

## CONSEQUENCES OF UNEMPLOYMENT IN WORLD ECONOMIES

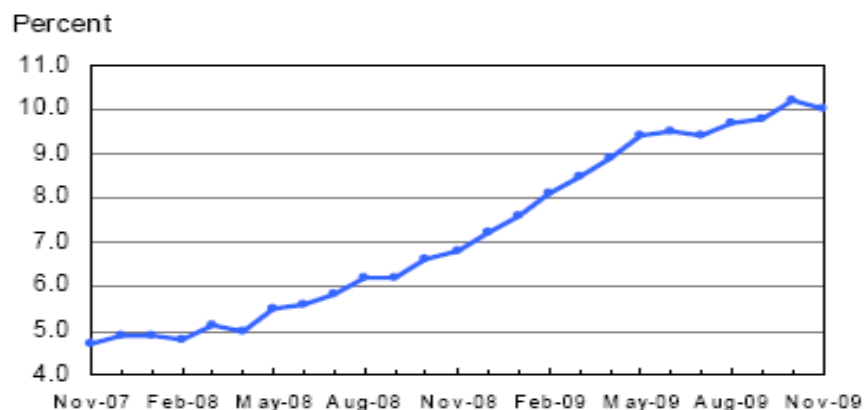
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It is an undeniable fact that the financial crisis that we are currently facing has imposed great challenges to the world economic development. Its consequences have negatively affected the economic and financial sectors of all countries. It goes without saying that unemployment and its severe rates is by far one of the most problematic issues determined by this economic crisis. Unemployment is deemed to be

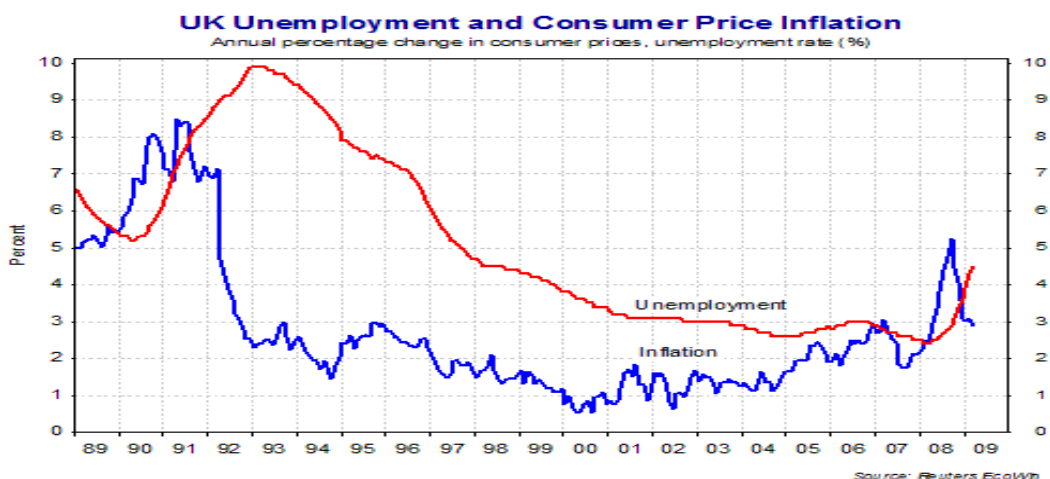
a truly important statistic used by the government to estimate the health of the economy.

The focus of this research report is to provide information about the consequences of unemployment to world economies and to present economic tools that deal with the growing rate of unemployment by avoiding or managing its economic and social consequences.

**Chart 1. Unemployment rate, seasonally adjusted, November 2007 – November 2009**



New, Release. "December, 2009". Bureau of Labor Statistics U.S Department of Labor. 03/01/2010  
<[www.bls.gov](http://www.bls.gov)>.



Riley, Geoff. "Revision: Consequences of Unemployment". Tutor2U. 2/01/2010 <<http://www.tutor2u.net>>.

## Consequences of Unemployment to World Economies

Unemployment determines both economic and social costs that are being paid by both individuals and governments. According to Riley, some of the major consequences of unemployment are:

- **The loss of income.** The higher the rates of unemployment, the lower the rates of income for the unemployed people and their families, the lower the living standards and subsequently, the lower the spending amount (Gupta 339).

- **The negative multiplier effects.** Unemployment consequences follow the domino effect. It is a known fact that unemployment determines a decline in spending, which determines a decline in the profits of local businesses, which may lead to the bankruptcy of these businesses and to more unemployment. Moreover, the bankruptcy of businesses leads to governmental loss due to less income from taxes and to higher unemployment rates (Riley 1).

