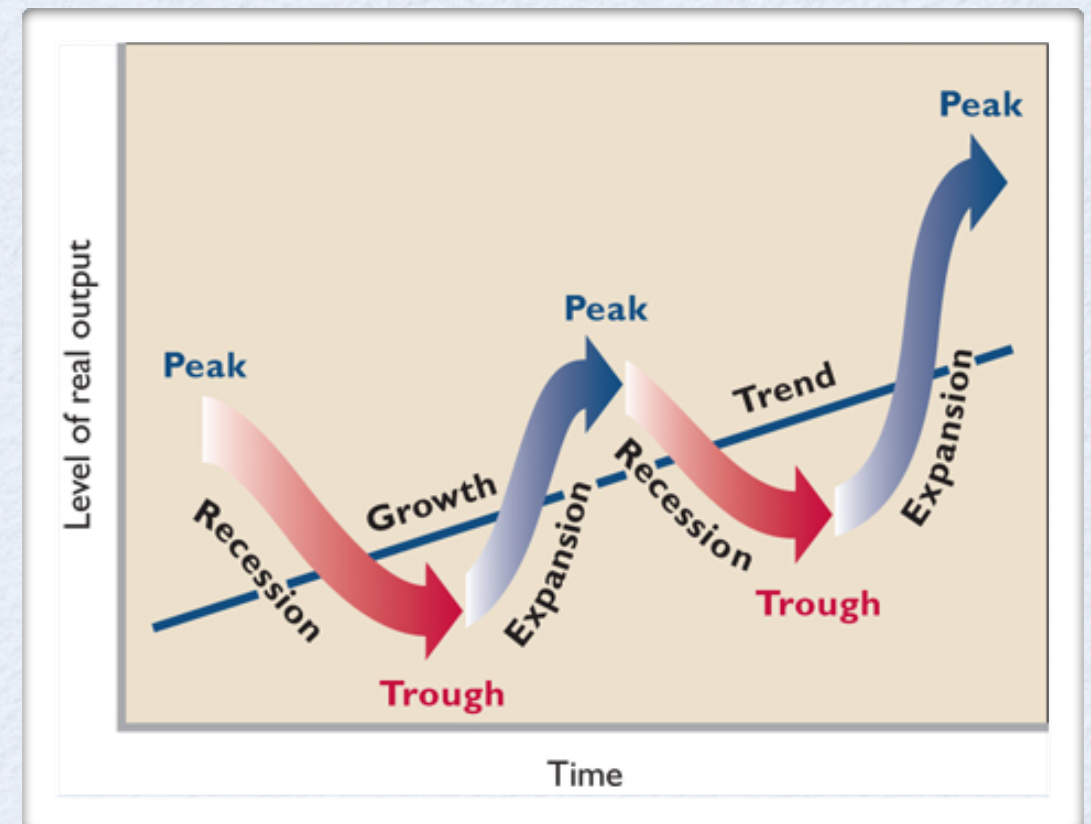


CHAPTER 12

The Business Cycle

- **Phases of the business cycle**
 1. Peak
 2. Recession
 3. Trough
 4. Expansion
- Cyclical impact: durables vs nondurables



Unemployment

- Measurement of unemployment

$$\text{Unemployment rate} = \frac{\text{unemployed}}{\text{labor force}} * 100$$

- Unemployment data is understated: part-time employment, discouraged workers

Types of Unemployment

- **Frictional unemployment** - workers who are “between jobs”
- **Structural unemployment** - *occupationally*: demand for certain skills changes, *geographically*: migration of workers to different locations (E ➡ W for example)
- **Cyclical unemployment** - unemployment that is caused by a decline in total spending and typically begins in the recession of the business cycle

Definition of Full Employment

- The unemployment rate that is consistent with full employment is called the full employment rate of unemployment or the **natural rate of unemployment (NRU)**
- **Economic cost of unemployment**
 1. **GDP Gap = actual GDP - potential GDP**
 2. **Okun's Law** - for every 1% by which the actual unemployment rate exceeds the natural rate, a negative GDP gap of about 2 % occurs (NRU = 6% \Rightarrow 7.4% unemployment - 6% = 1.4% \Rightarrow 1.4% * 2% = 2.8% GDP gap (1992 = \$7,337 Bill.)

Definition of Full Employment

