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Let's Keep Rising UK Unemployment in Perspective

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Nothing surprising happened. Unemployment in the United Kingdom rose this week. That was what any sensible economist should have expected. Nevertheless, with a swirl of panic in the air around the economies of the western world, it will pay us as a nation to keep a cool head and lay out a strategy for the next few years.

Measured properly, using the International Labour Office definition, the joblessness rate has actually increased in the United Kingdom in successive months. If normal historical patterns are played out, unemployment will now rise for the next year or two. Those who believe -- in my estimation wrongly -- that September 11 has itself fundamentally ruined global economic prospects will be gloomier still.

Why is unemployment rising? The right explanation is not going to be found by looking inside our shores. Policy-makers in the UK must resist parochial answers. Across planet Earth, the industrial countries are sliding into recession. German, US, Canadian and Australian unemployment rates have been increasing for most of the year. If anything, the puzzle is why the UK took a while to catch this world-wide flu.

There are three possible explanations for the increasing rate of joblessness in the UK.

The first, and most persuasive, is that we are feeling the consequences of yet another oil shock. In 1999-2000, the oil price lifted from approximately 10 dollars a barrel to, at its peak, 36 dollars a barrel. This was the fourth great oil-price spike of the post-war era. The others were 1974, 1979, and 1990.

We know, both from the simplest look at modern history and from more complicated kinds of statistical analysis, that large increases in the price

of petroleum are extraordinarily damaging. Oil is the main feedstock of modern life and has a virtual monopoly in transport. Those who argue that we are now less dependent on oil have not looked hard at the data and forget that OPEC indirectly controls the prices of all energy types.

Yet we also know that there is a lag: it takes time for expensive petroleum to topple a whole economy. On the best estimate, about 18 months goes by before a twist in the price of oil provokes a sharp change on the real side of an economy. If it does not have one already, HM Treasury should order for the wall of its main meeting room a large graph showing post-war movements in the real price of oil plotted against cycles in unemployment.

A second possible explanation for UK recession is the collapse of Information Technology profits in the United States. On this view, at the start of the new millennium, investment collapsed in the IT sector. Slowing industrial economies around the world, this argument goes, are simply a spill-over from the decline of a huge technology bubble.

But this does not make sense. One look at the IFO confidence index for Germany, the great powerhouse of the European economies, shows that in the summer of 2000, barely noticed by most commentators, the German economy began to slip into a downturn at exactly the same time as the key United States indicators also faltered. It is simply wrong to say that the US led.

Moreover, the IT tail, even in an important economy like America's, is too small to wag the whole dog of western labour markets.

A third possible way to make sense of rising UK unemployment is more subversive. It is that there is no explanation. On this view, economies are just inherently cyclical. They rise; they fall; they have a rhythm of their own. Believers in this theory argue that the only reason UK unemployment is going up now is that we had a boom in the 1990s. Our time was up.

By its nature, this nihilistic view of economies is difficult to disprove. But when we look at the patterns in unemployment over the last few decades, we do not find a smooth sine wave. Rather, we see highly irregular spikes in oil prices closely followed by spikes in unemployment.

So where do we go now?

First, modern monetary policy has developed fairly effective tools for dealing with recessions. The Bank of England has already cut the cost of borrowing, and if necessary can keep on cutting. Alan Greenspan has enacted remarkable reductions in US interest rates, to a mere 2%, and those too will eventually produce a boost to spending that will spill out across Europe.

Second, a surge of state spending is already feeding its way through the economy. Gordon Brown's boost to public expenditure, though not chosen for Keynesian reasons, has come at a fortunate time. Like a football manager, it helps an economy's manager to be lucky.

Third, oil prices have dropped. If sustained, this will help us by late 2002. A short though unpleasant recession, rather like the period around 1992, is likely.

Fourth, now is no time to give up on sensible attempts to keep the labour and housing markets as flexible as possible.

Fifth, fear will subside. It has been a bad year. There will be good years again.