Lecture 6b - Non-DMP approaches to unemployment

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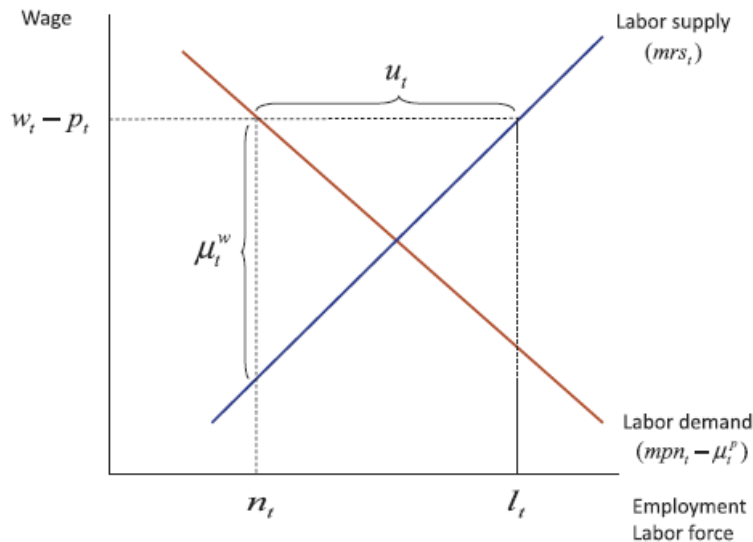
May 17, 2017

- Overview: Non-search (non-DMP) approach to unemployment
- Detailed: "Involuntary unemployment and the business cycle", Christiano, Trabandt and Walentin (2012)
  - Includes LFP - thereby connect to previous lecture

Wage markup

- Alternative to frictional unemployment: Wages stuck at level that doesn't clear the market, $mrs > mpn$
- Several reasons suggested for this:
  - Workers have market power when selling labor
    - Unions act as monopolists, yields markup μ_t^w of real wage: $w_t - p_t = mrs_t + \mu_t^w$
  - Efficiency wage (Akerlof and Yellen, 1986)
  - Costly worker search: Christiano, Trabandt and Walentin (2012)
  - (Legal minimum wage)

Wage markup yielding unemployment (Gali)

Efficiency wages

- Basic idea:
  - Job effort (at least partially) unobserved
  - Need to pay workers $>$ outside option so that they "do the right thing" (to keep their job)
    - Otherwise no punishment (loss) can be inflicted on slacking workers

Efficiency wages in quantitative DSGE models

- Bad fit with aggregate data if punishment is losing job
  ⇒wages too cyclical, employment too stable
  - Analogous to problems of DMP model with Nash bargaining and unemployment as outside option
- Alexopoulos (2004): If punishment is partial temporary loss of wage, nice quantitative results:
  - high employment volatility
  - low wage volatility

Summary unemployment modelling

- Search and matching models (DMP) is the dominant paradigm for unemployment modelling
- Alternatives exists, mainly based on wages too high, $mrs > mpn$
- Let's look in detail at one alternative...

Aspects of macro-labor we didn't cover (enough)

- Heterogeneity productivity across workers and firms
- Richer wage setting: Job (wage) ladders
- Earnings loss literature:
    - Major challenge to DMP framework is to match and explain the fact that job displacement is VERY costly (>1 year annual earnings in PDV terms)
- Many other things