

The Causes of Unemployment in the UK in 1994.

At present, in the UK there are three main types of unemployment: frictional, real wage, and demand deficient (or Keynesian). Each of these, however, contains various subsets, and these must also be examined to obtain a sufficiently detailed picture of unemployment.

Frictional unemployment almost always exists, and very little can be done to reduce its level of existence to zero. It occurs when one worker moves jobs, and is considered to be unemployed between the two jobs. While such unemployment can be very short term, it is a continuous process, and thus will register on statistics.

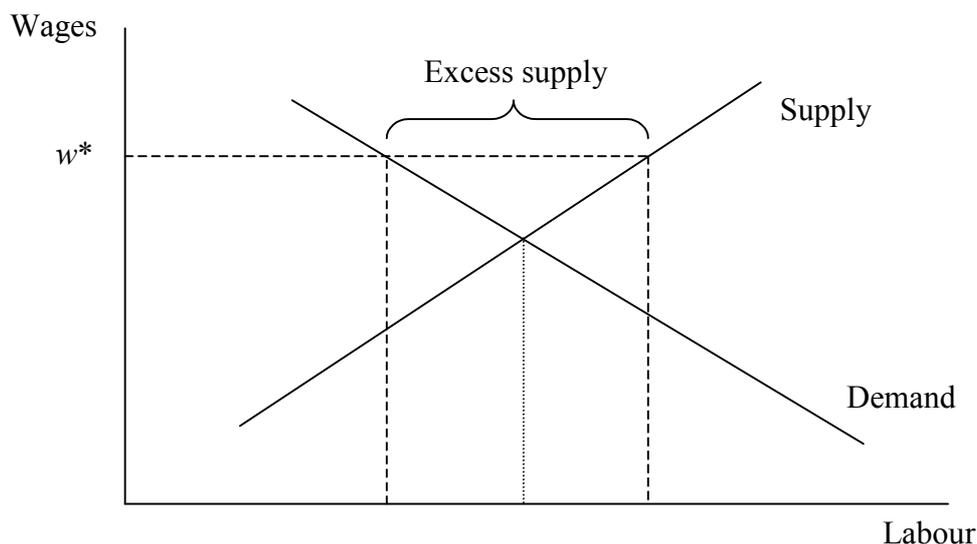
A more serious (and more curable) form of unemployment, similar to frictional unemployment, is search unemployment. This occurs when a worker does not take the first job he (or she) is offered, and thus is needlessly unemployed. It will be seen later that this does not fit under either the real wage or demand deficient headings, as the supply of labour for the unwanted industry shifts due to the reluctance of the worker to take the job. This reluctance may be due to several reasons, the most obvious being geographical or occupational immobility, excessively high expectations on behalf of the worker, or a need for higher wages (because of a mortgage, debt repayments, or so on).

Both of these forms of unemployment do exist in the UK at present, but not in extremely high amounts. As stated, frictional unemployment almost always exists, and the Government has tried to minimise the amount of search unemployment affecting the economy; this is discussed in my essay “Measures that Could be Used to Reduce the Level of Unemployment in the UK”.

The second major type of unemployment in the UK is a far more serious problem. **Real wage unemployment** occurs either in a basic form, or as cyclical unemployment. The latter can be split again, into the business (or trade) cycle, and the Kondratieff wave. These two can be represented in the form of waves (the first

with a time period of around five years, the second lasting fifty-seven years), and superimposed to give general cyclical patterns.

General real wage unemployment occurs when there is an excess supply of labour in the economy, due to the real wage rate (w^*) being set artificially high (thus above the market clearing level):