- **GDP loss.** Unemployment determines the loss of national input and it represents the waste of scarce resources such as labor.

- **Fiscal Costs.** Unemployment determines a decline of tax revenues and an increase of governmental spending on social and economic assistance to the unemployed people. Without any doubt, governments will impose higher rates of taxation and will lower their investments and public spending in improving infrastructure or social conditions. This situation determines an increase in the budget deficit for any country. Another cost of unemployment is the inequality in income distribution that determines changes in poverty and saving ratios (Gupta 341-2).

- **Social Costs.** Studies have shown that there is a strong correlation between high rates of unemployment and social disruption. As a matter of fact, the higher the unemployment rates, the higher the divorce rates, the lower the life expectancy and the higher the crime rates (342).

Even though unemployment is considered to be truly negative to world economies, Riley suggests that it also has some positive effects.

- **Boosting the small business sector.** Unemployment has inspired and motivated many people to create and operate their own businesses.

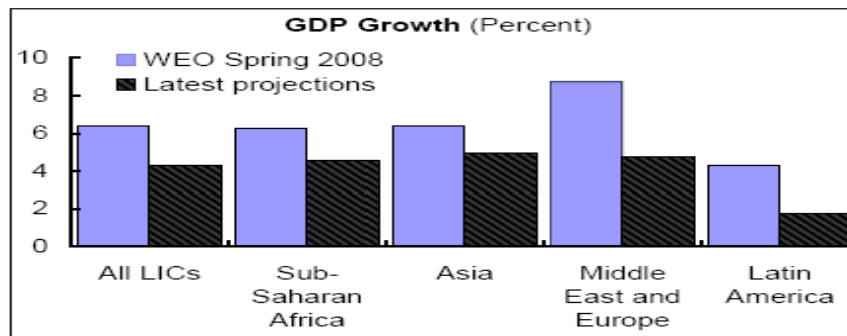
- **Increasing labor availability.** Despite the financial crisis, many businesses are actually

doing well and are willing to expand and take on more workers. More specifically, the availability of a greater variety of workers with respect to their education and working experiences allows these businesses to hire the most qualified employee for a specific position. This leads to higher productivity and higher profits (1).

## The Feasibility of Encouraging Economic Growth

Economists argue that economic growth is a way to cure unemployment, thus, they suggest using it against the current growing rate of unemployment. Whether this is feasible or not under the current financial crisis, it is a hotly debated issue. It is a fact that developed economies are in recession and undeveloped economies are experiencing a slowdown of their activity. According to IMF and its 2009 report, "*continued deleveraging by the financial sector and dramatic declines in consumer and business confidence has triggered a sharp deceleration in domestic demand across the globe*"(11). In addition, the world trade and industrial activity are significantly falling, whereas the labor market is weakening. To illustrate this, global growth was experiencing a weakening, with a deceleration of the activity from 3.5% in 2008 to 0.5% in 2009; a gradual recovery is expected for 2010. Also, the decline in external demand has hit the advanced economies such as the euro zone and Japan, whereas the economic insecurity has caused the consumption decrease and business investment decline in US. Also, these increase in a decreasing way of the growth, will have an impact on low-income countries as well.

Since the current situation demonstrates not an acceptable trend of economic growth to be used as a tool to combat unemployment, developed economies should apply a set of guidelines to make this idea feasible during the current crisis. John Swinney suggests some means to be implemented such as *growing competitiveness* by lowering taxes and creating a competitive edge, and *building blocks of success* by meeting social and environmental objectives and increasing competitiveness (1). I believe that unemployment can be a feasible tool to combat unemployment in the case the assumptions about growth rates expected improvement in 2010 prove true and the suggested tools will be applied.



IMF, 2009. "The Implications of the Global Financial Crisis for Low Income Countries". *International Monetary Fund*. 02/01/2010 <www.imf.org>.

