17

Employment, Recession, and Recovery

Learning Goals

Once you have completed this chapter, you should be able to:

- Identify the types, causes, and effects of inflation, deflation, and unemployment

- Describe the characteristics and causes of instability in each phase of the business cycle

- Explain the causes and consequences of the stagflation experienced in the Canadian economy from 1973 to 1982

- Apply economic thinking to assess and compare employment and production indicators

- Analyze public policy issues related to unemployment, inflation, and recession

Key Terms

- labour force
- employment rate
- seasonally adjusted unemployment rate
- participation rate
- Underemployment
- discouraged workers
- hidden unemployed
- frictional unemployment
- seasonal unemployment
- structural unemployment
- technological unemployment
- replacement unemployment

- geographical unemployment
- cyclical unemployment
- inadequate demand unemployment
- full employment
- potential output
- actual output
- Okun's law
- business cycle
- Recession
- Recovery
- demand-pull inflation
- cost-push inflation

- Phillips curve
- Stagflation
- "jobless" recovery
- Downsize
- Rightsize
- common good
- Sustainability
- The Atlantic Groundfish Strategy (TAGS)
- aquaculture

The Employment Rate

- **Employment Rate:** The total number of employed divided by the total labour force.

- The following formula is used to calculate the employment rate:

$$\text{Employment rate} = \frac{\text{Number employed}}{\text{Labour force}} \times 100$$

- In 2016, the total number of employed Canadians was over 18.2 million, and the total Canadian labour force was over 19.5 million people.

$$\frac{18\ 225\ 000}{19\ 575\ 700} \times 100 = 93.1\%$$

- Thus, the employment rate in Canada in 2016 was 93.1 percent.

The Unemployment Rate

- The unemployed group consists of all those who are not working but who are actively seeking and presently available for work.

- The following formula is used to calculate the unemployment rate:

$$\text{Unemployment rate} = \frac{\text{Number unemployed}}{\text{Labour force}} \times 100$$

- In 2016, the total number of unemployed Canadians was over 1.3 million.

$$\frac{1\,350\,700}{19\,575\,700} \times 100 = 6.9\%$$

- Thus, the unemployment rate in Canada in 2016 was 6.9 percent.

The Participation Rate

- **Participation Rate:** The labour force expressed as a percentage of the total employable population. The following formula is used to calculate the unemployment rate:

$$\text{Participation rate} = \frac{\text{Total labour force}}{\text{Total employable population}} \times 100$$

- The Canadian labour force consisted of over 19.5 million people in 2016. The total employable population (those over 15 years old) was almost 30 million.

$$\frac{19\,575\,700}{29\,841\,000} \times 100 = 65.6\%$$

- Thus, the participation rate in Canada in 2016 was 65.6 percent.

Limitations of Employment Data

- Unemployment figures may understate the true level of unemployment because part-time workers are recorded as fully employed workers. Although some people work part-time by choice, others would prefer full-time work but cannot find it. They are statistically recorded as fully employed, but they are, in fact, only partially employed.

- **Underemployment** A situation in which workers hold jobs that do not fully utilize their skills or that employ them only part time when they would prefer to work full time.

- **discouraged workers** Those who would like to work but have stopped looking because they believe nothing is available for them.

- **Hidden unemployed** The total of all underemployed workers plus all discouraged workers, a number not included in calculating the official unemployment rate.

Understanding Unemployment

- **Frictional unemployment** refers to the short-term unemployment of those workers who are presently between jobs or who are entering or re-entering the labour market. Given its short-term nature, this type of unemployment is considered the least serious.

example

The unemployment which exists in any economy due to people being in the process of moving from one job to another.

- **Seasonal unemployment** is the result of climatic changes that may leave workers unemployed for specific periods each year. As a result of Canada's climate, the construction, lumbering, fishing, farming, and tourism industries all experience seasonal fluctuations in employment.

Understanding Unemployment

- **Structural unemployment** is the direct result of structural changes in the economy. As the Canadian economy evolves, some industries grow while others decline and even disappear.
  - **technological unemployment** Unemployment caused by replacement of workers with more capital-intensive production methods
  - **replacement unemployment** Unemployment caused by the movement of firms with labour-intensive production to foreign countries in which labour rates are lower.

Full Employment

- **Full Employment:** The lowest possible rate of unemployment, seasonally adjusted, after allowing for frictional and structural unemployment. Full employment is the highest reasonable expectation of employment, sometimes referred to as the *natural employment rate*.

