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The traditional macroeconomic approach to unemployment depicts a one-way chain of causation in which wages, employment and productivity are affected by "given" psychological factors such as tastes, motivations and endowments of human capital. This paper draws on the work of numerous social psychologists to describe the relations among these variables as a feedback loop, wherein psychological factors are reciprocally affected by the economic variables. The interesting results of such interdisciplinary cross-fertilization include a proposal for reshaping human capital theory, and reasons to question the existence of a natural rate of unemployment.

MOTIVATION AND HUMAN CAPITAL

It is useful to understand human capital as divided into two conceptually distinct parts. Conventional human capital, which is based in skills as well as physical health, defines an individual's ability to initiate and complete tasks. Ability, however, does not predict action. If we want to know what will come of the potential described in skill-based human capital we have to add in the factor of motivation: this is what explains "effective human capital" -- i.e., the portion of an individual's innate and learned capacities that will be actually realized.

Standard measures of conventional human capital include education, experience, tenure and aptitude. Economic studies of the correlation of these factors with real wages suffer from omitted variable problems which are likely to lead to unreliable estimates of the various factors that determine wages and/or productivity. What is omitted may be broadly termed motivation; it is the psychological capital that determines the extent to which the more commonly measured aspects of human capital will be turned into effective human capital. Since psychological capital is likely to be correlated to some extent with the standard measures of human capital, and since some aspects of motivation may be jointly determined with personal productivity, the results will be skewed if randomness is assumed for this omitted variable. Nor can it be treated as a time-invariant variable whose impact is not contingent upon any observable regressor, since motivation is determined in important ways by the individual's employment history.

UNEMPLOYMENT AND MOTIVATION

It is evident that unemployment can affect an individual's psychological well-being; the responses that have been observed include depression, anxiety, low self-esteem and strained personal relations. Going beyond common-sense observation, there is an extensive literature [[1]]

that explores the two-way causal links between unemployment and psychological health, or ill-health. The mechanisms that complete the linkage from unemployment to psychological health to motivation are explicated in "expectancy theory," currently the most widely accepted and empirically verified theory of motivation

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> This theory posits that a person's motivation is directly related to beliefs that: 1) effort will lead to performance... 2) performance will be rewarded by compensation, opportunities to use skills, security and opportunity to develop professional relations; and 3) the rewards contribute to the realization of individual goals like autonomy, achievement, self-respect, status, recognition, friendship and security. [125]

Job loss, often experienced as a negation of some or all of these beliefs, can be a traumatic blow to self-esteem, and can create feelings of helplessness or lack of control over ones life. Such feelings are a common precursor to depression and are also known to "reduce motivation and result in detrimental cognitive effects that hamper learning." [124]

> To the extent that unemployment leaves a psychological imprint that persists following reemployment, individuals suffer lower self-esteem, learned helplessness, and a loss of the latent byproducts of working (like practice in time management), and their personal productivity is likely to suffer. Personal productivity of "survivors" is also expected to decline, as they witness the trauma of their co-workers.... Therefore, a deterioration in psychological well-being brought about by a recession triggers a subsequent decline in productivity across the labor force. [132]

QUANTIFYING THE CONNECTION BETWEEN UNEMPLOYMENT AND EMOTIONAL WELL-BEING

The propositions put forth here are: that unemployment damages psychological well-being; and that psychological well-being has an effect on productivity (via job attachment, as well as through both cognitive and emotional effects). These propositions are not reflected in standard economic analyses because economists have generally accepted the impossibility of making interpersonal comparisons or of measuring psychological variables. However this is an area in which there has been notable progress in recent decades. Tests of convergent validity (comparison of different measurement instruments, as well as self-reporting, to see if they achieve like results), of stability (does the same test generally produce similar results if repeated, e.g., two weeks later?) and of internal consistency have shown reason to place considerable confidence in several psychological survey tools that have now achieved a long history.

Goldsmith, Veum and Darity (1995), estimating separately the impact on wages of both skill-based human capital and psychological capital, have found that, while both are important determinants of productivity, "a 'one-unit' improvement in psychological capital has a much larger effect on productivity than an equivalent increase in skill-based human capital. For females, in particular, the impact of human capital is heavily contingent upon motivation." [129]

A BEHAVIORAL MACROECONOMIC MODEL

What would a macroeconomic model look like, if it represented the influence of psychological well-being on productivity and labor-force participation? As an example, we may consider how the ramifications of an employment shock work their way through an economy over time.

In a conventional economic model a sharp drop in employment is followed by equilibrating forces that will affect the price of labor until "the economy returns to its original real levels of employment, output and wages, but with nominal wage and output price deflation. In such a model, the short-term experience of joblessness has no long-term effect on workers, nor on supply and demand for labor." [132]

In contrast, a model that explicitly included the interconnections between a society's economic vitality and its psychological health, and that recognized the long-lasting cognitive and emotional damage of unemployment, would show some different possible consequences to a rise in joblessness. On the supply side the effect can be either increased or reduced labor supply, because, while emotional distress may create discouragement, leading to less attachment to work, it can also create a "trauma escape" effect, in which workers are willing to accept lower real wages in order to obtain a job. In either case, however, the debilitating effects of unemployment are expect to reduce the efficiency of labor, and will therefore reduce aggregate labor demand. This may cause unemployment to rise further, and may be the explanation for the persistence of episodes of lowered employment.

Given this psychological link we may find a new, less desirable equilibrium, even if unemployment is eventually reduced -- not only because of wage or price rigidities, but also as a result of unfavorable labor force histories. "Ultimately, with a labor force showing lower participation, employment and productivity, the output of the economy will be lower than the original potential.... Thus, the story of the intermediate run must include not only flexible nominal wages, but the productivity and labor market attachment consequences of joblessness...." [132]

Notes

1. Reviewed by Norman T. Feather in The Psychological Impact of Unemployment. New York: Springer-Verlag, 1990.