

## CHAPTER 15 - UNEMPLOYMENT

This chapter defines the unemployment rate and discusses its strengths and weaknesses as a measure of economic welfare. Further, it emphasizes that while the unemployment rate is a stock concept, there is an underlying set of flows into and out of that stock. Thus, different demographic groups may have different unemployment rates because of different propensities to quit or be laid off from jobs.

Next, we discuss four general types of unemployment: frictional, structural, demand deficient, and seasonal unemployment. In the section on frictional unemployment we discuss search theory and the effects of unemployment benefits on job search. When analyzing structural unemployment, occupational and geographical imbalances, government policies, and efficiency wages (including the "wage curve") are discussed. The section on demand deficient unemployment analyzes wage rigidity, the financing of unemployment benefits, and policies and adjustments found in Europe.

The chapter also treats the issue of "full employment." The structure of unemployment rates across demographic groups is presented, and we then discuss effects of the changing age, race, and sex composition of the labor force on the full employment rate of unemployment.

### List of Major Concepts

1. The unemployment rate is the number of nonemployed people seeking work divided by the number of people who are in the labor force. While this measure has a number of serious drawbacks, it remains a useful indicator of labor market conditions.
2. While one can think of a stock of unemployed persons, this stock is constantly changing, focusing only on the stock masks the highly dynamic nature of labor markets. Unemployment rates are affected by layoffs and quits, new hires and recalls, retirees from and new entrants into the labor market. As these flows change relative to each other, the unemployment rate changes in predictable ways.
3. Frictional unemployment occurs because labor market information is imperfect. It takes time even in the best of markets for unemployed workers and employers with job vacancies to find each other. Government efforts to improve the rapidity of the job-matching process could reduce the extent of frictional unemployment.
4. A period of unemployment can be looked upon as a period when job search can be undertaken, and the extent to which someone will spend time searching for work depends upon the expected benefits and costs of continuing search.
5. Since the receipt of unemployment insurance benefits reduces the costs of extra time spent searching for work, the more generous these benefits are, the longer unemployed workers will tend to search for jobs. Thus, more generous

unemployment insurance benefits may be expected to increase the duration of unemployment.

6. Structural unemployment occurs when flows of workers into and out of particular labor markets -- defined by skill or geography -- are impeded. Government efforts to subsidize mobility and/or job training would serve to reduce the incidence of structural unemployment.
7. Structural unemployment is also associated with firms' decisions to pay efficiency wages; in such cases, some workers without jobs "wait" for jobs in the high-paying sector and do not seek jobs in lower-paying firms.
8. Efficiency wages may underlie the "wage curve" found in almost all countries studied; this curve plots a negative relationship between the regions' wage rates and their unemployment rates.
9. Demand-deficient unemployment occurs when the aggregate demand for labor declines in the face of downward inflexibility of nominal or real wages.
10. There are several reasons for the downward inflexibility of money wages, including the preference of unions for layoffs over wage cuts, the asymmetry of information between employers and employees, firm-specific training, risk aversion of older workers, concerns about status, and implicit contractual agreements that after an initial period, when the risk of layoff is high, yearly earnings of workers will stabilize.
11. The government's tax treatment of most unemployment insurance benefits and its failure to perfectly experience-rate the unemployment insurance charges levied on employers lead to a higher layoff rate than would otherwise prevail.
12. In Europe, cyclical fluctuations in labor demand are more likely to be manifest in adjustments in hours, not employment levels. One reason for the greater adjustments in hours of work may lie in the wider use of partial unemployment compensation benefits in Europe.
13. Seasonal unemployment may be associated with changes in the weather or with model changeovers, but it is also affected by downward rigidity of money wages and the government's unemployment insurance program.
14. The full-employment rate of unemployment (i.e., unemployment in "normal" times) appears to have changed in recent years, in part due to the changing proportion of women, teenagers, and ethnic minorities in the labor force.