Labor Market Supply and Demand

ECO 120: Global Macroeconomics

Goals

Unit Goals

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

Reading and Exercises

- 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

- 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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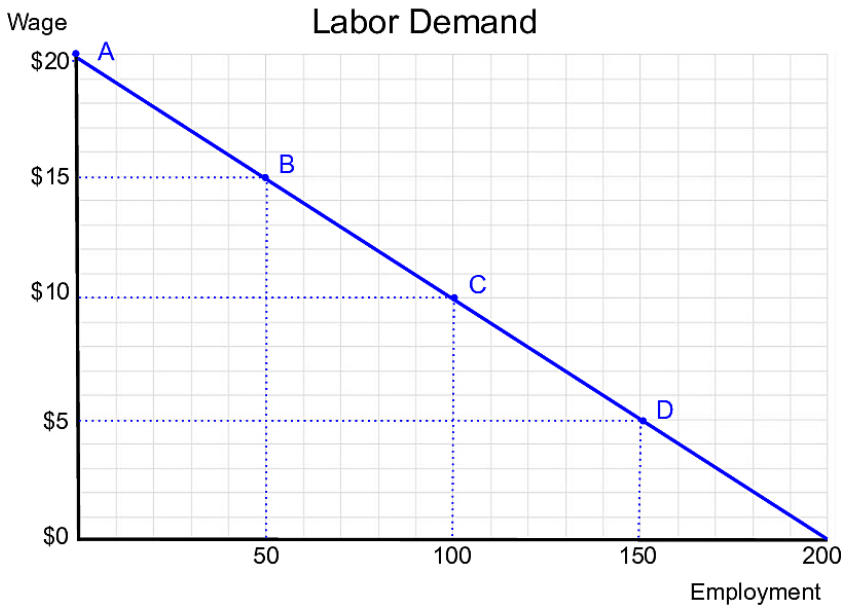
Demand

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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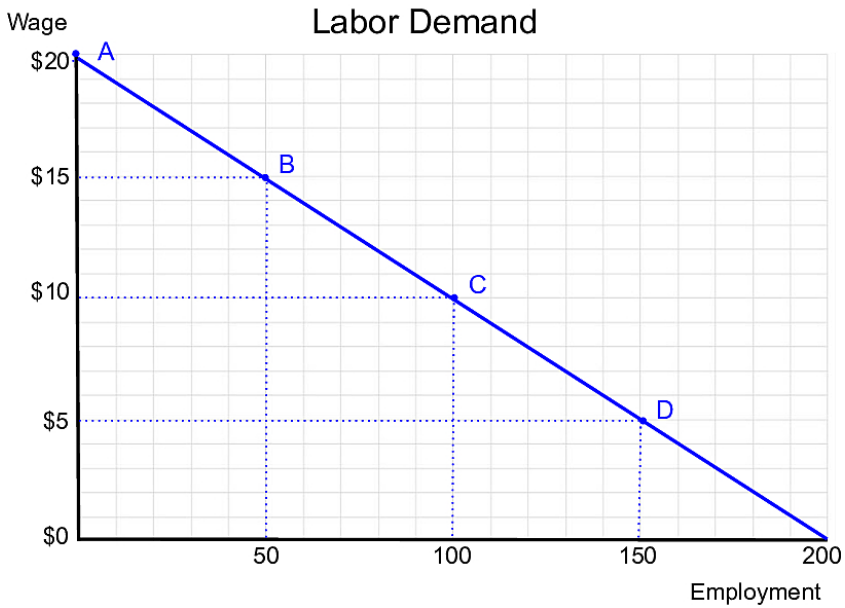

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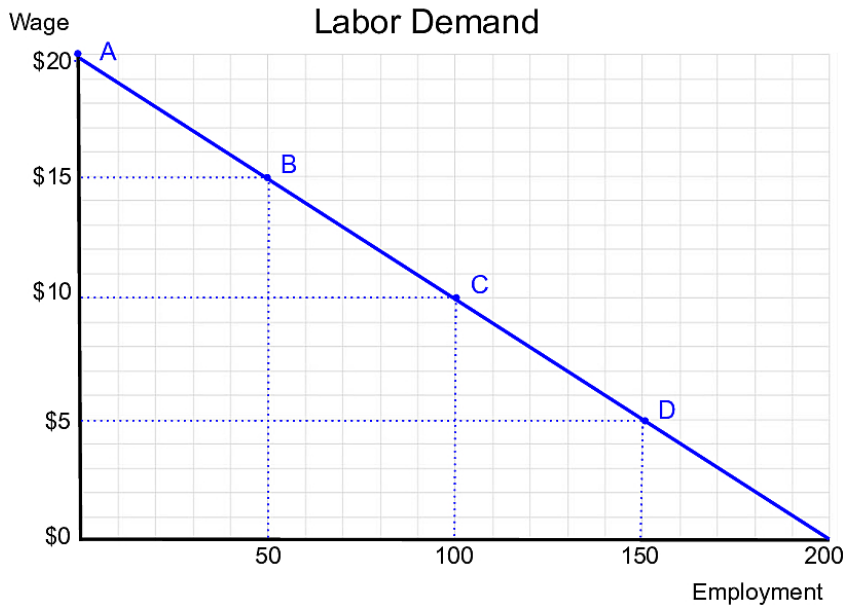

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Point	Wage	L_S
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B	\$15	130
C	\$10	100
D	\$5	70

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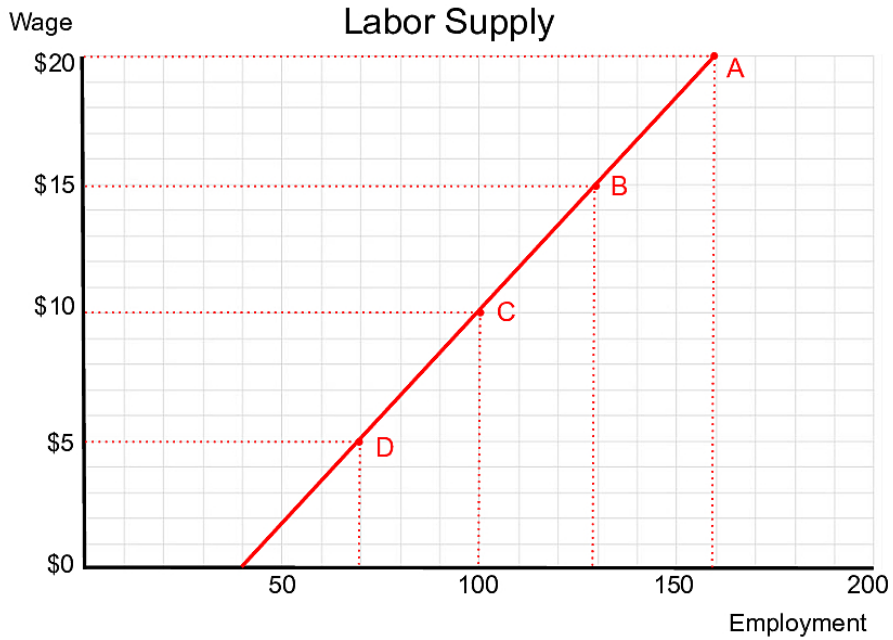

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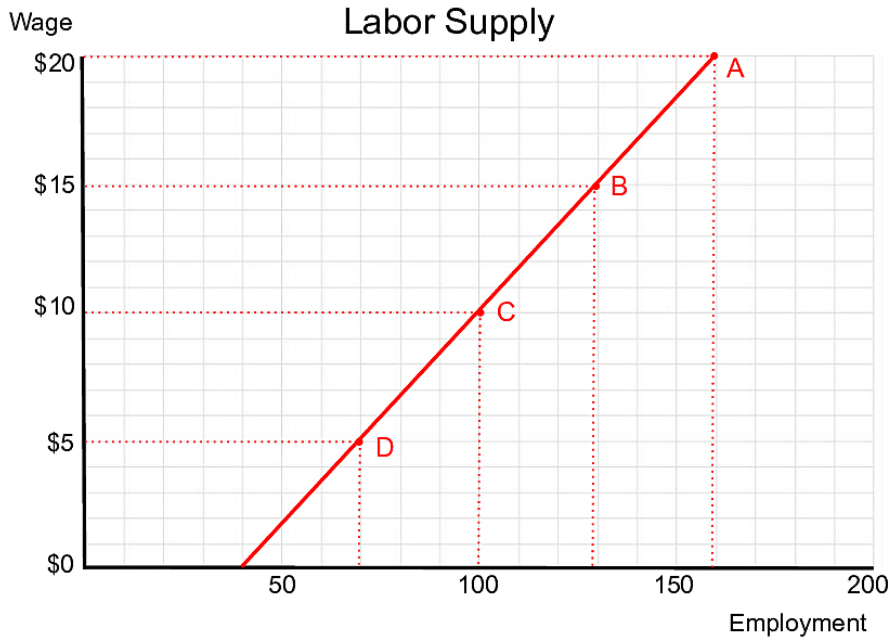

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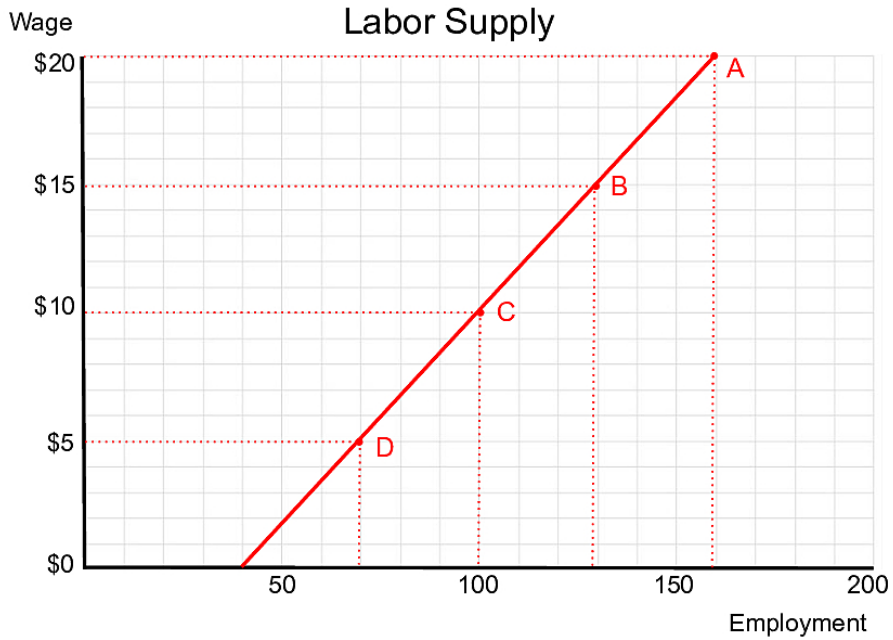

