

Help Wanted?

Impact of Unemployment Rates

Objectives:

- A** Explain unemployment.
- B** Discuss the impact of a nation's unemployment rates.



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So What?

Unemployment isn't a pleasant topic to think about. It's tough when people are out of work and looking for jobs that just don't seem to be available. However, unemployment is an unfortunate reality in every economy. How has unemployment affected you or someone close to you?

The effects of unemployment are felt by individuals, families, communities, and the nation as a whole. Learn more about the types, causes, and costs of unemployment.



Alex Slabodkin/iStock/Thinkstock

Out of Work

A perfect world

In a perfect world, every economy would achieve a state of **full employment** for all its workers. Full employment means that the economy is using all of its labor resources in the most efficient way possible. In other words, everyone who wants a job has a job, a job that s/he is well-suited for. Anyone who doesn't have a job has made a voluntary choice not to work.

As you can imagine, full employment is rare. When an economy does not achieve full employment, there is some level of non-voluntary unemployment present. The government attempts to keep tabs on this level by tracking the percentage of the labor pool that is currently seeking but unable to find work. This percentage is called the **unemployment rate**.

In the United States, the unemployment rate between 1948 and 2013 ranged from a low of 2.5 percent (in May 1953) to a high of 10.8 percent (in December 1982). The average unemployment rate over this time period was about 5.8 percent.

Find the unemployment rate for any month of any year after 1948 by clicking here—
<http://data.bls.gov/timeseries/LNS14000000>.

The unemployment rate is an important economic indicator that the government, economists, businesses, and consumers watch closely. However, it's important to note that it's a **lagging indicator**—it confirms what we already know about the economy, but it doesn't necessarily predict future trends. For example, if the unemployment rate went up last month, it reinforces other gauges that show the economy has been doing poorly. It doesn't, however, mean that the economy will continue to worsen in the near future.

If you're interested in learning more about economic indicators and which are "leading" or "lagging," visit
<http://www.moneycrashers.com/leading-lagging-economic-indicators/>.

Types of unemployment

Being unemployed simply means that one can't find a job, right? Not exactly. There are actually several different types of and reasons for unemployment, and being aware of them can help business owners, economists, and government leaders to gain clearer insights into the nation's economic situation. Let's take a look at some of the main types of unemployment.



Frictional unemployment. **Frictional unemployment** will always be present, even if the economy reaches full employment. That's because frictional unemployment is voluntary and results from normal life circumstances. Here are some examples of frictional unemployment:

- Rachelle quit her job at Target and is looking for something new with better hours.
- Aaron left his teaching job to go back to school and study engineering.
- Trina just graduated from college and is looking for a job in her field.
- Glenn is going back to work after being a stay-at-home dad for several years.
- Ingrid just moved from Kansas City to Chicago and is searching for a new job there.

Transitioning between jobs, changing careers, looking for a first position out of school, rejoining the work force after an extended absence, moving from place to place—there will always be workers in these types of situations, no matter how well or poorly the economy is doing. However, when the economy is poor, frictional unemployment tends to drop a bit, since many workers are reluctant to quit their current jobs to pursue new ones that might not be readily available.

For a humorous look at one person's experience with frictional unemployment, check out the TV show clip at <http://www.yadayadaeconomy.com/clip/39/>.

