt to changing labour demands.

Key point: demand-side policies (rate cuts, fiscal stimulus) cannot reduce unemployment below the NRU without causing accelerating inflation. Only supply-side policies reduce the NRU itself.



Real-World Example

UK NRU estimated at ~4–5% pre-financial crisis. Supply-side reforms of the 1980s (union reform, deregulation, training) are credited with reducing UK NRU from ~10% in the early 1980s to ~5% by the late 1990s — without requiring AD stimulus.

The Phillips Curve

The original Phillips Curve (1958):

A.W. Phillips observed an empirical relationship: lower unemployment was associated with higher wage inflation (and hence price inflation). As the labour market tightens, workers bargain for higher wages, pushing up costs and prices.

Short-Run Phillips Curve (SRPC):

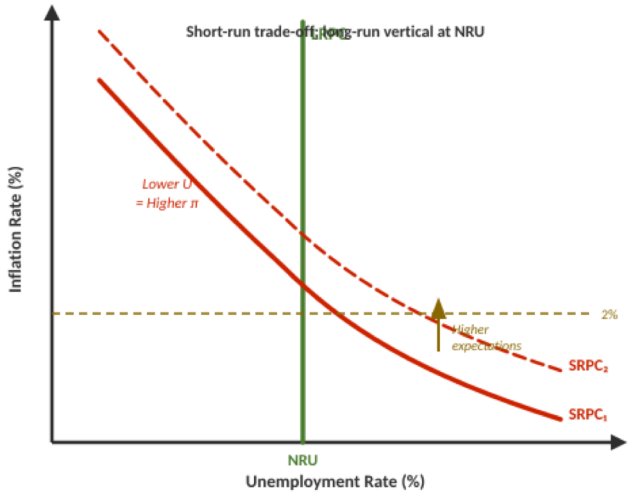
Downward sloping — there is a short-run trade-off between inflation and unemployment. Policymakers can 'choose' a point on the curve by adjusting demand. Moving down the curve (higher unemployment) reduces inflation but at a cost.

Long-Run Phillips Curve (LRPC):

Vertical at the NRU (Friedman/Phelps, 1968). In the long run there is no trade-off — any attempt to hold unemployment below NRU causes accelerating inflation as expectations adapt. Demand-side expansion only causes inflation.

The SRPC shifts when inflation expectations change.

If inflation expectations rise (e.g. workers demand higher wages), the SRPC shifts upward — the same unemployment rate now generates higher inflation. Expectations-augmented Phillips Curve.



Real-World Example

UK 2022–23: unemployment at historic lows (~3.5%) while wage growth hit 7%+ — consistent with SRPC theory. BoE raised rates to increase unemployment and reduce inflation. By 2024, unemployment rose to ~4.4% and wage growth moderated — the trade-off confirmed.

Policies to Reduce Unemployment (1/2)

Policy must be matched to the type of unemployment — demand-side for cyclical, supply-side for structural/frictional:

Monetary Policy — Rate Cuts / QE

Lower interest rates reduce borrowing costs → C↑ and I↑ → AD↑ → firms hire more workers → cyclical unemployment falls. QE also boosts AD indirectly. Most effective when unemployment is demand-deficient.

Eval: Ineffective for structural unemployment. Time lags 12–24 months. Limited at zero lower bound.

Expansionary Fiscal Policy

Government spending increases (G↑) or tax cuts (T↓) raise AD via the multiplier → output rises → cyclical unemployment falls. Direct job creation via public works programmes also possible.

Eval: Risk of crowding out. Budget deficit widens. Cannot fix structural mismatch. Multiplier may be small in open economies.

Education and Training

Investment in human capital reduces occupational immobility and structural unemployment. Apprenticeships, vocational training, and higher education all improve the match between worker skills and employer needs.

Eval: Long time lags — training takes years to feed through. Does not help those currently unemployed in the short run.

Policies to Reduce Unemployment (2/2)

Supply-side policies for structural and frictional unemployment:

Labour Market Flexibility

Reducing barriers to employment: reforming employment protection legislation, reducing union power, flexible contracts. Makes firms more willing to hire knowing they can adjust quickly. Reduces structural and frictional unemployment.

Eval: Can increase insecurity — zero-hours contracts and gig economy underemployment. Flexibility cuts both ways.

Improving Information / Job Centres

Better matching of workers to vacancies reduces frictional unemployment and its duration. Job Centre Plus, Universal Jobmatch, digital job boards, and careers guidance all improve market efficiency.

Eval: Cannot create jobs where demand does not exist. Limited impact on structural unemployment without accompanying training.

Regional Policy / Enterprise Zones

Targeted subsidies, tax breaks, and infrastructure investment to attract firms to high-unemployment regions. Addresses geographical mismatch — helps where jobs exist far from where unemployed workers live.

Eval: Risk of simply displacing activity from nearby areas rather than creating net new employment. Expensive if poorly targeted.

