

Understanding labour markets



Chris Pissarides, professor of economics at LSE and director of CEP's research programme on macroeconomics, has been jointly awarded the IZA Prize in Labor Economics 2005 with Professor Dale Mortensen of Northwestern University.

The prize, awarded by the Institute for the Study of Labor (IZA) in Bonn, honours the pioneering work of exceptionally creative scholars who have revolutionised theoretical and empirical research on labour markets. The prize committee includes Nobel Laureates George Akerlof and Joseph Stiglitz, and the previous winners are Jacob Mincer, Orley Ashenfelter and Ed Lazear. Pissarides is the first European scientist to receive this prestigious award.

Mortensen and Pissarides's work has focused on developing a better understanding of unemployment and job flows. In particular, they have shown how the intensity with which workers search for jobs and the timing of decisions of when to accept a job offer determine the distribution of unemployment durations.

The award team said: 'Professor Pissarides and Professor Mortensen have been awarded the prize for their path-breaking contributions to the analysis of markets with search and matching frictions. The vast literature that was stimulated by their fundamental contributions to search and matching theory is evidence of the power of their approach to the analysis of interactions in labour markets, marriage markets, housing markets, or generally all markets with frictions.'

'Both their individual contributions and their joint development of a dynamic equilibrium model of labour markets account for much of the success of job search theory and the flows approach in becoming a leading tool for microeconomic and macroeconomic analysis of labour markets. Their models, which are now widely used in labour economics and macroeconomics, have highly enriched research on unemployment as an equilibrium phenomenon, on labour market dynamics and cyclical adjustment. Dale Mortensen's and Christopher Pissarides's research on labour market search and job matching has also significantly directed and shaped the empirical literature.'

Commenting specifically on Pissarides's work, they note: '[it]... has broken new ground in studying macroeconomic implications of the flows approach to labour market analysis by using the matching function as a tool to study equilibrium unemployment... The matching function relates job creation to the number of unemployed, the number of job vacancies and the intensities with which workers search and firms recruit. It successfully captures the key implications of frictions that prevent an instantaneous encounter of trading partners and has proved a particularly powerful tool for modelling two-sided search frictions that stem from information imperfections about potential trading partners...'

'Pissarides further developed the matching model, which is at present the leading tool for studying imperfect labour markets in macroeconomics, in subsequent studies of equilibrium unemployment dynamics... [His work] highlights the effects of cyclical productivity changes on vacancy posting, labour market adjustment dynamics, unemployment and wage dynamics. It rationalises why vacancies respond more quickly and with greater amplitude to shocks than unemployment, that real wage changes do not fully reflect real output changes and that unemployment responds faster to a negative than to a positive shock.'

Further reading

Dale Mortensen and Christopher Pissarides (1993), 'Job Creation and Job Destruction in the Theory of Unemployment', CEP Discussion Paper 110, and *Review of Economic Studies*, 1994.

Dale Mortensen and Christopher Pissarides (1999), 'Job Reallocation, Employment Fluctuations and Unemployment', CEP Discussion Paper No. 421, and *Handbook of Macroeconomics*.

Dale Mortensen and Christopher Pissarides (1999), 'New Developments in Models of Search in the Labor Market', *Handbook of Labor Economics*.

Christopher Pissarides (1990, 2000), *Equilibrium Unemployment Theory*, MIT Press.