Chapter 28 – Unemployment

In this chapter, look for the answers to these questions:

- How is unemployment measured?
- What is the "natural rate of unemployment"?
- Why are there always some people unemployed?
- How is unemployment affected by unions and minimum wage laws?
- What is the theory of efficiency wages, and how does it help explain unemployment?

Labor Force Statistics

BLS divides population into 3 groups:

- **Employed**: paid employees, self-employed, and unpaid workers in a family business
- **Unemployed**: people not working who have looked for work during previous 4 weeks
- **Not in the labor force**: everyone else

The **labor force** is the total # of workers, including the employed and unemployed.

Labor Force Statistics

Unemployment rate ("u-rate"):

% of the labor force that is unemployed

$$\text{u-rate} = 100 \times \frac{\text{\# of unemployed}}{\text{labor force}}$$

Labor force participation rate:

% of the adult population that is in the labor force

$$\text{labor force participation rate} = 100 \times \frac{\text{labor force}}{\text{adult population}}$$

ACTIVE LEARNING 1

Calculate labor force statistics

Compute the labor force, u-rate, adult population, and labor force participation rate using this data:

Adult population of the U.S. by group, April 2011	
# of employed	139.7 million
# of unemployed	13.7 million
not in labor force	85.7 million

ACTIVE LEARNING 1

Answers

Labor force = employed + unemployed

= 139.7 + 13.7

= 153.4 million

U-rate = 100 x (unemployed)/(labor force)

= 100 x 13.7/153.4

= 8.9%

ACTIVE LEARNING 1

Answers

Population = labor force + not in labor force

= 153.4 + 85.7

= 239.1

LF partic. rate = 100 x (labor force)/(population)

= 100 x 153.4/239.1

= 64.2%

Cyclical Unemployment vs. the Natural Rate

There's always some unemployment, though the u-rate fluctuates from year to year.

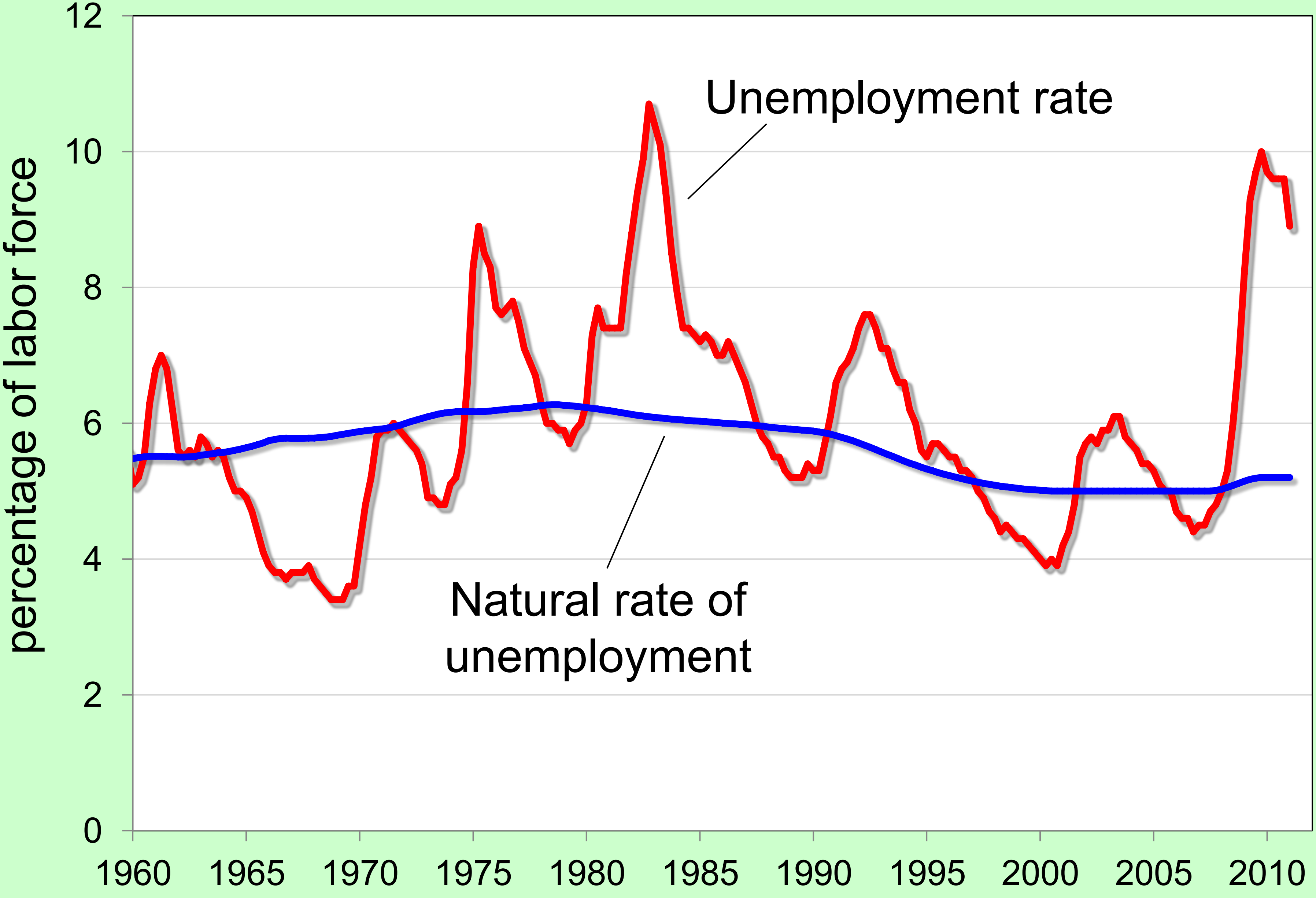
Natural rate of unemployment

- the normal rate of unemployment around which the actual unemployment rate fluctuates

