

Hours vs employment in response to demand shocks

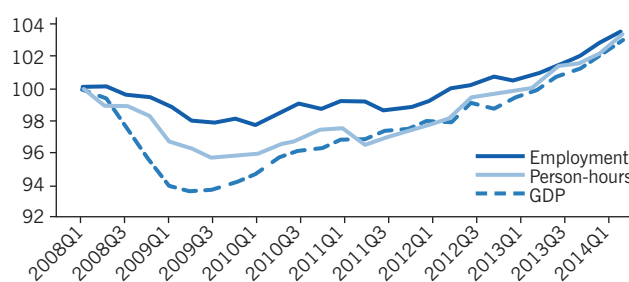
Evaluating the labor market effects of temporary aggregate demand shocks requires analyzing both employment and hours of work

Keywords: demand shocks, hours, employment, labor productivity

ELEVATOR PITCH

Labor market responses to temporary aggregate demand shocks are commonly analyzed and discussed in terms of changes in employment and unemployment. However, it can be seriously misleading to ignore the interrelated behavior of hours worked. Work hours can be altered relatively speedily and flexibly, and this strongly relates to employment, labor productivity, and unemployment outcomes. The hours–employment distinction is especially important in the evaluation of the performances of European labor markets during the negative shock experienced during the Great Recession.

Employment, work hours, and GDP in the UK



Note: Full-time, part-time, and temporary workers, 2008Q1=100.

Source: Author's own compilation based on UK Labour Force Survey (LFS).
Online at: <https://discover.ukdataservice.ac.uk/series/?sn=2000026>; and ONS data. Online at: <https://www.ons.gov.uk/>

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KEY FINDINGS

Pros

- + Short-term costs of adjusting employment are relatively high, so changes in hours enable national economies to react more speedily to unexpected aggregate demand shocks.
- + Different rates of adjustment of employment and hours worked have important implications for measuring the labor productivity effects of demand shocks.
- + Unemployment rates understate the full impact of negative demand shocks since, on average, employees are underemployed due to a positive gap between their desired and actual working hours.

Cons

- Not all hours worked offer demand-response flexibility, e.g. when an employee's required standard working hours do not include opportunities to deviate from prescribed daily/weekly schedules.
- Since measured hours typically fail to take changes in hourly effort into account, they may inadequately represent the adjustment of working time to demand shocks.
- If actual paid-for hours fall short of desired hours, effects on workers' morale may adversely impact work application and effort.

AUTHOR'S MAIN MESSAGE

Aggregate labor demand shocks serve temporarily to increase or decrease the demand for goods and services. From a labor market perspective, shocks necessitate speedy revisions of required employment and hours inputs in order to circumvent costly over- or under-supply of output. In their adjustments to shocks, many firms make use of short-term working time flexibility. Evidence from the 2007 negative shock that gave rise to the Great Recession indicates that policymakers should be cautious about imposing excessive restrictions on employers' ability to vary working hours as doing so may exacerbate adverse labor market repercussions.