

# labor



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Labor, capital, natural resources and entrepreneurship are the primary factors that contribute to

labor (lā' bə r),

and influence economic growth in the United States. Labor consists of

mental effort;

Capital is the equipment, machinery, manufacturing plants and office

activity that pro

like land, minerals, water and energy are nature's contribution to the

or services in

and innovations that pool the three other resources and create new

the services

to produce a country's gross domestic product, or total output of goods

workers for wag

no business and industry to meet the wants and needs of its people.

force; workers

*n*. 1: p h y s i c a l o r

the people who produce the goods and services in an economy.

w o r k . 2 : h u m a n

buildings needed to produce goods and services. Natural resources

v i d e s t h e g o o d s

production process. Finally, entrepreneurship provides the ideas

a n e c o n o m y . 3 :

processes, inventions or services. These components are all used

p e r f o r m e d b y

and services. Without all four components, a country would have

e s . 4 : t h e w o r k -

As the nation's central bank, the Federal Reserve must consider

c o l l e c t i v e l y .

the availability of all these resources in determining national monetary policy.

## The Labor Market and the Economy



Labor represents the human factor in producing the goods and services of an economy. Just as there are markets for cars, bread and steel, there is a market for the services people provide. What helps distinguish the labor market from, say, the steel market is that labor is made up of people who, in effect, rent their time to businesses for certain periods—for instance, an hour or a year. People provide their labor to businesses in exchange for wages, and they trade their unpaid leisure time for paid work time to make a living and to be able to purchase goods and services. Businesses, in turn, use this labor to produce goods and services demanded by consumers.



# the labor market

About 155.2 million civilians are employed either full- or part-time in the United States. Approximately 9 million business firms provide jobs for these people. How do they get matched up, and what determines the wages paid for these jobs? The answer: the dynamics of the labor market.





*Labor represents the human factor in producing the goods and services of an economy.*

Labor, capital, natural resources and entrepreneurship are the four essential components in the production of goods and services in an economy. The quantity and quality of labor that individuals supply is an important factor in determining the economy's level of production and rate of growth.

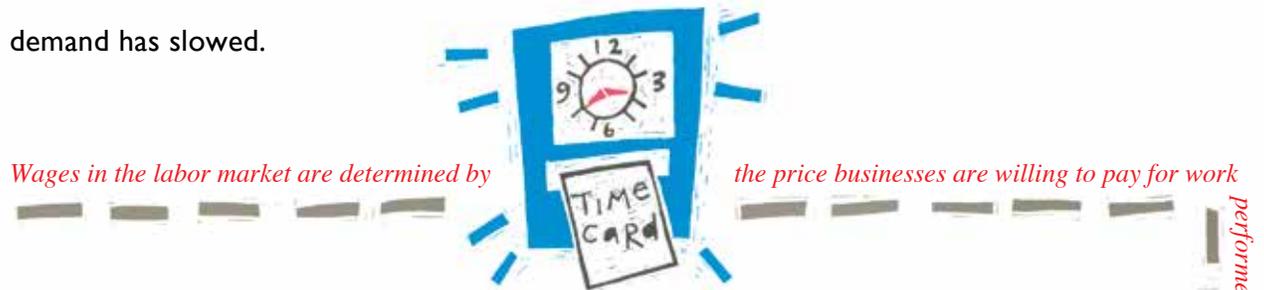
People with jobs, people looking for jobs and businesses seeking employees make up what is known as the labor market. This interaction between people supplying labor services and businesses demanding workers' services is what determines the wages and salaries paid to employees and the total number of people employed.

An important aspect of the labor market is the contribution made by the unique skills and abilities of all types of people. These talents can be changed and enhanced through education or training, making the labor force an evolving talent pool from which businesses hire. Using skills effectively and training people to meet new demands in the marketplace help make the production process more efficient.

Another important aspect of the labor market is the mobility of the workers that it comprises. In theory, people in the United States can move anywhere to find or train for a new job. This mobility is important when employers match skills to job openings. In practice, however, people may be unwilling to move where the jobs are located or unwilling to train for a new career. In these cases, the mobility in the labor market and the output of the economy slow down as people remain unemployed and jobs go unfilled.

