(Un)employment: The labor market

Principles of Macroeconomics // Spring 2025

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Readings

Recommended readings

Required readings:

- *Macroeconomics in Context*, 4th ed.
  - → Chapter 7, sections 2—3.

Recommended watching:

- 🔗 The manipulation of labor markets, by Richard Wolff (*Democracy at Work*)

Words of the day

- Labor supply;
- Labor demand;
- Bargaining;
- Uncertainty.

The market for labor

The market for labor

- In a *not-too-far* future from now, what ***characteristics*** will you be seeking in your job?

- And what will you want to ***avoid***?

The market for labor

First, defining what **markets** mean.

→ *Market*: an **institution** that facilitates economic interactions among *buyers* and *sellers.*

However, **labor markets** are *different* from other markets in ***several*** ways.

- What is for ***sale***?
- What is available for ***purchase***?
- Do ***interests*** necessarily *match* between all parts involved?

The market for labor

The **labor market** can be generally understood through *two* main *actors*:

- *Workers*: Those who **supply** labor.
- *Employers*: Those who **demand** labor.

These are not **static** over time.

- Determining **bargaining** positions.

The market for labor

- 🔗 `Unemployment rate over time`

→ Does the **behavior** of the unemployment rate relate to **economic activity**?

Unemployment & GDP

Unemployment & GDP

Unemployment tends to **rise** once a recession kicks in.

- However, it **does not** usually start *rising* before a recession starts.
- Unemployment is often considered a *lagging* variable that only moves once there are *already* other signs of economic trouble.

Conversely, unemployment tends to **decrease** in times of economic **expansion**.

This association is known as *Okun's law*.

- 🔗 `Who's Okun?`

Types of unemployment

Types of unemployment

While the *definition* of unemployment is **unique**, those **unemployed** differ in many aspects. (education, circumstances, industry, etc.)

Possible **explanations** for unemployment may be summarized into **three** different groups:

1. *Frictional* unemployment;
2. *Structural* unemployment;
3. *Cyclical* unemployment.

Types of unemployment

Frictional unemployment:

- The most “normal” kind of unemployment.
- Mostly *voluntary*.

Types of unemployment

Structural unemployment:

- Related to the **sectors** of an economy.
- Mostly *involuntary.*

Types of unemployment

Cyclical unemployment:

