Economics Chapter 5 – Prices and Unemployment

1. Economists measure prices, unemployment, gross domestic product (GDP) and Real RDP
2. An economy wants to reach the following goals: price stability, low unemployment, high/sustained growth
3. **Price Level** – the weighted average of the prices of all goods and services
4. **Price Index** – the measure of the price level
5. **Consumer Price Index (CPI)** – a widely cited index number for the price level; the weighted average of prices of a specific set of goods or services purchased by a typical household
6. **Base Year** – a year chosen as a point of reference or comparison for prices in other years; a benchmark year.
7. **Percentage of Change** – (Price of later year – Price of Earlier Year)/(Price of Earlier Year) * 100
8. **Inflation** – an increase in the price level
9. **Real Income** – Nominal income adjusted for price changes
10. **Nominal Income** – the current dollar amount of a person's income
11. **GDP Deflator** – based on all the goods and services produced in the economy, instead of a single market like the CPI.
12. **Labor Force** – all those whoa re either employed or unemployed
13. **Unemployment Rate** – the percentage of the civilian labor force that is unemployed
    a. Rate = Number of Unemployed Persons/Civilian Labor Force
14. **Unemployed Status –** to not have a job, but still actively searching for a job in the last two weeks
15. **Employment Rate** – the percentage of the civilian non-institutional population that is employed.
    a. Rate=Number of Employed Persons/Labor Force
16. **Labor Force Participation Rate** – the percentage of the civilian non-institutional population that is in the civilian
    a. labor force. Rate = Civilian labor force/Civilian non-institutional population
17. **Employment to Population ratio** – employed workers/ Civilian non-institutional population
18. **Job Loser** – a person who was employed and was fired or laid off – lots of these in recessions
19. **Job Leaver** – a person employed who quits his job – not very many of these in recessions
20. **Reentrant** – a person who was previously employed, hasn't worked for awhile, and is reentering the labor force
21. **New Entrant** – a person who has never held a full time job for two weeks or longer and is now looking for a job.
    a. **Seasonal Unemployment** – every June the unemployment jumps because of all the students entering the job force. This type of unemployment is normal and economics usually don't considering seasonal unemployment into the real unemployment rate
22. **Discouraged Workers** – workers who leave the labor force after not being able to find a job
23. **Frictional Unemployment** – unemployment due to the natural "frictions" of the economy, which is caused by changing market conditions and is represented by qualified individuals with transferable skills who change jobs
24. **Structural Unemployment** – Unemployment due to structural changes in the economy that eliminate some jobs and create others for which the unemployed are unqualified
25. **Natural Unemployment** – unemployment caused by frictional and structural factors in the economy
    a. Rate = Frictional unemployment rate + Structural unemployment Rate
26. **Full Employment** – the condition that exists when the unemployment rate is equal to the natural unemployment rate
27. **Cyclical Unemployment Rate** – the difference between the unemployment rate and the natural unemployment rate. Cyclical unemployment usually is due to a recession.
28. **Current Population Survey** – monthly survey of a sample of US households that measures employment, unemployment, and the labor force
29. **Job Search Theory** – individuals consider both the costs and the benefits of searching for a job and that they will search until the additional costs and additional benefits are equal.
30. **Reservation Wage** – the lowest wage a person will accept at any time in the job search process
31. **Optimal Search Time** – the mean duration of unemployment

Added 10/2002 – HS Students may not need this part

1. **Aggregate Hours** – since workers work part time, the number of employed workers is a bad measure of employment and production. The government thus uses the total number of hours worked of all employees to measure the potential for production
2. **Labor and Supply and Demand**
    a. think of labor demand curve as the number of workers employers are willing to hire at each wage
    b. Think of labor supply as the number of workers willing to work at each wage
    c. Wage refers to real wage, which is the actual wage adjusted for inflation (real wage = wage/price lv)
    d. Where the curves meet is the equilibrium wage where supply meets demand, everyone is employed
        i. This model is strictly theoretical. Obviously there is never 0 unemployment
        ii. Many reasons contribute to why this model isn't perfect
    e. Problems in the simple supply and Demand model
        i. **Job Rationing** – assume that the wage is higher than the equilibrium wage where demand meets supply. Hence, the supply is greater than the demand, causing unemployment

ii. **Minimum Wage** – the minimum wage law raises the equilibrium wage, especially for low paid unskilled workers. Hence, it causes unemployment
iii. **Insiders vs Outsiders** – insiders (those who have a job) want to stay in, even when outsiders (those that don't) are willing to work for less. Many times there are factors (unions, legislation, etc) that keeps the wages of the insiders high (ie. Defense engineers must be US citizens even though foreigners are wiling to work for less). This raises the equilibrium wage, causing unemployment
iv. **Efficiency Wages** – a company might pay a skilled worker higher than market value in order to give him an incentive to work harder. However, this causes the employer to generally hire less workers, causing unemployment
v. **Job Search** – Another explanation for the unemployment rate is that it's never static. The model is constantly in a state of flux, hence that flux causes the small amount of frictional and structural unemployment.

f. **Government policies and unemployment**
i. A high minimum wage raises unemployment
ii. Unemployment compensation increases unemployment because it makes more people stay unemployed longer (they're not as desperate)
iii. If taxes rise, chances are it will discourage some workers to work, hence the labor force participation rate may decrease. In addition, firms will find it more expensive to hire workers, hence employment declines and unemployment rises
iv. Each country's unemployment rate is vastly different due to a variety of factors including government policy, lifestyle, and culture.