EC132.02
Principles of Macroeconomics

Boston College

Tuesday, April 2

Announcements and Reminders

Aplia homework on Ch 28, Unemployment, due this Friday, April 5, at 9am.

Aplia homework on the first part of Ch 29, The Monetary System, due next Friday, April 12, at 9am.

Announcements and Reminders

Second midterm exam: next Thursday, April 11, 10:30 – 11:45am.

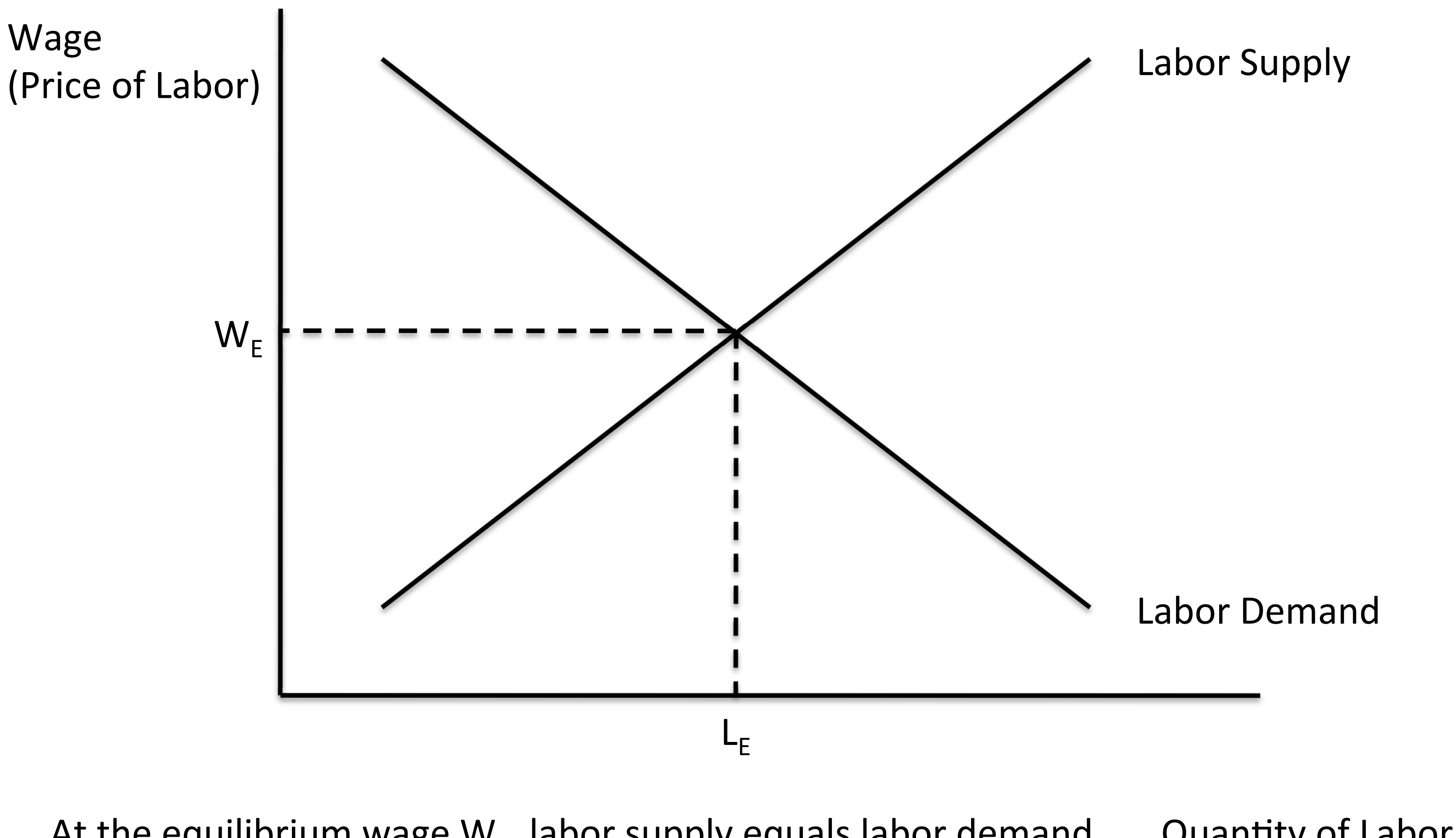
Closed book exam, between 6 and 12 questions (short-answer, with multiple parts) covering:

- Ch 26 – Saving, Investment, and the Financial System
- Ch 28 – Unemployment
- Ch 29 – The Monetary System (but only the first two parts)

Ch 28 Unemployment

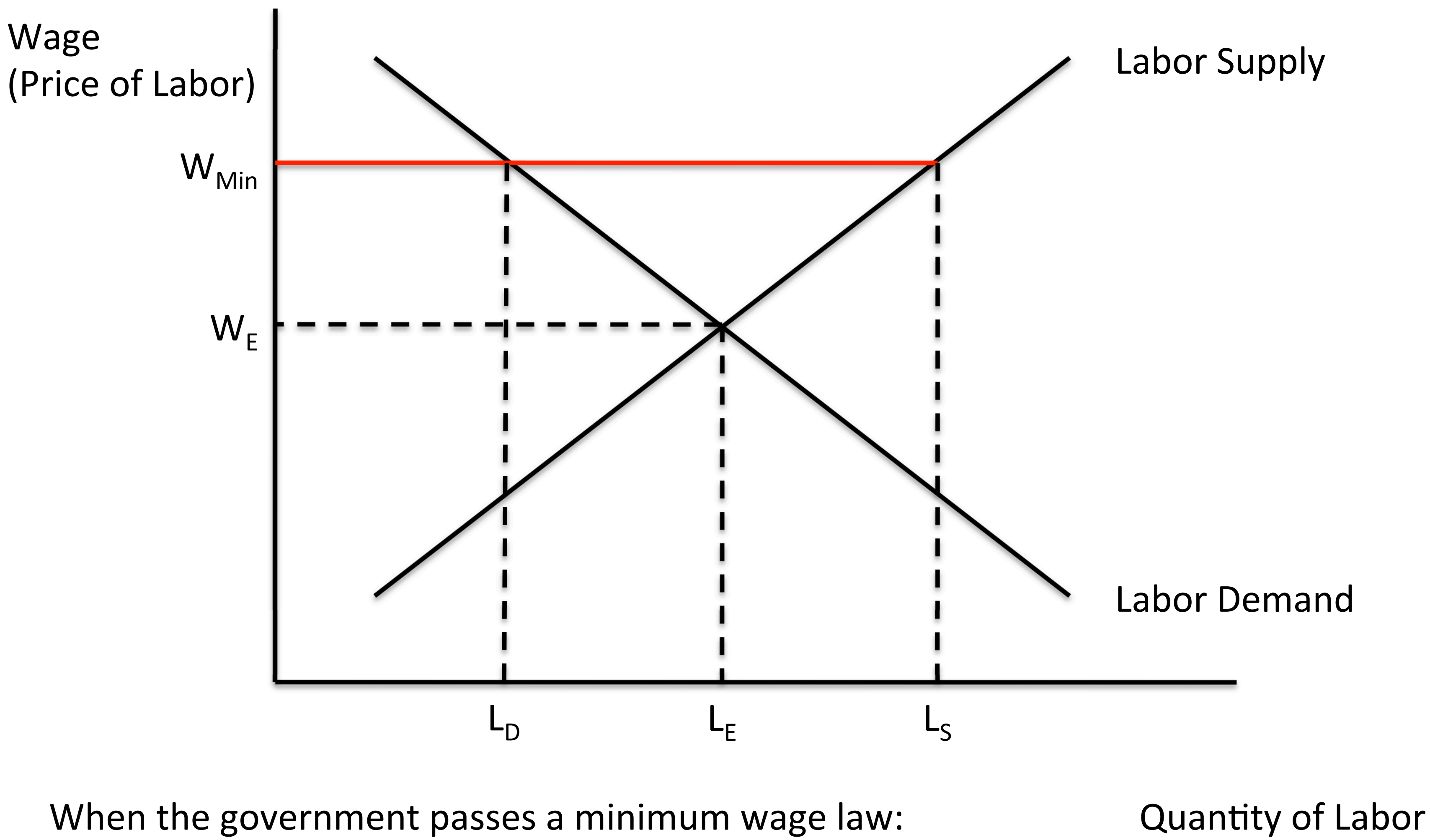
1. Identifying Unemployment ✔
2. Job Search - Frictional Unemployment ✔
3. Minimum Wage Laws - Structural Unemployment
4. Unions - Structural Unemployment
5. Efficiency Wages - Structural Unemployment

