

Unemployment and Its Natural Rate

IDENTIFYING UNEMPLOYMENT

The problem of unemployment is usually divided into two categories.

- 1 •The long-run problem and the short-run problem:
- 2 •The natural rate of unemployment and •The cyclical rate of unemployment

•*Natural Rate of Unemployment*

•The natural rate of unemployment is unemployment that does not go away on its own even in the long run.

•It is the amount of unemployment that the economy normally experiences.

•*Cyclical Unemployment*

•Cyclical unemployment refers to the year-to-year fluctuations in unemployment around its natural rate.

•It is associated with with short-term ups and downs of the business cycle.

•Describing Unemployment -Three Basic Questions:

•How does government measure the economy's rate of unemployment?

•What problems arise in interpreting the unemployment data?

•How long are the unemployed typically without work?

How Is Unemployment Measured?

•Unemployment is measured by the Bureau of Labor Statistics (BLS).

•It surveys 60,000 randomly selected households every month.

•The survey is called the Current Population Survey.

•Based on the answers to the survey questions, the BLS places each adult into one of three categories:

•Employed

•Unemployed

•Not in the labor force

•The BLS considers a person an adult if he or she is over 16 years old.

•A person is considered employed if he or she has spent most of the previous week working at a paid job.

•A person is unemployed if he or she is on temporary layoff, is looking for a job, or is waiting for the start date of a new job.

•A person who fits neither of these categories, such as a full-time student, homemaker, or retiree, is not in the labor force.

•Labor Force

•The *labor force* is the total number of workers, including both the employed and the unemployed.

•The BLS defines the labor force as the sum of the employed and the unemployed.

•The *unemployment rate* is calculated as the percentage of the labor force that is unemployed.

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

•The *labor-force participation rate* is the percentage of the adult population that is in the labor force.

Labor force participation rate

$$= \frac{\text{Labor force}}{\text{Adult population}} \times 100$$

Table 1 The Labor-Market Experiences of Various Demographic Groups

Demographic Group	Unemployment Rate	Labor-Force Participation Rate
Adults (ages 20 and over)		
White, male	3.7%	76.8%
White, female	3.6	50.2
Black, male	8.0	72.1
Black, female	7.0	65.4
Teenagers (ages 16–19)		
White, male	13.8	54.1
White, female	11.4	52.8
Black, male	30.5	38.0
Black, female	27.5	37.4

Source: Mankiew (2004)

Does the Unemployment Rate Measure What We Want It

- It is difficult to distinguish between a person who is unemployed and a person who is not in the labor force.
- Discouraged workers*, people who would like to work but have given up looking for jobs after an unsuccessful search, don't show up in unemployment statistics.
- Other people may claim to be unemployed in order to receive financial assistance, even though they aren't looking for work.

How Long Are the Unemployed without Work?

- Most spells of unemployment are short.
- Most unemployment observed at any given time is long-term.
- Most of the economy's unemployment problem is attributable to relatively few workers who are jobless for long periods of time.

Why Are There Always Some People Unemployed?

- In an ideal labor market, wages would adjust to balance the supply and demand for labor, ensuring that all workers would be fully employed.
- Frictional unemployment* refers to the unemployment that results from the time that it takes to match workers with jobs. In other words, it takes time for workers to search for the jobs that are best suit their tastes and skills.
- Structural unemployment* is the unemployment that results because the number of jobs available in some labor markets is insufficient to provide a job for everyone who wants one.

JOB SEARCH

- Job search* •the process by which workers find appropriate jobs given their tastes and skills.
- results from the fact that it takes time for qualified individuals to be matched with appropriate jobs.
- This unemployment is different from the other types of unemployment.
- It is not caused by a wage rate higher than equilibrium.
- It is caused by the time spent searching for the “right” job.

Why Some Frictional Unemployment is Inevitable

- Search unemployment is inevitable because the economy is always changing.
- Changes in the composition of demand among industries or regions are called sectoral shifts.
- It takes time for workers to search for and find jobs in new sectors.