- Related to the economy's **business cycles**.
- Mostly *involuntary.*

Theories of unemployment

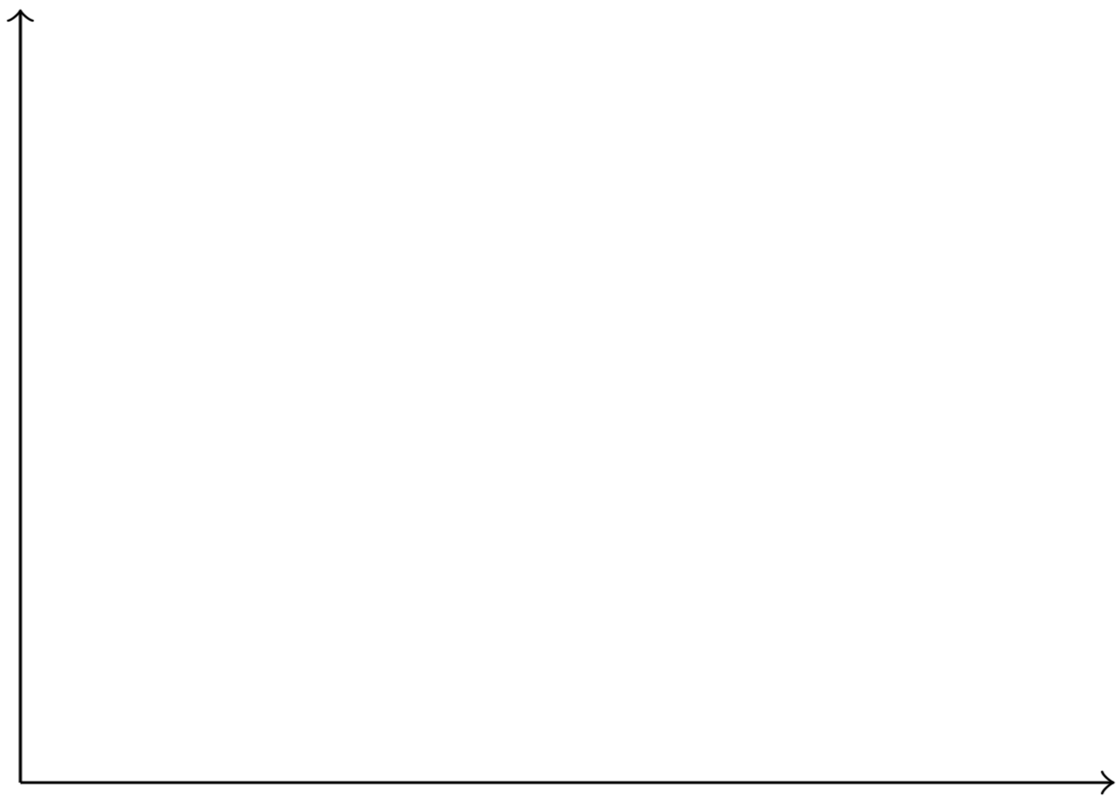
Theories of unemployment

Regardless of the economic **scenario**, **policymakers** are always faced with *unemployment-related puzzles*:

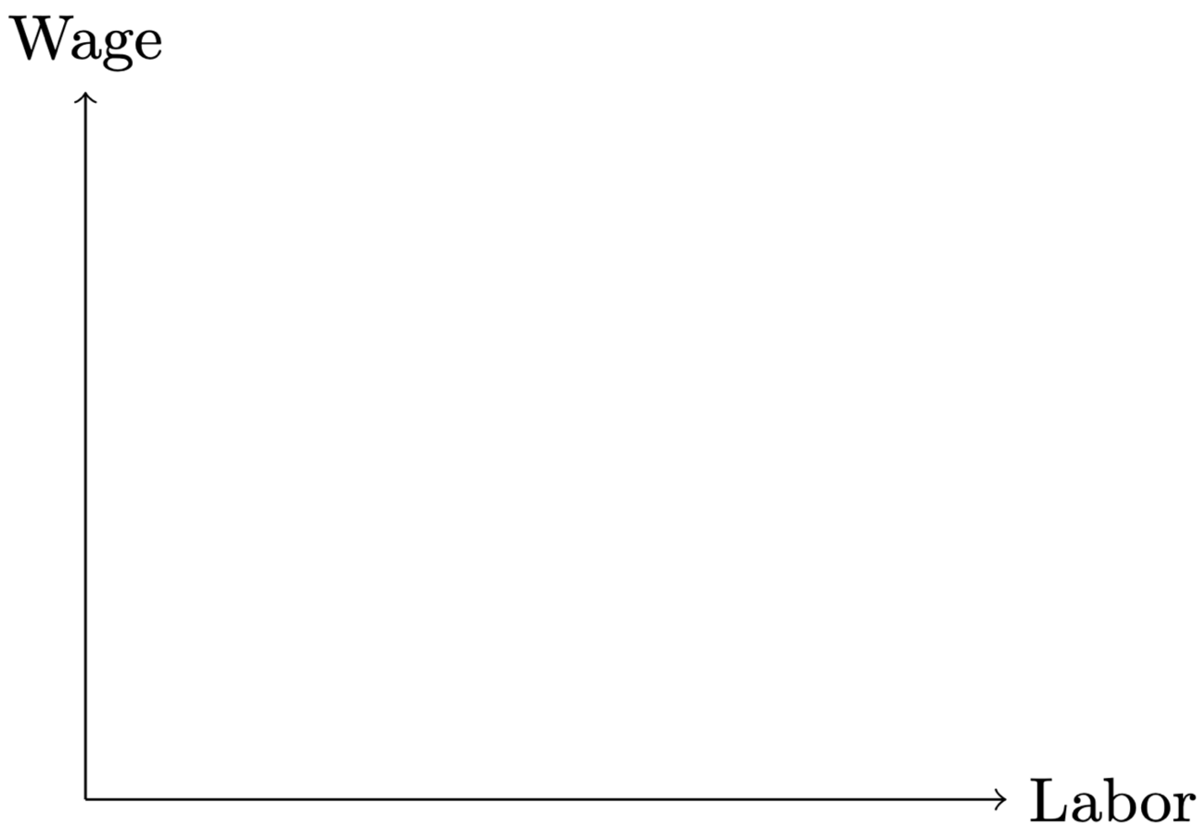
- Is a *low-unemployment* level *sustainable* for longer periods of time?
- How can we deal with *involuntary* unemployment?
- Will the labor market *adjust* on its own?
- How can the *government* help?