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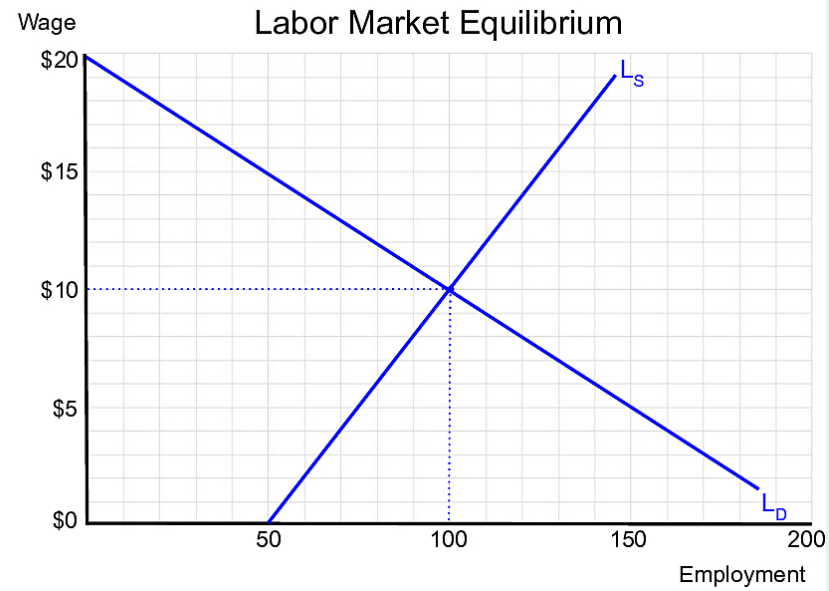
Equilibrium

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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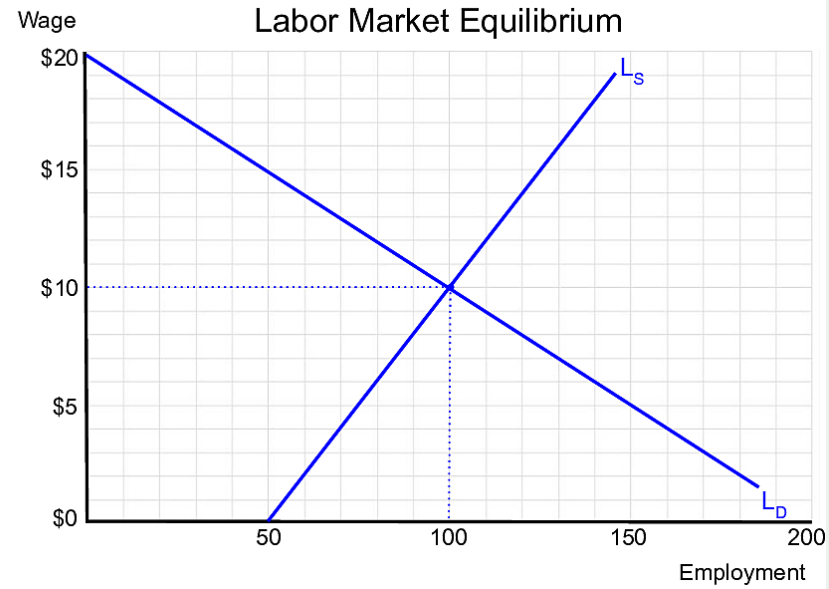

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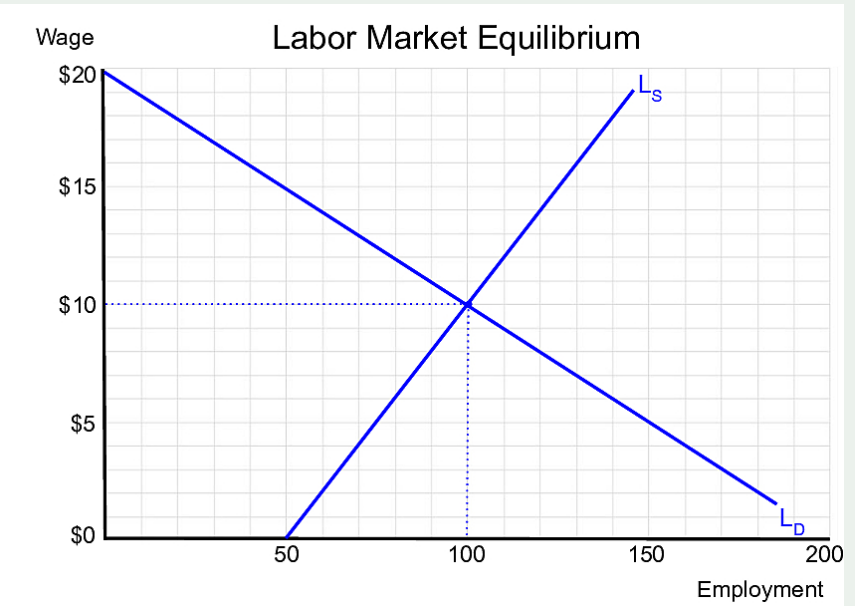

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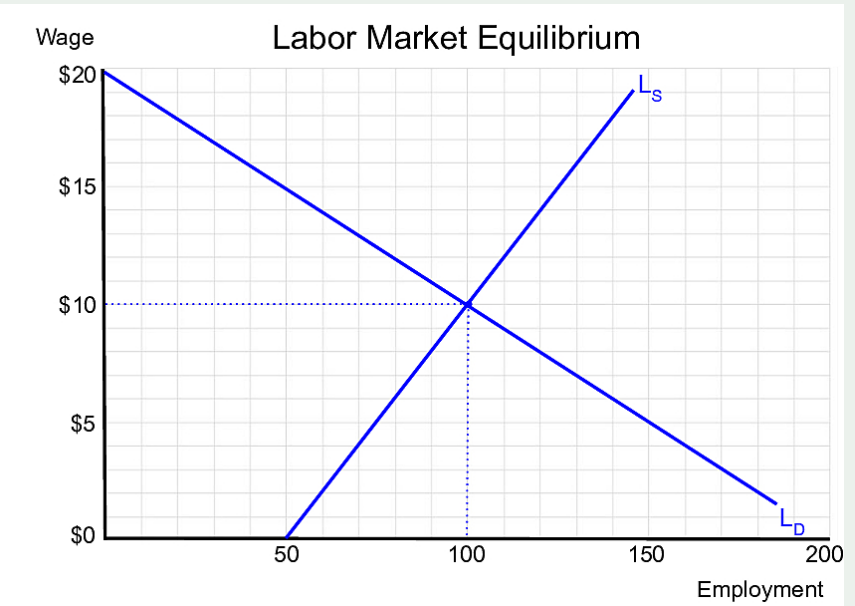
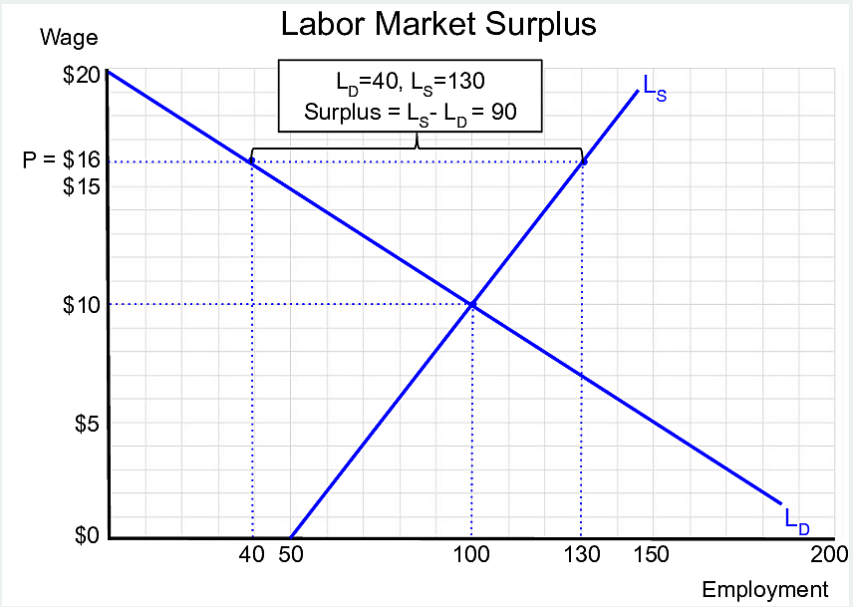


Labor Surplus is Unemployment

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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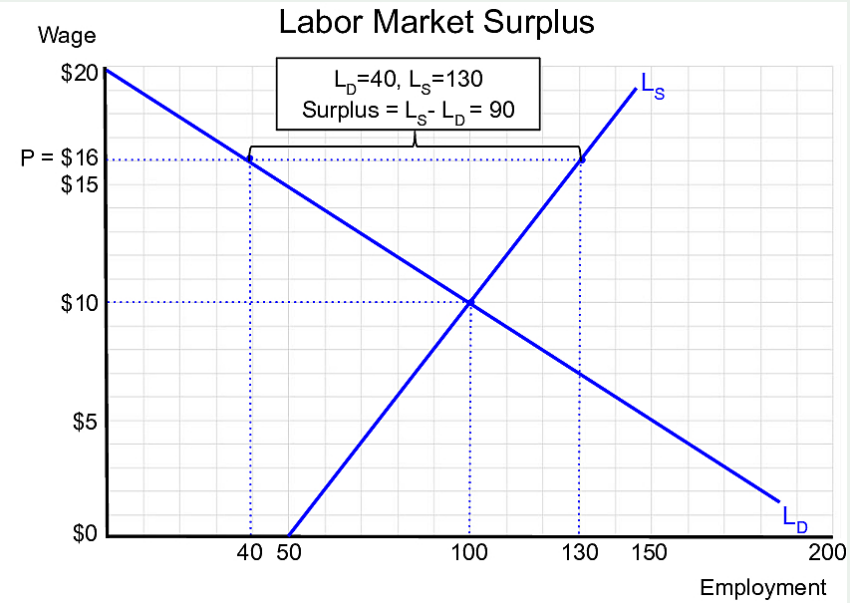

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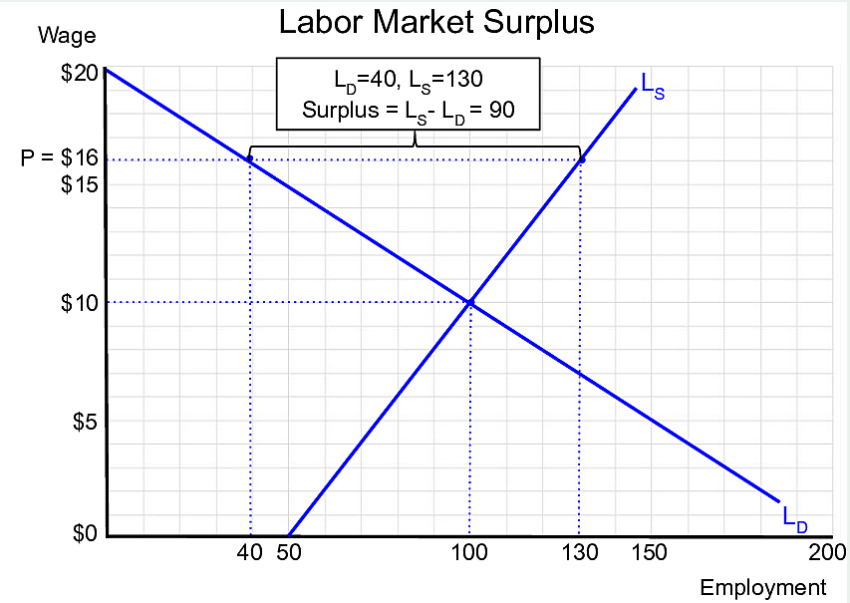

