

# EC1B5 Winter Term 2023-24

## Answer Key to Discussion Question 4 (Week 5 Class)

**Week 5 class:** In week 4 we learnt about different measurements in the labour market. One of the key statistics that has captured the attention of policy makers during recent decade is the female labour force participation rate.

- a. What is the definition of participation rate, unemployment rate and how does it relate to the measurement of GDP?
- b. There is a substantial difference in female labour force participation rates across countries. Explain how the decisions for women to look for a job may affect GDP, participation rate and unemployment rate?
- c. What are the economic mechanisms that cause unemployment in the data?

### Answer key:

As discussed in week 1, when a full-time housewife joins the labour market and works for pay, GDP increases. This is because she now produces market output through her job and she may also purchase from the market the output she used to produce at home.

By definition, participation rate is equal to size of the labour force divided by the number of potential workers, so it increases if more women look for jobs. It is, however, not clear what will happen to unemployment rate. The unemployment rate is equal to the number of unemployed divided by the total labour force. Clearly if the labour market is competitive, market wages will adjust and there is no change in unemployment rate (which is zero anyway).

There are two main economic mechanisms for why we observe unemployment in the data. First, it takes time for those who just join the labour force to find a job. Thus, the effect on unemployment rate depends on how quickly they can find a job. Second, wage may be rigid due to minimum wage laws, union, efficiency wage or other kinds of downward wage rigidity. These factors are important in this situation because the immediate effect of higher labour force is to lower the market wage. Thus, if wage does not fall, unemployment will rise, which may drive up unemployment rate especially in the short run.