

Labor Market Supply and Demand

ECO 120: Global Macroeconomics

Goals

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Unit Goals

- Define demand and identify what influences labor demand
- Define supply and identify what influences labor supply
- Predict how wages and level of employment are determined by supply and demand.
- Use these skills to make predictions about changes in wages and employment.

Reading and Exercises

2 / 20

- External reading posted on Canvas: Taylor, *Principles of Economics 2e*, Chapter 4
- **Canvas Quiz due Wednesday 11:59 PM.**
Multiple-choice, 10 questions, unlimited attempts allowed, only best score counts
- **Homework/In-class Exercise due Friday 11:59 PM.** We will work together in class on Thursday.

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Demand

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- In the market for labor, the price of labor is the **wage**, and the quantity of labor is **total hours of employment**
- The **quantity of labor demanded** is the amount of worker time that **employers** are willing and able to hire in a given time period at a particular wage.
- Labor demand follows the **law of demand**: All other things remaining equal, the higher is the wage, the lower is the quantity of labor demanded.

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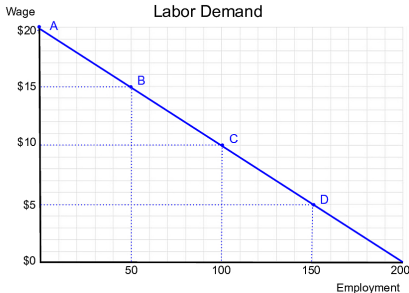
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Demand

Labor Demand Schedule

Point	Wage	L_D
A	\$25	0
B	\$20	50
C	\$15	100
D	\$5	150

Labor Demand Curve



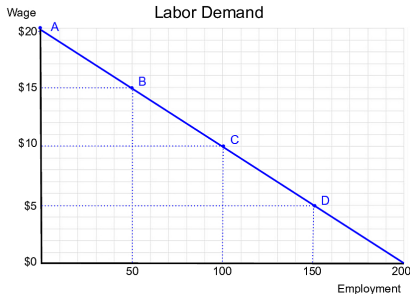
- Law of demand makes the labor demand curve **downward sloping**.
- **Change in quantity labor demanded:** when there is a **change in wage** causing a **movement** from one point on the labor demand curve to another point.

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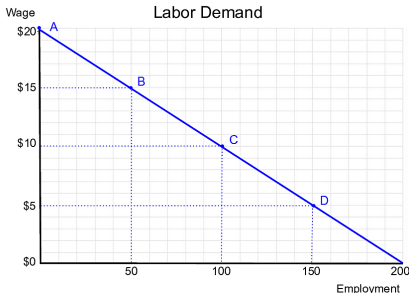
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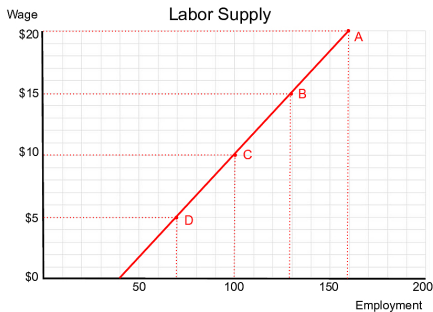
Supply

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Labor Supply Curve

Labor Supply Schedule

Point	Wage	L_S
A	\$20	160
B	\$15	130
C	\$10	100
D	\$5	70



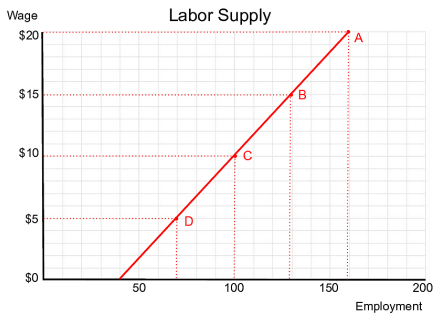
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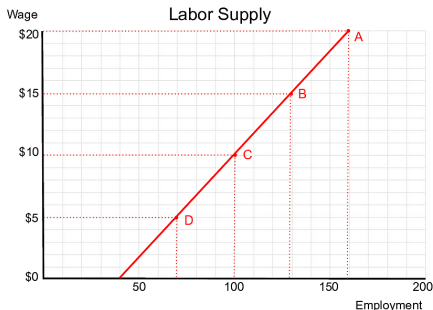
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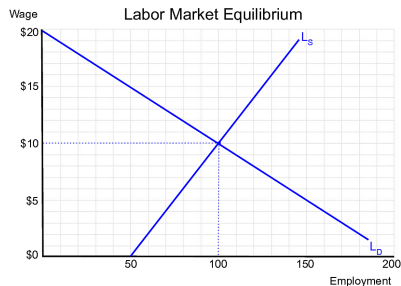
Equilibrium

