**Unemployment Theories - Causes of Unemployment - Whose fault is it?**

There are many different possible causes of unemployment, and unfortunately for governments, it is never easy to identify which is the most important and what to do about it. The causes of unemployment can be split into two main types:

1. **Demand-side**
2. **Supply-side**

The first cause of unemployment (**demand-side**) is simply a lack of *aggregate demand*. When there isn't enough demand employers will not need as many workers, and so *demand-deficient unemployment* results.

Unemployment caused by **supply-side** factors results from imperfections in the labour market. A perfect labour market will always clear and all those looking for work will be working - supply will equal demand. However, if the market doesn't clear properly there may be unemployment. This may happen because wages don't fall properly to clear the market. This is shown in the diagram below:



Wages are initially too high and so unemployment of ab results (supply is greater than demand). To get rid of this unemployment and clear the market wages should fall. However, if they are *'sticky-downwards'* this may not happen and the unemployment may persist.

Supply-side unemployment may also happen because there is *occupationa* or *geographical immobility*. It may happen because there is poor information about job opportunities. This will lead to people taking a long time looking for jobs, increasing the level of *frictional or search unemployment*.

One final cause of unemployment which tends to be discussed less but is no less important, is changes in the workforce. The workforce is made up of people who are of working age and not currently in full-time education. Their number will change with the demographic (age) structure of the population. If there is a baby-boom (a rapid increase in the *birth rate*) then these people will become of working age between 16 and 21 years later. They then join the work-force. If there are the same number of people retiring from the work-force at the other end, then unemployment will stay the same. However, following a baby boom there are often more joining the work-force than leaving. This may increase unemployment, *unless* there are enough extra jobs created to employ the extra people in the work-force. This was one of the causes of unemployment in the early 1980s when people born in the baby-boom of the 1960s joined the work-force.

**Unemployment and the cycle**

The economy tends to follow a cyclical pattern of growth with boom periods and periods of lower growth or recession. This is known as the *trade cycle*. In the table below, fill in what you would expect to be happening to the economic variables given in a time of boom and recession:

|  |  |  |
| --- | --- | --- |
| **Economic growth** | **Unemployment(High or low?)** | **Inflation(High or low?)** |
| Boom / High growth |    |  |
| Recession / negative growth |    |    |

These changes in unemployment will also have a significant effect on the governments *fiscal policy* stance. Delete terms in italics as appropriate in the sentence below, to show the effect of higher unemployment on the government:

Lower growth in the economy often comes about because of *higher / lower* aggregate demand and as a result firms will tend to *increase / reduce* their workforce. As unemployment *rises / falls* the government will find that there are *more / fewer* people paying tax and so their tax revenue *rises / falls*. At the same time there will also be an impact on government expenditure. With *higher / lower* unemployment there will also be an *increase / decrease* in the number of people claiming benefits. This will mean that government expenditure will *rise / fall*.

**Who caused the unemployment?**

What are the causes of unemployment? (write cause in bold & brief explanation).

**Supplying unemployment?**

What is meant by unemployment caused by supply-side factors?

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What will be the effect on unemployment if the gap between benefits (for people out of work) and incomes (for people in work) is too low? Justify your answer.

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What could the government do to the level of taxation to improve this situation? Explain how this policy helps.