

16 UNEMPLOYMENT AND INFLATION

OVERVIEW

1. The population is divided into those in the labor force and those not in the labor force. The labor force is divided into those employed and those unemployed but looking for work. Those unemployed but looking for work are called unemployed. The unemployment rate is the percentage of the labor force who cannot find work.
2. The unemployment rate may not measure the true amount of unemployment because some people become discouraged and do not even look for a job. Also some people may take jobs at skill levels below their abilities or can find only part-time employment. These people are underemployed.
3. Those unemployed can be classified by their cause of unemployment. Frictional unemployment involves those who are between jobs. Seasonal unemployment involves those laid off during the off season. Cyclical unemployment occurs because the economy slows down. Structural unemployment occurs when those unemployed do not have the qualifications for the jobs that are available.
4. Frictional and seasonal unemployment are expected and generally are of short duration. Cyclical and structural unemployment are not expected and are targets of policy action.
5. Full employment is usually defined as a percentage of the labor force unemployed. The exact percentage is a matter of dispute.
6. Full employment is desirable because the unemployed resources represent output that is lost to society. Furthermore, those unemployed bear the personal costs of unemployment.
7. Inflation is a continued rise in the average price level. The main cost of inflation is a redistribution of income.
8. Inflation has several causes. Demand-pull inflation is caused by an excess demand at full employment. Cost-push inflation is due to an increase in production costs. Supply shock results from infrequent drastic changes in the production cost of fundamental products. Expectations inflation occurs because we expect inflation to occur.

MATCHING - UNEMPLOYMENT

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|-------|-----|------------------------------|----|---|
| _____ | 1. | unemployed | | |
| _____ | 2. | labor force | a. | unemployment due to being in the off season |
| _____ | 3. | unemployment rate | b. | frictional plus seasonal unemployment |
| _____ | 4. | underemployment | c. | those employed and those unemployed but looking |
| _____ | 5. | frictional unemployment | d. | when workers cannot find jobs fully utilizing their skills |
| _____ | 6. | seasonal unemployment | e. | when the unemployed lack the skills needed for the jobs available |
| _____ | 7. | cyclical unemployment | f. | those actively looking for work but cannot find it |
| _____ | 8. | structural unemployment | g. | unemployment due to people relocating and between jobs |
| _____ | 9. | full employment | h. | around 4% of the labor force unemployed |
| _____ | 10. | natural rate of unemployment | i. | unemployment due to the economy slowing down |
| | | | j. | the number unemployed divided by the labor force |

MATCHING - INFLATION

- | | | | | |
|-------|----|------------------------|----|---|
| _____ | 1. | inflation | a. | when the inflation is caused by excess demand |
| _____ | 2. | hyperinflation | b. | a continued rise in the average price level |
| _____ | 3. | demand-pull inflation | c. | inflation due to a drastic change in the price of a fundamental product |
| _____ | 4. | cost-push inflation | d. | inflation that occurs because people expect prices to rise |
| _____ | 5. | supply-shock inflation | e. | when the inflation is caused by an increase in production costs |
| _____ | 6. | expectations inflation | f. | an accelerating increase in the price level |

TRUE-FALSE

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|-------|----|---|
| _____ | 1. | If the number employed rises, the unemployment rate falls. |
| _____ | 2. | Seasonal unemployment is caused by the ups and downs of the economy. |
| _____ | 3. | Frictional unemployment is one reason why full employment is not zero percent unemployment. |
| _____ | 4. | Inflation due to people expecting prices to rise is called demand pull inflation. |
| _____ | 5. | Inflation is a one-time increase in the price level. |

PROBLEMS

1. The numbers shown here are for the unemployed and the labor force for various years. Both are in thousands of people. Find the unemployment rate.

Year	1985	1986	1987	1988	1989
Unemployed	8,312	8,237	7,425	6,701	6,528
Labor force	115,461	117,834	119,865	121,669	123,869
Unemployment rate	_____	_____	_____	_____	_____

2. The data shown here is for the unemployed and labor force for different groups of the population (expressed in thousands). Calculate the unemployment rate for these groups.

1989	all women	all men	all teen	white	black
Unemployed	3,003	3,525	1,194	4,770	1,544
Labor force	56,198	69,360	7,954	106,355	13,497
Unemployment rate	_____	_____	_____	_____	_____

3. The following data shows the amount of unemployment in the 1980s. Explain why the Reagan administration focused on the employment data rather than the unemployment data. Which data do you believe tells the important story for the economy? Why? _____

Year	Employment	Unemployment Rate
1980	99,303,000	7.1
1981	100,397,000	7.6
1982	99,526,000	9.7
1983	100,834,000	9.6
1984	105,005,000	7.5
1985	107,150,000	7.2

IN THE NEWS

1. In the 1960s the economy was thought to be at full employment at 4 percent unemployment. The unemployment rate is now about 5.5 percent. We appear not to be at full employment.

- a. Is it reasonable to assume that what was full employment in the 1960s is full employment today? Explain. _____
- b. Why isn't the government doing more to reduce unemployment? _____
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2. Auto workers have been concerned that domestic auto producers are going to introduce highly automated plants with robotic equipment. This would cause widespread unemployment in an industry already badly hurt by imported cars. The communities where cars are built are heavily dependent on auto employment so if the employment in the auto industry goes down, there is no place for these displaced workers to find jobs. Unemployment in these areas will be severe and long term.
- a. If this situation occurred, how would you classify the unemployment?