7 / 20

Equilibrium Definition

- The **equilibrium wage** is the wage where the quantity of labor supplied is equal to the quantity labor demanded.
- The **equilibrium employment** is the corresponding quantity of labor.
- This is the wage and level of employment that should prevail in the long-run in the labor market

Graphical Equilibrium



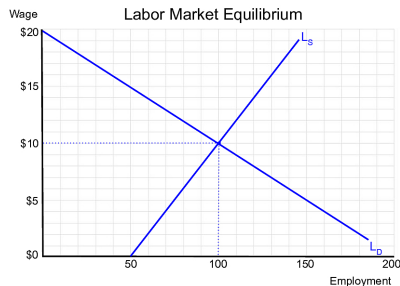
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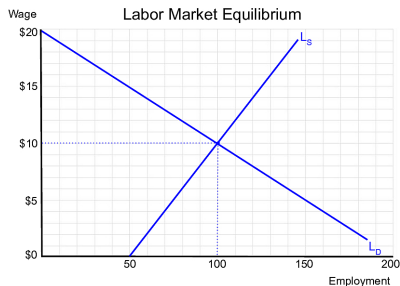
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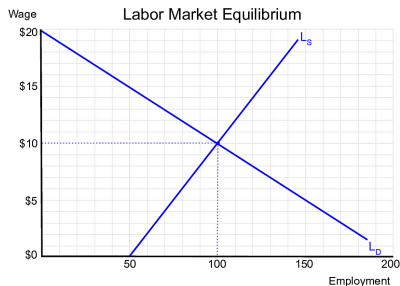
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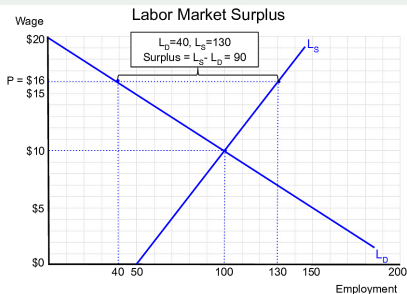
Labor Surplus is Unemployment

8 / 20

Labor Surplus Definition

- When the prevailing wage is **above** equilibrium wage, quantity of labor supplied exceeds quantity of labor demanded
- Quantity of labor supplied \equiv people who want work
- Quantity of labor demanded \equiv how much employers want to hire
- Difference is the surplus = unemployment
- In an unregulated market, market forces will push wage lower toward equilibrium

Graphical Surplus



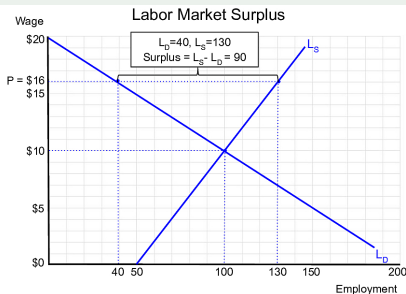
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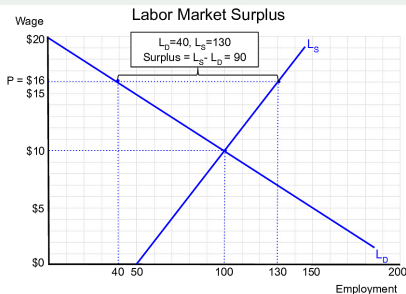
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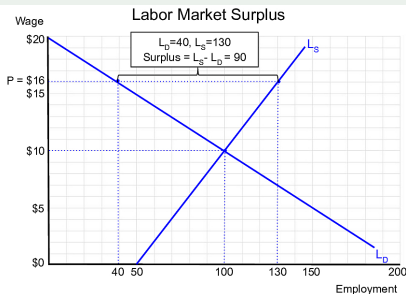
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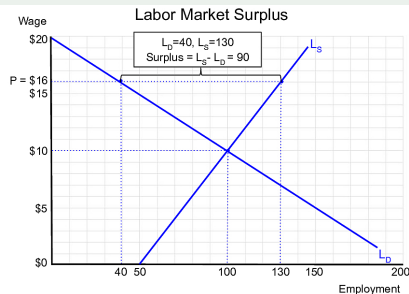
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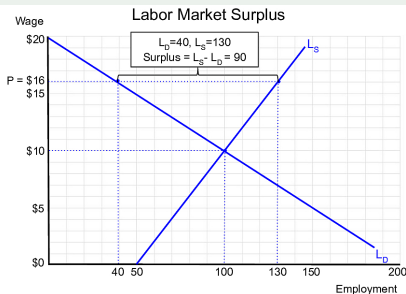
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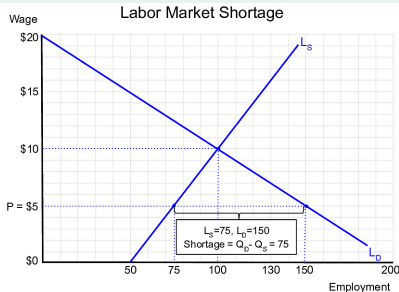
Shortage