- The full-employment rate has been adjusted over time.
  - In the 1960s, the Economic Council of Canada concluded that a 3 percent rate of unemployment was reasonable.
  - By 1980, the full-employment rate was doubled to 6 percent to reflect increases in frictional and structural unemployment.
  - By 2000, most definitions of full employment included a natural unemployment rate of almost 7 percent

The Cost of Unemployment

- The cost of unemployment for the entire economy is reflected by the GDP gap (see Chapter 12).

- To recap **Okun's law**: *For every 1 percent that the actual unemployment rate exceeds the full-employment rate (the natural rate of unemployment), there is a 2 percent gap in GDP.*

- During the major recession of 1983, unemployment reached 11.8 percent while the GDP was determined to be $439.5 billion, based on 1986 dollar values. Assuming a 7 percent full employment rate, we can estimate the GDP gap during that recession

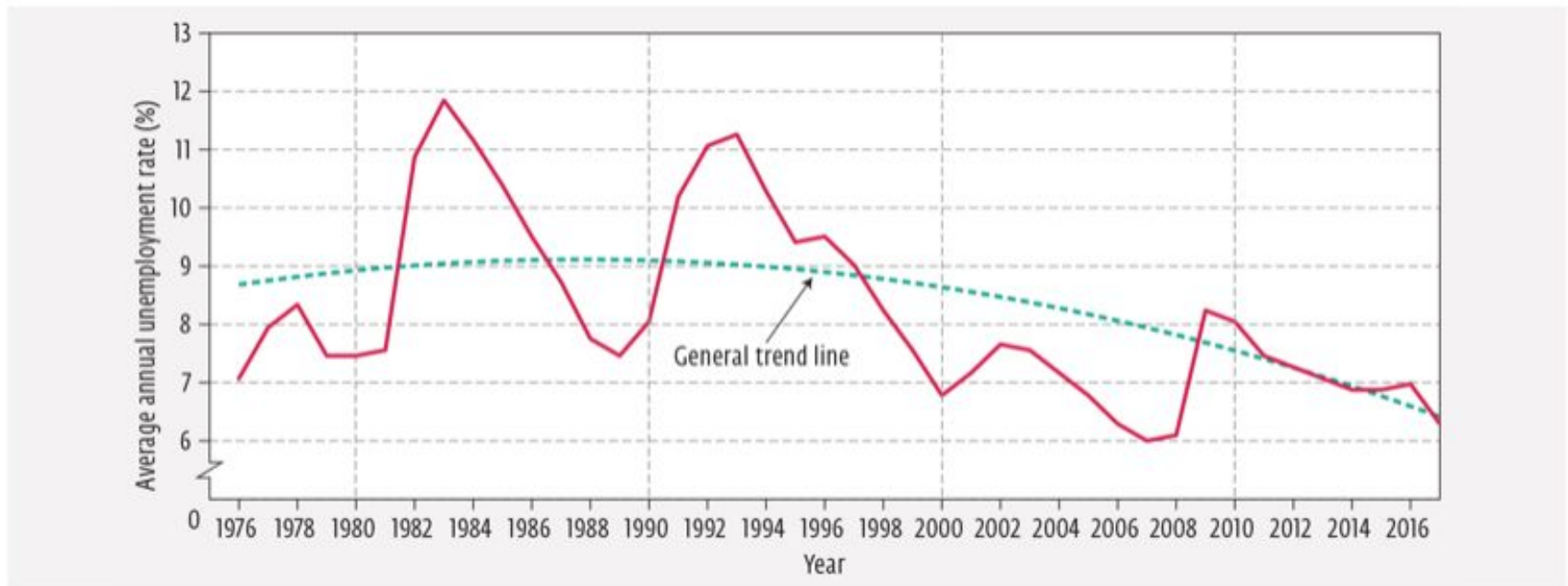$$\text{GDP gap} = \$439.5 \text{ billion} \times \frac{(11.8 - 7) \times 2}{100}$$

$$= \$42.19 \text{ billion}$$

Canadian Unemployment Patterns 1976 - 2017

FIGURE 17.1

Average annual unemployment rates in Canada, 1976–2017

Fluctuations in the Canadian Economy

- **business cycle:** A rise and fall in national economic performance characterized by four phases: peak, contraction, trough, and expansion.

- **recession** A contraction of the economy in which real GDP declines for a minimum of two consecutive business quarters (six months).

- **recovery** The first part of an expansionary period following a downturn in the economy.

- Since expansion phases represent periods of sustained increases in real aggregate output, generally speaking, employment rates increase as the economy expands. A direct relationship exists between GDP and employment. By contrast, an inverse relationship exists between GDP and unemployment.

