

The labor market, unemployment and inflation

Econ 202 Lecture 5

Petar Stankov

`petar.stankov@cerge-ei.cz`

27 Oct. 2009

- 1 The labor market: what do we know so far?
- 2 The classic and the modern view about unemployment
- 3 The relationship between unemployment and inflation

The labor market: what do we know so far?

The unemployment rate

The labor market: what do we know so far?

The unemployment rate

The number of people unemployed as a percentage of the labor force.

Types of unemployment:

- 1 **Frictional unemployment** is caused by the normal working of the labor market.
- 2 **Structural unemployment** is caused by changes in the structure of the economy that create a mismatch between workers' job skills and the skills demanded by employers.
- 3 **Cyclical unemployment** is unemployment caused by recessions and depressions.

The major concern of macroeconomists is the Cyclical unemployment.

The labor market: what do we know so far?

The unemployment rate

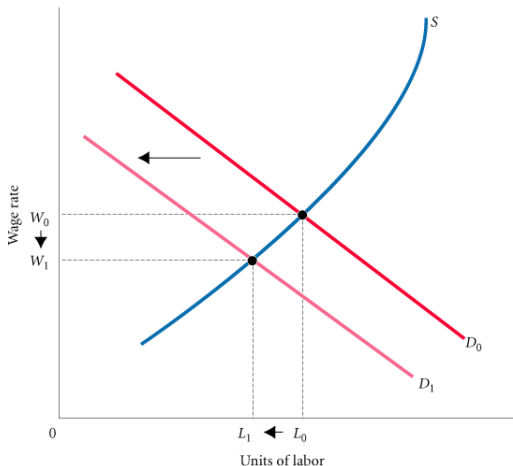
The number of people unemployed as a percentage of the labor force.

Types of unemployment:

- 1 **Frictional unemployment** is caused by the normal working of the labor market.
- 2 **Structural unemployment** is caused by changes in the structure of the economy that create a mismatch between workers' job skills and the skills demanded by employers.
- 3 **Cyclical unemployment** is unemployment caused by recessions and depressions.

The major concern of macroeconomists is the Cyclical unemployment.
Let's play managers and workers...

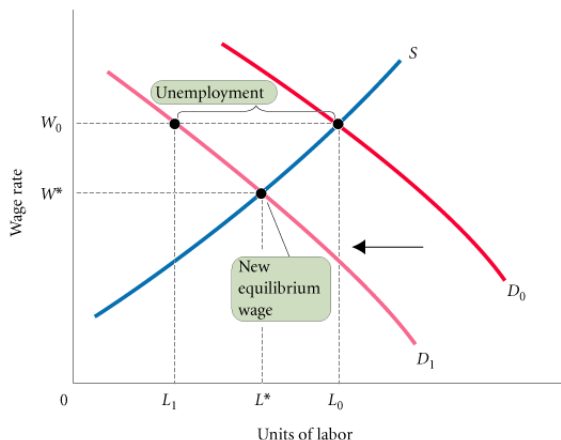
The Classical View of the Labor Market



Let's analyze the graph...

The crucial assumption of the classical view: wages adjust quickly; unemployment is voluntary.

The Flaw in the Classical View



If wages are not quickly adjusting (*sticky*), unemployment occurs.

Reasons for sticky wages and unemployment

Some of the reasons that wages are not flexible are:

- ① Social conventions that wages should only go up
- ② Explicit contracts between workers and the firms
- ③ Minimal wage legislation
- ④ Union activity: cost-of-living adjustment
- ⑤ Economic geography: capital cities VS. the countryside

These theories are complements, not substitutes!

Looking for a job

Tell me your experience... How did you find the job?

Looking for a job

Tell me your experience... How did you find the job?

Where did you start looking for it?

How much did it cost?

How much time did it take?

Did you feel *matched* with the employer?

Looking for a job

Tell me your experience... How did you find the job?

Where did you start looking for it?