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Labor Shortage Definition

- When the prevailing price is **below** equilibrium price, quantity demanded exceeds quantity supplied
- Difference is the shortage
- In an unregulated market, market forces will push equilibrium price higher

Graphical Shortage



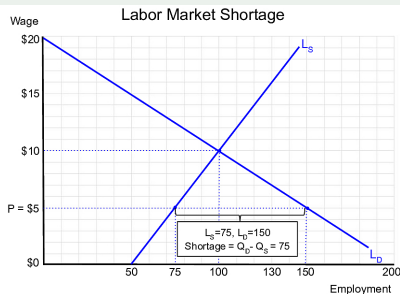
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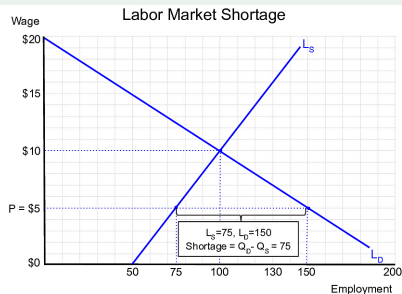
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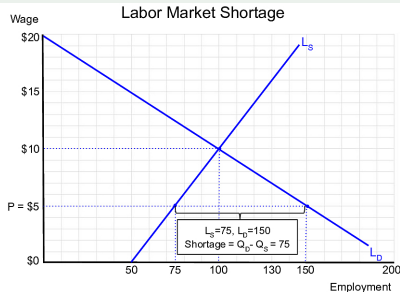
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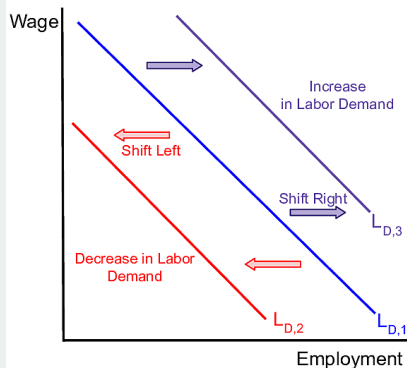
Labor Demand Curve Shifts

10 / 20

Shifts in Whole Demand Curve

- When something *besides the wage* effects labor demand, we say there is a *change or shift in labor demand*.
- Something that **increases** labor demand shifts the labor demand curve to the **right**
- Something that **decreases** labor demand shifts the labor demand curve to the **left**

Shifts in Labor Demand



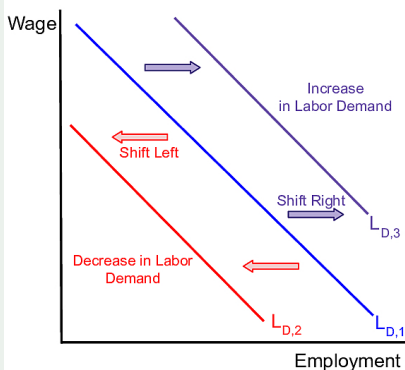
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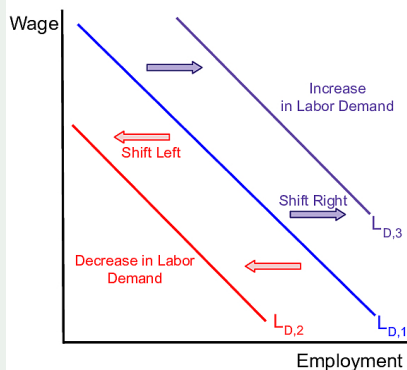
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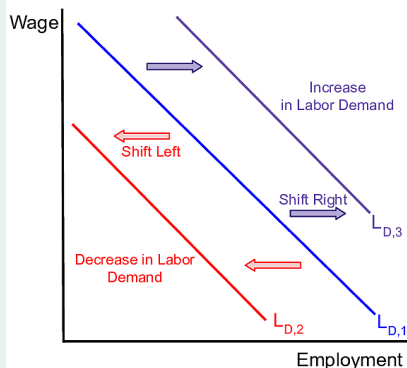
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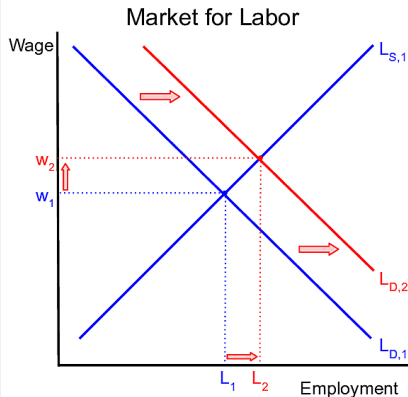
Improvement In Labor Productivity

11 / 20

Mechanism

- If labor productivity improves, workers can produce more goods and services per hour of work
- This generates more revenue for firms per hour of work hired
- This will **shift labor demand right**
- Equilibrium wage increases, employment increases
- Improvements in technology improve labor productivity **at an aggregate level**