Cyclical unemployment

- the deviation of unemployment from its natural rate
- associated with business cycles, which we'll study in later chapters

U.S. Unemployment, 1960–2011



Explaining the Natural Rate: An Overview

Even when the economy is doing well, there is always some unemployment, including:

Frictional unemployment

- occurs when workers spend time searching for the jobs that best suit their skills and tastes
- short-term for most workers

Structural unemployment

- occurs when there are fewer jobs than workers
- usually longer-term

Public Policy and Job Search

- *Govt employment agencies*
  provide information about job vacancies to speed up the matching of workers with jobs.
- *Public training programs*
  aim to equip workers displaced from declining industries with the skills needed in growing industries.

Unemployment Insurance

- **Unemployment insurance** (UI):
  a govt program that partially protects workers' incomes when they become unemployed
- UI increases frictional unemployment.
  To see why, recall one of the
  Ten Principles of Economics:
  People respond to incentives.
  UI benefits end when a worker takes a job, so workers have less incentive to search or take jobs while eligible to receive benefits.

Unemployment Insurance

Benefits of UI:

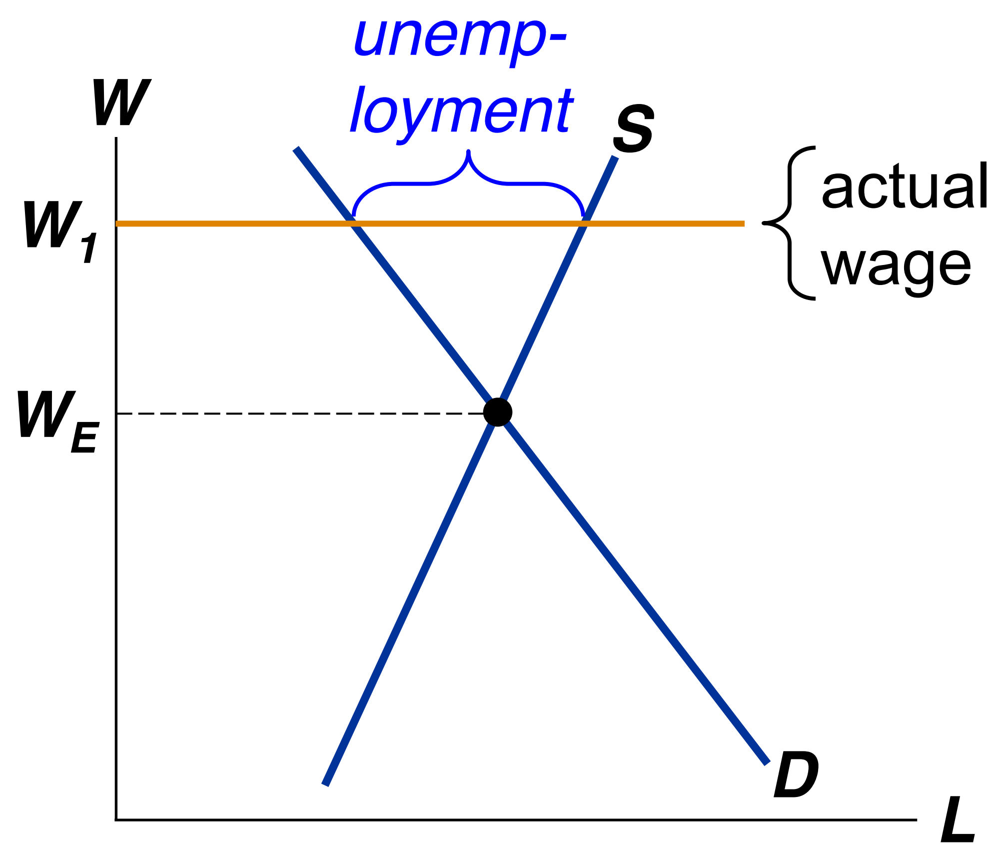
- Reduces uncertainty over incomes
- Gives the unemployed more time to search, resulting in better job matches and thus higher productivity

Explaining Structural Unemployment

Structural unemployment occurs when not enough jobs to go around.

Occurs when wage is kept above eq'm.

There are three reasons for this…



1. Minimum-Wage Laws

- The min. wage may exceed the eq'm wage for the least skilled or experienced workers, causing structural unemployment.
- But this group is a small part of the labor force, so the min. wage can't explain most unemployment.

2. Unions

- **Union**: a worker association that bargains with employers over wages, benefits, and working conditions
- Unions exert their market power to negotiate higher wages for workers.
- The typical union worker earns 20% higher wages and gets more benefits than a nonunion worker for the same type of work.

3. Efficiency Wages

- The theory of **efficiency wages**:
  Firms voluntarily pay above-equilibrium wages to boost worker productivity.
- Different versions of efficiency wage theory suggest different reasons why firms pay high wages.

SUMMARY

- The unemployment rate is the percentage of those who would like to work who do not have jobs.
- Unemployment and labor force participation vary widely across demographic groups.
- The natural rate of unemployment is the normal rate of unemployment around which the actual rate fluctuates. Cyclical unemployment is the deviation of unemployment from its natural rate and is connected to short-term economic fluctuations.

SUMMARY

- The natural rate includes frictional unemployment and structural unemployment.
- Frictional unemployment occurs when workers take time to search for the right jobs.
- Structural unemployment occurs when above-equilibrium wages result in a surplus of labor.
- Three reasons for above-equilibrium wages include minimum wage laws, unions, and efficiency wages.