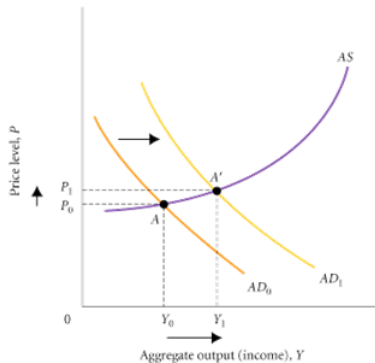
How much did it cost?

How much time did it take?

Did you feel *matched* with the employer?

Looking for a job is sometimes a full-time job...

The relationship between unemployment and inflation



The relationship between unemployment and inflation

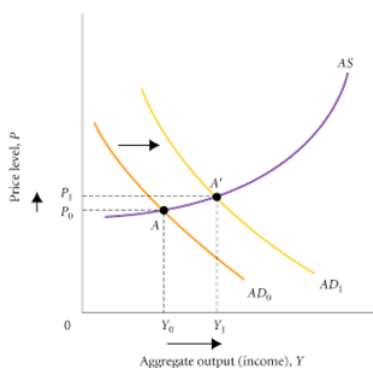


Figure: The Phillips Curve

The Phillips Curve: Evidence

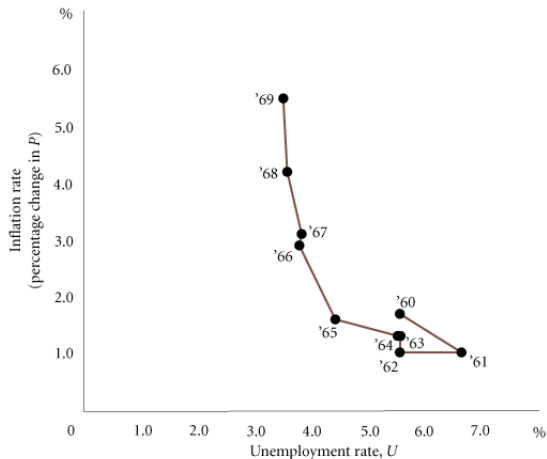


FIGURE 14.6 Unemployment and Inflation, 1960–1969

Figure: The Phillips Curve: Evidence

The Phillips Curve: Counter-Evidence

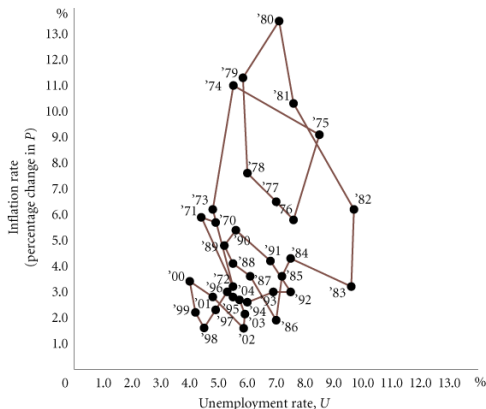
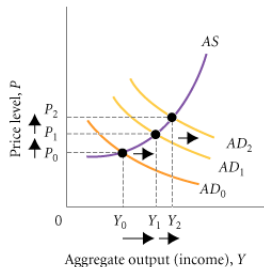


FIGURE 14.7 Unemployment and Inflation, 1970—2004

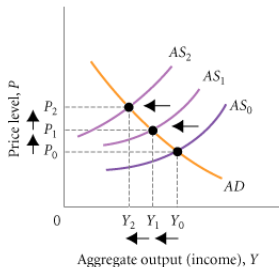
Little long-term evidence that the Phillips curve exists. This is so because the original PC was based on data only, and not on some sound economic model that can explain the data.

The Phillips Curve: Reasons for non-existence in long-run



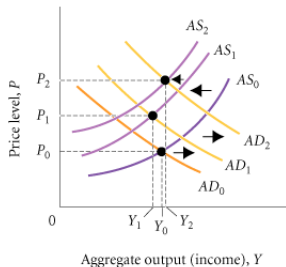
a.

AD shifts with no AS shifts trace out the AS curve (a positive relationship between P and Y).



b.

AS shifts with no AD shifts trace out the AD curve (a negative relationship between P and Y).



c.

If both AD and AS are shifting, there is no systematic relationship between P and Y .

In short-run (SR), the relationship is working because only AS or AD move. However, in long-run both shift, and the relationship is unstable.