

A Fair Wage Model of Unemployment with Inertia in Fairness Perceptions*

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Abstract

Theories of psychology and empirical evidence suggest that the reference transactions against which workers judge fairness exhibit inertia. This paper shows that a fair-wage model with inertia in fairness perceptions provides a plausible explanation for the observed negative correlation between changes in productivity growth and equilibrium unemployment over the medium run, a stylized fact that remains elusive to most other classes of models. It also shows that skill-biased productivity shocks and shocks to workers' taste for equal pay have permanent effects on unemployment and the skill premium. Thus, skill-biased shocks to productivity increase unemployment among the low-skilled while, if high-skilled workers are less inequity-averse, they reduce unemployment among the high-skilled.

Keywords: Fairness; Unemployment; Skill Premium; Fair Wage-Effort Hypothesis; Inequity Aversion; Personnel Management.

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