



Unemployment/Full Employment - Frictional / Structural / Cyclical

by Sophia



WHAT'S COVERED

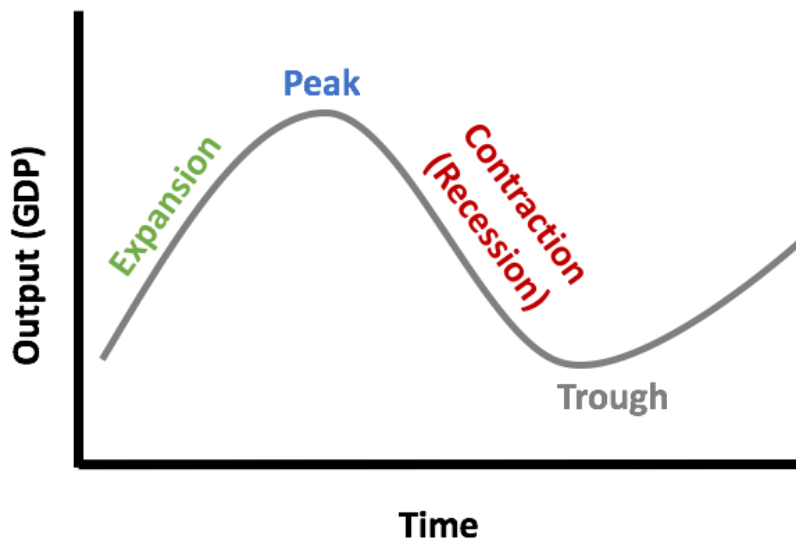
This tutorial will cover the different types of unemployment.

Our discussion breaks down as follows:

1. Measurement of Unemployment
2. Types of Unemployment
 - a. Frictional Unemployment
 - b. Structural Unemployment
 - c. Cyclical Unemployment
 - d. Natural Rate of Unemployment/Full Employment

1. Measurement of Unemployment

Let's begin by revisiting the business cycle, shown below. As you may recall, it is common and natural for our economy to go through periods of growth and contraction.



Now, when most people consider the business cycle, they are concerned about things like the unemployment rate and inflation. Economists use all kinds of data to help us predict where the economy is headed, to explain what has just occurred in the economy, and to look at what is currently happening in the economy.

However, calculating and understanding unemployment is a huge part of this, which is what we will focus on today.

The **Bureau of Labor Statistics (BLS)** is the government agency that produces the Employment Situation report, of which the unemployment rate is one significant statistic.

So, how do they measure unemployment? Well, to be unemployed, you have to be a person 16 years of age or older who is not working, is available for work, and has made efforts to find work during the last four weeks.

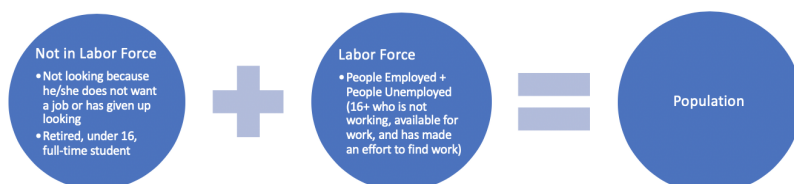


Keep in mind that because of this definition, the unemployment rate does not actually represent the full number of people who are actually unemployed.

Now, it is important to clarify a few terms before we continue our discussion on unemployment. Many people are just not in the labor force, a point that many people neglect to understand.

⇒ **EXAMPLE** For example, a person who is not looking for work, either because they do not want a job or they have given up looking, is considered to be not in the labor force. Also, people not in the labor force would include anyone who is retired, anyone under age 16, and generally, any full-time student.

It is essential to understand that the labor force is not the total population. It is the number of people employed plus the number of people unemployed. The population is comprised of people in the labor force, as well as people *not* in the labor force.



Sometimes people think that unemployment is measured over the entire population, but it really is a measurement based on the people in the labor force.

It follows, then, that the unemployment rate is the number of people unemployed divided by the labor force, *not* the population.



FORMULA TO KNOW

Unemployment Rate

$$\text{Unemployment Rate} = \frac{\text{Unemployed}}{\text{Labor Force}} = \frac{\text{Unemployed}}{\text{Employed} + \text{Unemployed}}$$



TERM TO KNOW

Bureau of Labor Statistics (BLS)

The government agency that produces the Employment Situation report of which the unemployment rate is one statistic

2. Types of Unemployment

Now, it is important to understand that there are different kinds of unemployment. The reason this is important is that depending on the cause of the unemployment rate at the time, the government may want to take action.

However, two of the three types of unemployment we will cover today are immune to government intervention, so if either of these types is making up the unemployment rate, then there is no cause for action.

