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## WHAT IS UNEMPLOYMENT?

5/99

**G R Steele**

**Q:** What is unemployment?

**A:** Unemployment is made up of individuals who, though they capable of work, are not in work, not in full-time education, and not in jail!

**Q:** What causes unemployment?

**A:** There are many causes. Most obviously, a person who insists upon a wage that is greater than the value of his work to a potential employer will remain unemployed.

**Q:** Isn't that an unlikely situation?

**A:** No-one should sell himself short. It is sensible to seek a high wage before settling for a lower one.

**Q:** How would you know what wage to ask for?

**A:** A worker, who becomes unemployed because his employer goes out of business, might hope to find a similar position at a similar wage; so that's what he might ask for. Economists call this setting a reservation wage.

**Q:** The reservation wage is set by the level in the worker's former job?

**A:** That's one possibility. Another is for the reservation wage to be linked to the level of welfare benefits. There is little incentive to accept work which pays less than benefit entitlements.

**Q:** I agree.

**A:** However the reservation wage is set, and at whatever level it is set, the job-seeker may be unsuccessful in finding an offer at, or above, that level.

**Q:** What then?

**A:** Well, re-training might be a possibility, or else he might decide to lower his aspirations (set a lower reservation wage) or even decide to remain unemployed.

**Q:** If a worker remains unemployed, does he continue to receive benefits?

**A:** Welfare entitlements are a matter for the state. These are political decisions, but payments to those who remain voluntarily unemployed are questionable.

**Q:** Surely, no-one wants to be unemployed. How can you call it 'voluntary'?

**A:** If a worker refuses to lower his job and wage aspirations and, in consequence, cannot find work, he is unemployed by his own volition.

**Q:** That's hard-faced!

**A:** You may think so; but if the value of a man's work lies below the value of his wage, he is benefiting from somebody else's effort. These raise all kinds of political issues which I think we should try to avoid in our discussion.

**Q:** Then let's get back to unemployment. If some unemployment is categorised as 'voluntary', there must also be some which is categorised as 'involuntary'. Right?

**A:** That *is* right; but take your reasoning further. Give me a definition of involuntary unemployment.

**Q:** It must be the exact opposite .... involuntary unemployment exists when workers lower their job and wage aspirations but are still unable to find work.

**A:** That's good; but why should that happen, when we are dealing with people who are capable of work?

**Q:** Please! I'm supposed to ask the questions. You deal with it!

**A:** As you wish. An economist - a very famous economist - John Maynard Keynes ....

**Q:** I've heard of him.

**A:** ... introduced this concept of involuntary unemployment against the background of the general economic malaise of the 1930s.

**Q:** I think I can recall something about this. If wages are cut, demand is reduced and the recession continues.

**A:** It certainly has been put that way, but if it were really that simple it would not have required any great intellect to formulate the proposition!

**Q:** I suppose not, but what is wrong with that admittedly very simple idea?

**A:** Try to reverse the argument

**Q:** If you increase wages, you increase demand and the situation improves.

**A:** Well?

**Q:** It sounds improbable ... but what then is meant by a 'high wage economy'.

**A:** Just that. A 'high wage economy' is either a vacuous proposition or an improbable proposition; but let's not become political!

**Q:** What did Keynes mean by 'involuntary unemployment'?

**A:** Suppose that, in a situation of high unemployment, *all* workers volunteer to work for a lower wage. Production costs are lowered, and this means that more goods and services can be produced.

**Q:** Which means that more workers can be hired.

**A:** Exactly, and the net additional income which they earn (plus rents, profits and interest) must precisely equal the value of the additional output produced. (After all, someone must receive the proceeds.)

**Q:** So the new income created by producing more is precisely the amount needed to buy the amount produced?

**A:** Yes.

**Q:** So the problem is solved. Unemployment falls.

**A:** Not according to Keynes. He argued that income recipients can either spend their new incomes or they can save it. If some is saved, the total amount of additional expenditure must be less than the amount produced as a result of hiring previously unemployed workers.

**Q:** So employers will have produced more than they can sell?

**A:** And in that situation, how would you expect them to react?

**Q:** I think they might cut their prices.

**A:** With the effect of lowering their profits and ....

**Q:** .... causing them to lay off workers.

**A:** Back to square one!

**Q:** Suppose they leave their prices unchanged ....

**A:** Sales would be even lower and production (and employment) would have to be cut still further.

**Q:** So there is no way out? Was that Keynes's argument?

**A:** Yes. Keynes said that workers were involuntarily unemployed if their willingness to accept a cut in their wages would not solve the problem of general unemployment.

**Q:** Did he suggest anything that might be done?

**A:** He said that the government should boost 'aggregate' demand by increasing its own expenditure.

**Q:** And does that work.

**A:** Well, it seems to .... in the short term; but the 'solution' is not without its own particular problems.

**Q:** Permit me a quick joke: an economist is someone who finds a problem in every solution!

**A:** I've heard it before, except that it was an economist - Brian Loasby - who said that 'a good economist ... is someone who has a difficulty for every solution'. I prefer his emphasis to yours.

**Q:** Hmmm. What are the difficulties with Keynes's solution?

**A:** In order to boost demand by government expenditure, that expenditure has to be paid for.

**Q:** Of course. What are the options?

**A:** Taxation, borrowing, and printing new money.

**Q:** So, where are the problems?

**A:** If taxation is increased, consumers might reduce their own expenditure. If more is borrowed, interest rates are likely to be forced up, and businesses might be forced to cut their expenditure.

**Q:** And if new money is printed ....

**A:** ... this has the tendency to cause the general level of prices to rise, so that people cannot afford to buy as much as previously.

**Q:** These were problems raised against Keynes's solutions?

**A:** Yes. In the 1930s, such arguments against Keynes were presented and referred to as 'the Treasury View'.

**Q:** That is not familiar to me

**A:** The same objections are now referred to as 'crowding out'; government expenditure 'crowds out' private expenditure.

**Q:** Ah yes. And does it?

**A:** By and large, the evidence seems to suggest that it does.

**Q:** What other reasons are there for unemployment?

**A:** In general, labour turnover is ever-present in the jobs market. Hiring, firing and quits are occurring all the time. For many reasons, workers seek (or are compelled to seek) new opportunities and, for a short period, they may be 'frictionally' unemployed.

**Q:** What if they quit on Friday and are hired the following Monday.?

**A:** Then there is no hiatus.

**Q:** Or they might take the opportunity for some time off?

**A:** Yes, they might wish to decorate a bedroom, take a break, or check a wider range of potential job opportunities.

**Q:** Is it really justifiable to categorise these as unemployed .... if, through their own choice, they remain out of work?

**A:** You seem to be suggesting that they are voluntarily unemployed? Earlier, I suggested something similar and you accused me of being hard faced!

**Q:** Can we stop there?

**A:** Perhaps we should!