The labor market operates to find good matches between workers and jobs. Workers search for jobs that offer high wages and other desirable characteristics, while employers search for workers who are productive and will work for the wages being offered. Certain economic conditions can make it difficult for people and businesses to match their searches in the labor market. In a rapidly growing economy, for example, some businesses may have difficulty

finding enough people with the right skills to meet increasing demand. This often results in rising wages in some industries. Likewise, a slowdown in the economy can result in unemployment and falling wages in sectors of the economy where demand has slowed.



## What Affects the Labor Market?

Just about everything that happens in the economy affects the labor market. Changes in the demand for goods and services, the size of the population and the minimum-wage rate can each have substantial impact on the job market.

Changes in the economy have perhaps the most significant impact on the overall job market. Rapid economic growth caused by an increase in the demand for goods and services can create a myriad of new job opportunities for workers. Likewise, a severe slowdown in the economy, or a recession, can have a devastating impact on employment opportunities. As demand for many goods and services slows, businesses must cut back production and often lay off workers.

Unemployment is a serious economic problem in the labor market. To be officially counted among the unemployed in the United States, a person must be out of work, actively looking for a job and willing to accept a position for the wages being offered.

Creating policies to reduce unemployment is complicated because unemployment can result from a number of distinct causes. Generally, economists recognize three types of unemployment: frictional, structural and cyclical. Frictional unemployment is associated with normal turnover in the labor market, while structural unemployment stems from mismatches that evolve when







*There are two kinds of mobility: geographical and occupational. Geographical mobility means that if the jobs are located in Kansas City, people move to Kansas City. Occupational mobility means that if jobs are available in the health care industry, people switch from working in industries with few job opportunities to working in the health care industry. As people become more specialized in the types of work they do, however, an occupational move becomes more difficult. Doctors and lawyers, for example, have large investments in their careers, and they will tend to move geographically before they move occupationally.*

*mobility*

workers are trained in one field while the jobs are available in another. Cyclical unemployment occurs with changes in the business cycle, as a downturn in the overall economy causes the total demand for goods and services to decline. This type of unemployment gets the most attention from economic policymakers.

An economy is said to be at full employment when cyclical and structural unemployment is very low. When an economy is operating at full employment, any further reduction in the unemployment rate could put too much upward pressure on wages and prices and ultimately cause inflation. So it is natural and healthy for an economy to have some unemployment as people enter the labor force for the first time or move to new and better jobs.

Having a mobile labor force helps keep unemployment low. It is important to an economy that people be willing and able to go where the jobs are located. In countries where mobility is more difficult, like England, the unemployment rate tends to be higher and the output of goods lower.

*of tuition  
and earnings. A person pays the direct cost*



*their market skills, productivity*

*Expenditures on education and training are investments individuals make in themselves to increase*



Changes in technology and productivity growth are also important considerations in the labor market. One possible effect of technological advances can be the displacement of workers in industries that have found more efficient production techniques. In the short run, technological change can have adverse effects on workers in occupations made obsolete by new technology, and it can have very positive effects on workers trained for the new technology. Over the long run, advances in technology and productivity lead to higher wages for the workforce as a whole.



as well as the indirect cost of income lost while in school. The future benefits to the person are higher wages that can be earned after graduation.

## How Government Affects the Labor Market



The U.S. government influences the labor market through such actions as paying unemployment insurance benefits, setting the minimum wage, raising or lowering business and income taxes, and establishing rules under which labor unions operate. The government also can undertake special programs to create jobs temporarily when unemployment is unusually high.

Unemployment insurance provides wages for a specific amount of time for people who have been laid off by companies and are looking for work. This insurance may make people more particular about accepting a job offer because they are receiving some income. In general, the higher these benefits, the longer people will take to accept a new position.

The federal government has set the minimum wage that can be paid by employers in the United States. Some people benefit from an increase in the minimum wage, while others—particularly teenagers and those in lower skilled jobs—can be shut out of the job market as employers hire fewer people to hold down costs.