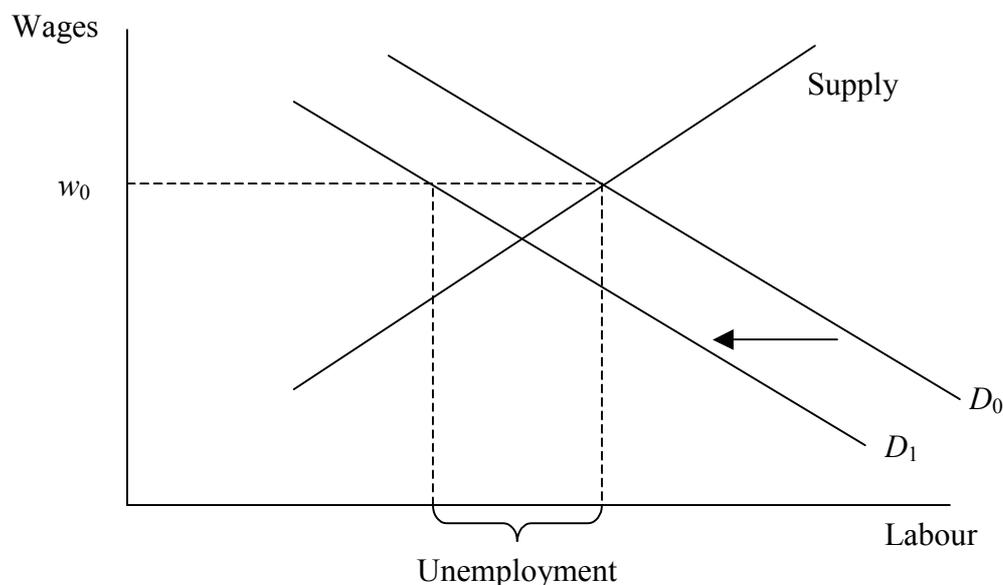


This may be due to a number of factors, but a set minimum wage, high benefit levels, and the existence of a poverty trap are the most common. The high wages may also be due to high expectations or needs, as found in search unemployment. It should be stressed, however, that search unemployment is not caused in the same way, because here the unemployment is in the whole economy; in search unemployment, unemployment only occurs in the industry where there was a vacancy and supply over the whole economy will remain the same.

Cyclical unemployment is, along with frictional, in existence for no real curable reason. It has been observed that approximately every ten years, industry and trade falls, and then picks up again. This phenomenon, known as the trade cycle, has not been clearly explained by economists, but it is widely regarded as an impurity in unemployment statistics. The influence of the cycle has waned in recent years, and this will be investigated later.

The Kondratieff wave does not only predict economic successes and failures, but world events as well. The wave was developed by Nikolai Kondratieff, and studied the advent of new inventions, wars, and of industrial nations in various years. His findings were published in the 1920s, and predicted the depressions in 1930 and 1987. This long-term cycle seems to be as strong as ever, and studies into its causes continue.

The idea of demand deficient unemployment was refined by Keynes, and it is this type of unemployment that has the most variations on a general theme. Demand deficient unemployment (generally) occurs when a deflationary gap exists in the economy, and thus aggregate supply exceeds demand:



It should be noted that, although both real wage and demand deficient unemployment are caused by excess supply, they differ in the level of equilibrium national output; the first assumes that the economy always has an equilibrium point at Y_{FE} (the level of output where there is theoretically no unemployment or inflation), whereas the second states that this is not necessarily true, and there may be an equilibrium level below that of full employment.

Keynesian unemployment can be studied as seasonal, structural (itself split into regional and sectorial), or technological unemployment, as well as in a general form. Each of these must be understood to be merely variations, and thus the main ideas remain as above.

Seasonal unemployment is, as the name suggests, Keynesian unemployment which varies with the time of year, or, indeed, any type of time period (other than those dealt with under cyclical unemployment; the results may be the same, but the reasons are different). Examples of this can be seen in agriculture (during the winter months), or party organisers (who will be in greater demand over Christmas, and at the end of decades, centuries and millennia).

Regional structural unemployment occurs when some geographic areas have high unemployment, while some have very little. This may be due to a lack of geographical mobility, high levels of external economies of scale, the different effects of a recession for various groups, or the purchase of goods for other areas. Sectorial structural unemployment is similar to this, except between occupational areas; this may be caused by high exchange rates, high expertise in existing industries, a short supply of raw materials, or foreign competition.

Technological unemployment is simply a shortage of demand due to technology, such as robots replacing car assemblers.

Both real wage and demand deficient unemployment exist in the UK, but it is a matter of debate which is the more important. It appears from the November 1994 budget that Kenneth Clarke believes real wage unemployment the more pressing problem, due to the number of measures taken to reduce this.

Demand deficient unemployment is currently caused by high interest rates (leading to high exchange rates and cheap imports; demand is considered to be elastic here) and restraints on government spending (especially concerning benefit payments, which reduces consumption). Both of these have a similar magnitude of effect, and therefore

it is equally advantageous to focus on either. There are a few other (relatively minor) causes; these include the large inflows of ‘hot money’ from overseas, and high levels of overseas investment.

Structural unemployment has been increasing due to privatisation. Most industries will have been affected if they supplied one of the formerly national industries with raw materials; the privatised industries can (and often do) go elsewhere if British firms are uncompetitive. Also, in many cases, the newly privatised industries will swap from break-even pricing (or average cost pricing) to profit maximising, and this inevitably leads to a fall in the quantity produced.

Real wage unemployment has been roughly constant for a period of around five years, but while the figures may have stayed the same, the reasons for their existence have not. In 1994, it can be seen that real wage unemployment was reduced due to a fall in trade union membership, restraints on public sector wages, and a growth in part time labour (part time labour is less likely to ask for higher wages, as they are in constant threat of unemployment). However, at the same time, real wage unemployment was being increased by oligopoly firms giving wage rises, increased National Insurance contributions (for employers, not employees), and an increase in the long term unemployed (who are considered to be unemployable, from insider outsider theory). If anything, real wage unemployment may have fallen, as this would help explain the rise in demand deficient unemployment.

Cyclical unemployment is, at present, not a large problem; the business cycle is near the peak, but the Kondratieff wave is on a downwards slope at present. As already stated, however, the business cycle’s importance is waning due to better management of the economy.

Demand deficient unemployment is therefore the main cause of unemployment in the UK in 1994, and measures should be taken to reduce this.

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*Tim Miller, October 1994.
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