

Unemployment

ECON201 - Winter '24

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This Lecture

- Financial distress, skill loss, mental health crises, and broken life trajectories are some of the potential outcomes of the loss of a job. Unemployment is a subject of particular importance.
- Here, we will focus on the question of why there is always some unemployment and what determines this long-run *natural rate of unemployment*.
- In a later lecture, we will also discuss why unemployment fluctuates, e.g. why unemployment increases rapidly in recessions.

Outline

1. Measuring Unemployment

2. Types of Unemployment

3. The Minimum Wage

4. Unions and Collective Bargaining

5. Theory of Efficiency Wages

Survey Categories

- The [Bureau of Labor Statistics \(BLS\)](#) regularly surveys 60,000 households about their members' (16 years or older) employment status. There are three broad categories:
 - **Employed:** Anyone who has a paid job, is self-employed, or works unpaid in a family business. Full-time, part-time, or temp. absent.
 - **Unemployed:** Anyone who (i) was not employed, (ii) is available for work, *and* (iii) has been looking for a job in the previous four weeks.
 - **Not in the labor force:** Anyone who does not fit in the above categories (e.g. students, homemakers, retirees).

Labor Statistics

Labor force = Number of employed + Number of unemployed.

$$\text{Unemployment rate} = \frac{\text{Number of unemployed}}{\text{Labor force}} \times 100.$$

$$\text{Labor-force participation rate} = \frac{\text{Labor force}}{\text{Adult population}} \times 100.$$

Example: November 2023

- According to [Table A-1](#) of the BLS's "Employment Situation" report in November 2023, there are
 - ca. 161,969,000 employed,
 - ca. 6,291,000 unemployed, and
 - ca. 99,562,000 out of labour force.

- **Labour force:**

$$168,260,000 = 161,969,000 + 6,291,000.$$

- **Unemployment rate:**

$$3.74\% = \frac{6,291,000}{168,260,000} \times 100.$$

- **Labor-force participation rate:**

$$62.83\% = \frac{168,260,000}{267,822,000} \times 100.$$

- Difference between “unemployed” and “out of labor force” is subtle. Some people say they are not looking for a job, but end up having one in the next survey anyway.
- **Marginally attached workers** would like a job but are not actively looking. If they do not search because of the condition of the job market, they are called **discouraged workers**.
- Why not distinguish between full-time employed and part-time employees who'd want a full-time job? *Persons employed part-time for economic reasons*.
- Alternative measures of unemployment try to address these problems. U-1 to U-6.

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Composition of Unemployment

- For most people, unemployment is very short. There is a constant stream of people who are unemployed for a few weeks and then find a new job.
- However, the majority of unemployment at any given time is **persistent**.
- That is, the set of long-term jobless workers is large relative to the number of short-term unemployed at any point in time, but small compared to the sum across time.
- The “between-job” short-term unemployment is called **frictional unemployment**.
- Persistent unemployment is also called **structural unemployment**.

Frictional Unemployment

- Frictional unemployment can be the result of disagreements between workers and employers.
- More interestingly, it may arise from changes in demand for goods. These changes shift production and employment to different firms, industries or regions. Temporarily, such **sectoral shifts** will cause unemployment.
- As long as the economy is changing in any way (incl. due to trade), frictional unemployment will exist. It shows that the economy is flexible and can reallocate resources when necessary (**churning**).

Public Policy

Public policy can alleviate or worsen frictional unemployment:

- Government-run **employment agencies** help match workers and vacancies.
- Public **training programs** help workers qualify for more jobs (ideally in growing industries).
- **Unemployment insurance** increases frictional unemployment by decreasing the financial incentive to searching for and accepting a new job.
- Note that longer frictional unemployment may not be bad if the **quality of matches** between workers and jobs increases, due to better search.

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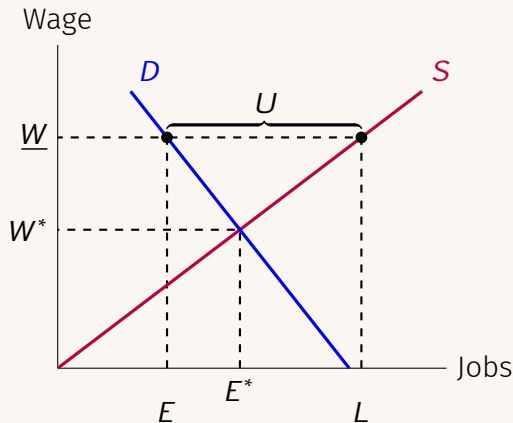
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Minimum Wage

- Structural unemployment could be explained by minimum wage laws.
- If the minimum wage is above the equilibrium wage, this will result in a labor surplus, i.e. unemployment.
- There are few workers for whom this is true in the U.S..
- Most workers' market wage is well above the minimum wage. But it may affect the least-qualified/ experienced workers.



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Unions and Unemployment

- Some economists argue that unions (workers associations which bargain with employers) may cause structural unemployment in a similar manner as the minimum wage.
- By using their market power in the labor market, unions may be able to bargain for wages (and non-wage benefits) above the perfectly competitive market equilibrium. Such high wages would lead to unemployment as seen in the above diagram.
- In the U.S., only 11% of workers are union members. Their market power in most industries is arguably very limited.

Insiders and Outsiders

- By their nature, unions primarily look out for their current members, rather than potential future members.
- Thus, unions may make it harder for unemployed workers to find a job, thus indirectly increasing the supply of labor in less unionized industries.
- Unions may also be socially beneficial if they do not raise labor costs too much above equilibrium.
- For example, Germany has a system of “codetermination” which gives workers’ representatives seats on corporate boards, thus improving communication between the factory floor and board room. Unions also have an important role in ensuring safe working conditions.

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Firms May Want High Wages?!

- Famously, Henry Ford introduced a \$5-a-day wage (twice the “normal” wage). Result: Decreased turnover, less absenteeism, higher productivity.
- **Efficiency wage:** An above-market wage may increase efficiency because higher opportunity cost of getting fired incentivizes greater effort.
- Especially profitable if firm needs (i) high-quality workers or (ii) job required a lot of training, i.e. turnover is costly.
- Another reason why efficiency wage may raise productivity: Improved worker health.

Conclusion

- **Unemployed** workers are actively looking for a job. Discouraged workers stop searching due to market conditions.
- Labor force participation rate is an alternative measure of labor market activity.
- **Frictional unemployment** is due to shifting demand. Govt programs may help matching workers and vacancy, but **unemployment insurance** may increase spells.
- There are many reasons why wages may be above their equilibrium level, e.g.:
 - Minimum wage laws,
 - unions and collective bargaining, and
 - efficiency wages.
- **Next:** What causes the economy to grow?

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