

Macroeconomics & Global Economics

Presentation 4*

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* Adapted on the Presentation on chapter 8 –
Blanchard, Amighini and Giavazzi –
Macroeconomics a European Perspective

Labor Market - EU27 in 2011

- The **total population** was 495 million.
- The **population in working age (active population: age 15-65)**: 331 million
- The **labour force** – the sum of those either working or looking for work : 240 million (i.e. the labour force is a fraction of the active population).
- In the labour force: 217 million were **employed**, and 23 million were **unemployed** (looking for work)

Labor Market - EU27 in 2011 - Ratios

- The **participation rate**, defined as the ratio of the labour force to the population in working age, was therefore $240/331 = 73\%$.
- The **non-participation rate**, defined as the number of people out of the labour force divided by the population in working age, was $91/331 = 27\%$.
- The **unemployment rate**, defined as the ratio of the unemployed to the labour force, was $23/240 = 9.6\%$.
- The **employment rate**, defined as the ratio of the employed to the labour force, was $217/240 = 90.4\%$.

Age dependency ratio

- **Age dependency ratio** is the ratio of dependents-people younger than 15 or older than 65-to the working-age population-those ages 15-65

What's behind the unemployment rate?

The unemployment rate may reflect two very different realities:

1. It may reflect an active and dynamic labor market, with many **separations** (workers who are leaving for another job) and many **hires** (newly employed workers).
2. it may reflect a sclerotic labor market, with few separations, few hires, and a stagnant unemployment pool.

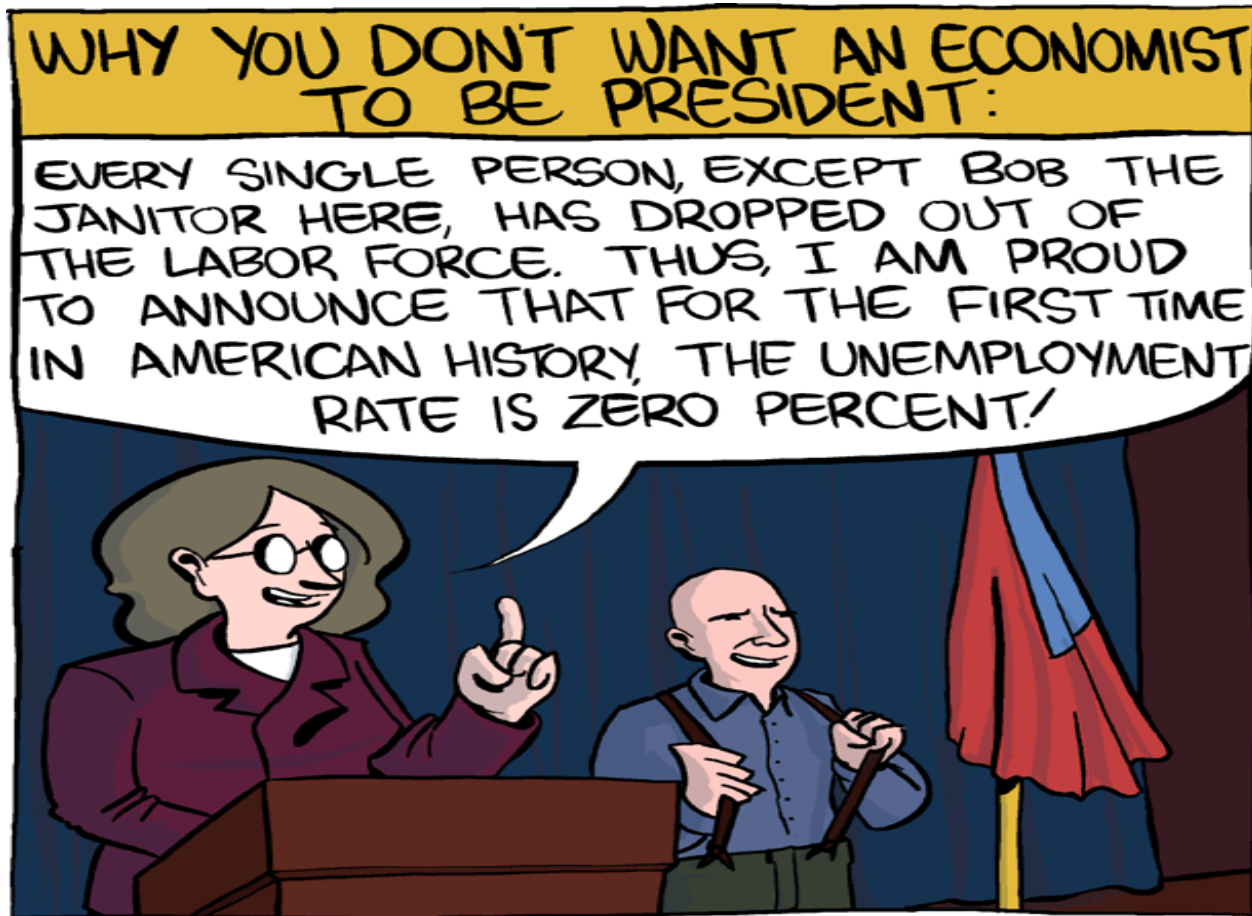
Flows of Workers and Discouraged Workers

