

# WHAT CAN NEW LABOUR RESEARCH TEACH US ABOUT THE ECONOMY?

Christopher A Pissarides, IMC March 1, 2011

# Roadmap



- New labour research: search and matching
- Policy applications
- Applications to other markets
- Current recession: role of fiscal policy
- Other labour market issues: the natural rate of unemployment and structural change
- Summary of lessons



# New labour research: Search and matching

# The matching approach to labour markets



- Based on matching frictions
- Large flows of workers in and out of jobs necessary for growth and structural change
- Outcome “natural” unemployment; co-exists with job vacancies
- Expansionary policy at this rate causes inflation, active labour market policy can reduce it

# The Beveridge curve



- Unemployment is lower when there are more job vacancies
- In a frictionless (full employment) economy the curve collapses to the origin
- Flexible labour markets have curves closer to the axes



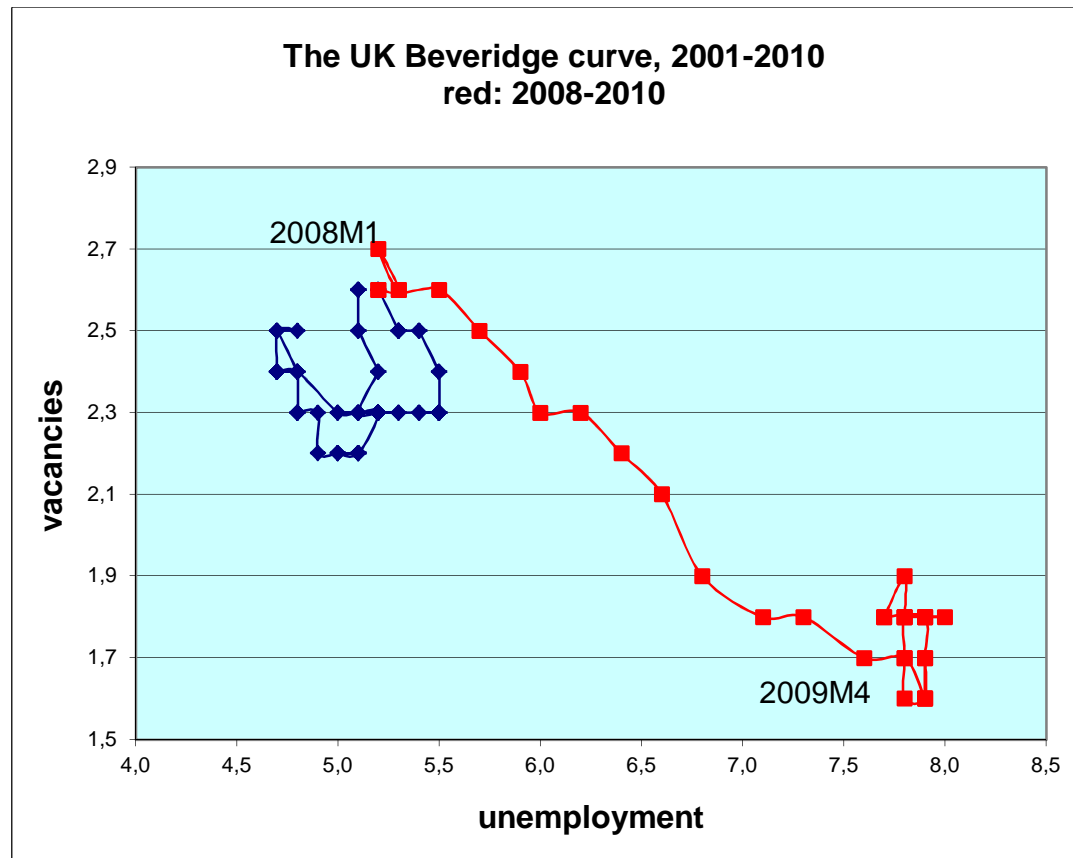