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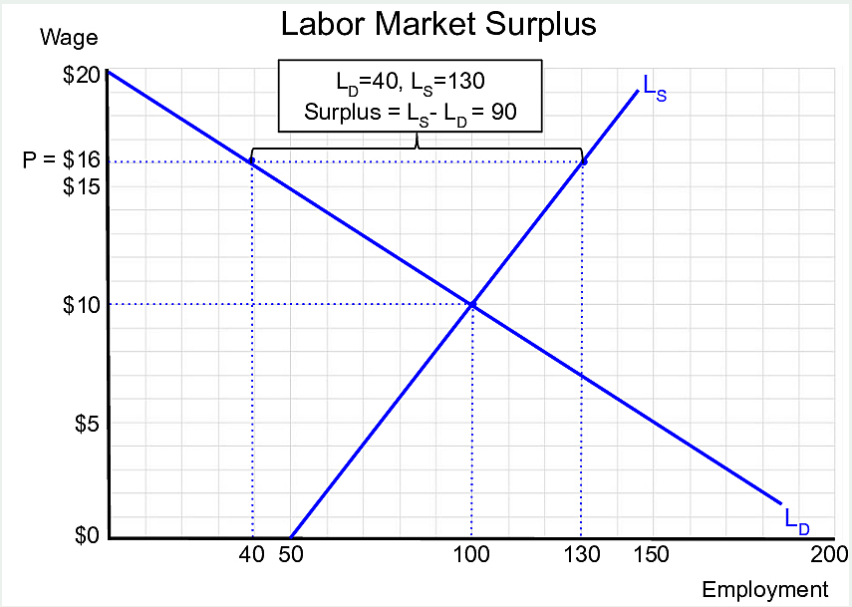

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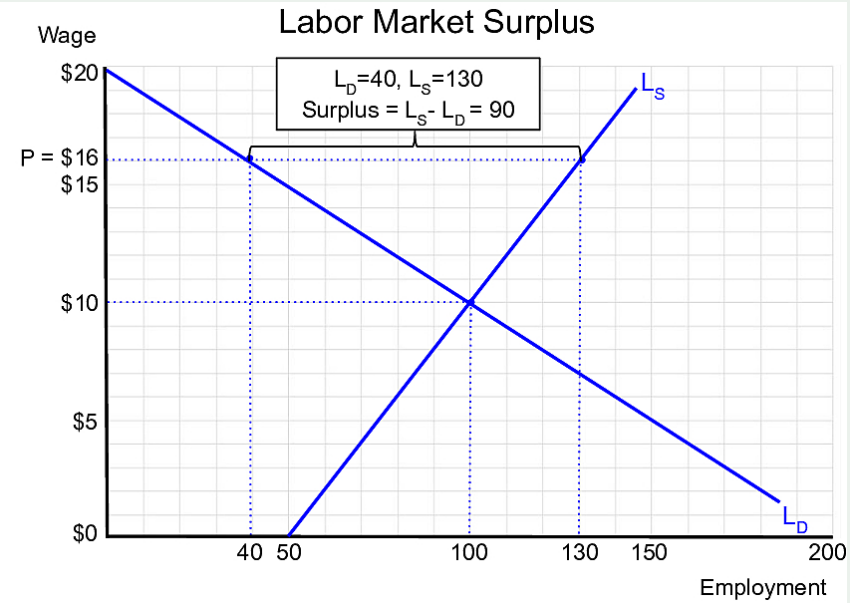

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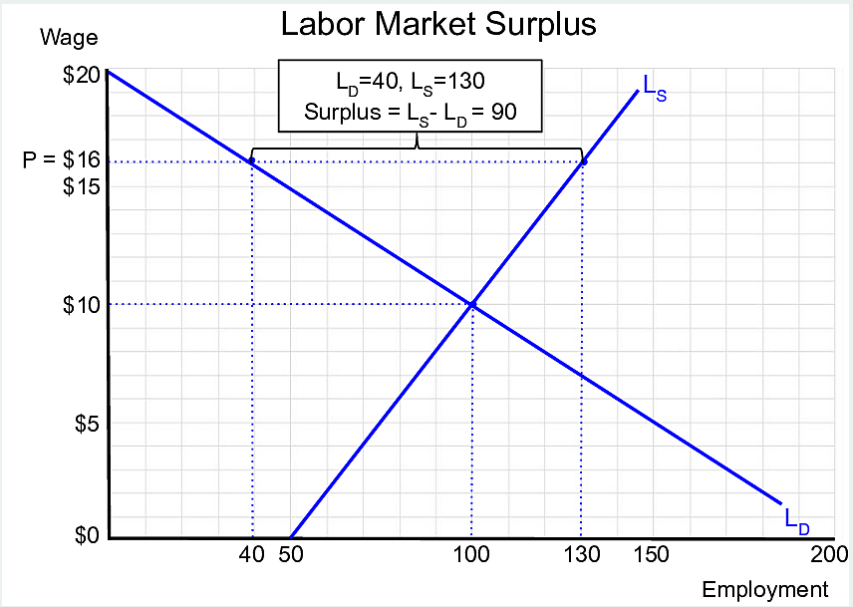

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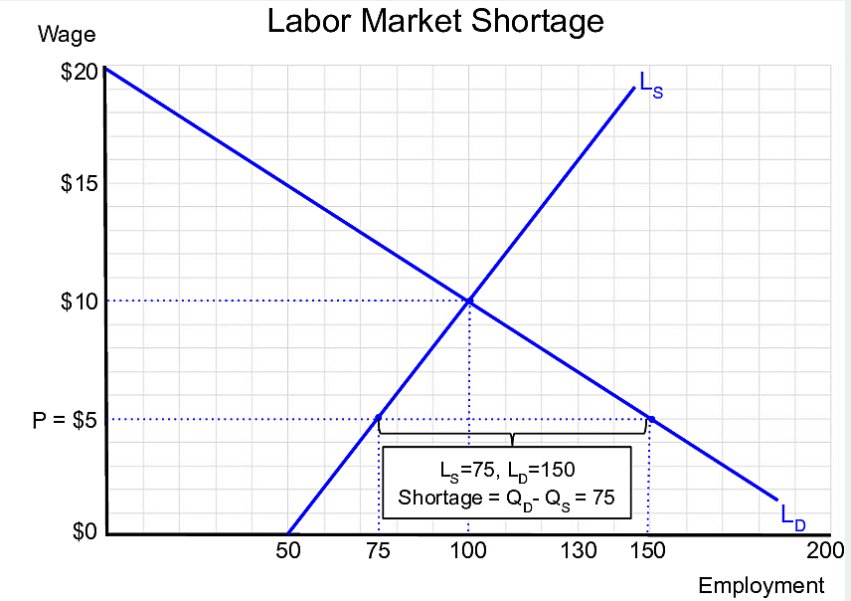

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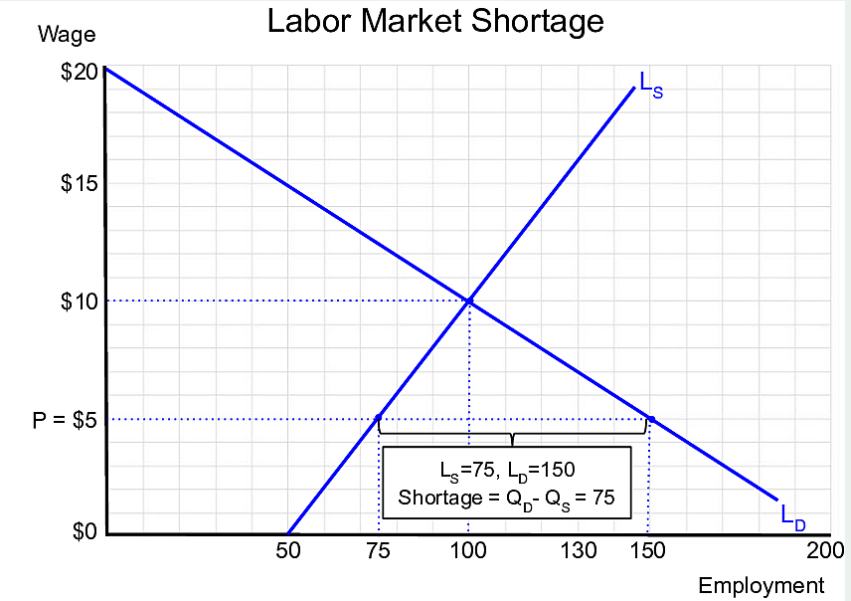

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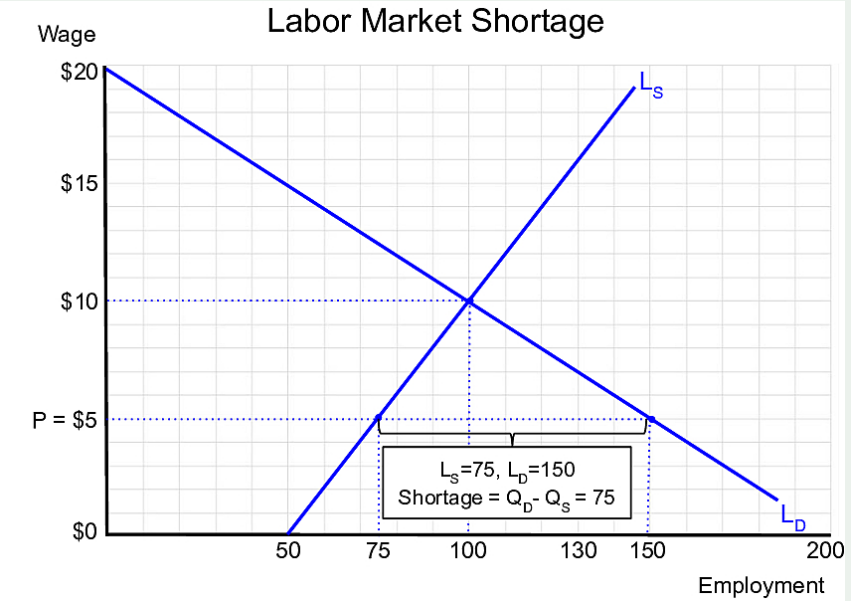

