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Work of Economics Nobel Winners Informs Current Labor Debate

The work of the winners of the economics Nobel has particular applications to the current disruptions in the U.S. labor market.

The **Sveriges Riksbank Prize in Economic Sciences in Memory of Alfred Nobel** 2010, the official names of the economics Nobel, was awarded to **Peter A. Diamond** of the **Massachusetss Institute of Technology**, **Dale T. Mortensen** of **Northwestern University** and **Christopher A. Pissarides** of the **London School of Economics** for "their analysis of markets with search frictions," according to the Nobel committee. Though the theories are useful for many markets where interactions are more complicated than matching buyers and sellers, including housing and monetary theory, the committee cited its application to the labor market as a key contribution.

"In a number of studies, Dale Mortensen and Christopher Pissarides have systematically developed and applied the theory to examine the labor market — particularly the determinants of unemployment. This has resulted in a model known as the Diamond-Mortensen-Pissarides (DMP) model," the committee wrote. "Today, the DMP model is the most frequently used tool for analyzing unemployment, wage formation and job vacancies. The DMP model describes the search activity of the unemployed, the recruiting behavior of firms and wage formation. When a job seeker and an employer find one another, the wage is determined on the basis of the situation on the labor market (the number of unemployed workers and the number of vacancies). The model can thus be used to estimate the effects of different labor-market factors on unemployment, the average duration of spells of unemployment, the number of vacancies and the real wage. Such factors may include the benefit level in unemployment insurance, the real interest rate, the efficiency of employment agencies, hiring and firing costs, etc."

The research aids economists looking at the current state of the U.S. labor market, who are trying to understand why job openings are rising while the number of new hires is lagging. As noted in a previous Real Time Economics post, Diamond, who has been nominated for a slot on the **Federal Reserve**'s **Board of Governors**, wrote a seminal paper on the subject. The issue is of great interest to the Fed, which is aiming to determine how much of the current unemployment is demand-based, or cyclical, and how much is structural, or based on a fundamental mismatch between the skills employers are looking for and the skills job seekers have to offer.

Economist **Tyler Cowen**, who includes links to key papers by the winners here, here and here, points to Diamond research on search theory and unemployment.

"The relationship to the current day U.S. is striking. One point he stresses is that subsidization of production can make sense and also that there can be real costs of converging to the lowest possible rate of unemployment too quickly. This remains an important 'framework' paper for analyzing the interaction of search and aggregate demand," Cowen says.