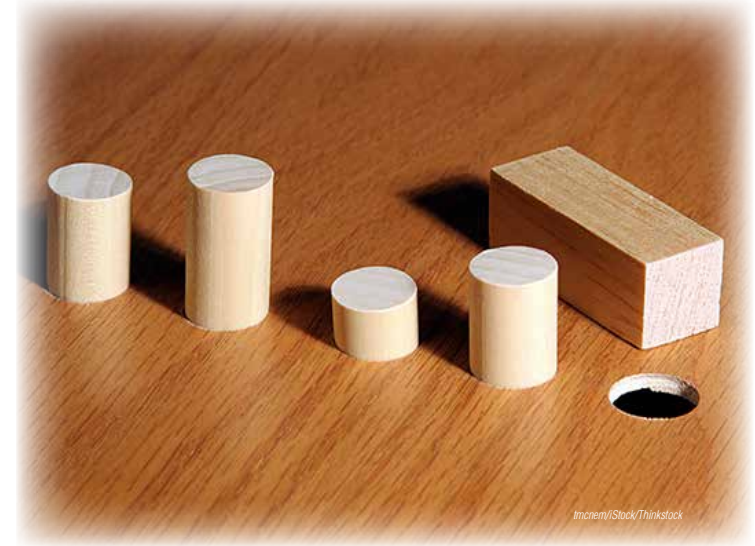


▲ *Normal life circumstances and voluntary changes result in frictional unemployment.*

Structural unemployment. **Structural unemployment** arises when there is a mismatch between available workers and available jobs. This doesn't simply mean that there are fewer jobs than there are workers, although that could be true. It might also mean that there are not enough workers qualified for the types of jobs that are available. Let's say you're an accountant looking for work. There are many job openings where you live, but they are for positions such as machinist, administrative assistant, marketing representative, etc. You haven't found anything that matches up with your education and experience. You're unemployed, but it isn't because there are no jobs available. It's because an appropriate job for *you* isn't available.

Technological unemployment is a kind of structural unemployment that occurs when advances in technology eliminate certain job positions. Examples of technological unemployment date back hundreds of years. Here are just a few:

- During the Industrial Revolution in the 1800s, many labor-saving machines were invented to make farming easier. This reduced the number of jobs available for farm workers.
- The invention of the telephone cut down on the number of workers needed to transmit messages by telegram.
- The advent of commercial air transportation reduced the number of people taking passenger trains, therefore reducing the number of employees needed in the rail industry.
- Video-game systems for the home put many arcades out of business, causing related jobs to disappear.



▲ *Structural unemployment occurs when people can't find the job that's the right fit for their qualifications.*

- ATMs took the place of many bank tellers.
- **Automated** manufacturing equipment has been replacing human workers for many decades.

As you can see, technology makes work easier, but it can also reduce the number of jobs available in certain industries. The jobs that remain are usually suited for highly trained or educated workers, meaning unskilled laborers are typically the first to lose their jobs and tend to stay unemployed for longer periods of time.

Technological advances do, however, increase the overall productivity of the economy and create jobs in new sectors. For instance, many displaced farm workers in the 1800s learned to build machines. The invention of the phone created jobs for manufacturers and operators. The airline industry opened up positions for pilots, mechanics, flight attendants, baggage handlers, and more. The video-game business employs designers, engineers, and even script writers. ATMs must be serviced and repaired by humans. And, automated manufacturing equipment still requires some amount of “real-life” input and supervision. Clearly, technology still benefits society, even though it can create some unemployment. However, new technologies require the rearrangement of human resources, a situation that can be uncomfortable for many workers.

Not everyone agrees that technological unemployment is offset by the benefits technology creates. Check out Aaron Frank’s article “Could Automation Lead to Chronic Unemployment?” at <http://www.forbes.com/sites/singularity/2012/07/19/could-automation-lead-to-chronic-unemployment-andrew-mcafee-sounds-the-alarm/>.



▲ *Technology makes work easier, but it can also reduce the number of jobs available in certain industries. For example, automated manufacturing equipment that can produce bread dough may put a baker out of a job.*

Seasonal unemployment is another type of structural unemployment that affects seasonal employees, such as farm workers, summer-camp counselors, lifeguards, ski-resort employees, tax-return preparers, etc. Obviously, these types of jobs are more abundant at certain times of the year than at others. The **United States Bureau of Labor Statistics**, the government agency responsible for calculating the unemployment rate, takes measures to exclude seasonal unemployment from the overall unemployment rate.