# Policy applications

# Learning about the economy



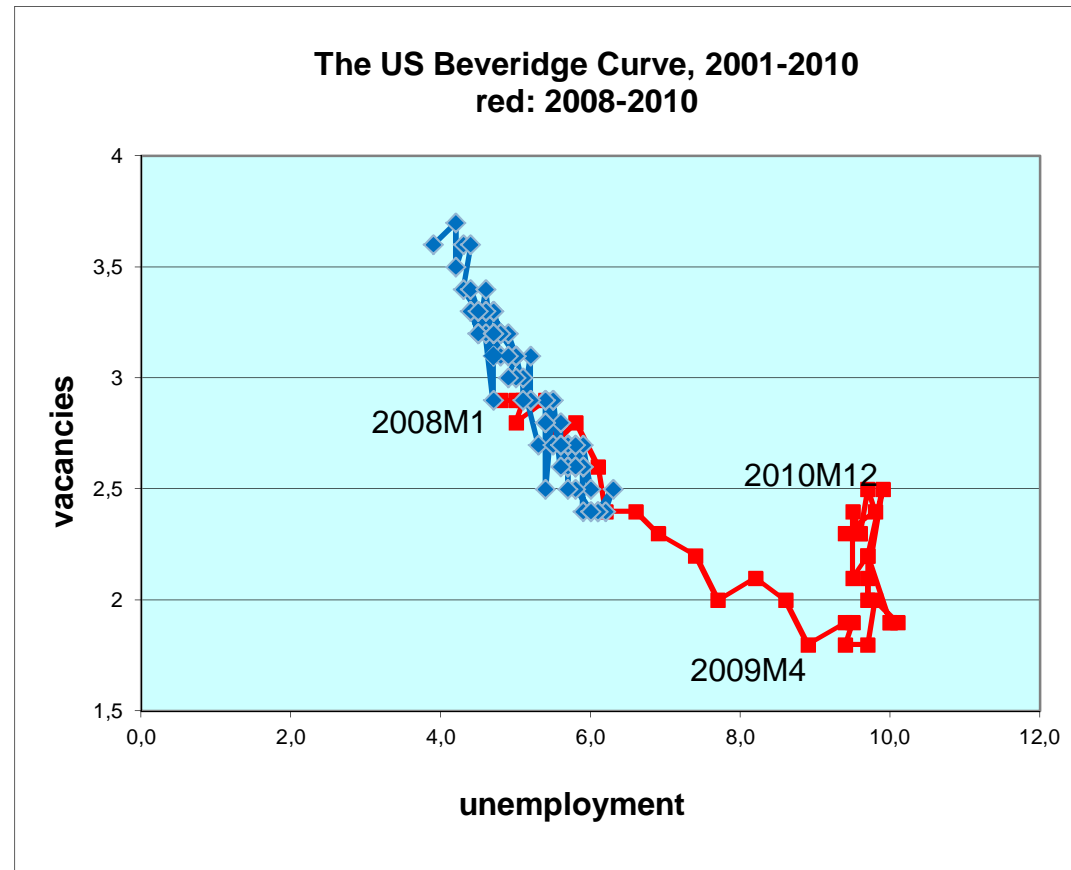
- If the economy moves down the curve it is facing recession due to job shortage
- If, in addition, it moves away from the axes, it is also suffering from structural problems

# Recession in Britain





# More than recession in America?





# Applications to other markets

# Housing



- Main result is an explanation for housing crashes
- Number of houses that become available and number of buyers feed on to each other
- Possible to get stuck in “low level” equilibrium, without big numbers of either
- Require large price falls to revive the market

# Financial markets



- Just as in labour markets, it takes time to find good projects to finance
- If lending is done fast (e.g., because of competition between bankers, or wrong incentives) more agreements will break up before maturity – a theory of “bad loans”



# The current recession

# Fiscal policy



- Why isn't fiscal policy working – causing either big falls in unemployment or inflation?

