

Labor Economics. Employment / Unemployment.

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➤ **Labor Economics:** study of economic behavior of employers and employees in response to changing prices, profits, wages, and working conditions. It combines two fundamental approaches: microeconomic and macroeconomic.

➤ **Definitions:**

✓ **Working Age Population:** the population old enough to take employment, includes persons in the labor force and persons not in the labor force;

✓ **Persons not in the Labor Force:** working age population, who are not working and are not interested in finding any jobs;

✓ **Labor Force (Economically Active Population):** working age population who are able and willing to work. People in labor force are either employed, or unemployed;

✓ **Unemployed** are persons in the labor force who are actively looking for jobs, but can not find it;

✓ **Employed** are the rest of the labor force.

➤ **Indicators:**

✓ **Unemployment Rate:** number of unemployed divided by the total labor force (UE/LF).

✓ **Employment Ratio (Rate):** the employed fraction of the working-age population (E/WA).

✓ **Participation Ratio (Rate):** the fraction of the working-age population in the labor force (LF/WA).



Sources & Types of Unemployment

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➤ Four sources & types of unemployment:

- ✓ **Frictional Unemployment** happens when employees look for better jobs and employers look for better employees (*a voluntary unemployment*).
- ✓ **Structural Unemployment** happens due to a mismatch between requirements or locations of available jobs and qualifications, skills or locations of available workers (*partially a voluntary unemployment*).
- ✓ **Cyclical (Demand Deficient) Unemployment** happens due to business cycles, businesses reduce their demand for labor as production declines during recessions (*an involuntary unemployment*).
- ✓ **Seasonal Unemployment** happens in some industries, due to natural reasons (weather, climate, technological process, etc.) when both supply and demand of goods and services fluctuate with seasons in a year (*an involuntary unemployment*).

Natural Rate of Unemployment

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- **The Natural Rate of Unemployment:** Unemployment that occurs even under the full employment in the economy is called the natural rate of unemployment or the full-employment rate of unemployment. (*includes frictional and partially structural unemployment*).
- **The natural rate of unemployment** changes over time depending on several factors:
 - ✓ **availability of job information:** lack of information is a source for frictional unemployment;
 - ✓ **skills and education:** mismatch in skills and qualification is a source for structural unemployment;
 - ✓ **degree of labor mobility:** the less is mobility, the more chances for both frictional, and structural unemployment;
 - ✓ **flexibility of the labor market:** multiple influences restrict ability of the labor market reach and rest in its equilibrium and increase disequilibrium unemployment;
 - ✓ **hysteresis:** the lagging of unemployment behind its cause - when workers are unemployed for a long time period they become deskilled and de-motivated and are less able to get new jobs.

➤ Impacts of Unemployment:

- ✓ **Social Impact:** social & political unrest, abuse and anti-social activities: theft, violence, terrorism and other forms of crime;
- ✓ **Human Psychological Impact:** psychological stresses, loss of confidence and self-respect, illnesses, depression, higher suicide rates;
- ✓ **Economic Impact:** loss of income for individuals and loss of output for the economy (*not produced by unemployed workers*), loss of profits for the producers, loss of tax revenue and increase of expenditure (welfare payments) for the government.

➤ Okun's Law:

- ✓ for every one percentage point by which the actual unemployment rate exceeds the Natural Rate of Unemployment, there is a 2 to 4 % "GDP Gap" (gap between potential and actual GDP).
- ✓ thus, for every 1% excess of the natural unemployment rate, an ~2.5% fall in GDP is predicted:

$$\Delta Q = \frac{Q^P - Q}{Q^P} = 2.5 * \Delta U$$

Labor Market

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➤ Determinants of labor demand:

- ✓ price or demand for output;
- ✓ change in technology;
- ✓ price of another input;
- ✓ number of firms.

➤ Determinants of labor supply:

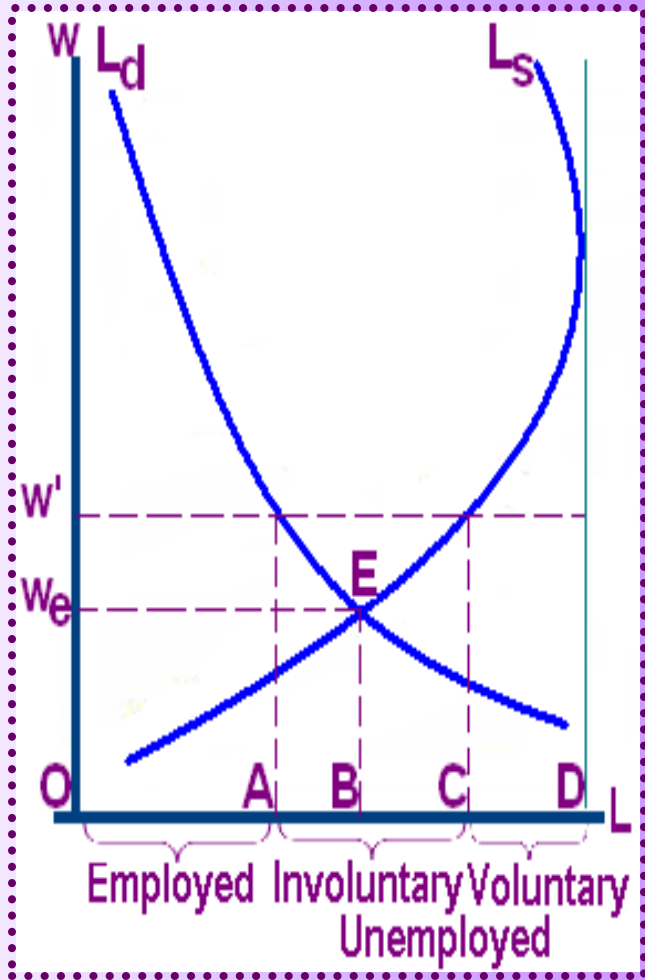
- ✓ income and wealth;
- ✓ prices of consumer goods;
- ✓ taxes;
- ✓ number of workers;
- ✓ expectations of the above.

➤ Voluntary Unemployment: frictional & partially structural unemployment of workers looking for different kinds of jobs.

- ✓ *Examples:* prefer not to work at the going wage rate, searching for better job, prefer welfare, etc.

➤ Involuntary Unemployment: qualified workers who want to work at the prevailing wage, but cannot find it. Reason: Non-clearing labor market - sticky wages:

- ✓ *minimum wage rates* (government & trade unions);
- ✓ *menu costs* - wages not following day-to-day labor market fluctuations, set by contracts;
- ✓ *implicit contracts* - employer-employee relationship;
- ✓ *relative wage concerns* - workers compare their wages to the wages of other workers in other firms;
- ✓ *efficiency wage theory* the productivity of workers increases with the wage rate, which motivates firms to pay wages above the market-clearing rate.



- ✓ ***definition of money***
- ✓ ***labor economics***
- ✓ ***measurements of unemployment***
- ✓ ***the natural rate of unemployment***
- ✓ ***sources and types of unemployment***
- ✓ ***impacts of unemployment, Okun's law***
- ✓ ***non-clearing labor market***
- ✓ ***voluntary vs. involuntary unemployment***

Course Web Support:

<http://www.skylinecollege.info/mosesov/macro/>

<http://www.mhhe.com/economics/samuels17/students/Ch31.mhtml>