Minimum Wage Laws



At the equilibrium wage W_E, labor supply equals labor demand. The market "clears" without any unemployment.

Minimum Wage Laws



When the government passes a minimum wage law:

Employment falls from L_E to L_D.

Unemployment rises from zero to $L_S - L_D$.

Minimum Wage Laws

Unemployment caused by minimum wage laws is structural, since there are not enough jobs for everyone who wants one.

Note, however, that this type of unemployment arises only if the minimum wage dictated by law is above the equilibrium wage.

Since most American workers earn more than the minimum wage anyway, these laws can't explain all of the unemployment that prevails even in good times.

But it can explain why unemployment is chronically higher among teenagers.

Minimum Wage Laws

Note that minimum wage laws succeed in increasing the wages of those workers who retain their jobs.

But they also work to reduce the number of workers who have jobs.

Since some people benefit while others are harmed, economists, politicians, and even workers themselves disagree on whether minimum wage laws have positive effects on net.

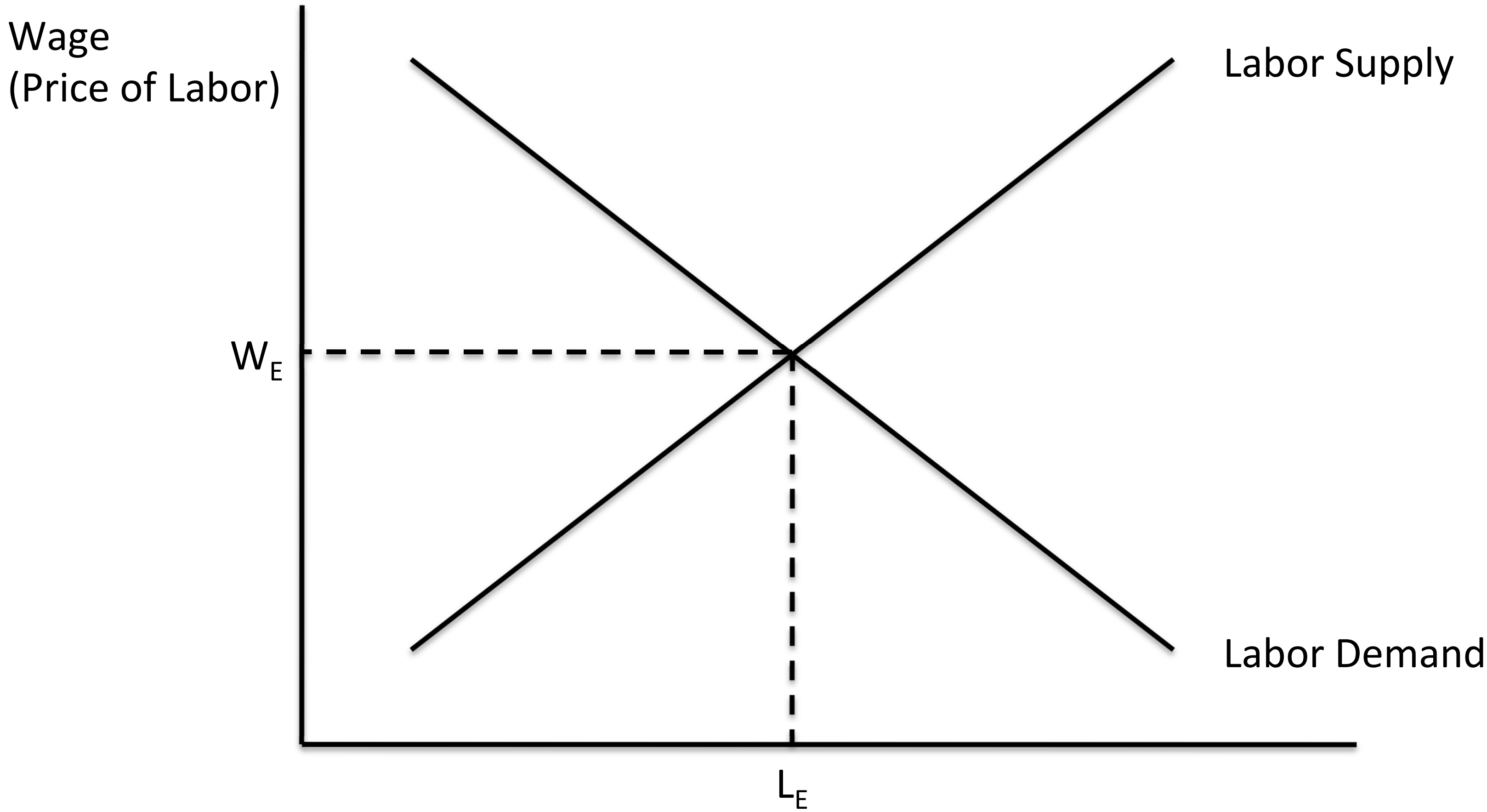
Unions and Collective Bargaining

A labor union is an association of workers that negotiates with employers over wages, benefits, and working conditions through collective bargaining.

If the two sides can't agree, the union can organize a strike, an organized withdrawal of labor from the firm.

Studies show that through collective bargaining, unions can increase the wages their members receive by 10 to 20 percent.

Unions and Collective Bargaining



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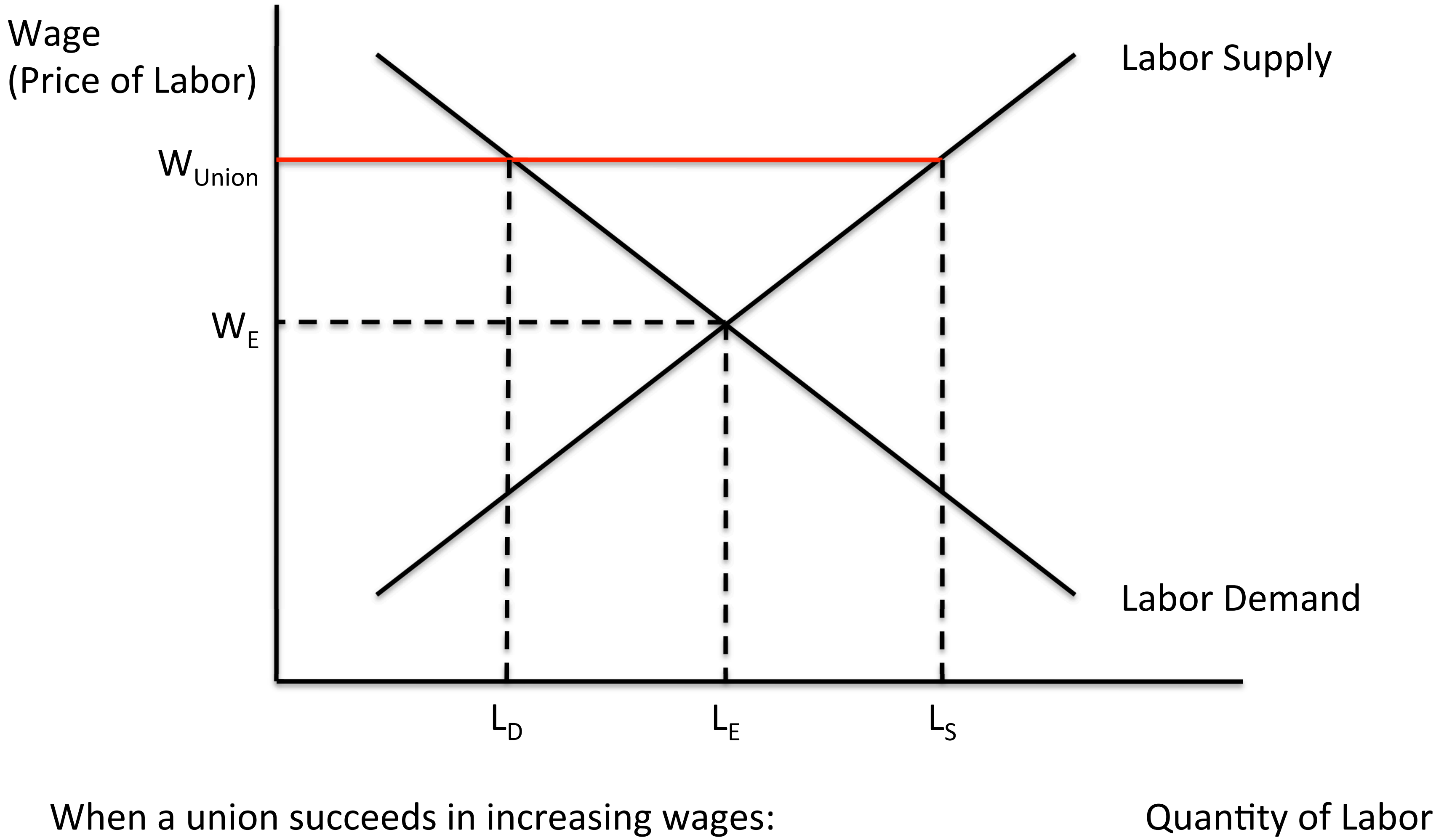
Unions and Collective Bargaining



