

The Natural Rate of Unemployment

U_n

Three Facts

- Unemployment is good for you
- There is a natural rate of unemployment

Unemployment is good for you

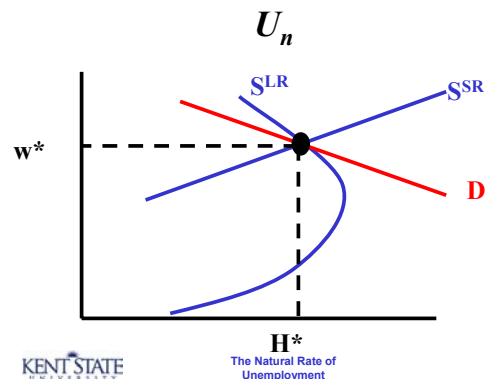
- Resources get reallocated
 - Joseph Schumpeter called this the process of *creative destruction*.
- Unemployment is part of the process by which we reallocate resources.

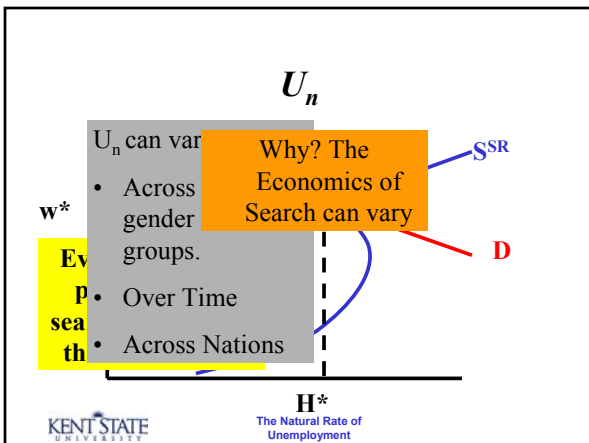
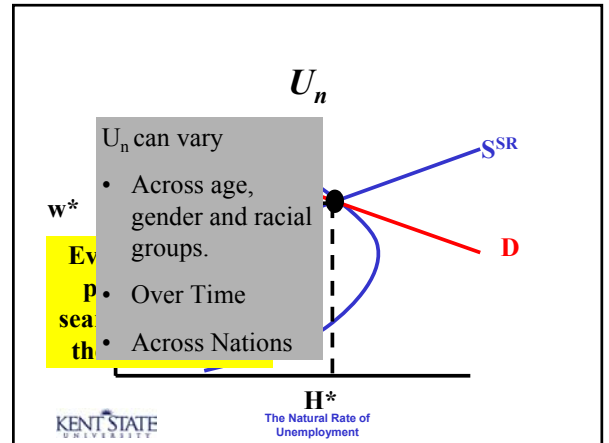
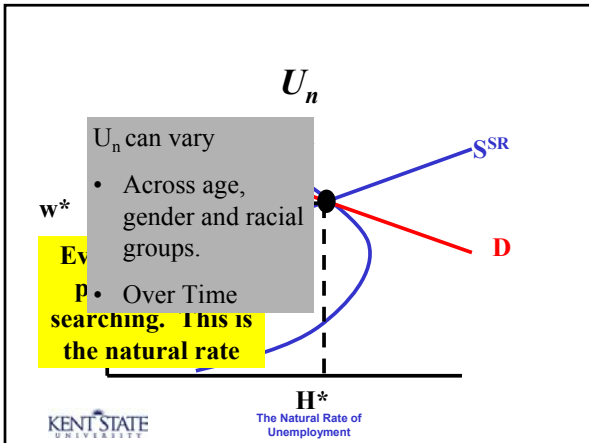
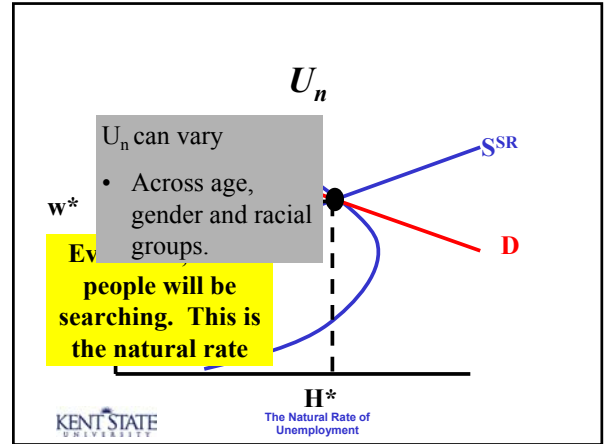
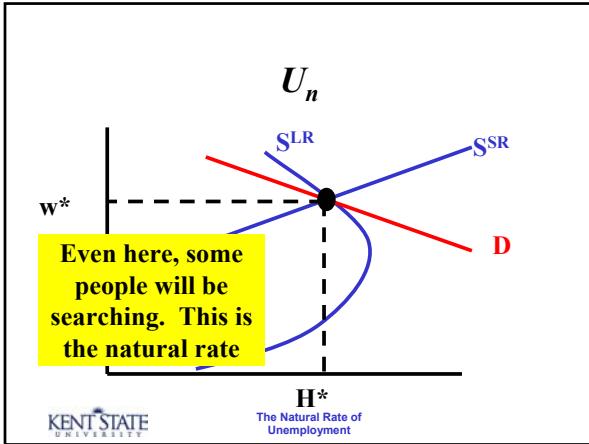
Unemployment is good for you