- The flows of workers in and out of employment are large in the US.....
- **Separations** consist of: **leavers**, or workers leaving their jobs for a better alternative, and **layoffs**, which come from changes in employment levels across firms.
- There are large flows in and out of the labor force, much of them directly to and from employment.
- The average **duration of unemployment** is about 7.8 months in the US, 14.3 months in Europe.

Flows of Workers and Discouraged Workers

- **Discouraged workers** are classified as “out of the labor force” but they may take a job if they find it... for this reason the unemployment rate may sometimes be a too optimistic measure...
- The **non-employment rate** is the ratio of working age population minus employment to population (it includes discouraged workers...)
- **Non-employment rate in the EU = $(331 - 217) / 495 = 23\%$** (more than two times the unemployment rate).

Flows of Workers and Discouraged Workers



Movements in Unemployment- US

FRED 

— Civilian Unemployment Rate



Source: US. Bureau of Labor Statistics

Shaded areas indicate US recessions - 2015 research.stlouisfed.org

Movements in Unemployment

When unemployment is high, workers are worse off in two ways:

- Employed workers face a higher probability of losing their jobs.
- Unemployed workers face a lower probability of finding a job; equivalently, they can expect to remain unemployed for a longer time.

Homework

Go to <http://www.oecd.org/employment/labour-stats/>

Where you will find the OECD – Labour force statistics

Consider data for the EU-28 (or Europe when EU-28 is not available) and the US for 2015 – Q2 (i.e. second quarter)

- Where do we observe the largest participation rate?
- What is the female participation rate?
- Compare unemployment rates by age and sex. What do you notice?
- What is the recent time path of the average duration of unemployment in the two economies?
- In recent years do we observe more or less discouraged workers?
- Compute the non-employment rate for the two economies.

Wage Determination

How are wages set?

In many European countries wages are set **by collective bargaining**: bargaining between firms and unions.

Coverage of collective bargaining in Europe: 80-90% in countries such as Germany, France, Austria, Finland and Belgium...

In the UK and in the US only the manufacturing sector is covered....

Of course when wages are set we observe a vast range of possibilities: from a take-it-or-leave basis (specially for low skill job) to first-class graduate or very skilled workers who can negotiate several aspects of their compensation (individual bargaining).

Wage Determination



MANAGEMENT AND STAFF WAGE
NEGOTIATIONS HAD REACHED A
CRUCIAL STAGE

Wage Determination



"Our best strategy for collective bargaining is to send our biggest guy."

Wage Determination

Whatever the type of bargaining (individual or collective) we have TWO common forces at work in the determination of wages include:

1. Workers are typically paid a wage that exceeds their **reservation wage** (i.e. the wage that would make them indifferent between working or being unemployed)
2. Wages typically depend on labor market conditions. The lower the unemployment rate, the higher the wages.

Wage Determination

How much bargaining power a worker has depends on two factors.

- How costly it would be for the firm to replace him—the nature of the job (skilled v. unskilled workers)
- How hard it would be for him to find another job—labor market conditions.

Wage Determination

Efficiency Wage Theories

Economists call the theories that link the *productivity* or the *efficiency* of workers to the wage they are paid **efficiency wage theories** (seminal paper by Shapiro and Stiglitz, American Economic Review, 1984)... the idea is that firms want to pay more than the reservation wage to induce workers to be more efficient!



Wage Determination

Efficiency Wage Theories

These theories also suggest that wages depend on both the nature of the job and on labor-market conditions:

- Firms that see employee morale and commitment as essential to the quality of their work, will pay more than firms in sectors where workers' activities are more routine.
- Labor market conditions will affect the wage (firms will be induced to increase the wage to avoid leavers during periods of boom!)

Wage Determination

Efficiency Wage Theories



Wage Determination

Take home messages:

- The skilled the worker, the higher the wage
- The more workers are unionized, the higher the wage
- The lower the unemployment rate, the higher the wage