UNEMPLOYMENT is costly in many ways. Apart from the human suffering, the economy as a whole suffers through loss of output and the cost to taxpayers of welfare benefits. Yet despite such waste and despite reams of learned economic articles, governments have failed to solve the problem.

Few people remember when unemployment in OECD countries averaged a modest 2-3% of the labour force during the 1950s and 1960s. Today, a record 35m people, or 8.5%, are on the dole, up from 25m as recently as 1990. Some countries have been hit harder than others: Japan's official jobless rate is only 2.9%, Spain's is a horrendous 23.1%.

Indeed, Europe as a whole is an unemployment black spot: the average jobless rate in the European Union (EU) is expected to hit 12% this year, almost double America's 6.5%. It was not always so. In the 1960s and 1970s America's unemployment rate was twice Western Europe's (see chart 1). It is only since the early 1980s that Europe has had a higher rate than America. While America's current jobless rate is slightly lower than in 1980, Europe's dole queues have lengthened unremittingly over the past two decades, from 2.4% in 1970, to 6% in 1980, to almost 12% now.

 Movements in unemployment reflect the difference between the growth in the labour force--ie, people who are looking for jobs--and the change in employment. The size of the labour force depends on the growth in the population of working age and the proportion who want to work. More women, for example, have joined the labour force over the past few decades.

The faster the growth in the labour force, the faster employment must grow simply to hold unemployment steady. Demographic changes are therefore sometimes blamed for the rise in European unemployment over the past decade. Europe's labour-force growth did accelerate in the 1980s as the baby boomers of the 1960s became job-seekers. But this does not explain the different paths of unemployment in different countries: the labour force in the EU actually grew more slowly in the 1980s (0.8% a year) than in America (1.7%).

Europe's big problem has been its failure to create jobs. Since 1960 employment has risen by 84% in America and by 46% in Japan; over the same period, European employment has risen by a paltry 6% (see chart 2).

 Countries measure unemployment in different ways, so national jobless rates are not always strictly comparable. One method of compiling the figures, used in America, is through a household sample survey which asks people whether they have a job, and if not, whether they have been looking for one. Only those who are actively seeking work are counted as unemployed.

Most West European countries simply count those who register at government job centres or who are claiming benefits. The snag with this is that they thus exclude those who lose their jobs but are not eligible for benefit. On the other hand, they may include some "scroungers", who are illegally claiming benefits while working in the black economy (see box on next page). But in all countries, official jobless figures understate the true amount of slack in the labour market, because they exclude discouraged workers who, after long spells of unemployment, have given up looking for a job.

 Working it out

If unemployment figures are suspect, an alternative measure is the employment rate--the proportion of the population aged between 15 and 64 that have jobs. This gives a less gloomy picture (see chart 3 on next page). Although unemployment in OECD economies has more than doubled since the early 1970s, the average employment rate has risen. The proportion of working-age Americans with jobs jumped from 62% in 1972 to 71% in 1992. Japan's employment rate rose from 70% to 74%. In most EU countries, however, it is broadly the same or slightly
lower than 20 years ago. The proportion of Europeans with jobs is also lower than in America or Japan. In France, only 59% of 15-64-year-olds have jobs.

These changing, and varied employment rates make it hard to speak, as politicians often do, of "full employment". Once, this meant full-time, life-long jobs for all men. Times have changed. In Britain, just one job in three is now "normal" in the sense of being "nine to five", five days a week: an increasing number of jobs are part-time or contract work; and women will soon account for half of all workers.

Full employment is crudely defined as when everybody who wants to, can work. But even in an ideal world there will always be temporary unemployment. In the 1950s and 1960s most governments defined full employment as a jobless rate of 3%. Today, half of the 24 OECD countries have jobless rates of 10% or more.

Four of a kind

Economists have traditionally distinguished between four types of unemployment.

- Seasonal. Construction workers are often laid off in the winter, while ski instructors are jobless in the summer. There is little the government can do about this type of unemployment--short of investing taxpayers' money in indoor snow domes.

- Frictional. There are always people changing jobs, shifting between companies, or moving from one region to another. Again, this sort of unemployment can never be eliminated; but efficient job-information services can help to minimise it.