# Reasons

- Liquidity shortage: consumers save

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# Reasons



- Liquidity shortage: consumers save
- Capital market liberalization and foreign borrowing: need to rebalance from public to private sector
- International trade keeps prices and wages subdued: need to rebalance international transactions and exchange rates



# Other labour market issues

# Higher natural rate?



- Some economists claim that the natural rate of unemployment has risen permanently because
  - competition from BRICS
  - low innovation activity in OECD countries
  - fiscal debt problems
  - eurozone coordination problems

# Structural changes



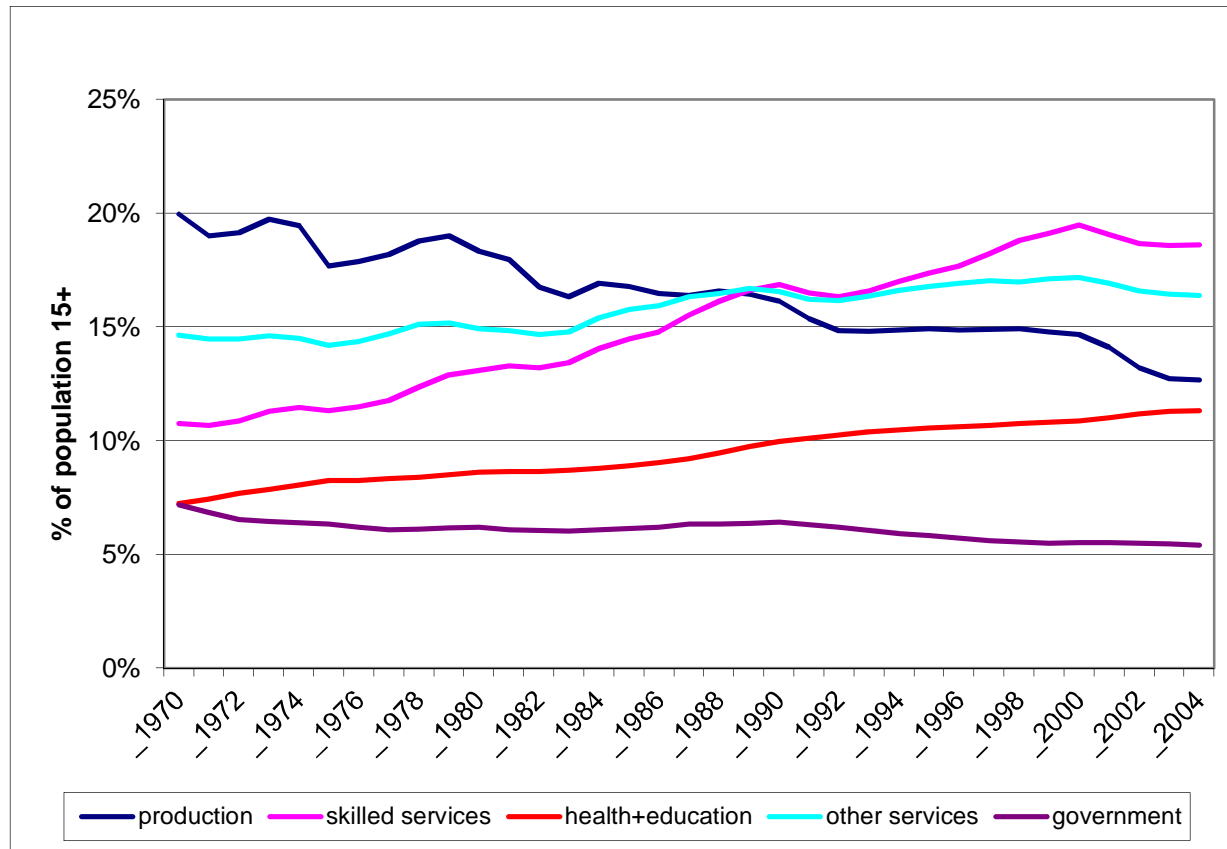
- But this argument ignores the process of structural change
- New sectors replace old ones