### Should Developed Countries Help Third World Countries?

It is a fact that the current global financial crisis has imposed great difficulties to developed countries, to their economy and to their financial situation. This justifies the decline of their foreign investment to undeveloped countries and the decline of their export level (Strauss-Kahn, 1). Developed countries should indeed help third world countries for many reasons benefiting both parties. According to the World Bank, the boosting economic growth (GDP per capita) in developing countries is strongly connected to their goal of reducing poverty (How to Help Developing Countries Reduce Poverty,1). This may be justified by the argument of the comparative advantage and the ability to produce goods at a lower opportunity cost varying from the availability of land abundance, scarce resources, and labor. Also, it helps companies to increase export levels and to reach mass production that is characterized by low cost production and higher profit margins, not to mention all the social benefits (1). Thus, developed countries should help third world countries due to the fact that apart all other reasons, it is in their benefit as well. Some may argue that during financial crisis, it is rather difficult for developed countries to give their help to other countries. It is indeed important for developed countries to find a balance between boosting their own economy and help undeveloped countries, to further enhance their growth. One counterargument we can use at this point is the fact that developed countries are obliged to control outsourcing, in order to decrease their unemployment rates at the cost of increasing the undeveloped countries unemployment rates.

#### Foreign Investment

Developed countries have the power and the ability to contribute to third world countries

by boosting their economy and level of unemployment through direct investment. It goes without saying that the current financial crisis has shaken the developed countries' economy. Due to this fact, their foreign investment to third world countries has declined. According to Dominique Strauss-Kahn, Managing Director of the International Monetary Fund, the third world countries will be significantly affected by the difficulties that the financial crisis imposed to developed countries due to their increased integration and exposure into the global economy(1). This is illustrated by the fact that IMF most recent growth forecast for 71 countries eligible for concessional IMF lending was just over 4 percent in 2009-more than 2% points lower than what IMF expected.

Moreover, Strauss-Kahn argues that the investor uncertainty and the significant downturn in commodities will cause a 20% decline in foreign direct investment in developing countries. Strauss-Kahn also discusses the fact that the main impact on low-income countries will be through trade, since exports are expected to significantly decline and since exporters are expected to deal with many difficulties (1). Due to these arguments, I support the idea that private investors would not risk their capital in third world countries. Also, the weakened growth in the advanced and emerging economies where workers from low-income countries have found employment will raise unemployment in these countries. According to the March,2009 IMF Report on "The Implications of the Financial Crisis for Low-Income Countries", the low-income countries "are especially sensitive to trade, aid and remittances shocks, while FDI appears to be less important transmission channel" (34). To sum up, foreign investment for low-income countries has declined due to the financial crisis that has directly affected the developed countries and indirectly affected the undeveloped ones.

## Dealing with the Growing Rate of Unemployment

It goes without saying that unemployment is a major issue to world economies. Suggested solutions to this problem must be used to decrease its growing rate.

- **Increasing Governmental Spending.** Governments can decrease unemployment invest in infrastructure or any infant industry that has potential to grow and become profitable.

- **Increasing Money Supply and lowering Interest rates.** According to Blinder, this tactic can boost investment, increase the aggregate demand and subsequently decrease unemployment. A side effect will be an increase in inflation (1).

- **Creating Career Training and Information Programs.** Statistics show that illiterates experience higher % of unemployment than educated people. By increasing education, people will be able to acquire a sense of duty and dignity of labor and learn to consider the opportunity cost of a career (Gupta 342).

- **Offering reliable and updated information.** The availability of incorrect information about job opportunities and wage structure is a cause of unemployment thus the offering of reliable and updated information will help out people to select a proper career that matches supply and demand of labor (343).

- **Cutting Real Wages.** Through decreasing minimum wages, and increasing the paying power, governments offer the possibility to increase employment.

- **Introducing Policies that Affect the Labor Market by Reducing the Supply of Labor.** We can mention early retirement, work sharing etc .

### Recommendations

The extremely dangerous economic and social costs of unemployment emphasize the need of immediate actions of dealing with the growing rate of unemployment. In my opinion, as well as based on the reliable sources I have used to write this report, governments must implement many effective actions to decrease unemployment such as imposing education and increasing its spending. In this case, labor will be better trained and able to deal with the responsibility of selecting a career that matches its supply and demand, as well as better educated to meet responsibilities. Also, by increasing its spending, the government causes a decrease of

unemployment as well as invests in its infrastructure and its citizens well-being.

### Conclusion

The unemployment rate, increased by the current financial crisis, represents indeed a very concerning issue to world economies. Its economic and social costs have revealed to be great difficulties to individuals and economies. Both developed and undeveloped countries suffer from the recession and experience high levels of unemployment that can be solved by introducing monetary or fiscal policies, by educating people, by always providing the right and updated information.

Unemployment is deemed to be a truly important statistic used by the government to estimate the health of the economy and the current dissatisfactory rates represent a problem that needs an immediate solution.

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