2a. Frictional Unemployment

The first type of unemployment that exists is called **frictional unemployment**, which is natural separation from employment. This underlies the natural rate of unemployment, which we will discuss later in the tutorial. These are employees looking for positions that are, in fact, available.

They are unemployed because they are changing jobs, for instance:

- Recent college graduates looking for first jobs
- People making career changes
- People relocating to a different city

This type of unemployment is typical, and it will always exist. It does not suggest that anything is wrong with the economy.



TERM TO KNOW

Frictional Unemployment

Unemployment = natural separation from employment; underlies the "natural rate of unemployment."
Employees looking for positions that are available.

2b. Structural Unemployment

The second type of unemployment is called **structural unemployment**, which is unemployment resulting from changes in the structure of the economy.

Our economy is constantly changing how we produce goods and services. We have a very dynamic economy, so people's skills do not match the skills necessary for jobs all of the time. This can be caused by a variety of reasons, such as:

- New technology
- New resources
- Changes in consumer demand
- Globalization
- Lack of education

⇒ **EXAMPLE** For example, the invention of computers means that there is really no longer a need for typewriter repairers. These people would not have the skills necessary today to do the jobs that are available.

This type of unemployment can be painful and difficult for people, but it does not mean that we should necessarily revert to old and outdated methods of production. It also does not suggest that anything is wrong with the economy. It is a standard type of unemployment that results from a dynamic economy that is always changing.



TERM TO KNOW

Structural Unemployment

Unemployment resulting from changes in the structure of the economy

2c. Cyclical Unemployment

Now, there is a type of unemployment that is *not* part of a healthy economy, called **cyclical unemployment**. It is called cyclical unemployment because it follows the business cycle. It falls as the economy expands, and increases, unfortunately, as the economy slows.

This is the type of unemployment that we see whenever we are in a recession or depression. Cyclically unemployed people are typically people who do have the current skills for current jobs. They are not structurally unemployed, but they simply cannot find a job because of the slow economy.

Cyclical unemployment does move with the business cycle, but it generally lags, meaning that people do not tend to actually get their jobs back until after the economy has begun to recover.

Businesses are slow, waiting to see if the economy is actually entering a recovery before they start to hire people back. This is what we sometimes refer to as a "lagging indicator" in the economy.



TERM TO KNOW

Cyclical Unemployment

Unemployment that follows the business cycle; falls as the economy expands and increases as the economy slows

2d. Natural Rate of Unemployment/Full Employment

Natural unemployment is the type of unemployment that occurs naturally due to people changing jobs--that frictional unemployment that will always occur--and a dynamic or changing economy, or structural unemployment, where people's skills just do not match what is necessary for the jobs available today. This is the rate of unemployment when the economy is operating at full capacity.



DID YOU KNOW

Most people suggest that this rate is somewhere around 5%, although some people think that this is starting to increase slightly and that our frictional plus structural unemployment might actually be a bit higher than 5%. Certainly, in some European countries, it is definitely higher than 5%. In some of those countries, it is estimated to be anywhere between 5% and 10%.

As mentioned, some unemployment is inevitable. It is going to happen because of friction and structural unemployment. Therefore, full employment does not mean that 0% of the population or the labor force is unemployed.

The **natural rate of unemployment**, as noted, to be around 5%, is frictional plus structural unemployment. Another way of expressing this, then, is that **full employment** would be 100% minus that natural rate of unemployment.

The two terms essentially mean the same thing, though they may be stated differently in various economic textbooks, defined as the unemployment level consistent with full employment, typically considered to be about 5% and attributed to frictional and structural unemployment.



TERM TO KNOW

Natural Rate of Unemployment/Full Employment

The unemployment level consistent with full employment; typically considered to be 5% and attributed to frictional and structural unemployment.



SUMMARY

Today we learned **how unemployment is measured**, and we learned about the different **types of unemployment: frictional, structural, and cyclical**. We also learned that the **natural rate of unemployment, or full employment**, is when the economy is operating at full capacity, which is thought to be around 5%, as opposed to 0%.

Source: Adapted from Sophia instructor Kate Eskra.

**Bureau of Labor Statistics (BLS)**

The government agency that produces the Employment Situation report of which the unemployment rate is one statistic.

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Unemployment that follows the business cycle; falls as the economy expands and increases as the economy slows.

Frictional Unemployment

Unemployment = natural separation from employment; underlies the "natural rate of unemployment."
Employees looking for positions that are available.

Natural Rate of Unemployment/Full Employment

The unemployment level consistent with full employment; typically considered to be 5% and attributed to frictional and structural unemployment.

Structural Unemployment

Unemployment resulting from changes in the structure of the economy.