Seasonal workers who are unemployed aren't always eligible for government unemployment benefits. For more information, read Annalyn Censky's article "No More Unemployment Checks for Seasonal Workers" at <http://money.cnn.com/2012/05/31/news/economy/seasonal-unemployment-benefits/>.

Other reasons for structural unemployment include:

- Changes in consumer preferences (e.g., fewer jobs available in music stores now that people like to download their music from the Web)
- A lack of skilled workers
- A lack of available jobs where unemployed workers live (a situation that can worsen during bad economic times when it's difficult to sell a house and move)
- Political changes (e.g., a presidential administration with economic policies that make job creation difficult)
- Globalization (e.g., consumers' ability to go online and order a product from another country rather than patronizing a local business)



▲ *What happens to lifeguards employees during the winter? Seasonal unemployment means they may be out of work.*

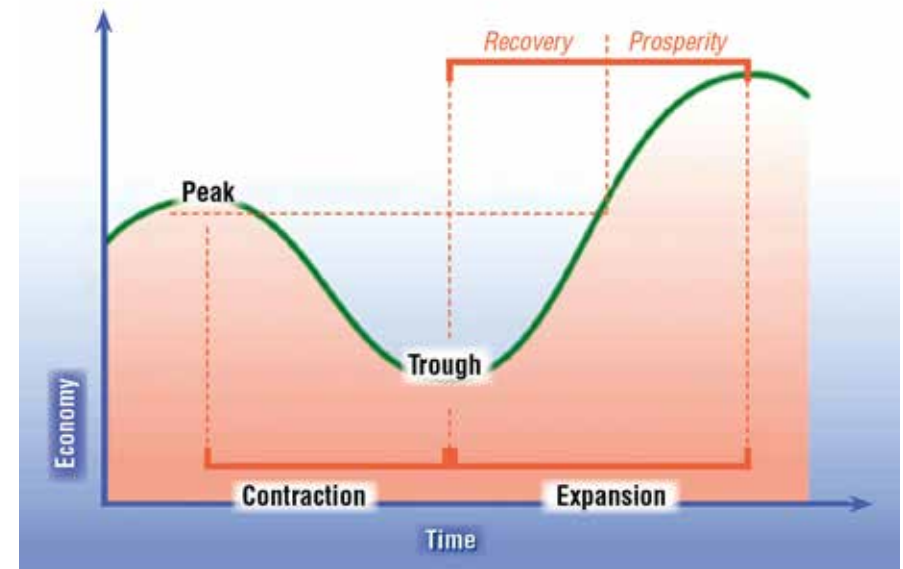
- A major corporation's **outsourcing** of jobs or bankruptcy
- The reduced competitiveness of one of the economy's main industries (e.g., the expense of manufacturing in the United States causing companies to move jobs overseas)

Structural unemployment is a long-term issue that can compound itself for many decades within an economy. It is a problem that economists and governments are constantly trying to address and solve.

Cyclical unemployment. Unemployment that rises and falls in rhythm with the ups and downs of the economy's **business cycles** is known as **cyclical unemployment**. When the economy is poor, consumers spend less, and there is less demand for products. When businesses create fewer products, they need fewer workers, and unemployment rises. Let's say you used to stop for coffee every morning on your way to school or work. However, you didn't receive your yearly raise because of poor economic conditions, and you've decided you should cut down on your spending. You reduce your coffee habit to just twice a week. If other consumers take similar measures, it could lead to lost profits for the coffee shop and unemployment for some of its workers.

Cyclical unemployment (sometimes called demand-deficient or Keynesian unemployment) can seriously worsen an already bad state of structural unemployment. We'll get into a little more detail now, as we look at theories of unemployment.