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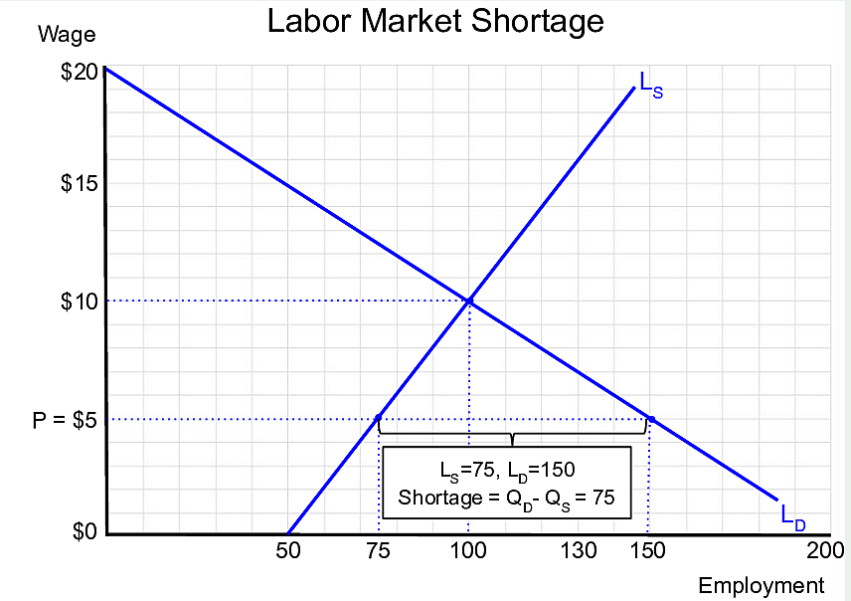
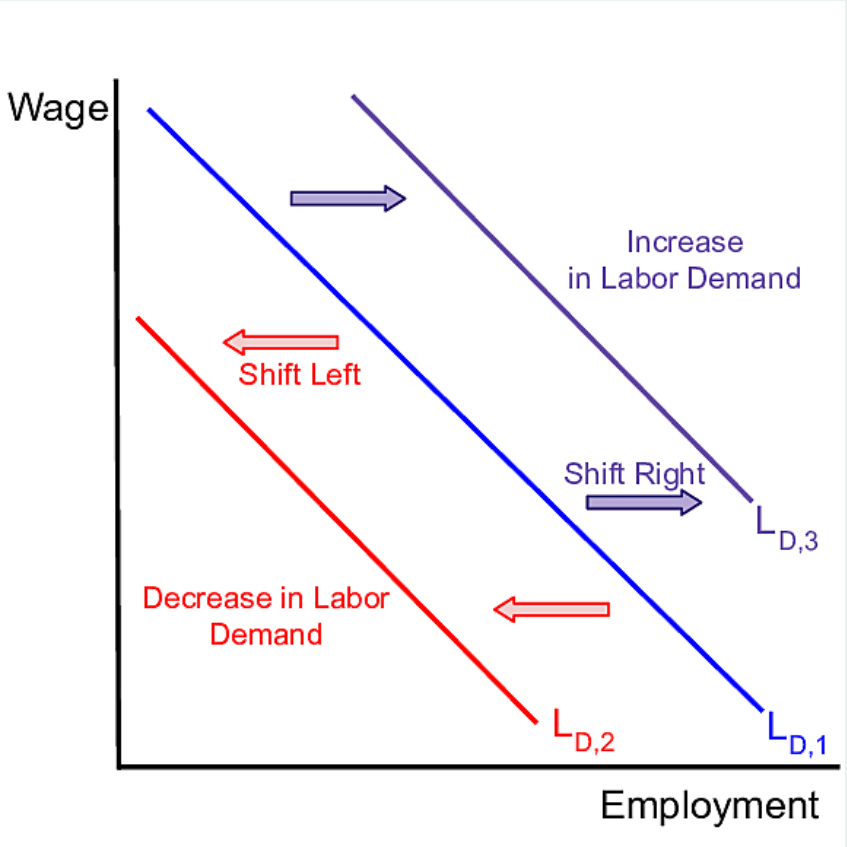


Labor Demand Curve Shifts

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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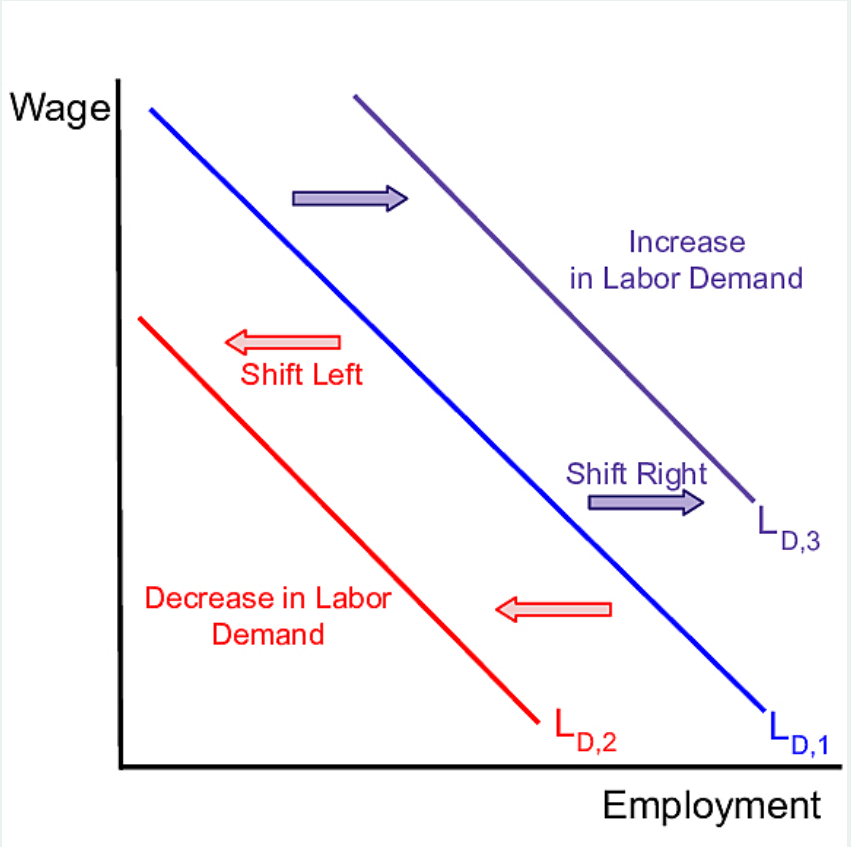

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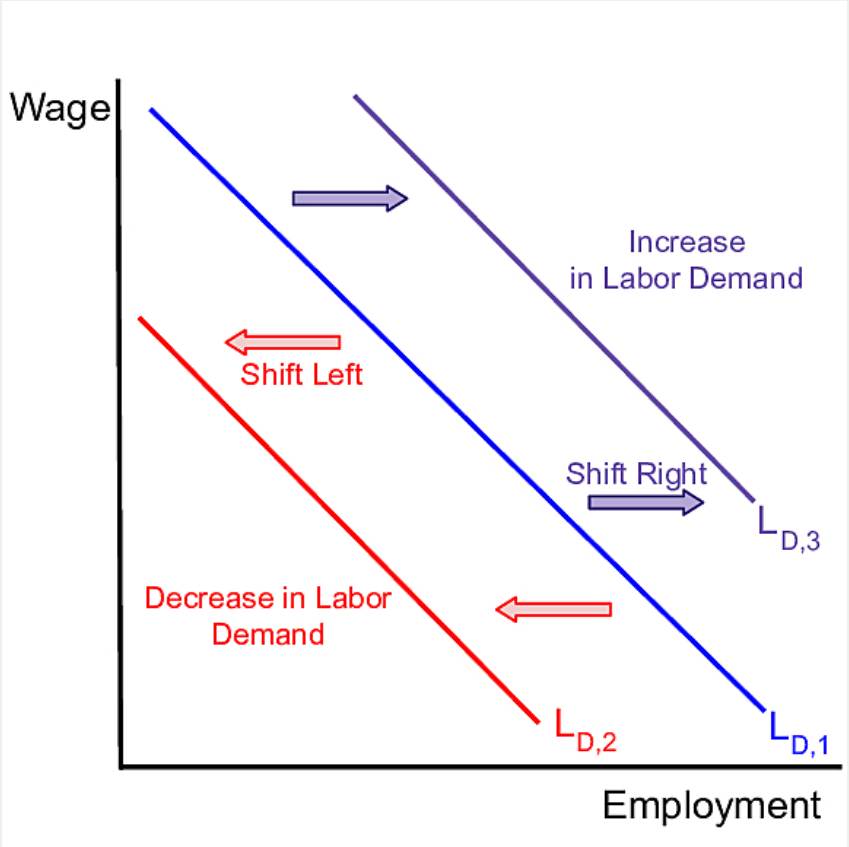