When a union succeeds in increasing wages:

Employment falls from L_E to L_D.

Unemployment rises from zero to $L_S - L_D$.

Unions and Collective Bargaining

In the 1940s and 1950s, about one third of all American workers were unionized.

Now that number is only about 12 percent.

So like minimum wages, unions help explain some, but not all, of the natural rate of unemployment in the US.

Unions and Collective Bargaining

Unemployment caused by unions is structural, since there are not enough jobs for everyone who wants one.

Note that unions succeed in increasing the wages of those workers who retain their jobs.

But they also work to reduce the number of workers who have jobs.

Since some people benefit while others are harmed, economists, politicians, and even workers themselves disagree on whether unions laws have positive effects on net.

Efficiency Wage Theory

The “above equilibrium” wages resulting from minimum wage laws come from government actions.

The above equilibrium wages resulting from unions come from workers’ actions.

Efficiency wage theory suggests reasons why individual firms might want to pay above equilibrium wages.

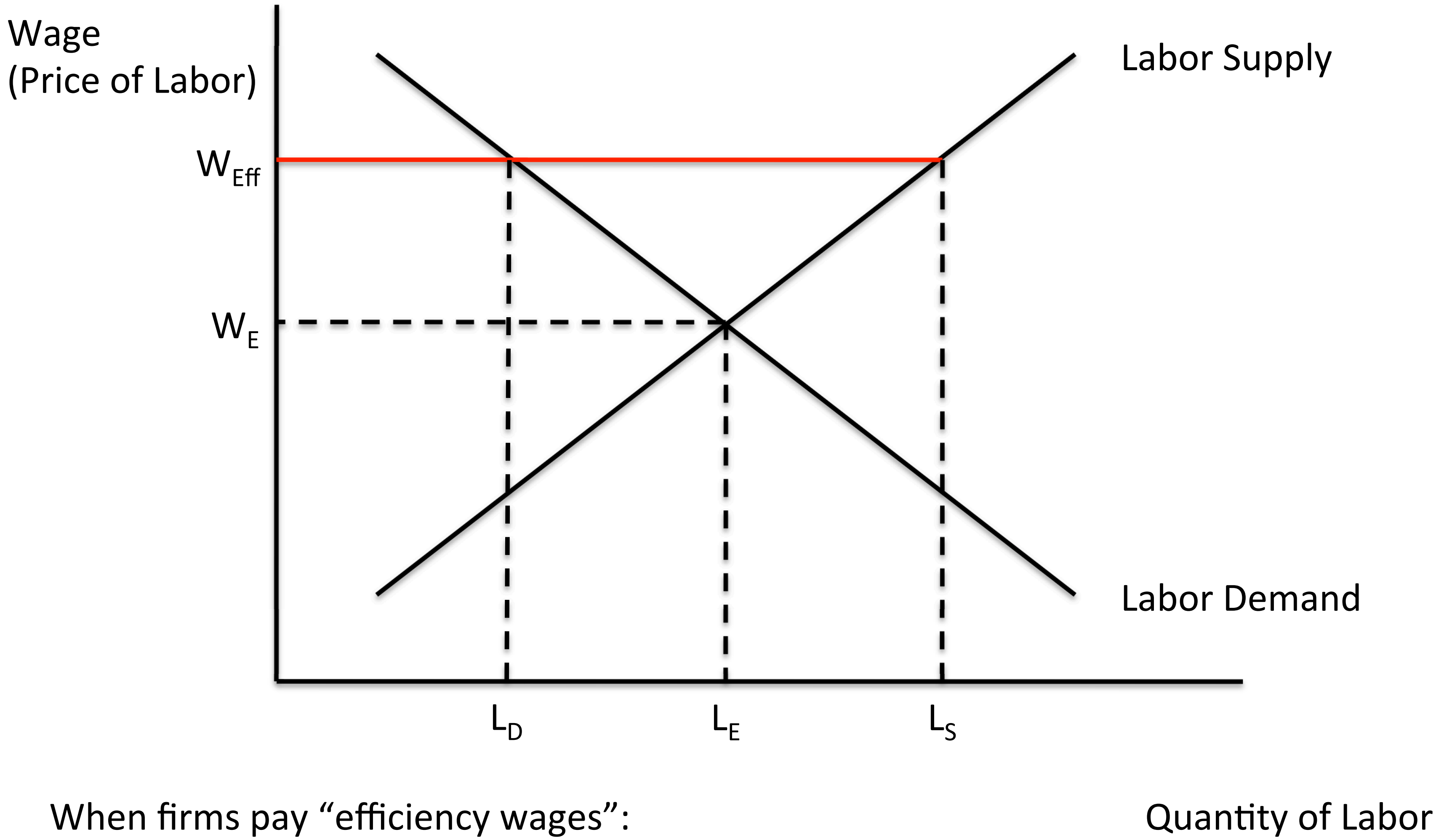
Efficiency Wage Theory

Why might firms voluntarily pay above equilibrium wages?

1. To improve workers' health.
2. To minimize worker turnover.
3. To attract the best workers.
4. To maximize worker effort.

Paying workers $5/day was "one of the finest cost-cutting moves we ever made." – Henry Ford (1914).

Efficiency Wage Theory



When firms pay “efficiency wages”:

