

## Unemployment      Romer Chapter 9.1

- Why does unemployment exist?
  - Frictions, mismatch
  - Other mechanisms (wage setting, insufficient demand, ..)
  - Largely illusory (unimportant frictions) or non-Walrasian features (waste of resources)
- What determines the size of unemployment?
- Cyclical behavior of the labor market
  - Evidence: Real wage is moderately procyclical
  - => implies that labor supply must be quite elastic or shifts in labor supply must be important
  - Both seem unlikely, which suggest that non-Walrasian features are important
- Chapter 9: Why doesn't unemployed workers bid down the wage so that supply and demand balance?

## **Why don't unemployed workers bid down the wage so that supply and demand balance?**

- Efficiency wages
  - Nutrition
  - Imperfect monitoring
  - Unobserved differences in ability that are positively correlated with reservation wages
  - Fairness-considerations – high wage induce loyalty and effort
- Explicit or implicit agreement between workers and firm that prevents wage cuts in downturn (contracting models)
  - Risk neutral firms smoothen wages as insurance for risk averse workers.
- Insider-outsider models
  - Existing workforce (insiders) set the wage without consideration of the unemployed (the outsiders)
- Search-matching models
  - Heterogeneity among workers and firms