Graphical Equilibrium



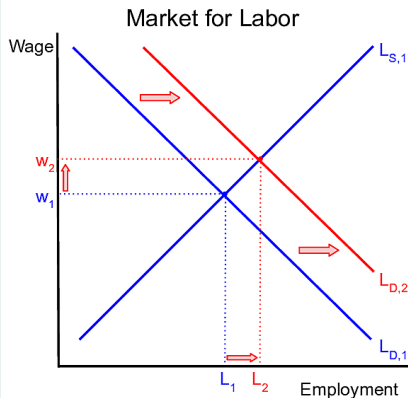
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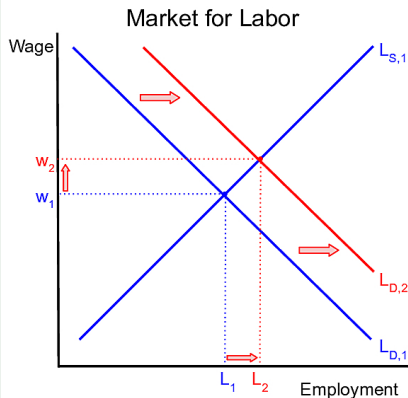
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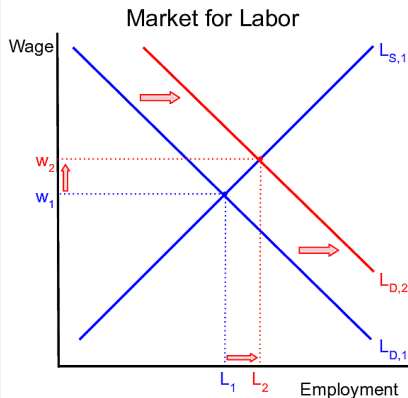
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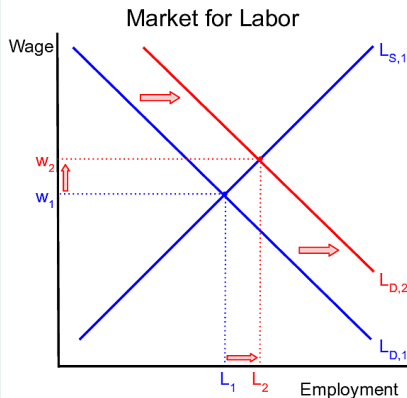
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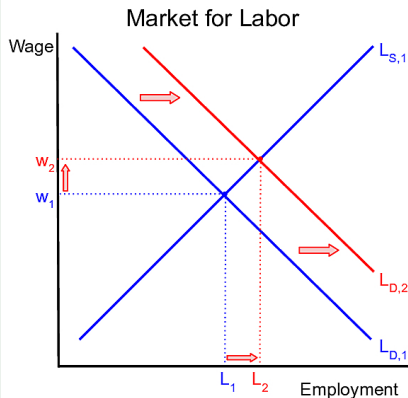
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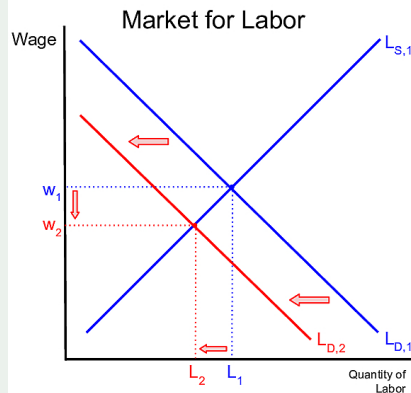
Destruction of Capital Stock

12/ 20

Mechanism

- Capital complements labor and makes labor more productive
- Suppose a natural disaster leads to a destruction of capital stock
- Less capital stock leads to lower labor productivity and lower labor demand
- This will **shift labor demand left**
- Equilibrium wage decreases, employment decreases