- The modern American economy is quite dynamic; with over 130 million employed.
- Tens of millions of jobs are created and destroyed each year.

Unemployment is good for you

- Suppose
 - No one is allowed to quit.
 - No one can be fired.
 - Anyone wanting to start work must take the first job offered.
- This would not be a pretty situation.





Why differences across countries?

- Large safety net.
 - Workers in Europe receive a large portion of their pay when unemployed and for much longer time than in the US. The rules about which type of jobs they have to accept are very narrow. Hence, many prefer to remain unemployed.

Why differences across countries?

- Large safety net.
- Rigid labor force.
 - In Europe, it is very difficult to fire someone, so firms are hesitant to hire. The benefits that companies are required to give each worker make it cheaper to pay overtime in many cases rather than hire a new worker.

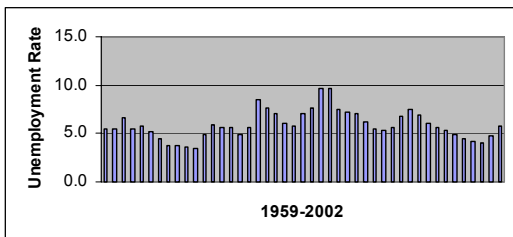
Why differences across countries?

- Large safety net.
- Rigid labor force.
- Different hiring policies for young people.
 - Given the difficulty of firing, many European firms are unwilling to hire inexperienced young people. They spend much more time working as casual workers, or in the gray market.

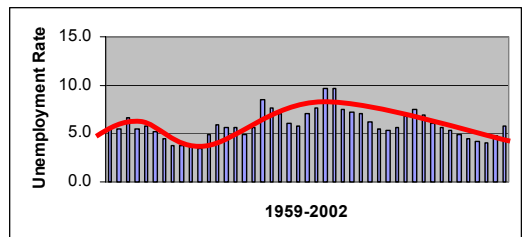
Why differences across countries?

- Large safety net.
- Rigid labor force.
- Different hiring policies for young people.
- Different employment policies.
 - Many Japanese firms will not fire or lay off any workers. In Japanese companies, many workers go to work, though they have nothing to do. Some estimates put the number of workers in this situation at over one million.

U, 1959-2002



U, 1959-2002



What does this mean?

- The natural rate fluctuates.
- The unemployment rate can differ from the natural rate.

Can we alter U_n ?

- What happens if we eliminate
 - Welfare
 - Unemployment Compensation
 - Job Retraining Programs

Can we alter U_n ?

- What happens if we eliminate
 - Welfare
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Natural rate falls because it is more attractive to finish search quickly.

Can we alter U_n ?

- | | |
|---|--|
| <ul style="list-style-type: none"> • What happens if we eliminate <ul style="list-style-type: none"> – Welfare – Unemployment Compensation – Job Retraining Programs | <ul style="list-style-type: none"> • What happens if we expand <ul style="list-style-type: none"> – Welfare – Unemployment Compensation – Job Retraining Programs |
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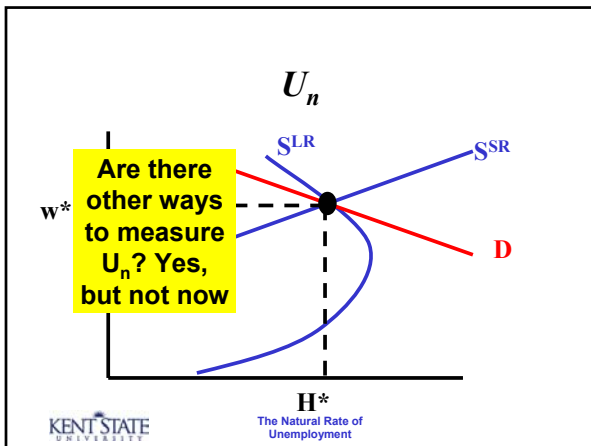
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Natural rate rises because it is less attractive to finish search quickly.

Should we alter U_n ?

- Each program has its benefits and costs.
- Don't think you can expand unemployment compensation or welfare without affecting the Natural Rate.
- Don't think you should eliminate these programs without imposing other costs.



End

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