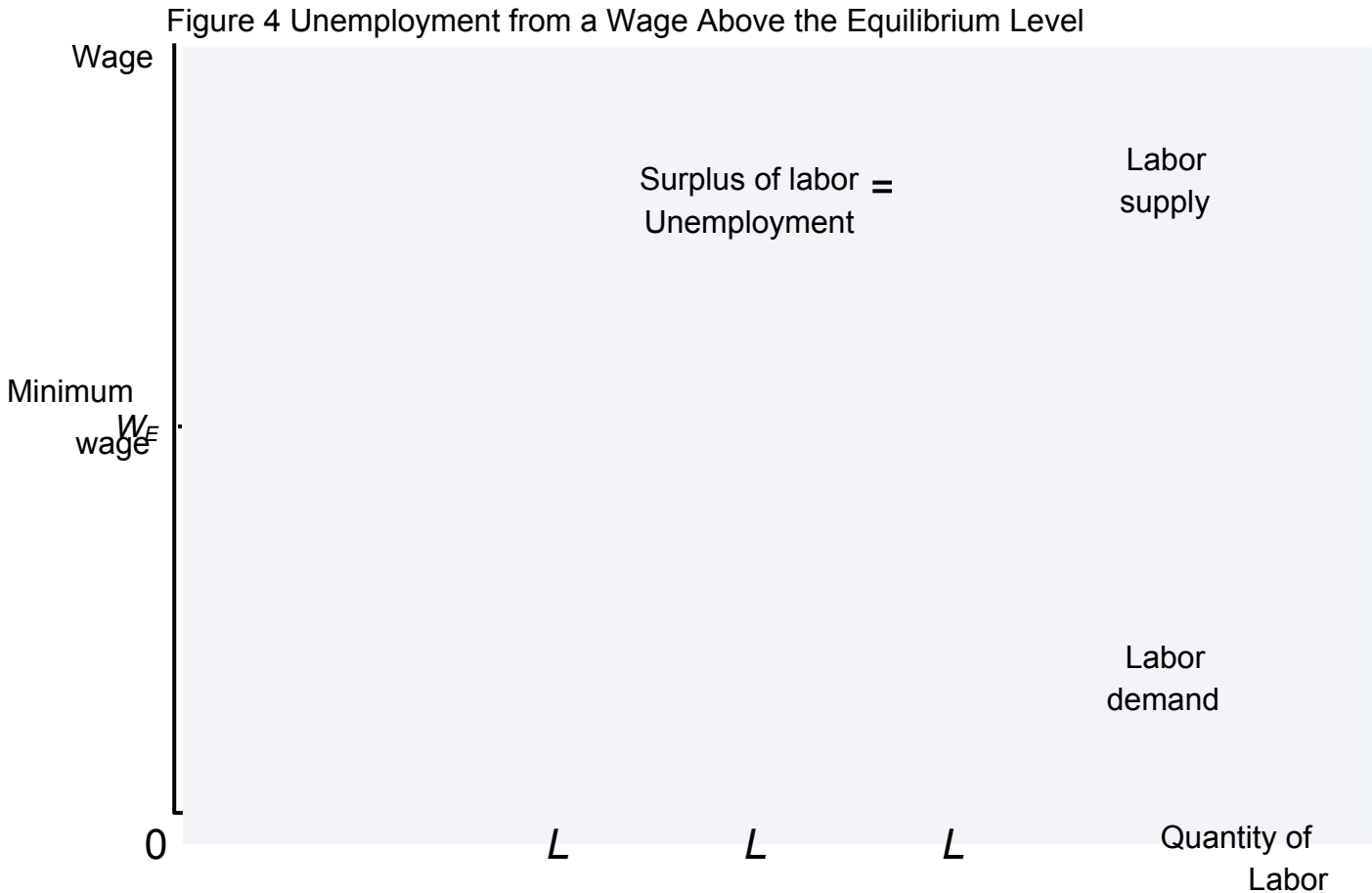
Public Policy and Job Search

- Government programs can affect the time it takes unemployed workers to find new jobs.
- These programs include the following:
 - Government-run employment agencies
 - Public training programs
 - Unemployment insurance
- Government-run employment agencies give out information about job vacancies in order to match workers and jobs more quickly.
- Public training programs aim to ease the transition of workers from declining to growing industries and to help disadvantaged groups escape poverty.
- Unemployment insurance is a government program that partially protects workers’ incomes when they become unemployed.
- Offers workers partial protection against job losses.
- Offers partial payment of former wages for a limited time to those who are laid off.
- Unemployment insurance* increases the amount of search unemployment.
- It reduces the search efforts of the unemployed.
- It may improve the chances of workers being matched with the right jobs.
- Structural unemployment occurs when the quantity of labor supplied exceeds the quantity demanded.
- Structural unemployment is often thought to explain longer spells of unemployment.
- Why is there Structural Unemployment?

- Minimum-wage laws
- Unions
- Efficiency wages

MINIMUM-WAGE LAWS

•When the minimum wage is set above the level that balances supply and demand, it creates unemployment.



UNIONS AND COLLECTIVE BARGAINING

- A *union* is a worker association that bargains with employers over wages and working conditions.
- In the 1940s and 1950s, when unions were at their peak, about a third of the U.S. labor force was unionized.
- A union is a type of cartel attempting to exert its market power.
- The process by which unions and firms agree on the terms of employment is called *collective bargaining*.
- A *strike* will be organized if the union and the firm cannot reach an agreement.
- A strike refers to when the union organizes a withdrawal of labor from the firm.
- A strike makes some workers better off and other workers worse off.

- Workers in unions (insiders) reap the benefits of collective bargaining, while workers not in the union (outsiders) bear some of the costs.
- By acting as a cartel with ability to strike or otherwise impose high costs on employers, unions usually achieve above-equilibrium wages for their members.