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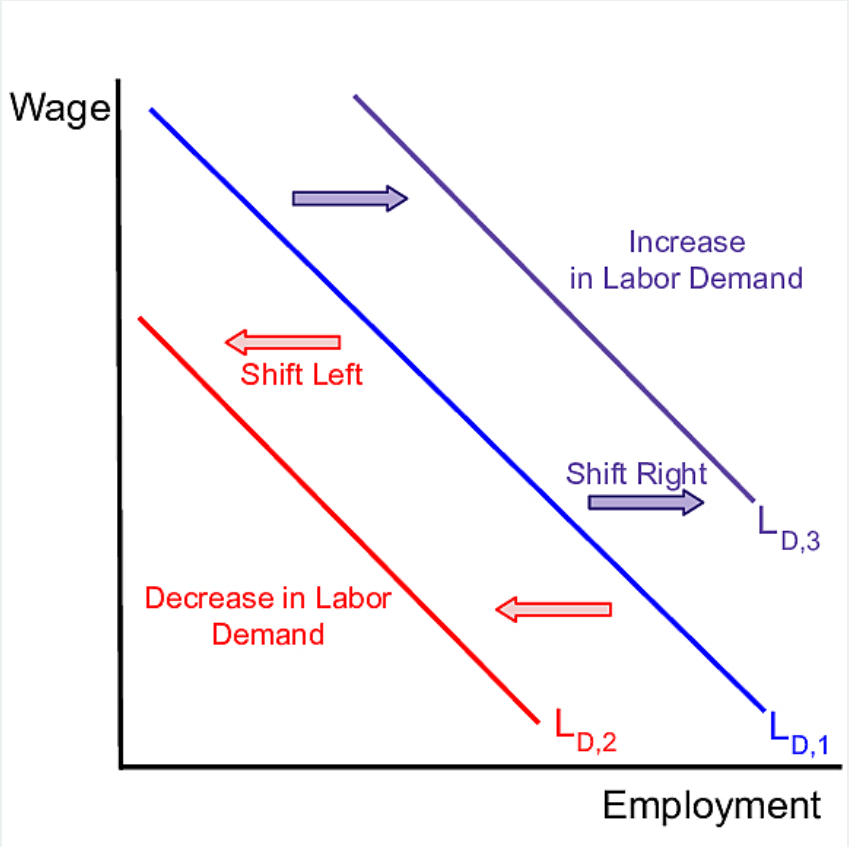
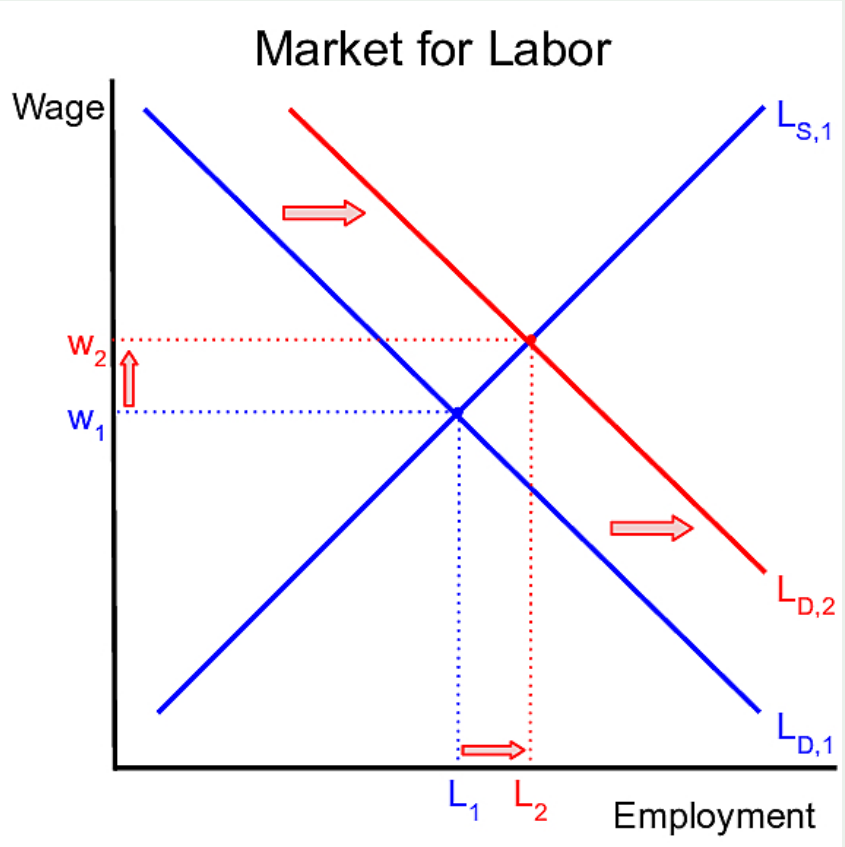


Improvement In Labor Productivity

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 can improve labor productivity **at an aggregate level**

Graphical Equilibrium



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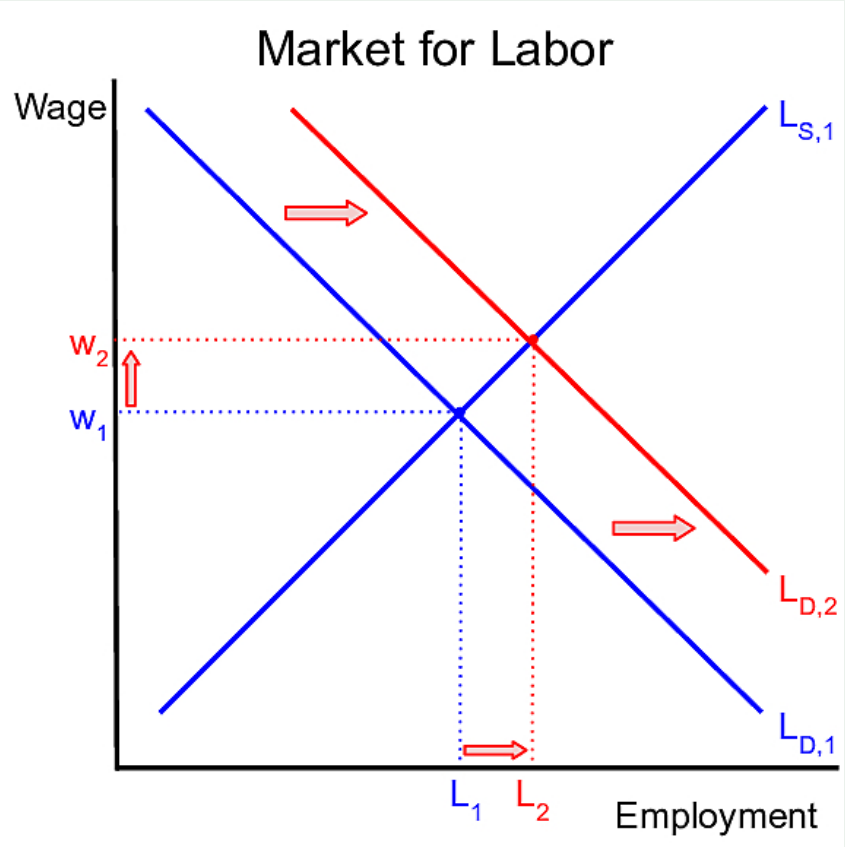

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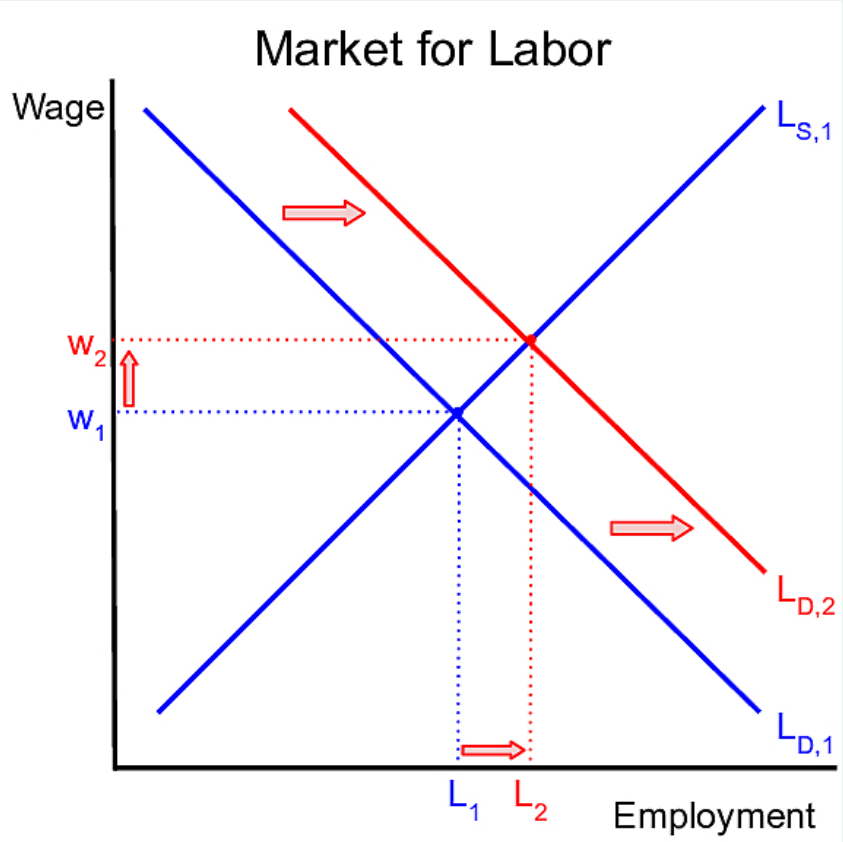

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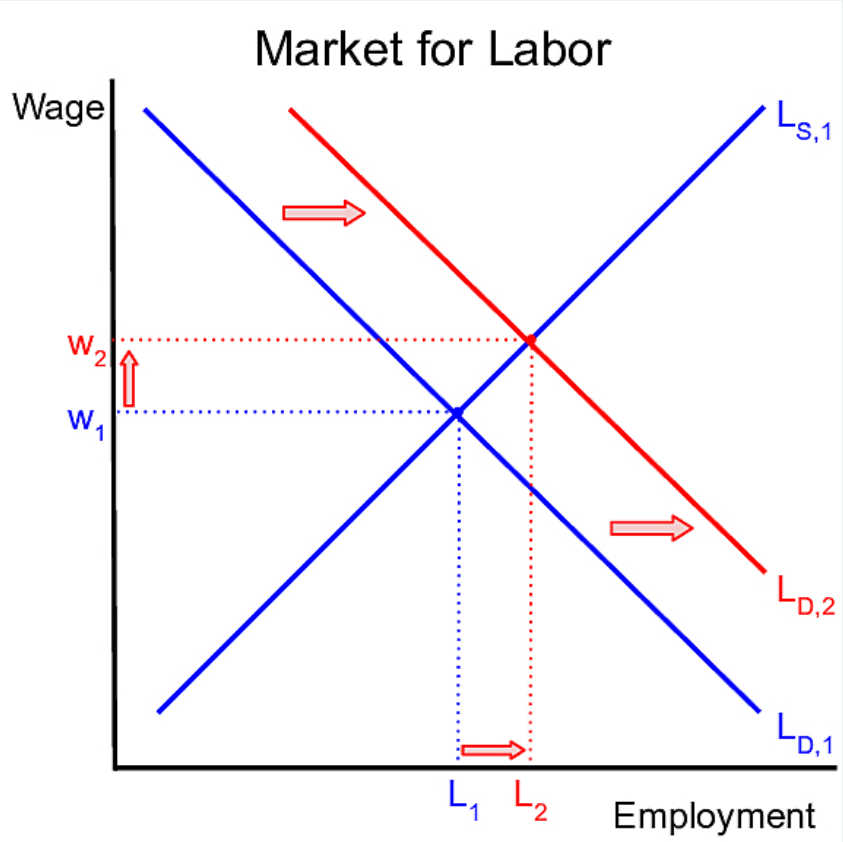