Business Cycles



- ▲ *Unemployment that rises and falls in rhythm with the ups and downs of the economy's business cycles is known as cyclical unemployment. When the business cycle is at its peak, unemployment is at its lowest. And when the business cycle is on the decline, unemployment increases.*

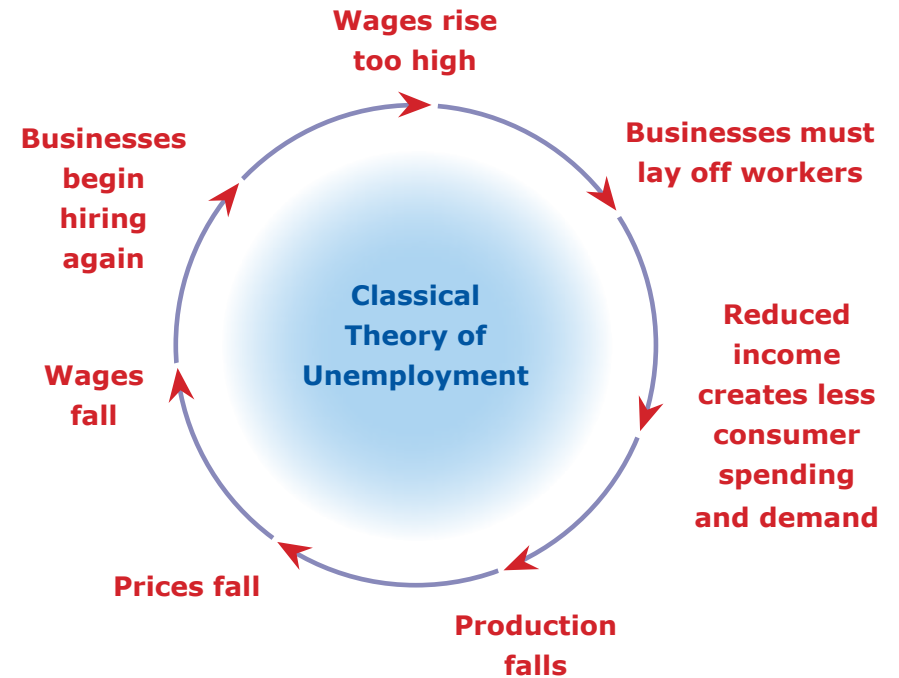
Theories of unemployment

Not all economists agree on what causes unemployment or how to fix it. There are two main theories of unemployment—classical and Keynesian. Let's explore both.

The classical theory of unemployment. The **classical theory of unemployment** states that unemployment goes through natural cycles of its own. It begins when wages rise too high. At that point, businesses can't afford to employ as many workers, and they have to lay off some of their employees. When more people are out of work, there is less spending and less consumer demand in the economy. When demand goes down, so do prices—and when prices go down, wages will eventually fall as well. As wages fall, businesses will again be able to afford to hire workers, and the unemployment level will correct itself (until wages rise again, setting off the entire cycle anew).

To an economist who holds to the classical theory of unemployment, the solution is cutting wages. If wages aren't allowed to rise too high, the cycle of unemployment can be stopped in its tracks. As you might imagine, most workers don't love this idea too much!

