

Big Question: When is unemployment in equilibrium?

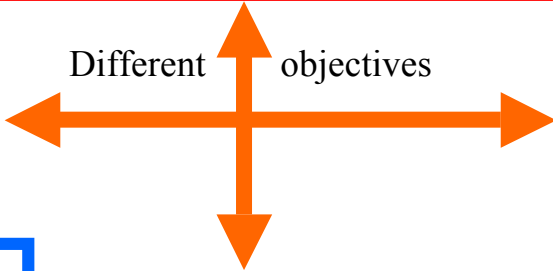
Government – while objectives are largely the same the priorities differ according to the political party

Firms

- ⊙ Profits
- ⊙ Market share
- ⊙ Competitors

Unions / labour

- ⊙ Higher wages/ benefits e.g. more vacation
- ⊙ Maintain pace with RPI- Retail price index
- ⊙ Wages are 'sticky' downwards



(A)
Types of unemployment

1. Frictional
2. Seasonal
3. Structural
4. Cyclical/ Keynesian or demand deficient (see C)
5. Hidden
6. Classical or real wage unemployment (see C)
7. residual unemployment

See webnote 309

(B)
Natural Rate of Unemployment
(monetarist / Friedman school – late 1960's)
Is there a natural rate of unemployment or an equilibrium rate of unemployment? Yes!
frictional + structural + seasonal unemployment = 'natural unemployment'.
This is clearly indicated in diagram A whereby at the market wage rate of W_e a natural level on unemployment exists in the economy the quantity of which is represented by ab or q_e or $q_e N$. See diagram A. Natural rate is that rate established by market forces. At this rate there is no tendency to change wages

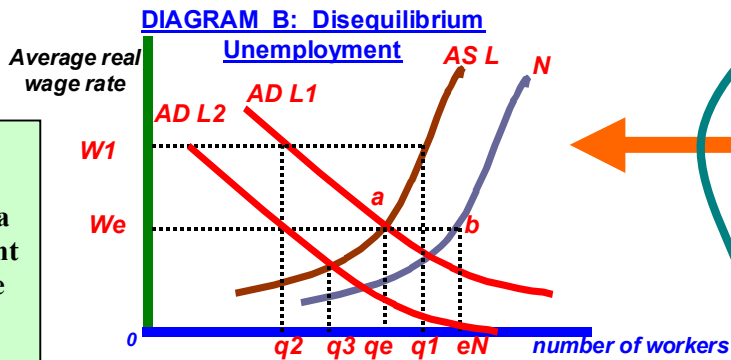
(C)
Disequilibrium

Disequilibrium rate of unemployment i.e. the labour market is not clearing.
Two possible causes:

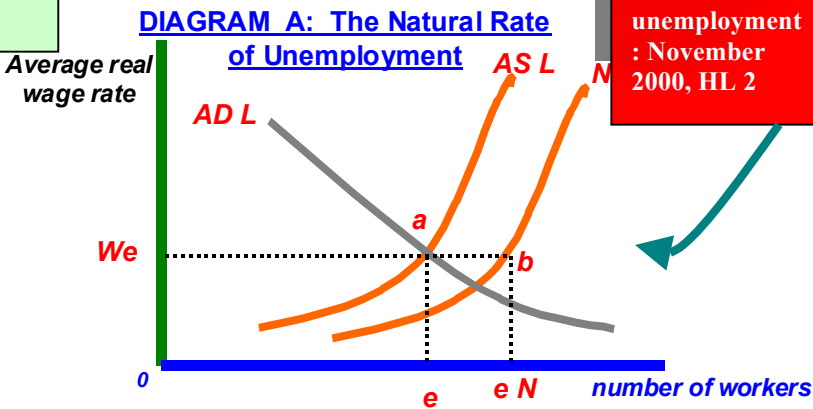
1. Classical or real wage unemployment
2. demand deficient or cyclical unemployment

Note: economists disagree as to which of the above causes disequilibrium unemployment

IB:
Explain two ways a government can reduce its natural rate of unemployment.
2008-Nov h2 q4



Note: the key issue here is that the labour market is in equilibrium at W_e a q_e



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IB: What is the natural rate of unemployment : November 2000, HL 2

(D)

1. Classical or real wage unemployment
 - ⊙ Trade unions
 - ⊙ Minimum wage legislation
2. Demand deficient or cyclical (Keynesian) unemployment
 - ⊙ Extends across whole economy
 - ⊙ See inflationary gap/ deflationary webnote 328
 - ⊙ Effectively caused by a fall off in AD for goods and services in the economy (AD L also falls) and whereby the labour markets do not clear
 - ⊙ Labour resists wage cuts and therefore unemployment occurs as labour wage rates do not adjust to the lower demand in the economy. Therefore we have unemployment between q_2 and q_e in diagram B