# Sectors of new job creation

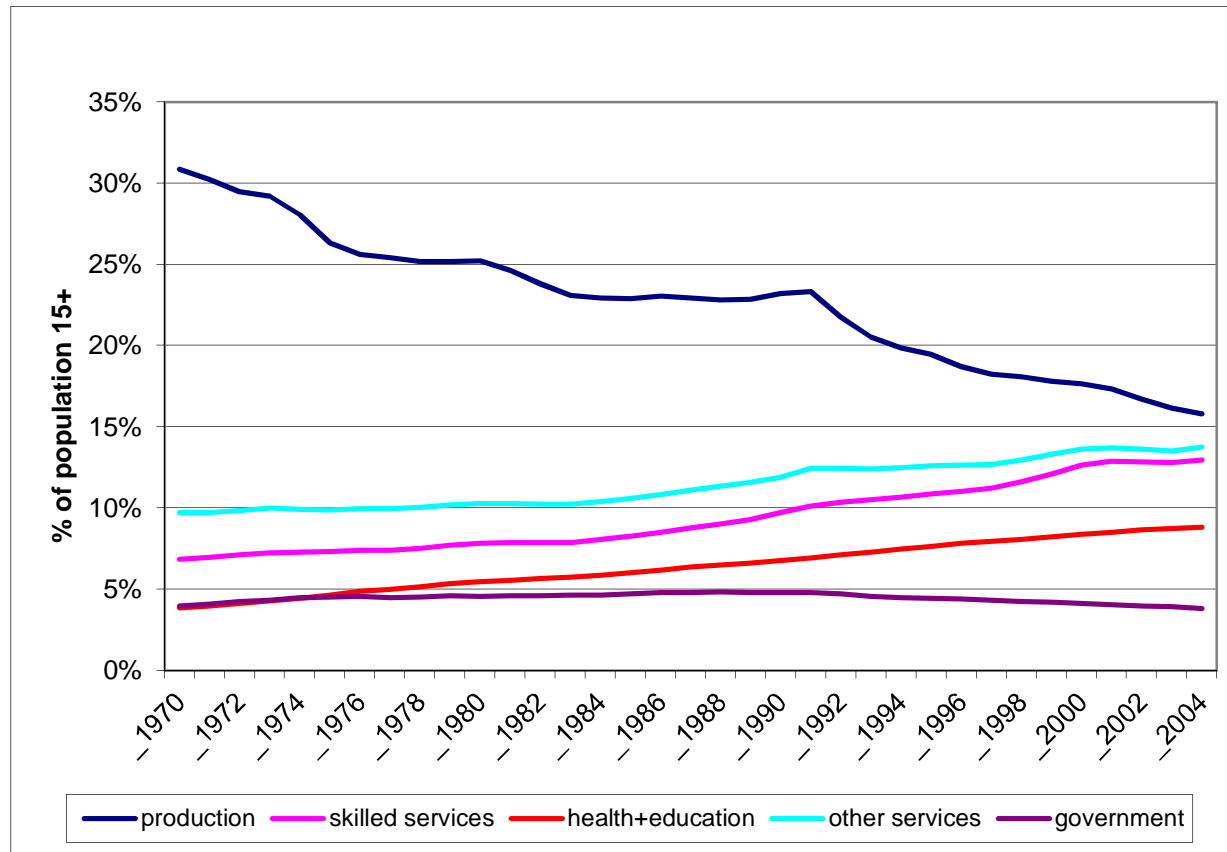


- Health, education, personal and community services dominate
- Up to now FIRE major job creation sector too. But its future growth uncertain

# Employment rates in USA



# Employment rates in Germany





# Summary of lessons



# One



- Unemployed workers are compensated with UI to help them find a good job match
  
- Financial institutions need to be regulated to ensure good match with borrowers
  - ▣ make sure that enough safeguards are taken before match
  - ▣ there is enough liquidity to pay for the few that fail after match

# Two



- Recessions are different from past
- New theory can help identify right policy
- Employment trends point to further decline of production industries and rise of health, education and less skilled services
- Policy that delays this process not likely to be beneficial in medium term

# Three



- In the 20 years since the mid 1980s the big profits were in FIRE, especially finance
- In the next 20 years likely to be in health services and private education, both for domestic consumption and export