- Union workers earn 10 to 20 percent more than nonunion workers.

Are Unions Good or Bad for the Economy?

- Critics argue that unions cause the allocation of labor to be inefficient and inequitable.
- Wages above the competitive level reduce the quantity of labor demanded and cause unemployment.
- Some workers benefit at the expense of other workers.
- Advocates of unions contend that unions are a necessary antidote to the market power of firms that hire workers.
- They claim that unions are important for helping firms respond efficiently to workers' concerns.

THE THEORY OF EFFICIENCY WAGES

- Efficiency wages* are above-equilibrium wages paid by firms in order to increase worker productivity.
- The theory of efficiency wages states that firms operate more efficiently if wages are above the equilibrium level.
- A firm may prefer higher than equilibrium wages for the following reasons:
 - Worker Health: Better paid workers eat a better diet and thus are more productive.
 - Worker Turnover: A higher paid worker is less likely to look for another job.
- A firm may prefer higher than equilibrium wages for the following reasons:
 - Worker Effort: Higher wages motivate workers to put forward their best effort.
 - Worker Quality: Higher wages attract a better pool of workers to apply for jobs.

Summary

- The unemployment rate is the percentage of those who would like to work but don't have jobs.
- The Bureau of Labor Statistics calculates this statistic monthly.
- The unemployment rate is an imperfect measure of joblessness.
- In the U.S. economy, most people who become unemployed find work within a short period of time.
- Most unemployment observed at any given time is attributable to a few people who are unemployed for long periods of time.
- One reason for unemployment is the time it takes for workers to search for jobs that best suit their tastes and skills.
- A second reason why our economy always has some unemployment is minimum-wage laws.
- Minimum-wage laws raise the quantity of labor supplied and reduce the quantity demanded.
- A third reason for unemployment is the market power of unions.
- A fourth reason for unemployment is suggested by the theory of efficiency wages.
- High wages can improve worker health, lower worker turnover, increase worker effort, and raise worker quality.