Graphical Equilibrium



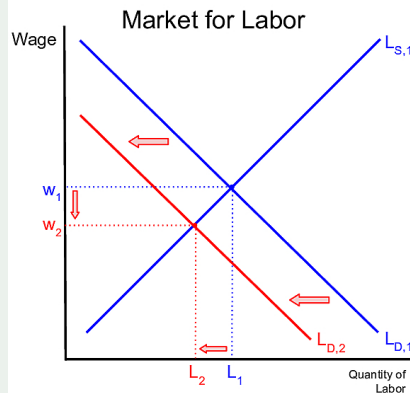
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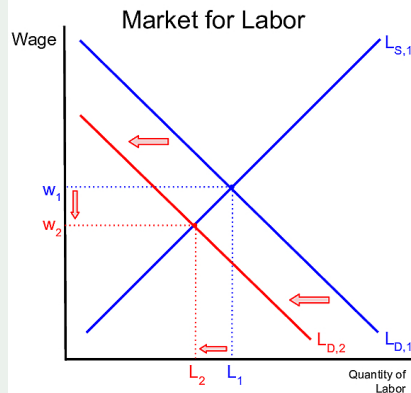
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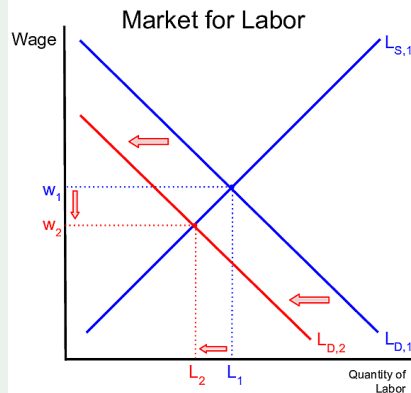
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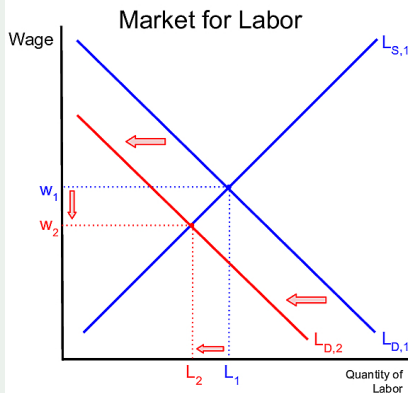
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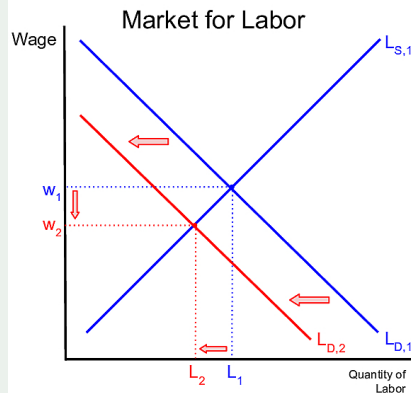
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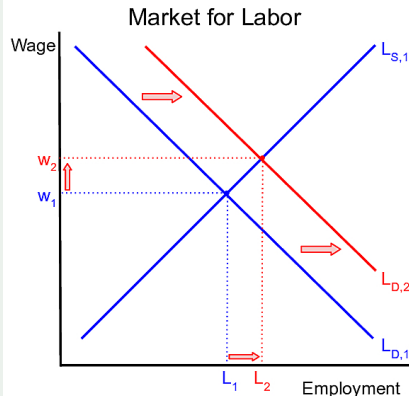
Increase in Demand for Goods and Services

13 / 20

Mechanism

- Labor is a **derived demand**, demand depends positively on the demand for the goods and services the workers produce
- Suppose consumer demand for goods and services increases
- This will **shift labor demand right**
- Equilibrium wage increases, employment increases

Graphical Equilibrium



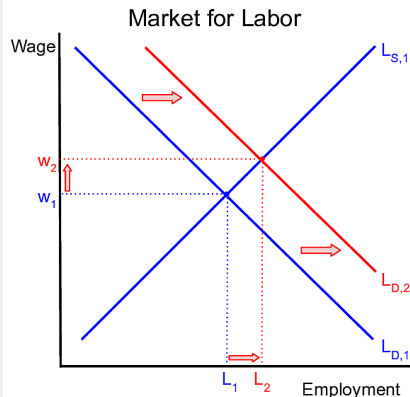
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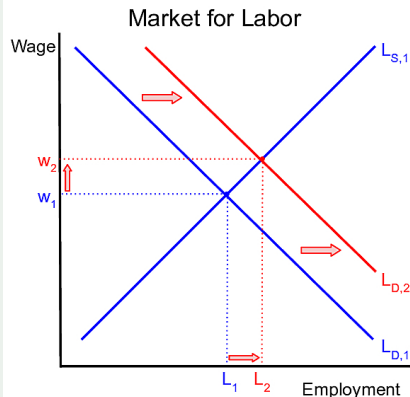
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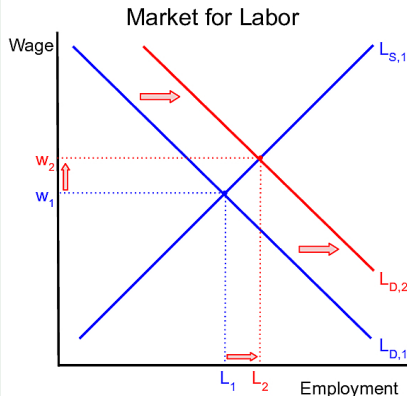
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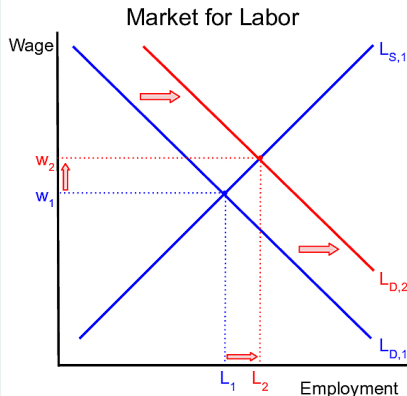
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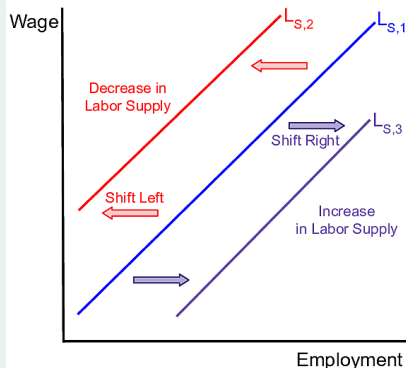
Supply Curve Shifts

