Labor, The Economy, and Monetary Policy

Federal Reserve Bank of Dallas

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Description:
Full color booklet which describes the labor market in relation to the national economy.

This document may be printed.
Labor, capital and natural resources are the three primary factors that contribute to and influence economic growth in the United States. Labor is the participation of human mental effort; machinery, manufacturing plants and office buildings that are necessary to activity that produces water are nature's contribution to the production process. Natural resources and services and transport them to their destinations. These components output produced in the country. Without all three components, business workers for wage force; workers nation's central bank, the Federal Reserve must remain aware of situations.
n. 1: physical or work. 2: human produces the goods and services. Natural resources like land, minerals and also include energy resources—the power necessary to produce goods and industry would not be able to produce goods and services. As the process 4: the work that influences the availability of labor, capital and natural resources collectively.

and must consider each of these economic variables in determining national monetary policy.
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.
About 120 million people are employed either full- or part-time in the United States. Approximately five 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, capital and natural resources are the three 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 wages paid to workers, the number of people employed, and the distribution of income among households in the economy.

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 can move anywhere to obtain employment 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 jobs and workers. Workers search for jobs that offer high wages and other desirable characteristics, while employers search for workers with high productivity who are willing to work for the wages being offered. If labor market conditions are
disrupted, people and businesses have problems matching their searches. In severe cases, high unemployment causes many problems in the market's ability to produce goods and services efficiently and the economy's ability to maintain or expand growth.

Wages in the labor market are determined by the price businesses are willing to pay for work performed and what people are willing to take for their work.

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.

Perhaps the most significant impact on the job market is an economic slowdown, which usually results in decreases in hiring. Severe slowdowns, like recessions, can have a devastating impact on employment opportunities because businesses frequently can alter hiring practices more quickly than other aspects of production. During economic hard times, employers will stop hiring or, if conditions worsen, will lay off employees before they stop producing products or turn off the electricity used in production.

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
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.
market, while structural unemployment stems from mismatches that evolve when workers are trained in one field while the jobs are available in another. Cyclical unemployment is related to business-cycle fluctuations in total demand for goods and services.

The natural rate of unemployment is the level of unemployment at which the economy can continue to operate smoothly. At this level, almost everyone who wants a job has one, and there is the normal activity of people moving between jobs and people looking for work. This is what economists call full employment. For the United States, the natural rate of unemployment is between 4 and 6 percent.

Having a mobile labor force helps keep the natural rate of unemployment low. It is important to an economy that people be willing to go where the jobs are located. In countries where many people do not move to change jobs, like England, the natural rate of unemployment is higher and the output of goods is lower.

Changes in technology and productivity growth are also important considerations in the labor market. The initial effect of advancements in technology is the displacement of labor as more efficient techniques of production allow firms to produce more goods with fewer people. Technological change may have an adverse effect on workers in occupations made obsolete by the technology. Over the longer run, however, technological change leads to higher wages for the work force as a whole because it enables workers to be more productive.
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 government sets the minimum wage for specific types of jobs. The minimum wage has its greatest effect on teenage workers and people working in lower skill jobs. Some people benefit from an increase in the minimum wage rate, but others are shut out of the job market because employers will hire fewer people to hold down costs.

Raising or lowering income taxes affects the labor market in more subtle ways. People tend to work less if they are taxed more on their labor and work more if they can take home more income. But even though people may want to work less if after-tax wages are lower, they may choose to work more so they 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 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.
In determining monetary policy, the Federal Reserve must consider what is best for the nation's economy as a whole. When unemployment rises, the Fed must weigh the inflationary and recessionary pressures on the economy before making its decisions. The Fed's mission to foster a stable and growing economy is an important component in keeping the national economy healthy.
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? Can the Fed, through monetary policy, help lower unemployment?

In general, the Fed's monetary policy affects the cost and availability of money in the economy but cannot directly affect the availability or demand for labor. Because monetary policy only affects the economy and its stability as a whole, Fed policy has little effect on specific industries that are laying off workers or facing declining consumer demand. There may be some industries that are especially sensitive to monetary policy, but it is not the Fed's role to decide which industries win or lose in the financial marketplace.

During periods of high unemployment, the Fed can try to stimulate the economy by increasing the money supply. While this strategy may temporarily boost economic activity, it will not be effective over the long term. Initially, an illusion of greater wealth in the economy is created because wages and prices have not had time to adjust to the increase in money growth. This illusion could stimulate consumer spending and production, which, in turn, might lead to increases in hiring. However, as wages and prices adjust upward to the change in money growth, the stimulus would lose effect and companies would probably stop hiring.

On the other hand, what actions can the Fed take when the unemployment rate is low? If the unemployment rate is near the natural rate, then the Fed would not want to do anything to interfere with this positive situation. However, an unemployment rate below the natural rate signals the Fed that the economy may begin overheating. Overheating indicates that inflationary pressures are on the
rise, because 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. Those increased costs are then passed on to the consumer in the form of higher prices.

Over the long term, increasing the supply of money in the economy contributes to a higher rate of inflation. However, by conducting monetary policy in such a way as to hold the inflation rate at low, somewhat predictable levels, the Fed can help create an environment in which businesses and individuals do not expect high inflation. Helping to reduce uncertainty in the marketplace is important. In a stable economic environment, business decisions will not be postponed, investment will continue and people will be hired. This stability helps keep the economy growing and producing at high levels.

In the final analysis, the Fed cannot directly affect the nation’s labor market. Over the long run, the Fed’s monetary policy cannot directly affect the number of jobs or force the economy to operate at full employment. Temporary measures may be taken to stimulate the economy, but any surge in the market will itself only be temporary. Operating under its mission to foster steady growth in the nation’s money supply while controlling inflationary and recessionary pressures on the economy, the Fed must consider both the short- and long-term effects of its actions on the health of the nation’s economy. By helping to create a stable and healthy environment, the Fed provides the opportunity for more and better jobs in the future.