- b. What solution would you suggest? _____
3. The basic economic reforms currently transforming the Russian economy will considerably reduce the role of state planning. Russia proposes to free some market forces, to reduce price controls, and to force businesses to compete. The removal of price controls, particularly on those goods that were priced below their cost of production, may result in inflation.
- a. What might cause inflation in Russia? _____
- b. If the inflation does in fact occur, what will the Russian government do? _____
4. During the administration of Lyndon B. Johnson, an effort was made to fight a war on poverty and a war in Vietnam. Both of these efforts together caused the demand for output in the economy to exceed full employment and inflation was the result.
- a. What type of inflation resulted? _____
- b. What could Johnson have done to avoid the inflation? _____
- c. What cost does the inflation impose on the economy? _____
5. A survey asks which is worse, unemployment or inflation. People who pick unemployment say that there is no greater tragedy than unemployed resources. Both the society and those unemployed are affected. People who pick inflation say inflation is like a tax that no one wants and hurts everyone.
- a. Do those who choose unemployment as the greater evil mean that inflation is not harmful? _____
- b. Do those who choose inflation as the greater evil mean that unemployment is not harmful? _____

PRACTICE TEST

Circle the correct answer.

1. The labor force is made up of:
 - a. those employed.
 - b. those unemployed and not looking for work.
 - c. those unemployed and looking for work.
 - d. both a and c.

2. Types of unemployment include all but:
 - a. seasonal.
 - b. cyclical.
 - c. contractual.
 - d. structural.

3. Use the rule of 72 to determine the number of years it takes for the value of your money to fall in half when the inflation rate is 9 percent.
 - a. 6 years
 - b. 8 years
 - c. 9 years
 - d. 10 years

4. The expression "too much money chasing too few goods," describes:
 - a. demand-pull inflation.
 - b. cost-push inflation.
 - c. hyperinflation.
 - d. supply-shock inflation.

5. Types of inflation include all but:
 - a. expectations.
 - b. supply-shock.
 - c. consumer.
 - d. demand-pull.

ANSWERS

Answers – Unemployment and Inflation

Matching - Unemployment

1. f
2. c
3. j
4. d
5. g
6. a
7. i

- 8. e
- 9. h
- 10. b

Matching – Inflation

- 1. b
- 2. f
- 3. a
- 4. e
- 5. c
- 6. d

True-False

- 1. T
- 2. F
- 3. T
- 4. F
- 5. F

Problems

1.						
	Year	1985	1986	1987	1988	1989
	Unemployment rate	7.2	7.0	6.2	5.5	5.3
2.						
	Group	all	all	all	white	black
		women	men	teen		
	Unemployment rate	5.3	5.1	15.0	4.5	11.4

3. When there is a recession, the administration wants to emphasize the positive. While there was a dip in employment, there was an increase in employment in 1983. This might say that the economy was improving. The important question is whether there are enough jobs for all who want one. This question is not addressed by the employment figures but is answered by the unemployment rates.

In the News

- 1. a. We cannot assume that 4 percent should be full employment in the 1990s just because it was in the 1960s. The labor force has changed. Changes in the labor force may change the natural rate of unemployment. If so, full employment may occur at a level of unemployment higher than 4 percent. The full employment rate may not be 4 but may not be 5.5 either.
- b. The unemployment rate has been reduced recently from over 7 percent to the current 5.5 percent. If 5.5 percent is close to the actual rate of full employment, further

reductions will be quite difficult to accomplish. Also, unemployment is not the only economic problem of the government. For example, the national debt is at a record level and the balance of trade deficit causes concern. Inflation, too, is a significant concern and in Chapter 27 we will see that the solutions to inflation may only increase unemployment.

2. a. These workers would be structurally unemployed.
- b. The best choice might be to retrain the workers and then provide them with incentives to move where there are jobs. The problem is not that there are not enough jobs for them, but that the jobs may not be where they are or for their current skills. Remember that labor and other resources are capable of satisfying some of our unlimited wants. There are more "jobs" for resources than there are resources. The difficulty is getting the resources allocated.
3. a. One cause of inflation is demand-pull. But for demand-pull to continue there has to be a continued increase in buying power. If the level of additional income does not rise too quickly and there is not too much money in circulation, there may not be demand-pull inflation. Cost-push inflation would occur as the price of goods used as inputs goes up. This would mean that costs of production would rise, and prices would rise to cover the added cost.
- b. The Russian government could take some money out of circulation. This will reduce the buying and demand-pull pressure. If necessary, Russia could again administer prices.
4. a. Demand-pull inflation resulted.
- b. Johnson had several alternatives. He could have reduced the "war on poverty" or the war on Vietnam or both. In previous wars we raised taxes, forcing consumers to spend less and reducing total demand on the economy. These resources would then be free to flow to the war effort with less competitive pressure on prices.
- c. The inflation hurt those whose income did not keep up with it. Thus the burden was felt by those who could least afford it.
5. a. Of course inflation hurts everyone. But those who are more concerned about unemployment may see inflation as something that can be fixed. Make sure that everyone's income goes up at the rate of inflation. Then no one is badly hurt by the inflation. They prefer to face rising prices than stable prices with no job and no income.
- b. Those who believe inflation is the greater evil realize that unemployment costs the society. But they may be afraid that more inflation would lead to even further unemployment. They also believe that some unemployment is voluntary.

Practice Test

1.d., 2.c., 3.b., 4.a., 5.c.