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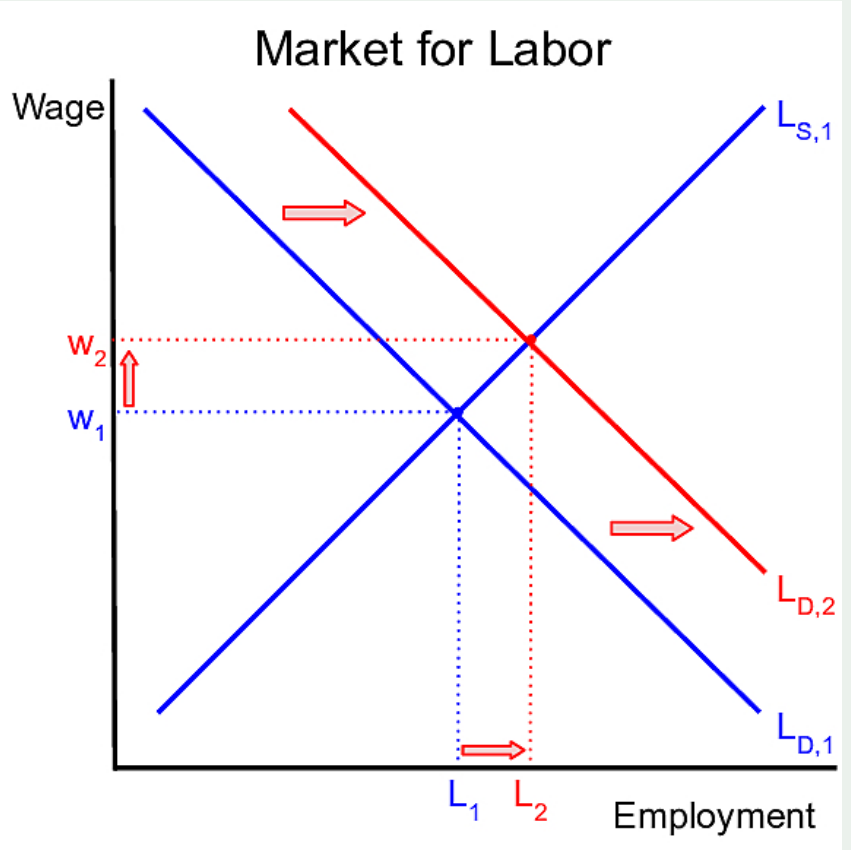

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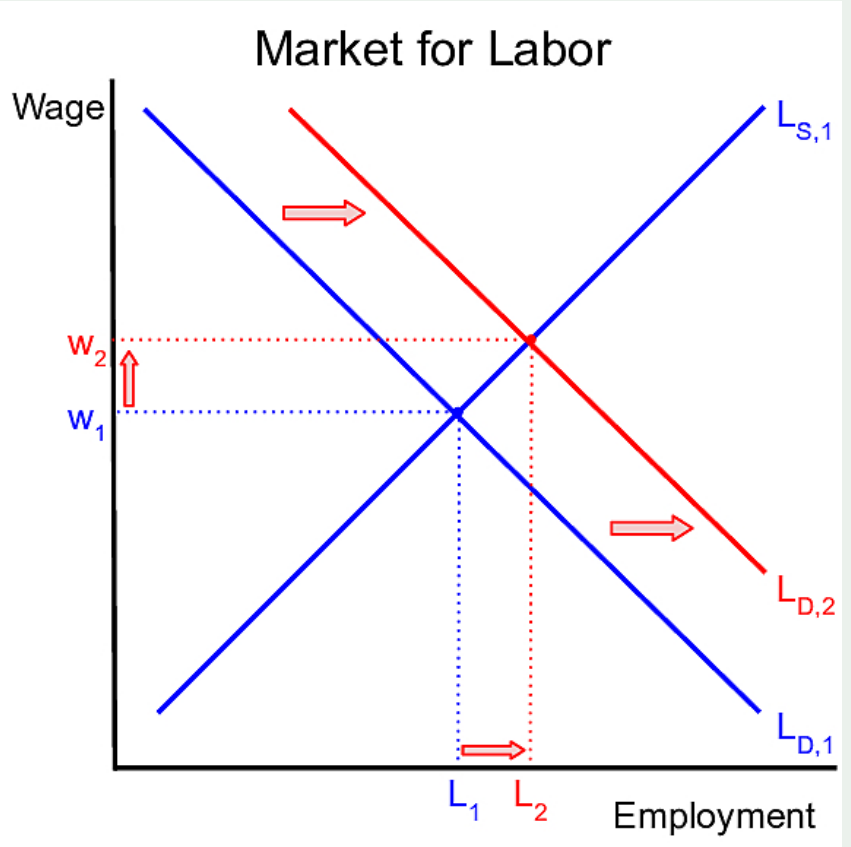

Spotlight: Daron Acemoglu & Pascual Respreto

Automation and New Tasks: How Technology Displaces and Reinstates Labor, *Journal of Economic Perspectives*, Spring 2019.

Displacement + New Tasks

- *Displacement effect:* Automation has led to decreases in demand for certain types of labor, increases in demand for capital
- Examples: Manufacturing, routine tasks in accounting / sales / logistics replaced by software and AI
- Stagnation in labor demand in last decade due to the displacement effect

Dr. Daron Acemoglu (left)
Massachusetts Institute of Technology

Dr. Pascual Restrepo (right)

Boston University

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Displacement + New Tasks

- *Productivity effect:* Automation has also led to creation of new tasks, increase in demand for other types of labor
- Computer programming, information systems design, cyber-security, product designers
- Explored both effects in industrial revolution and modern automation
- No one effect always dominates the other

Dr. Daron Acemoglu (left)
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Destruction of Capital Stock

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

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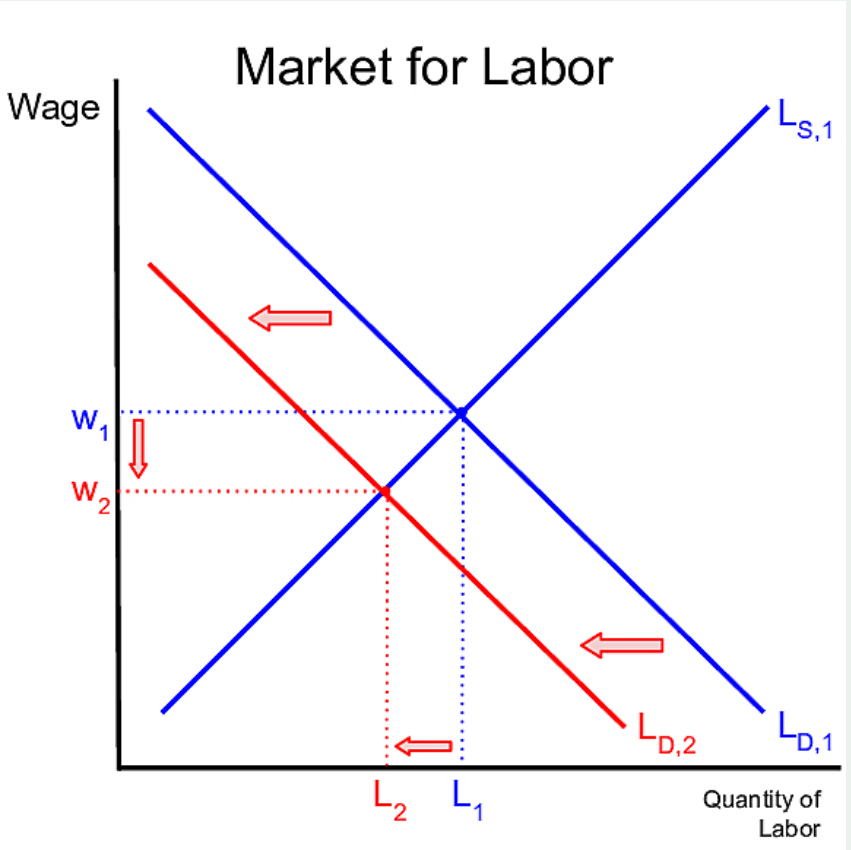

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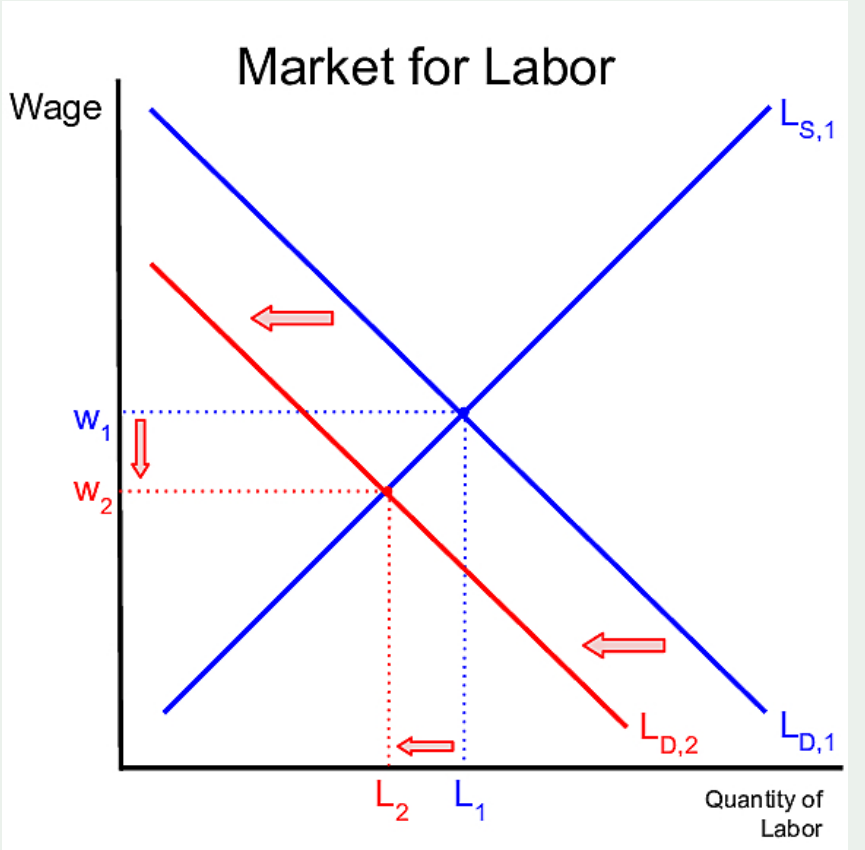

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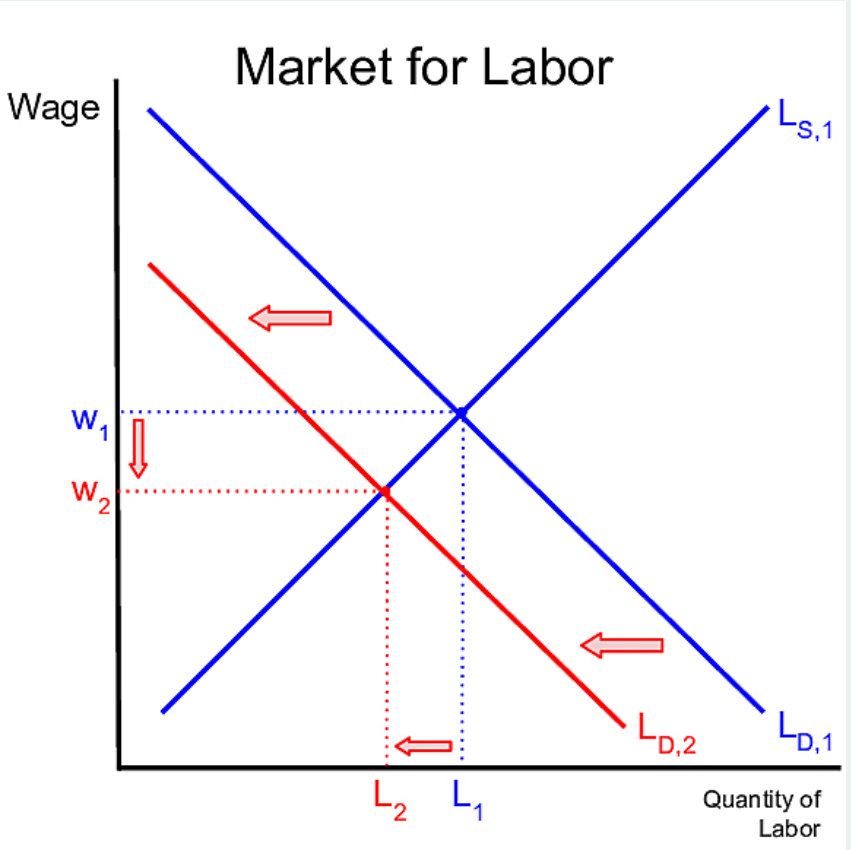