14 / 20

Shifts in Whole Supply Curve

- When something *besides the wage* affects how much people are willing and able to work, we say there is a *change or shift in labor supply*.
- Something that **increases** labor supply shifts the labor supply curve to the **right**
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Shifts in Labor Supply



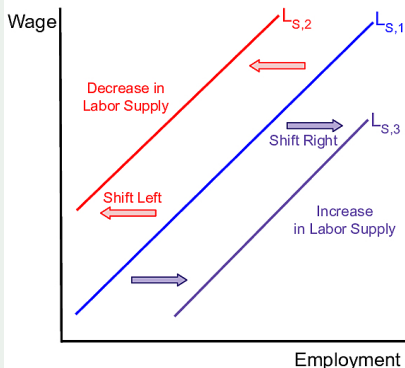
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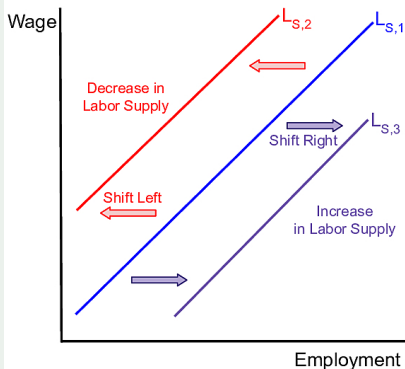
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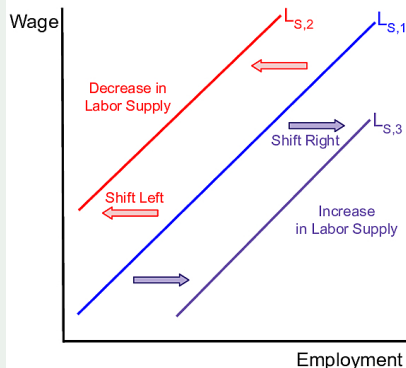
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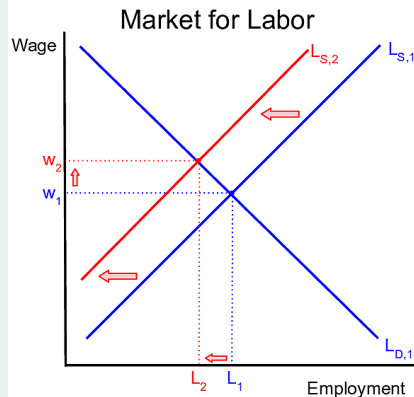
Increase in Retirements

15 / 20

Mechanism

- Suppose a healthy stock market causes more people to decide to retire
- This will **shift labor supply left**
- Equilibrium wage increases, employment decreases

Graphical Equilibrium



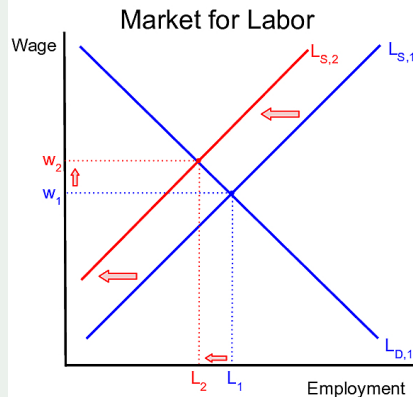
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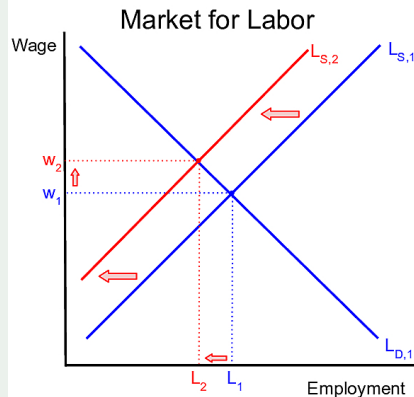
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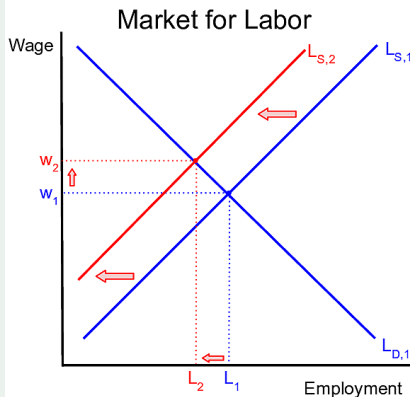
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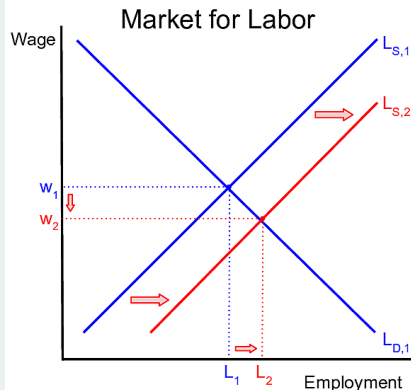
Increase in Labor Force Participation