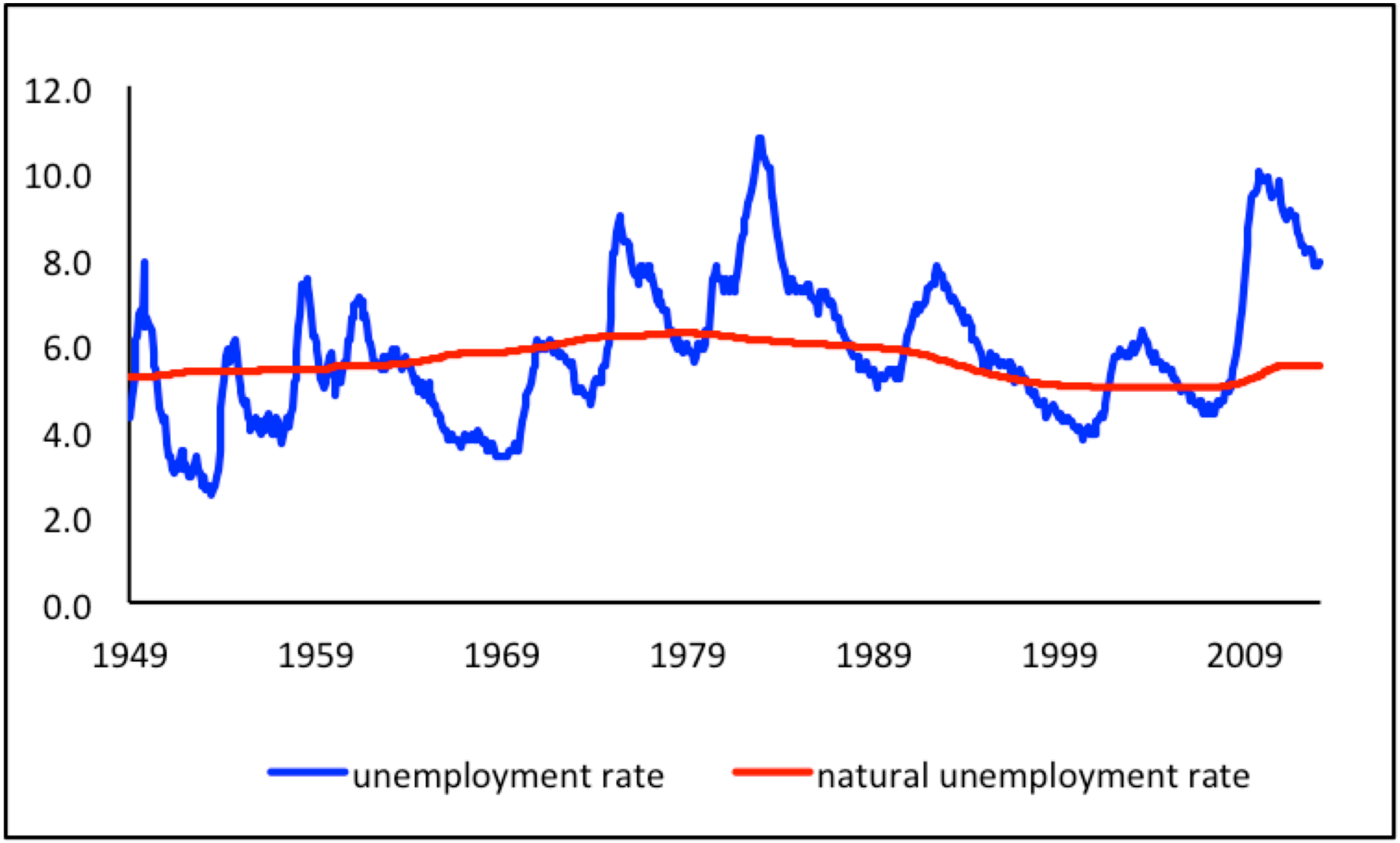
Employment falls from L_E to L_D.

Unemployment rises from zero to $L_S - L_D$.

Job Search

In 2010, Peter Diamond (MIT), Dale Mortensen (Northwestern), and Christopher Pissarides (LSE) were awarded the Nobel Prize in economics for their work on search and matching.

Unemployment Rate, US



The Natural Rate of Unemployment

The natural rate of unemployment as estimated by the Congressional Budget Office declined from over 6.25% in the late 1970s to 5.5% today.

Why?

The Natural Rate of Unemployment

The natural rate of unemployment as estimated by the Congressional Budget Office declined from over 6.25% in the late 1970s to 5.5% today. Why?

The internet makes it easier for workers to find jobs and firms to find workers.

And the aging of the US population means that there are fewer younger workers engaging in vocational discernment.

As a result, the amount of frictional unemployment has declined.

The Natural Rate of Unemployment

The natural rate of unemployment as estimated by the Congressional Budget Office declined from over 6.25% in the late 1970s to 5.5% today. Why?

Minimum wages have risen by less than inflation.

And the aging US population means that there are fewer younger workers who are affected by minimum wage laws.

Union membership has declined.

As a result, the amount of structural unemployment has also declined.