Inflation and Employment

- During a recession, levels of unemployment are relatively high. With more workers unemployed, consumer spending is adversely affected. Both the amount of money in circulation (*money supply*) and the rate at which money changes hands through business transactions (*velocity of money*) are also adversely affected. All of these economic adjustments act to reduce aggregate demand and inflationary pressures in the economy; thus, prices generally stabilize.

- During periods of economic expansion, levels of unemployment are reduced because more of the labour force is able to find work. With more workers employed, the demand for consumer goods increases. As economic activity increases, both the supply and the velocity of money increase. If the production side of the economy does not keep pace with this increased demand, prices will rise as more dollars attempt to chase after available goods and services. Economic expansion can produce inflationary pressures in the economy.
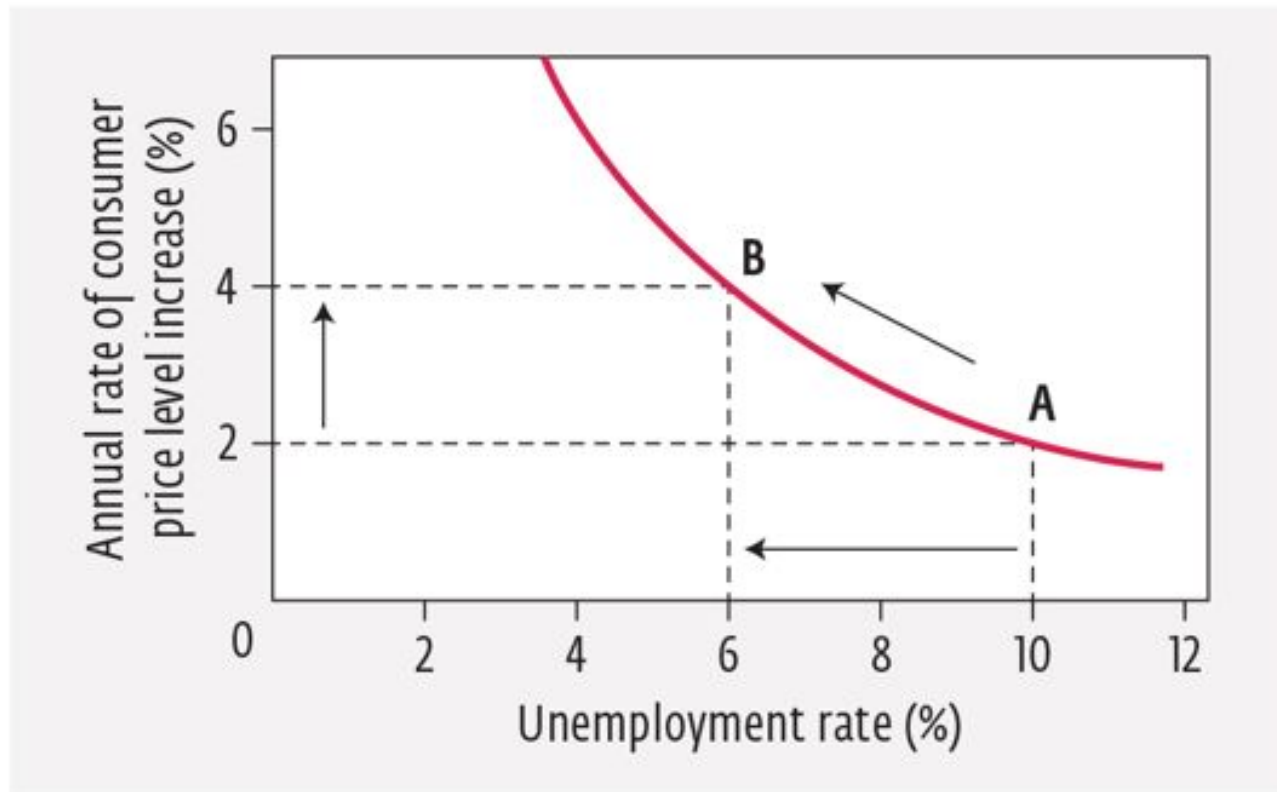
Inflation and Employment

- Two distinct types of inflation are identified by economists.
  - **Demand-pull inflation** results from excessive increases in consumer demand, relative to available aggregate production.
  - **Cost-push inflation** results from the passing down of increased operating costs from producer to consumer. Thus,recession is synonymous with unemployment.

- **Phillips curve:** A diagram demonstrating an inverse relationship between inflation and unemployment rates.
  - This curve presumes a natural trade-off between inflation and unemployment: the lower the inflation rate, the higher the unemployment rate, and vice versa. In Figure 17.2, as the inflation rate rises from 2 to 4 percent, reflected in a movement from point A to point B, unemployment decreases from 10 to 6 percent.