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- U.S. labor force participation rate is about 62% (2021)
- Suppose more people decide to be part of the labor force
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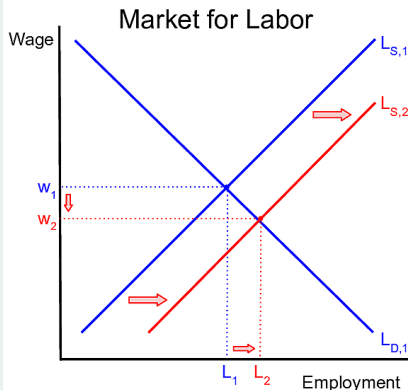
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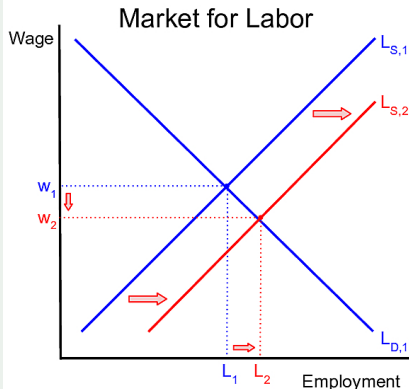
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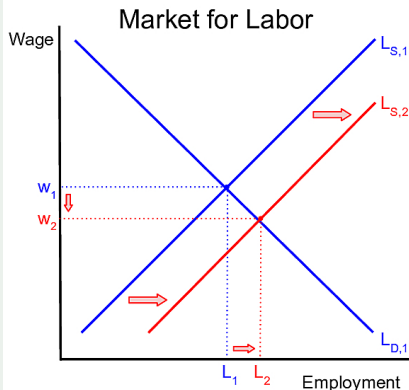
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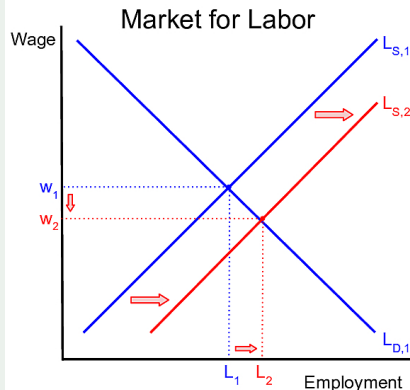
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Sticky Wages

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- Usually, wages do not quickly adjust to new equilibrium levels
- Employers are hesitant to change wages until they recognize market wages have permanently changed
- Labor contracts, policies, salaries often negotiated and changed annually
- Across the board paycuts can hurt employee morale more than layoffs
- Wages can take 3 months - 12 months to adjust to new equilibrium levels

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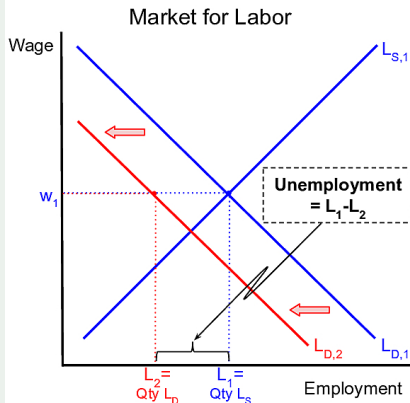
Unemployment with Sticky Wages

18 / 20

Drop in Consumer Spending

- Suppose drop in consumer confidence leads to a drop in consumer spending
- Labor is a derived demand, so **labor demand shifts to the left**
- When wage does not move to new equilibrium level, labor market surplus is created
- Labor market surplus \rightarrow unemployment