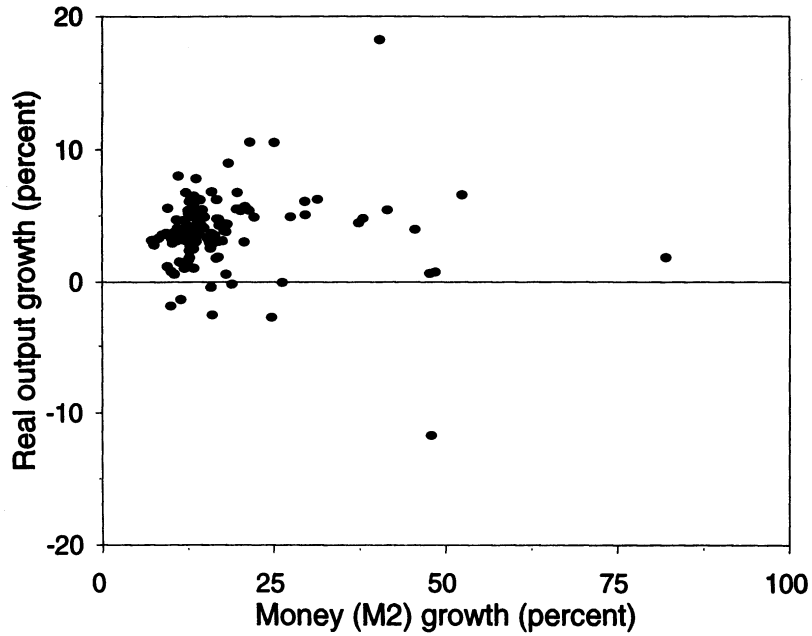
The Natural Rate of Unemployment

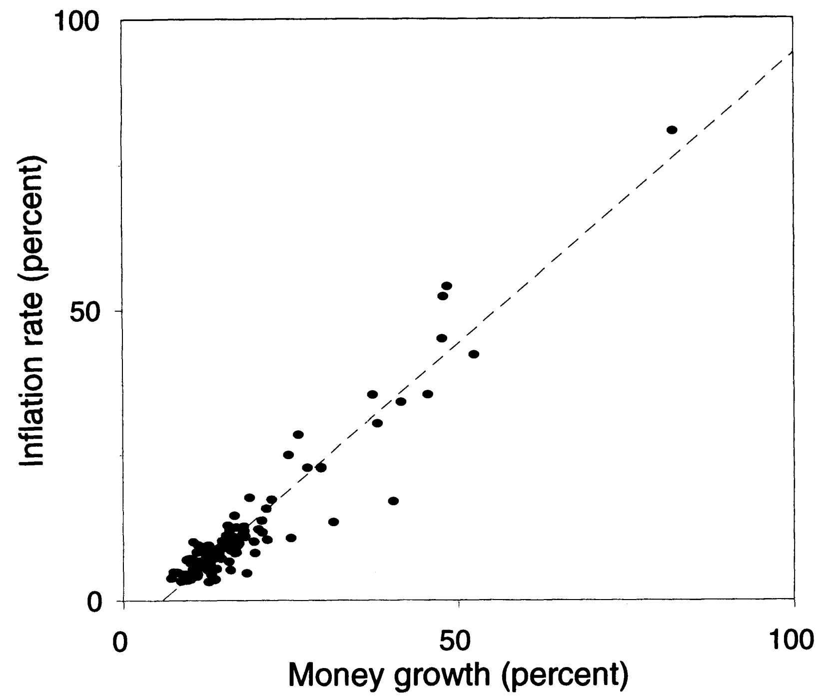
A highly influential study that attributes the fall in the natural rate of unemployment in the US since 1970 to demographic factors is:

Robert Shimer, "Why is the US Unemployment Rate So Much Lower?" In Ben S. Bernanke and Julio Rotemberg, editors, *National Bureau of Economic Research Macroeconomics Annual 1998*.

The Long-Run Effects of Money Growth

Across 110 countries, average money growth over the period from 1960 to 1990 is uncorrelated with real GDP growth, but highly correlated with inflation.





From: George T. McCandless and Warren E. Weber. "Some Monetary Facts." Federal Reserve Bank of Minneapolis Quarterly Review, Summer 1995.

Ch 29 The Monetary System

1. The Meaning of Money
2. The Federal Reserve System
3. Banks and the Money Supply
4. The Fed's Tools of Monetary Control
5. The Federal Funds Rate
6. Banking and Financial Crises

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Covered on Second Midterm