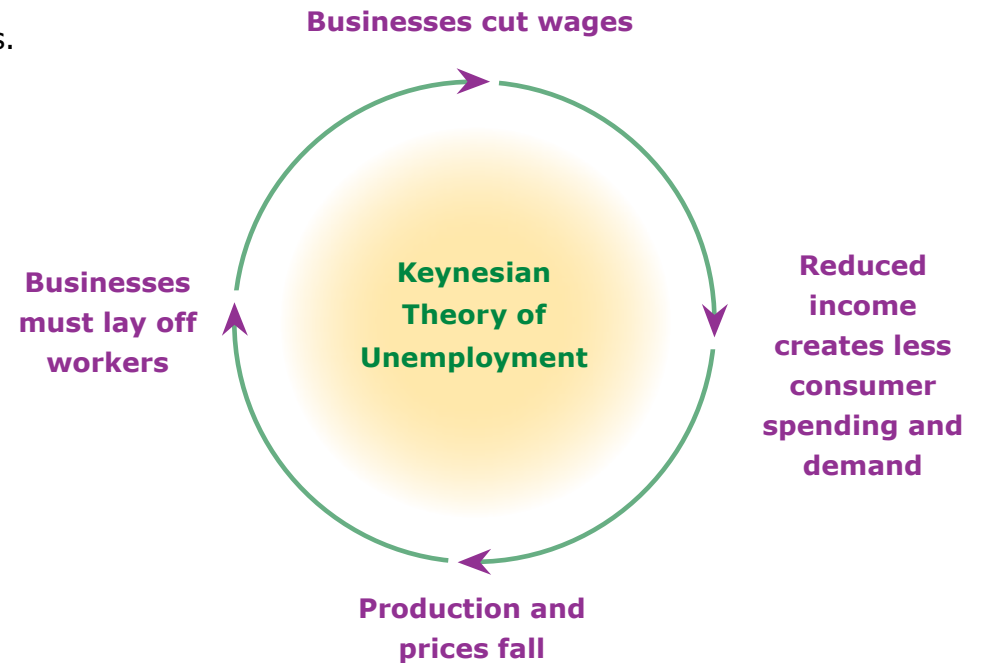
For a more in-depth look at the classical theory of economics, see <http://www.cliffsnotes.com/more-subjects/economics/classical-and-keynesian-theories-output-employment/the-classical-theory>.



The Keynesian theory of unemployment. The **Keynesian theory of unemployment** (named for famous British economist John Maynard Keynes) states that unemployment begins when businesses cut wages. Reduced income leads to reduced spending and consumer demand in the economy. Reduced demand leads to reduced production, which leads to layoffs and unemployment. It's the same cycle seen in the classical theory of unemployment; however, Keynesian economists view the cycle as beginning at a different point than classical economists do.

To an economist who holds to the Keynesian theory of unemployment, the solution is increasing consumer demand and encouraging spending, usually through a government **stimulus** (injection of money into the economy) of some kind.

For a more in-depth look at the Keynesian theory of economics, see <http://www.cliffsnotes.com/more-subjects/economics/classical-and-keynesian-theories-output-employment/the-keynesian-theory>.



The whole truth?

The unemployment rate is a key economic indicator; however, it does have its limitations. There are times when the unemployment rate tends to be understated (it's really higher than the number suggests), and there are times when the unemployment rate tends to be overstated (it's really lower than the number suggests).

During poor economic times, the unemployment rate is often understated. There are several reasons for this. First, there may be people who give up looking for work, having become discouraged from being unemployed for so long. These people are then categorized as "not in the work force" rather than "unemployed." They are not included in the unemployment rate because they are not actively seeking work.

The unemployment rate may also be understated because it does not include **underemployment**, a situation in which a worker is not working enough or is not using his/her skills effectively. When times are tough, people often take part-time jobs because working part-time is better than not working at all. However, the unemployment rate doesn't differentiate between full-time employees and part-time employees. It also doesn't take into account **wait unemployment**, a situation in which a worker wants a higher paying job, or a job that's a closer match to her/his experience and skills, but "waits" in another position until that job becomes available. Consider aspiring actors and musicians who wait tables until they get that big break!

Here's an article by Matt Nesto called "United States of Underemployment" that talks about understated unemployment rates due to underemployment—
<http://finance.yahoo.com/blogs/breakout/united-states-underemployment-why-wrong-jobs-propped-today-162511421.html>.

Classical and Keynesian are the two main theories of unemployment; however, some economists hold variations of these views or even "hybrid" views that contain some ideas from both.

During good economic times, the unemployment rate is often overstated. Many people who are contacted by the Bureau of Labor Statistics don't report their employment, sometimes because it isn't legal (e.g., working in an off-the-books gambling establishment), and they don't want to be prosecuted. Other people don't report their employment even when it *is* legal. They may not trust the government with the information, or they may be working a legal job while still collecting unemployment benefits and don't want to be caught. Another reason for overstatement of the unemployment rate is that it doesn't differentiate between involuntary and voluntary (frictional) unemployment. When the economy is good, there is more frictional unemployment as people seek better jobs, change careers, or move around.