The Phillips Curve

FIGURE 17.2
The Phillips curve

Stagflation

- Although inflation and unemployment were previously seen as opposites, the Canadian economy began to experience simultaneous increases in unemployment and inflation. These periods of economic stagnation, where aggregate production slows down and both unemployment and inflation rates increase, became known as **stagflation**.
  - **Stagflation:** A period of slow growth when both unemployment and inflation increase, as seen from 1973 to 1982 in Canada.

Public Policy Issues and Implications

- Many economists and politicians seek to influence public policy to better serve the common good. This **common good** can be defined as the well-being of Canadian society at large, or as an aggregate. Social activists constantly remind us that this "common" good must also extend to the poor and marginalized members of society.
  - **common good:** The well-being of society at large, sometimes referred to as the most good for the greatest number.

- All **sustainability** is rooted in economy, ecology, and equity (see Figure 17.6). This means that waste, inefficiency, environmental damage, and unfair treatment must be kept to an absolute minimum.
  - **Sustainability:** Practices and conditions that can be expected to continue safely for the long term because they minimize waste and inefficiency of resources, environmental damage, and the unfair treatment of vulnerable stakeholders.

Recipe for Sustainability

FIGURE 17.6
The recipe for sustainability
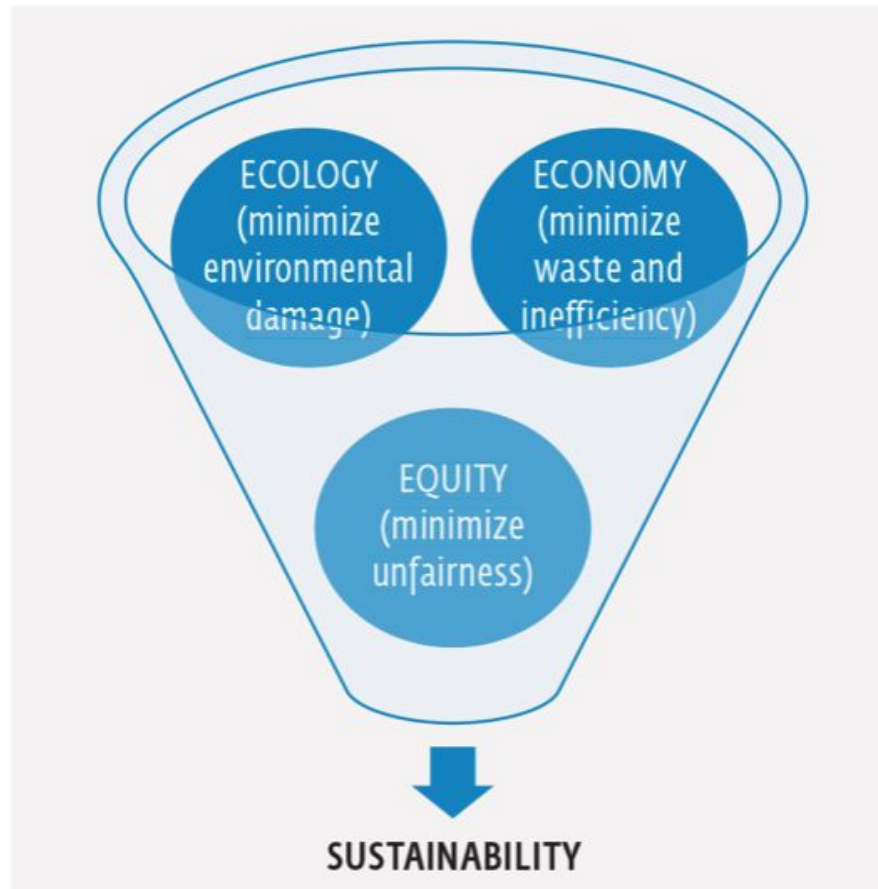
Regional Economic Diversification

- To avoid overdependence on a single industry or resource, different regions in Canada have sought to diversify their local economies. Once diversified, the impact of a prolonged setback in one industry can be softened by growth or stability in other industries.

- One of the best examples of diversification policy can be found in Newfoundland and Labrador, one of the regions in Canada that has traditionally experienced relatively high unemployment.

- After many years of relying on the fishing industry in Newfoundland and Labrador, the federal government placed a ban on northern cod fishing. As a result, 31,000 people lost their jobs, most of which were based in the province. The province had to use an economic diversification strategy to provide alternative employment opportunities to its population.