



UNEMPLOYMENT PART II

Cessation of work is not accompanied by cessation of expenses.
Cato the Elder



Defining Full Employment

...the situation that exists when the official unemployment rate equals the natural unemployment rate.

Natural unemployment is the unemployment that is caused by frictional and structural factors in the economy.

Full employment is not the same as **zero** unemployment.



Seasonal Unemployment

- **Seasonal unemployment** is unemployment due to seasonal changes in employment or labor supply.
- At the end of each season, thousands of workers must go searching for new jobs, experiencing seasonal unemployment in the process.



Frictional Unemployment

Frictional unemployment is the brief periods of unemployment experienced by people moving between jobs or into the labor market.



Frictional Unemployment

- Frictional unemployment differs from other unemployment in three ways:
 - ▣ There is an adequate demand for the labor of the frictionally unemployed.
 - ▣ The frictionally unemployed have the skills required for existing jobs.
 - ▣ The job-search period will be relatively short.



Structural Unemployment

Structural unemployment is the unemployment caused by a mismatch between the skills (or location) of job seekers and the requirements (or location) of available jobs.



Cyclical Unemployment

Cyclical unemployment is the unemployment attributable to the lack of job vacancies – i.e., to an inadequate level of aggregate demand.

Cyclical unemployment is the difference between the official unemployment rate and the natural rate of unemployment.

The depression is an example of this type of unemployment. Jobs are not there due to recession.

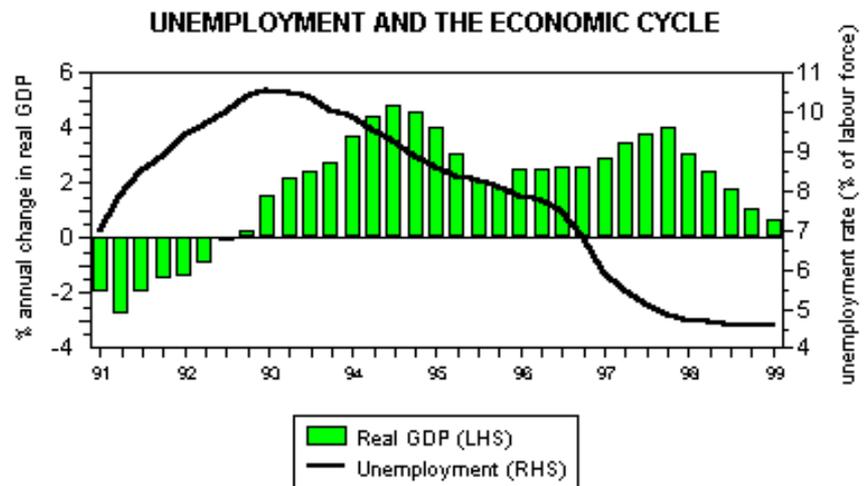
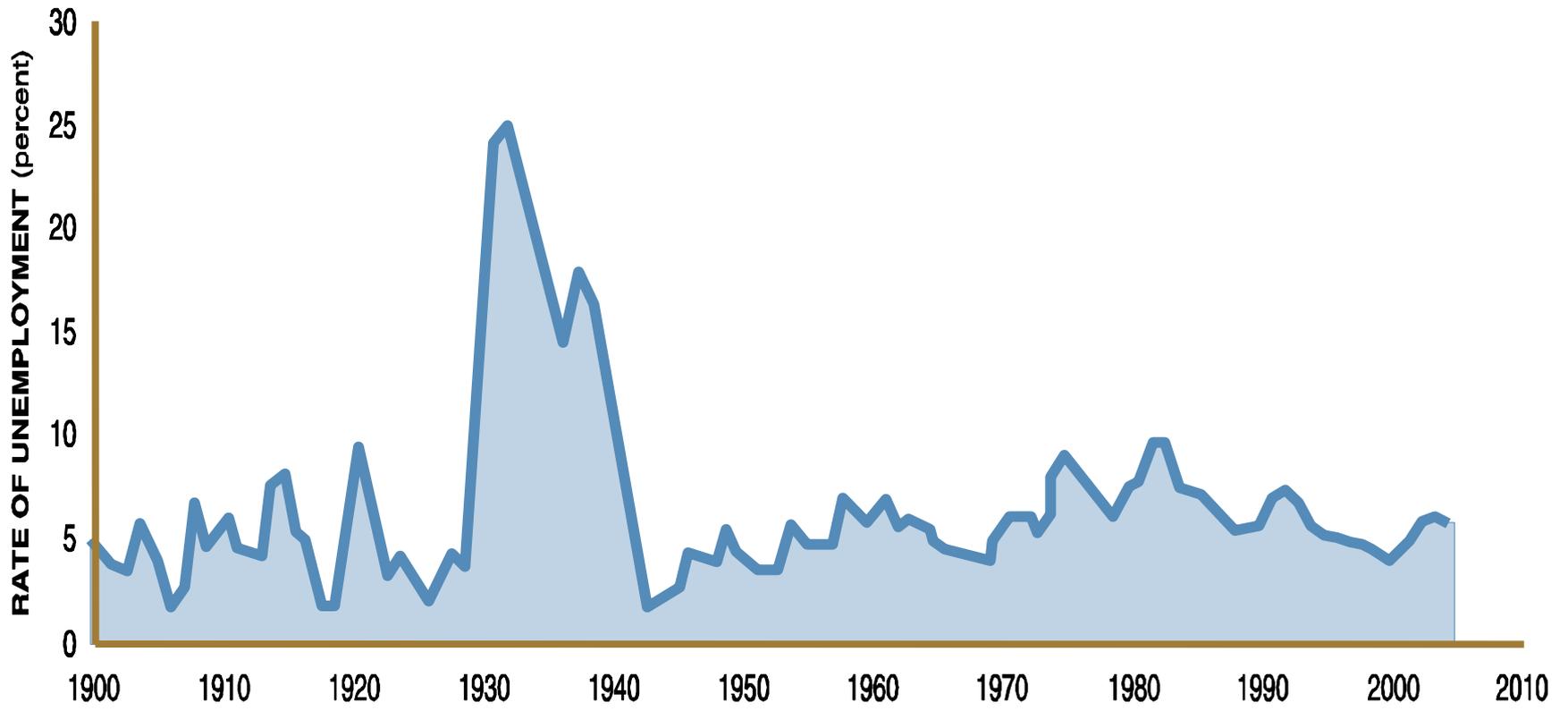