Lowering or raising income taxes can affect the labor market in more subtle ways. Lowering income tax rates could encourage people to work more, because they would be able to take home more of their income. Likewise, very high income tax rates might cause people to work less, because their labor would be so highly taxed. But even though people may want to work less if after-tax wages are lower, they may work more so they can earn enough money to cover their expenses.

Labor is also influenced by government investment in infrastructure, such as schools, roads and parks, because these amenities can be as influential as tax rates in determining where businesses and people locate. These amenities also







The  
S. economy

Policy

The Federal Reserve pays close attention to the labor market when determining the appropriate course for monetary policy. When the unemployment rate falls or rises, the Fed must look at a myriad of other indicators to weigh the inflationary and recessionary pressures on the economy before deciding on policy. The Fed's mission to foster a stable and growing economy is an important component in creating an environment where labor markets can operate smoothly and efficiently.



have an effect on the wages paid to the labor force because people may be willing to work for less if they can live in a place that offers what they value.

## What Role Does the Fed Play?



Can the Federal Reserve, in its role as the nation's central bank, have any effect on the nation's labor market? Through monetary policy, can the Fed impact the level of employment or the availability of jobs?

In general, the Fed's monetary policy directly affects the cost and availability of money and credit in the economy but only indirectly influences the demand for or availability of labor. For example, suppose monetary policy is too tight: The money supply is growing too slowly to keep up with business activity, and it is getting harder for businesses and consumers to obtain credit. This policy could dampen economic growth, potentially forcing some businesses—especially those that rely heavily on credit to finance their operations—to lay off workers. The Fed's crucial role, then, is to implement policies that ensure there is enough money and credit in the economy for continued growth but not so much that inflation rises.

During periods of high unemployment, the Fed must be particularly diligent in making sure the money supply is growing fast enough. The Fed could even try to lower the unemployment rate by increasing the growth of the money supply. This strategy may temporarily boost economic activity, but it is not necessarily a long-run cure for high unemployment. More money in the economy does not always translate into greater prosperity. Wages and prices would adjust upward to the change in money growth, inflation would negate the effect of the stimulus, and companies would again stop hiring. If tight monetary policy is not the cause of the unemployment, then looser monetary policy is probably not the cure.

*the search*  
The reason is that labor is the factor most often displaced in



*Efficiency in production may lead to a decrease in the number of jobs in certain industries.*



On the other hand, what is the Fed's role in the economy when the unemployment rate is very low? An unemployment rate that is below full employment is one signal to the Fed that the economy is beginning to overheat. Overheating indicates that inflationary pressures are on the rise. If workers are in short supply, businesses that want to hire new employees will have to offer higher wages to attract those already employed elsewhere, thereby increasing production costs. If the higher wages are not based on greater productivity, many businesses will have to pass them on in the form of higher consumer prices, thus wiping out the positive effect of the higher wages. The Fed's role in this case would be to slow the growth rate of money and credit so that the economy grows at a more sustainable pace.

By conducting monetary policy in such a way as to keep inflation at low, somewhat predictable levels, the Fed can help create an environment in which businesses and consumers do not have to worry about high inflation. Helping reduce uncertainty in the marketplace is one of the greatest services the Fed can perform for businesses and workers. In a stable economic environment, business



*for efficiency. Creation of new jobs to replace those lost to progress*

*is essential to continued prosperity and growth.*

*Only then can the drive for efficiency and productivity lead to true economic progress.*

decisions will not be postponed, investment will rise and more people will be hired. This stability helps keep the economy growing and producing at high levels.

In the final analysis, the Fed has a great indirect impact on the nation's labor market. Monetary policy cannot directly affect the number of jobs or force the economy to operate at full employment, but it has a huge impact on the economic environment, business activity and, eventually, the labor market. In fulfilling its mission to foster steady growth in the nation's money supply while anticipating inflationary and recessionary pressures, the Fed must consider both the short- and long-term effects of its actions on the health of the U.S. economy. By helping create a stable and healthy environment, the Fed provides the opportunity for more and better jobs in the future.



## everyday economics

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