Keep in mind that the Bureau of Labor Statistics calculates a monthly unemployment rate for over 200 million workers in the U.S. The number is never going to be 100-percent accurate, but it's close enough to trust as a good general measure of the country's unemployment level.

Another shortcoming of the unemployment rate is that it doesn't measure the *length* of a person's unemployment, which many people argue is a significant part of the overall unemployment picture.



- ▲ *Someone who works in an off-the-books gambling establishment might not want to report his/her employment to the Bureau of Labor Statistics. This can lead to the unemployment rate being overstated.*

Summary

Full employment happens when the economy uses all of its labor resources in the most efficient way possible. Full employment is rare, and there is usually a level of involuntary unemployment in the economy, in addition to frictional (voluntary) unemployment. Two main types of involuntary unemployment are structural unemployment (including technological and seasonal unemployment) and cyclical unemployment. The two main theories of unemployment are classical and Keynesian. The unemployment rate isn't perfect—it may be understated or overstated, depending on the state of the economy.

TOTAL RECALL

1. What is full employment?
2. How is unemployment measured?
3. What kind of economic indicator is the unemployment rate?
4. What is frictional unemployment?
5. What is structural unemployment?
6. What is technological unemployment?
7. What is seasonal unemployment?
8. What is cyclical unemployment?
9. What is the classical theory of unemployment?
10. What is the Keynesian theory of unemployment?
11. What are the limitations of the unemployment rate?

THE GRAY ZONE

How much responsibility do businesses bear for the unemployment rate? Workers often lose their jobs when businesses downsize, out-source, or replace human positions with technology. These cost-cutting measures can save businesses a lot of money and help them to remain profitable. Business owners would argue that many more employees would lose their jobs if they didn't take such actions. Some people, however, feel that businesses treat employees carelessly and impersonally, laying off low-level workers so the people "at the top" can get rich. What do you think?

Count the Costs

Unemployment, especially long-term unemployment, carries consequences for everyone—individuals, families, communities, businesses, government, and the nation as a whole. Here’s a closer look at unemployment’s impact on the world around us.

Costs for individuals and families

When a worker loses her/his job, the impact is usually felt almost immediately. Let’s consider a hypothetical situation with a worker named Karin. Karin has lost her job at the bank due to **downsizing**. Without any income, Karin’s standard of living goes down right away. She cannot afford to buy many of the goods and services she used to purchase for herself and her family.

Karin begins receiving unemployment benefits from the government, but they only amount to about 50 percent of her former salary. So, even though she can pay for the basics, she has to be very strict with her spending and eliminate extra expenses, such as dining out or ballet classes for her daughter. Like many workers in the U.S., Karin doesn’t have much in savings. She has to use what’s in her savings and retirement accounts to make ends meet. It’s a short-term fix that will have dire financial consequences down the road if she can’t rebuild those funds. If Karin doesn’t find new employment soon, she risks becoming trapped in the vicious cycle of long-term unemployment.



▲ *If you lose your job, the impact is usually felt almost immediately. And, if you don’t find new employment soon, you can face dire financial consequences.*

Long-term unemployment can be very detrimental to individuals and families. When a person is out of work for an extended period of time, her/his skills may get “rusty” and eventually erode. This makes it even more difficult to find work in the future. Long-term unemployment can also harm a person’s mental and physical health, which certainly has a negative effect on his/her family members as well. And, extended unemployment can make it very difficult for a family to pay for higher education for its children—a disadvantage that may follow them through the rest of their lives.

For a real-life account of the effects of unemployment on the individual, read Annie Lowery’s story “Caught in Unemployment’s Revolving Door.” You can find the article here— <http://www.cnbc.com/id/101204809>.

Costs for the economy and the nation

As you can see, the individual consequences of unemployment can be harsh. The consequences for the economy and the nation can be severe as well. As unemployment goes up, consumer spending and demand go down, dragging the entire economy with them. It can take years for an economy to recover from a **recession**.