Hysteresis: When Recessions Leave Permanent Scars

What is hysteresis?

Hysteresis occurs when a temporary shock causes a permanent change in the economy's equilibrium. In the labour market, a cyclical recession can cause long-run structural damage — cyclical unemployment becomes permanent structural unemployment.

Mechanisms of labour market hysteresis:

Skills erosion: workers who remain unemployed for long periods see their skills deteriorate — they become less attractive to employers even when demand recovers.

Employer discrimination: long-term unemployed workers face stigma — employers use unemployment duration as a negative signal, creating self-fulfilling exclusion.

Reduced job search intensity: discouraged workers stop searching and leave the labour force (become economically inactive) — permanently reducing labour supply.

Insider-outsider theory: incumbent workers ('insiders') set wages ignoring the unemployed ('outsiders'). High wages persist even with unemployment — outsiders cannot price themselves into work.

UK Post-2008 Scarring

UK output remained ~15% below pre-crisis trend a decade after the financial crisis — evidence of significant hysteresis. Workers who lost jobs in 2008–09 showed persistently lower earnings and employment rates years later.

Youth Unemployment

Young people who experience unemployment early in their careers show persistent 'scarring' — lower wages and higher unemployment rates for years afterwards. The 2008 recession created a 'scarred generation' of young workers.

Hysteresis: Evidence & Policy Implications

Policy implication:
Hysteresis argues for rapid and aggressive demand-side stimulus during recessions — getting people back to work quickly before skills and attachment to the labour market erode permanently. The cost of delay is permanent, not temporary.

Real-World Example

COVID-19 and the furlough scheme: the UK government deliberately chose to prevent hysteresis by keeping workers attached to jobs. By subsidising wages (furlough cost ~£70bn), workers maintained skills and employer relationships — when restrictions lifted, employment recovered rapidly rather than becoming structural.

★ Bonus: Unemployment & Inequality (1/2)

The unequal distribution of unemployment:

Unemployment is not spread evenly across society. It disproportionately affects younger workers, those with fewer qualifications, certain ethnic groups, people in deprived regions, and those in low-skilled occupations.

Youth Unemployment

Young people (16–24) face structurally higher unemployment — less experience, fewer qualifications, more likely to be in seasonal/frictional work. UK youth unemployment rate typically 3× the adult rate.

Note: Scarring effects are most severe for those who are unemployed young — lost earnings and skills persist for decades.

Ethnic Minority Groups

UK data consistently shows higher unemployment rates for Black and Asian workers than for white British workers — even controlling for education and location. Discrimination and structural barriers play a role.

Note: Despite Equality Act 2010, ethnic unemployment gaps persist. Data also show significant differences within ethnic minority categories.

★ Bonus: Unemployment & Inequality (2/2)

Unemployment is also unequal by place and by health:

Regional Disparities

UK unemployment varies dramatically by region. Post-industrial areas (e.g. former mining communities, coastal towns) have persistently higher unemployment — geographical immobility prevents workers moving to where jobs exist.

Note: Regional policy has had limited success — 'levelling up' remains an aspiration rather than an achievement for many deprived areas.

Disability and Long-Term Sickness

People with disabilities or long-term health conditions face much higher unemployment and inactivity rates. Post-COVID, long COVID has added ~2m people to economic inactivity in the UK — a major emerging structural challenge.

Note: Work Capability Assessments have been widely criticised as poorly designed — many genuinely unable to work are pushed toward unemployment statistics.

Summary: Key Terms & Relationships

Key Term	Meaning
Unemployment rate	(Unemployed ÷ Labour Force) × 100. Measures share of active workers without a job.
ILO measure	Without a job, actively seeking work, available within 2 weeks. Quarterly survey. International standard.
Claimant Count	Number claiming Universal Credit as unemployed. Monthly, administrative. Usually lower than ILO.
Economic inactivity	Not in work and not seeking work — students, carers, long-term sick. NOT counted as unemployed.
Cyclical unemployment	Caused by insufficient AD — rises in recession. Reduced by demand-side stimulus.
Structural unemployment	Skills mismatch from changing industries. Most persistent. Requires supply-side policies.
Frictional unemployment	Between jobs — short-term, inevitable. Reduced by better job market information.
Seasonal unemployment	Demand varies by season. Statistics adjusted seasonally. Difficult to eliminate.
Technological unemployment	Automation/AI replacing workers. A growing 21st-century concern.
NRU / NAIRU	Natural Rate of Unemployment — frictional + structural. Rate consistent with stable inflation.
Phillips Curve (SR)	Downward sloping — short-run trade-off: lower U ↔ higher inflation.
Phillips Curve (LR)	Vertical at NRU — no long-run trade-off. Demand expansion only causes inflation.
Hysteresis	Cyclical unemployment becomes structural as skills erode and workers detach from labour market.