Destruction of Capital Stock

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
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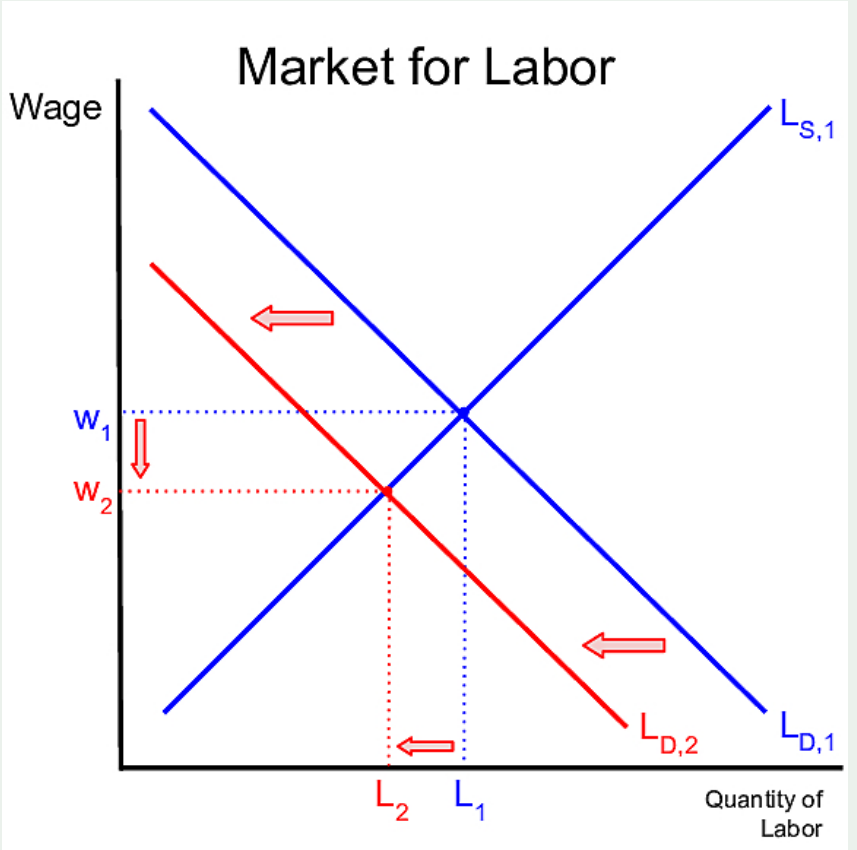

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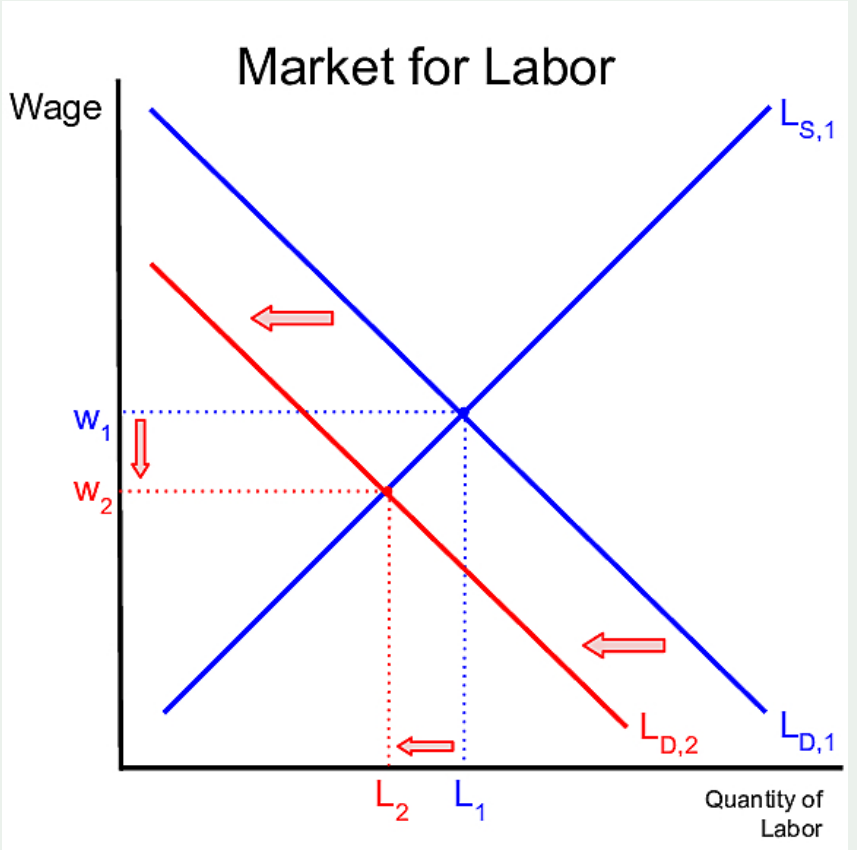

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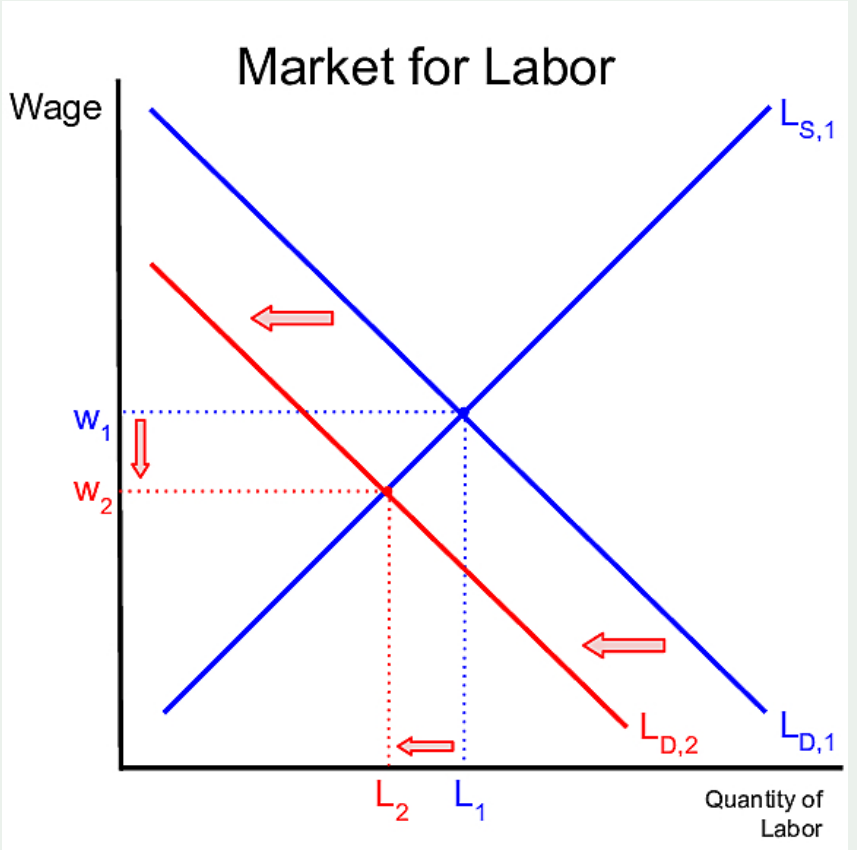

Increase in Demand for Goods and Services

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- Labor is a **derived demand**, demand depends positively on the demand for the goods and services the workers produce
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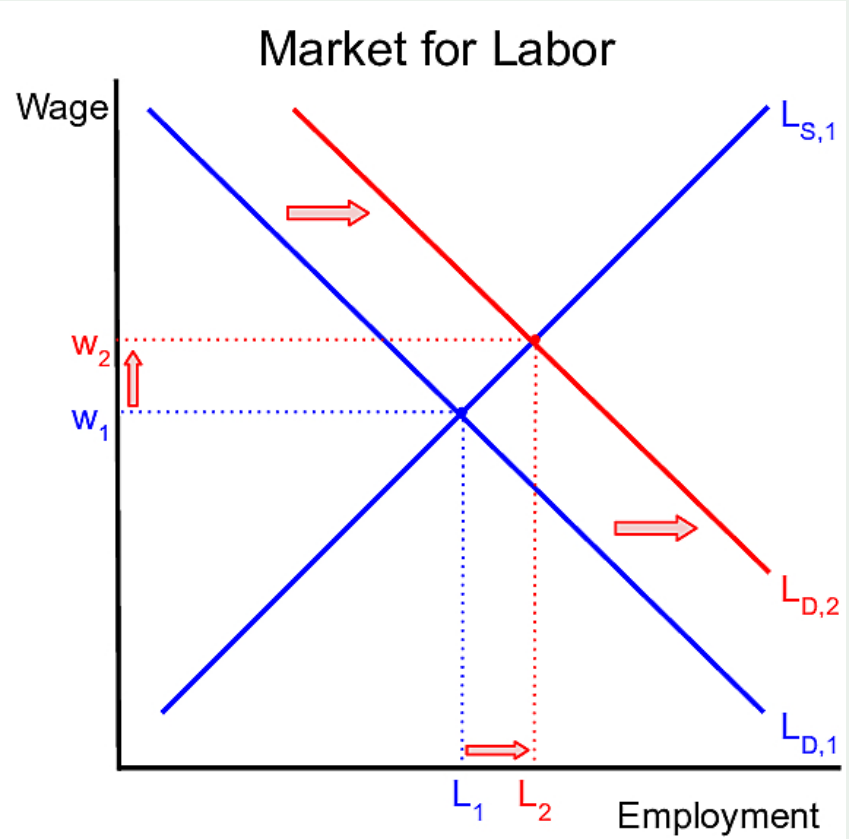