Theories of unemployment

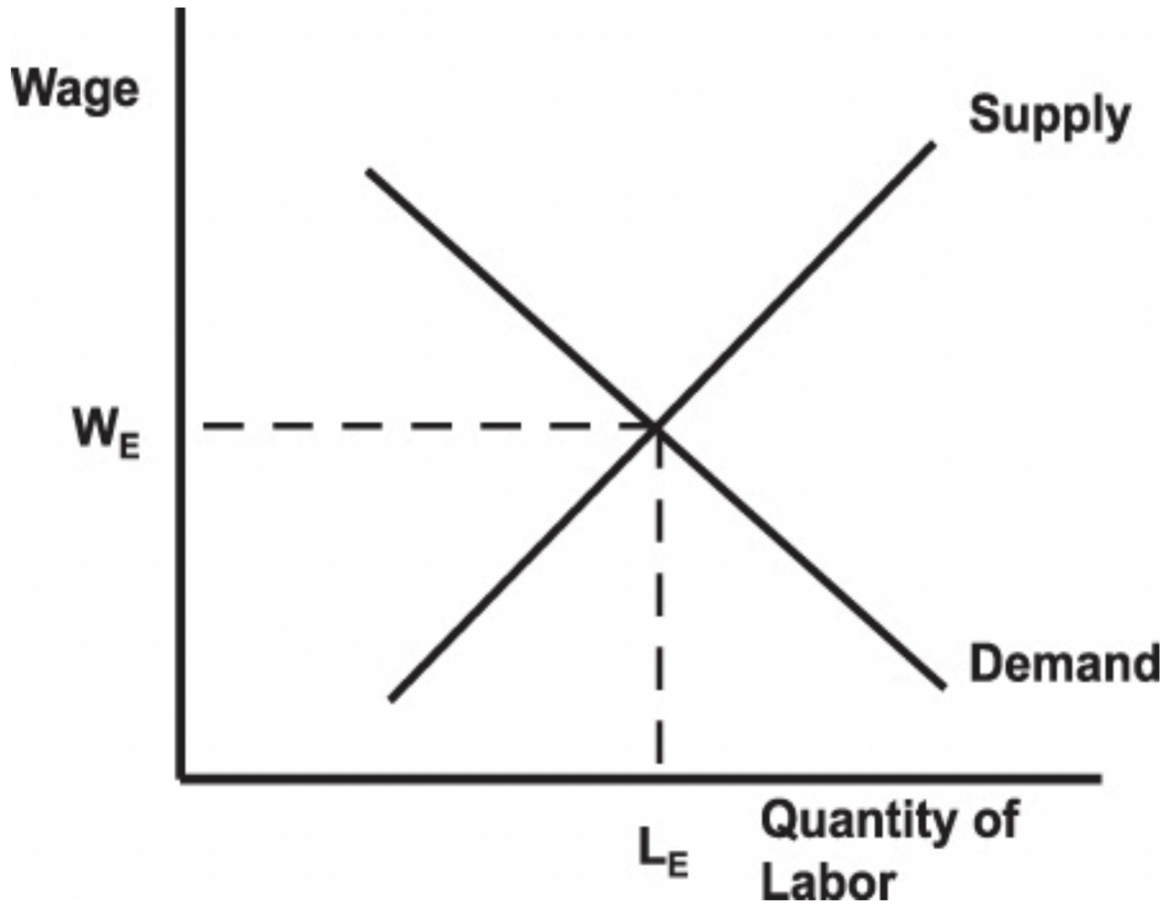
The “**classical**” (actually *standard*) doctrine on the functioning of labor markets can be represented through a simple **figure**:



Theories of unemployment

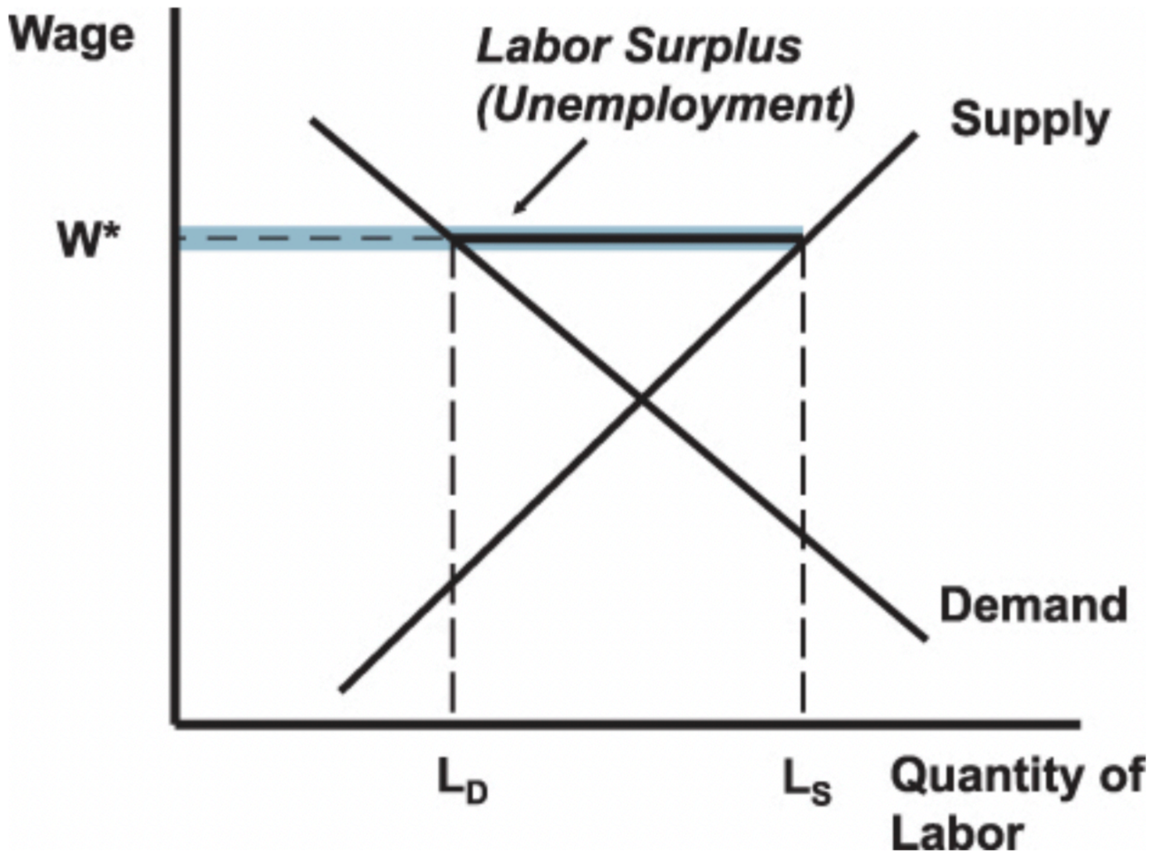


Theories of unemployment



Source: Goodwin et al. (2023)

Theories of unemployment



Source: Goodwin et al. (2023)

Theories of unemployment

Q: What gets in the way of *full employment*?

A: Market regulations;

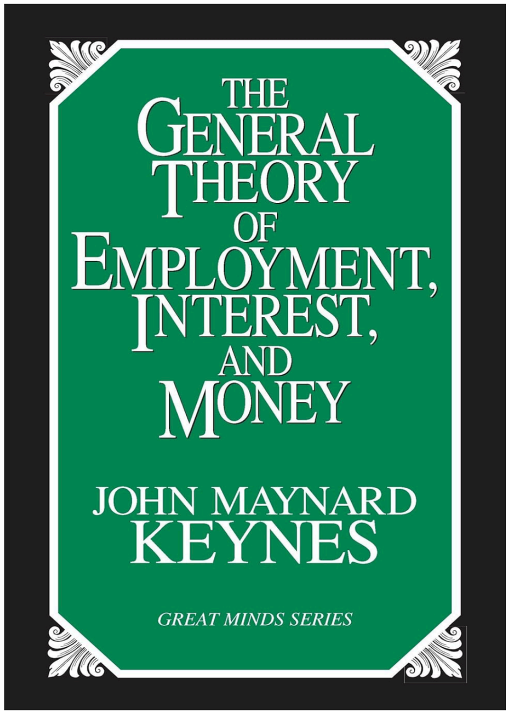
A: Labor unions;

A: "Safety net" policies.

Theories of unemployment

The **Great Depression** strikes again…

`John Maynard Keynes (1883–1946)` and the *Principle of Effective Demand (PED)*:



Theories of unemployment

John Maynard Keynes (1883–1946) and the *Principle of Effective Demand (PED)*:

- *Aggregate demand*: *C + I + G + (X - M)*
- *Aggregate supply*: The total value of **production** of final goods and services offered for sale in a given period.
- Interrelationship between *time*, *uncertainty*, and *money*.

→ The past is *irrevocable* and the future is *unknown*.

→ Every action is predicated on *uncertainty*.

→ *Money* as a *medium of exchange* and a *store of value*.

Theories of unemployment

John Maynard Keynes (1883–1946) and the *Principle of Effective Demand (PED)*:

- *Aggregate investment (I)* as the key component of aggregate demand.
- It links *time*, *uncertainty*, and *money* dimensions.
- Investment decisions based on *expected profits*.

Q: If future profitability expectations are **confirmed**, what happens?

Q: What if **not**?

Theories of unemployment

🔗 Comparing aggregate investment and consumption over time

🔗 Adding government to the picture

Next time: Unemployment & reality