When unemployment is high, the government pays more in unemployment benefits, food assistance, and **Medicaid**; however, at the same time, it collects less in tax revenue from personal incomes and sales. This can strap the government for funds and cause it to borrow more money or potentially raise **unemployment taxes** on businesses.



▲ *Economic and national consequences of unemployment can be severe. When unemployment goes up, consumer spending and demand go down, dragging the entire economy with them.*

A high unemployment rate causes many people to call for **protectionism** (policies that shield the domestic economy from foreign competition). Examples of protectionist policies include taxing imports (products coming in from other countries) or encouraging consumers to “buy domestic.” Protectionism may have some benefits, but it also tends to restrict trade and immigration in ways that may be unfavorable in the future. For instance, it can damage relationships with other nations.

Lastly, long-term periods of elevated unemployment are associated with increased poverty and higher crime rates. Studies show that people volunteer less often, and society as a whole suffers. It’s easy to see why the government takes the unemployment issue so seriously.

Unemployment isn’t just a problem in the United States. Check out this *Financial Times* video and accompanying article chronicling the issue of long-term unemployment for young people in Europe—
<http://www.ft.com/intl/cms/s/2/b9990f16-c43f-11e1-9c1e-00144feabdc0.html#axzz2lF5shKvi>.



▲ *Although shielding the domestic economy from foreign competition may seem like a good idea, the economy may actually suffer as a result of protectionism.*

Silver linings

As dreary as the unemployment discussion is, there are actually a few hidden positives to be found. Though paying unemployment benefits can be a drain on government funds, the practice does serve to stimulate the economy. Research shows that for every \$1 the U.S. government spends in unemployment benefits, it creates about \$1.65 in economic demand. This is because the spending creates a ripple effect—the unemployed worker uses the money to buy goods, which creates demand, which allows businesses to keep production up and current workers employed, and so on. These benefits work to stimulate the economy much faster than other relief measures, such as tax cuts.

Unemployment may drive people into habits of saving and spending they otherwise wouldn't have formed. Abbie, for instance, created a personal budget and cut down on her spending during the few months she was between jobs. Those habits stuck even after her income went back to normal, and her finances are now in great shape.

Unemployment can also force laid-off workers to reexamine their talents, skills, and desires, which may lead to more personal happiness as well as a better allocation of resources within the economy. For example, Jack was laid off from his job in the construction industry. It gave him the push he needed to pursue landscape design, a career he'd been interested in for years. If it weren't for his unemployment, Jack never would have wound up at his "dream job."



▲ *Unemployment isn't all bad news...there are some silver linings, too! Unemployment can even force laid-off workers to reexamine their talents, skills, and desires, which may lead to more personally satisfying jobs.*



Some unemployed workers take it a step further than Jack. Instead of seeking a new job or career, they decide to work for themselves. Self-employment and the creation of new businesses benefit individuals, society, and the economy. Often, these businesses are born out of the frustration of unemployment but go on to be successful enterprises that create new jobs.

Here's an inspiring success story about a business created from an unemployment situation! Read Fernando Alfonso III's article "How Craigslist Helped an Unemployed Family Start a Successful Business" at <http://www.dailydot.com/society/craigslist-start-business-terra-amico/>.

Summary

Extended unemployment affects everyone in the economy. Individuals and families reduce their standards of living and may drain their future savings. The economy slows down, and poverty and crime rates increase. There are, however, a few positives of unemployment. Unemployment benefits help stimulate the economy, and new businesses may be created.

TOTAL RECALL

1. What are the costs of unemployment for individuals and families?
2. What are the costs of unemployment for the economy and the nation?
3. What are the "silver linings" to unemployment?

Make It Pay!

What have you heard on the news lately regarding the unemployment rate? Is it up or down? How is the employment situation in the state or city where you live? Do you know anyone who is looking for a job? How long has s/he been out of work? Do you think the situation is likely to get better or worse in the near future?