NEGISHI-SOLOW EFFICIENCY WAGES, UNEMPLOYMENT INSURANCE AND STOCHASTIC ENDOGENOUS UNEMPLOYMENT BUSINESS CYCLES

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Abstract

This paper introduces efficiency wages designed to incite workers to provide the effort level required in their wage contracts, as in Negishi or Solow, and unemployment insurance, in a finance constrained, heterogeneous agents dynamic economy with a constant return technology as in Woodford (1986), Grandmont et al (1998). In contrast with the competitive case, when unemployment insurance is significant, local indeterminacy and endogenous fluctuations occur for elasticities of capital labor substitution that are larger than a quite small lower bound. Along the deterministic stationary state, raising unemployment insurance is good for employment, and generates a Pareto welfare improvement when effort does not increase too much, i.e. when workers’ relative risk aversion does not decrease too fast with income. Cyclical properties of stochastic endogenous unemployment (Sunspot) business cycles, in particular conditions leading to procyclicality of employment, real wages and effort (Phillips curve), are investigated.