

UNEMPLOYMENT

- The macroeconomic problem that affects people most directly and severely.
 - There is always some unemployment! (fig. 6-1, p.156)
 - The rate of unemployment: the percentage of the labor force unemployed
 - The *natural* rate of unemployment: the average level around which the unemployment rate fluctuates
- The determinants of the natural rate of unemployment (not SR fluctuation)

(1) Job Loss, Job Finding, and the Natural Rate of Unemployment

- A model of labor-force dynamics that shows what determines the natural rate of unemployment
- $L = E + U$, where L : labor force, E : the employed, U : the unemployed
 - the unemployment rate (u) = U/L
- L is assumed to be fixed
 - the transition of individuals in the labor force between employment and unemployment
 - Rate of job separation (s): fraction of employed individuals who lose their job
 - Rate of job finding (f): fraction of unemployed individuals who find a job

- s and f determine the rate of unemployment
- In a steady state,
 - the number of people finding jobs (fU) = the number of people losing jobs (sE)
 - steady-state unemployment rate?
 - Since $E=L-U$, $fU=s(L-U)$
 - Solving for U/L gives $U/L=s/(s+f)$
- The higher the rate of job separation, the higher the unemployment rate
- The higher the rate of job finding, the lower the unemployment rate
 - Any policy aimed at lowering the natural rate of unemployment must either reduce the rate of job separation or increase the rate of job finding

(2) Job Search and Frictional Unemployment

- Frictional unemployment: the unemployment caused by the time it takes workers to search for a job
 - Sectoral shift
 - Change in nature of economy
 - e.g., when worker's characteristics do not fit with employers' requirement
- Public policy
 - Government employment agency
 - Unemployment insurance

(3) Real-Wage Rigidity and Wait Unemployment

- Wage rigidity: the failure of wage to adjust until labor supply equals labor demand (fig. 6-3, p.162)
 - reduces the rate of job finding and raises the level of unemployment (= “Wait Unemployment”)
- Minimum-Wage
- Unions and Collective Bargaining
- Efficiency Wages → how wages affect productivity
 - reduce labor turnover
 - average quality of a firm’s workforce
 - increase a worker’s effort level

Therefore, a firm may find it profitable to keep wages above the equilibrium wage rate, b/c the firm operates more efficiently if it pays its workers a high wage.