- Cyclical. Unemployment always rises in recession, then falls during a recovery. The recent recession clearly carries some blame for high rates of unemployment, but only some. Europe's unemployment rate, for example, has averaged 10% over the past decade, even though economies were booming for much of that period.

- Structural. This is when workers remain jobless long after economies recover. The unemployed may have the wrong skills or be unwilling to move to a region with better job prospects.

Economists fall into two camps. Keynesians blame high unemployment on inadequate demand. In the 1930s, when jobless rates soared above 20% in America and Britain, a British economist, John Maynard Keynes, argued that the cure for unemployment was to stimulate demand by increasing public spending or cutting taxes. In the 1950s and 1960s Keynesian demand management seemed to do the trick. Unemployment stayed low. But since the early 1970s, it has ratcheted up in each cycle. An increasing proportion of unemployment is clearly structural. So the second camp, neo-classical economists, argues that the real problem is that labour markets are over-rigid, over-regulated and over-priced—in other words, that workers have priced themselves out of jobs. Today, most economists accept that both forms of failure exist.

Europe, in particular, is riddled with rigidities that prevent the labour market from clearing. For example, trade unions or minimum wages put an artificial floor under wages. Instead of protecting workers as intended, they actually push some out of a job. Likewise, over-generous benefits discourage the unemployed from seeking work, while high labour taxes deter employers from hiring more workers. It is surely no coincidence that America's more flexible job market—with lower trade-union membership, lower labour taxes and less generous jobless benefits—delivers a lower unemployment rate than in the EU.

Americans, however, fret more about the quality of their jobs. A common worry is that America's success in creating employment has been bought at the price of creating an underclass of working poor. America has created more jobs because, unlike in Europe, real wages have been allowed to fall at the bottom end of the wage scale. Low-skilled men with 12 years or less of schooling saw their real wages drop by an average of 20% in the 1980s. Wage inequalities between skilled and unskilled labour
have widened sharply.

In Japan, wage flexibility has taken another form. When the economy dips into recession, companies cut wage costs not by laying off workers but by reducing the overtime and bonus payments that account for a quarter of their pay bills. This system of life-time employment worked well for decades, allowing firms to build up a loyal, well-trained workforce. Japan's jobless rate has not exceeded 3% since the second world war. But Japan's current recession has been so severe that firms are now overburdened with excess workers. They have so far tried to avoid sackings, by trimming working hours and encouraging early retirement, but more job cuts look inevitable. Indeed, part-time and casual workers have already suffered: some economists reckon that Japan's true jobless rate is almost 10% once such "discouraged" workers (mainly women) are taken into account.

Fear of the future

America seems to offer European governments some lessons on how to cut unemployment. But doomsters warn that even when economies recover and if labour markets are deregulated, jobs will not return. Technological change and increased competition from low-wage developing countries, it is argued, will leave ever more workers idle. Robots will build cars and computers will handle bank accounts. Yet men have fretted about being replaced by machines ever since the invention of the printing press. Each technological advance can create a temporary rise in unemployment, but despite continuous mechanisation, there has not been a steady increase in unemployment over the centuries. Instead output, employment and living standards have risen.

Behind the phobia about new technology lies the notion that the amount of output is fixed, and so more machines must mean fewer jobs. But the amount of output is not fixed. If new technology boosts productivity it will reduce prices which, in turn, will boost demand and so create new jobs to offset those lost to machines. In the long run, therefore, new technology need not be job-destroying. The snag is that the workers who lose their jobs to machines are often not equipped with the right skills needed for the new jobs.

The second fear--of competition from low-wage countries--is also exaggerated. True, this may hasten the decline of employment in basic manufacturing industries, but as poor countries grow richer by selling their widgets to rich ones, employment will expand in skill-intensive and service industries in which rich industrial countries are competitive. Does it matter if manufacturing shrinks? Some people think so. Yet America, which has seen the fastest decline in manufacturing as a share of its economy, has also enjoyed the biggest overall increase in jobs.

Issues such as deindustrialisation and the "threat" from the third world will be examined in detail in later briefs. But before that we will explore how government policy can help or hinder the working of labour markets. John Kennedy said, "We believe that if men have the talent to invent new machines that put men out of work, they have the talent to put those men back to work." The coming years will put those talents to the test.

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The jobs gap

Employment
1960=100

Total 1992, m

United States
188

Japan
64

European Union
140

Source: Datastream