Chart: The Unemployment Record





Slow Growth

The economy must grow at least as fast as the labor force to avoid cyclical unemployment.



The Full-Employment Goal

- In the Employment Act of 1946, Congress committed the federal government to pursue a goal of “maximum” employment.
- Congress didn’t specify what the rate of unemployment should be.



The Full-Employment Goal

A full employment goal presumably means avoiding as much cyclical and structural unemployment as possible, while keeping frictional unemployment reasonably low.



Inflationary Pressures

- In the early 1960s, the council of economic advisors concluded that rising prices are a signal that employment is nearing capacity.
- The Council placed *full* employment at 4% - below that, prices begin rising.



Changes in Structural Unemployment

During 1970s and early 1980s the 4% unemployment goal was considered too high.



Redefining Full Employment

- Critics suggested that structural barriers to full employment had gotten worse.
 - ▣ more youth and women
 - ▣ liberal transfer payments
 - ▣ structural changes in demand



Redefining Full Employment

In 1983, the Reagan administration concluded that the “inflation-threshold” unemployment rate was 6% - 7%.



Declining Structural Pressures

- The structural barriers that intensified inflationary pressures in the 1970s and early 1980s receded in the 1990s.
- That made it easier to lower unemployment rates without increasing inflation.



The Natural Rate of Unemployment

- The **natural rate of unemployment** is the long-term rate of unemployment determined by structural forces in labor and product markets.
- The natural rate of unemployment consists of frictional and structural components only.



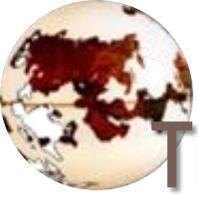
Congressional Targets

The Full Employment and Balanced Growth Act of 1978 (Humphrey-Hawkins Act) set 4% unemployment rate and 3% inflation as a national goal.



The Historical Record

- During the Great Depression as many as one-fourth of the labor force was unemployed.
- Unemployment rates fell dramatically during World War II and the civilian unemployment rate reached 1.2%.



The Historical Record

- From 1982 to 1989, unemployment fell, but shot up again in the 1990-91 recession.
- Unemployment fell steadily during the last half of the 1990s.
- The unemployment rate rose sharply in late 2001.



The Historical Record

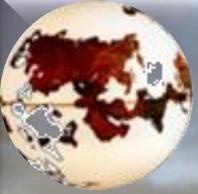
Since 1950, the unemployment rate has fluctuated from a low of 2.8% during the Korean War (1953) to 10.8% during the 1981-82 recession to 10.1% in the current recession.

The difference with the current unemployment are the large numbers of the long-term (6 months-1 year) unemployed (46%) and the very-long-term (more than 1 year) unemployed (23%).



The Historical Record

Many of the very-long-term unemployed eventually leave the labor force permanently, and some of those end up on the disability rolls. Very-long-term unemployment consequently generates adverse effects on the Treasury and on the capacity of the economy to grow in the long-run.



THE END