Graphical Illustration



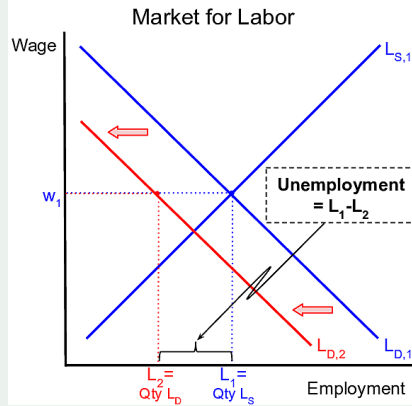
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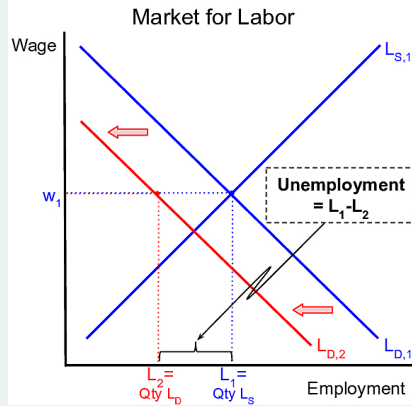
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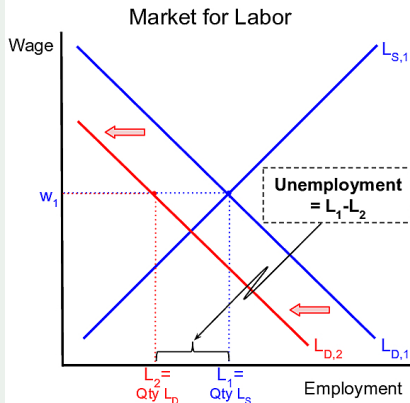
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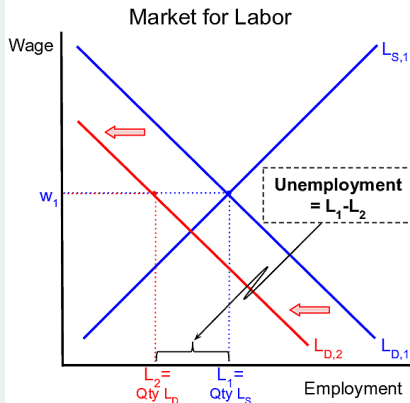
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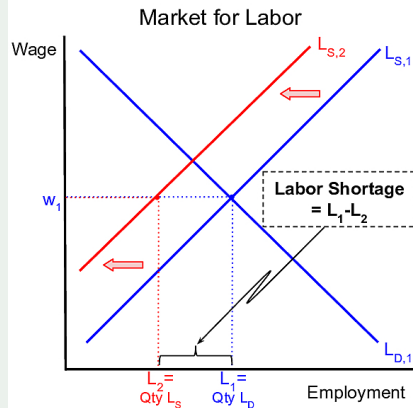
Labor Market Shortage with Sticky Wages

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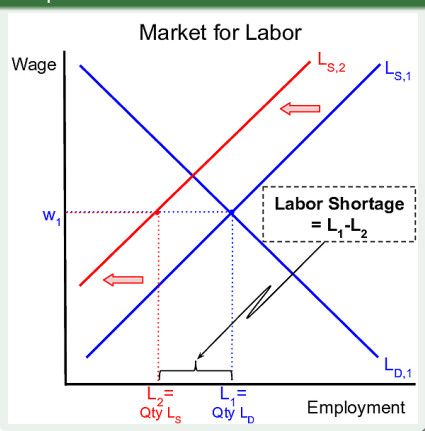
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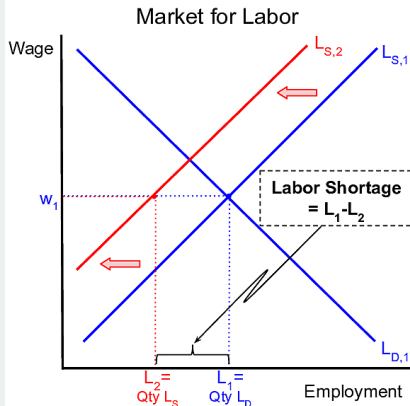
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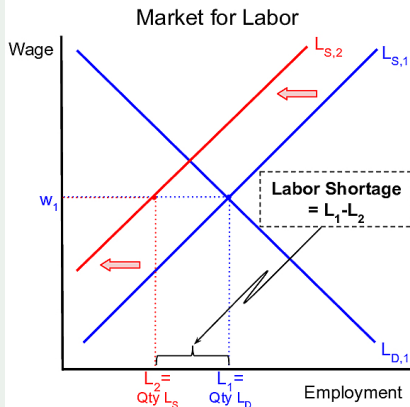
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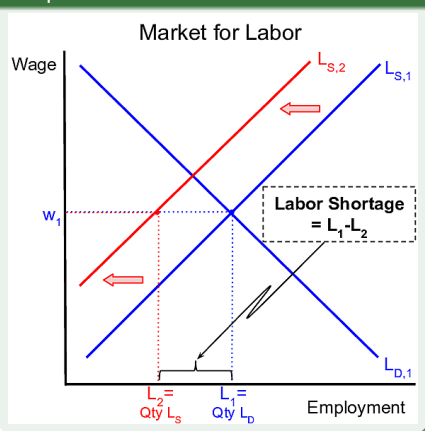
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Reading and Exercises

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