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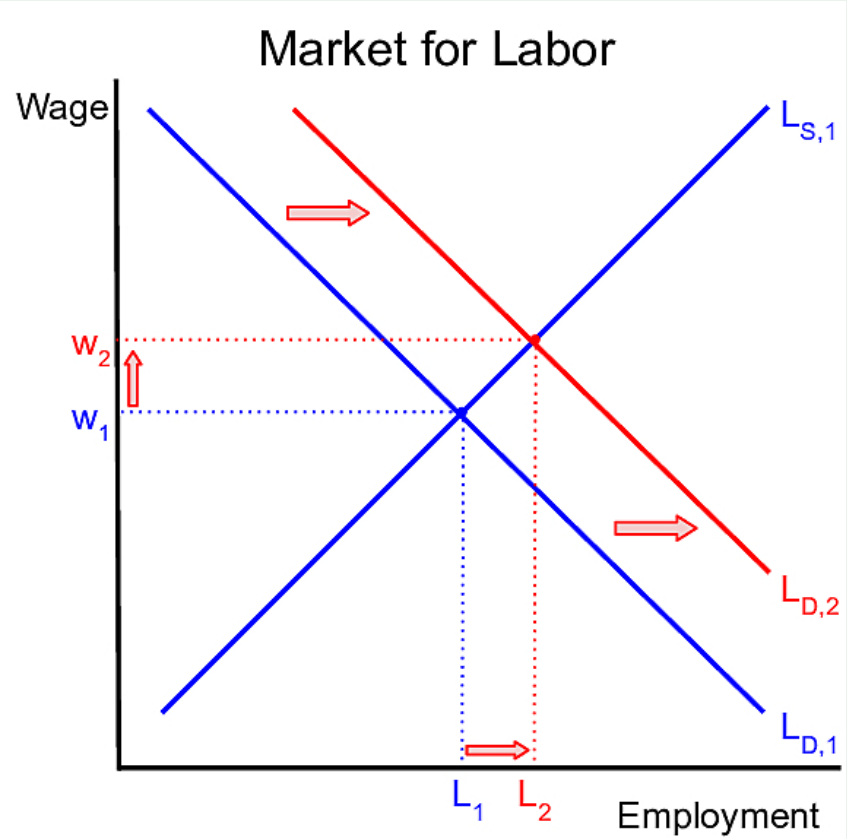

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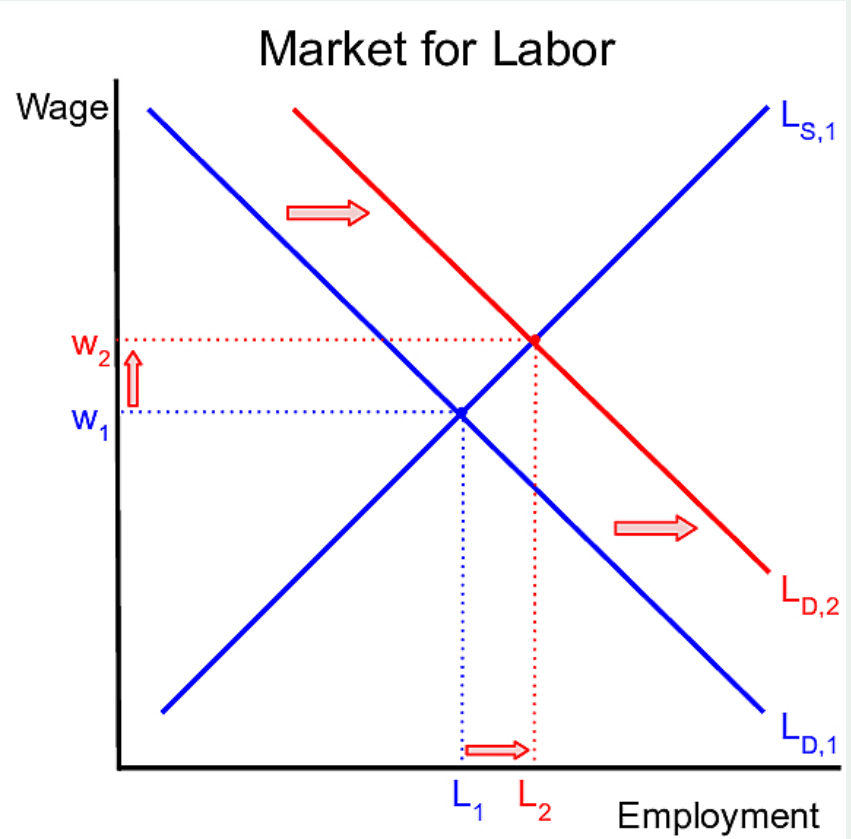

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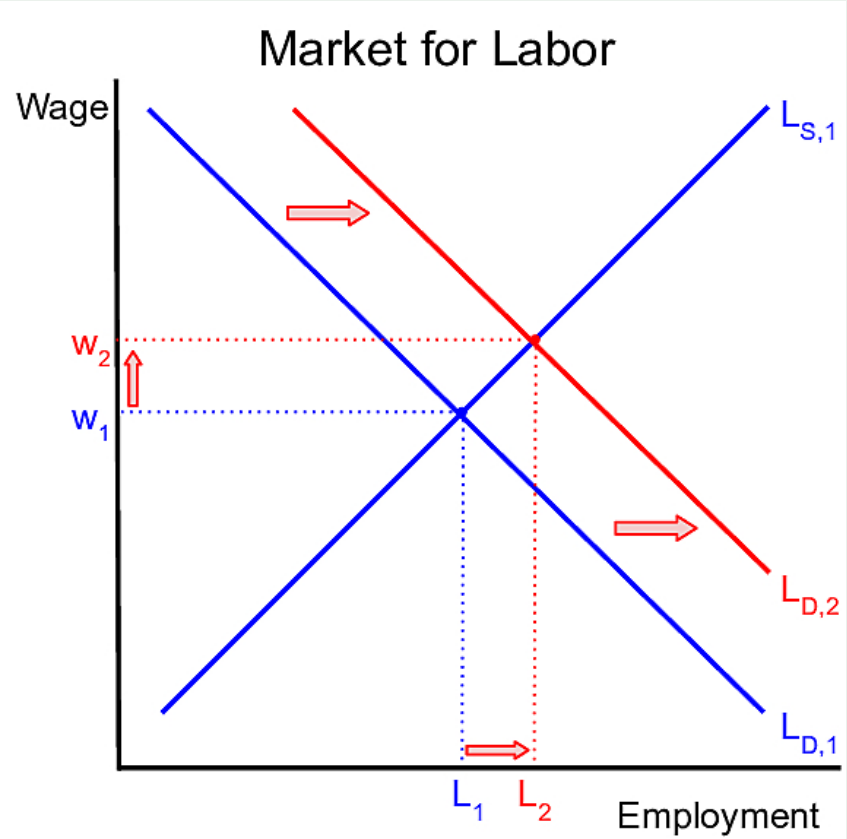

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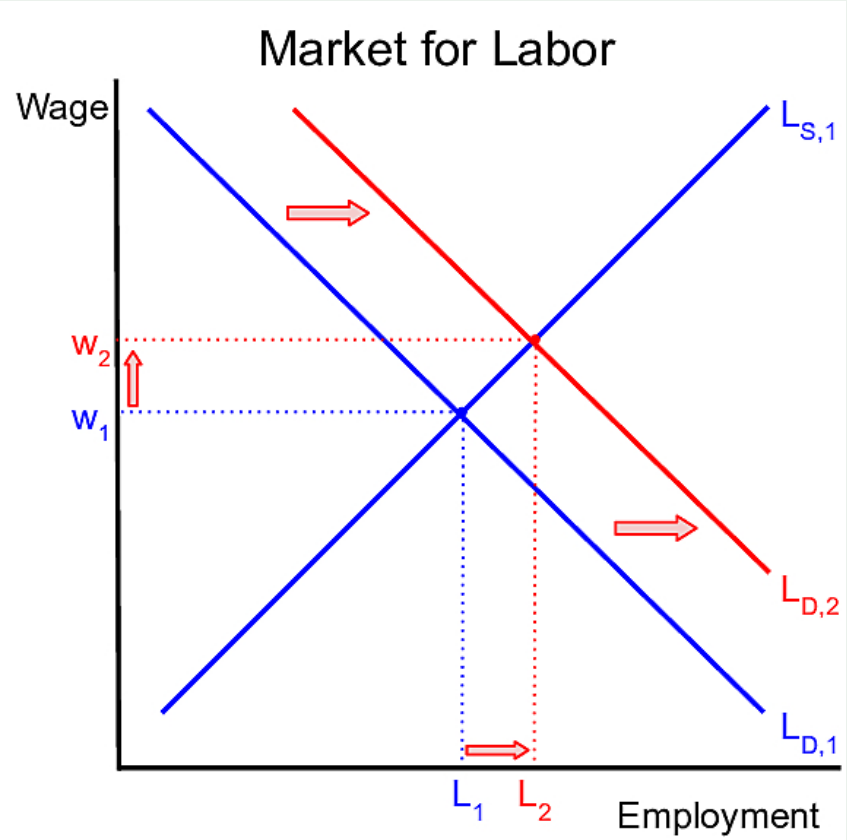

Supply Curve Shifts

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*.
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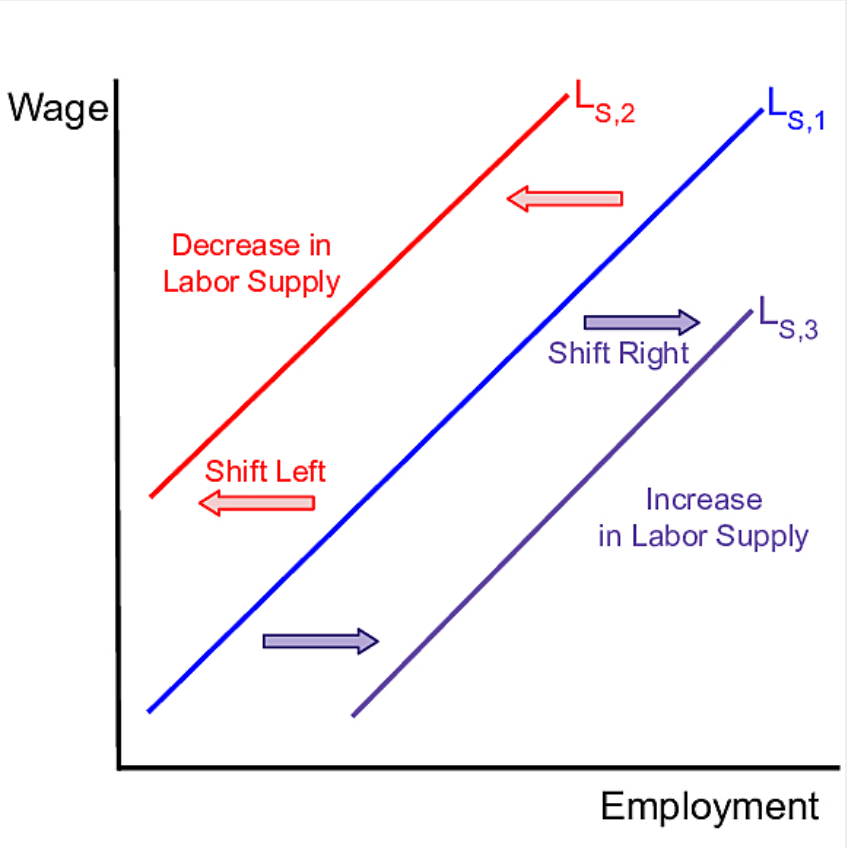

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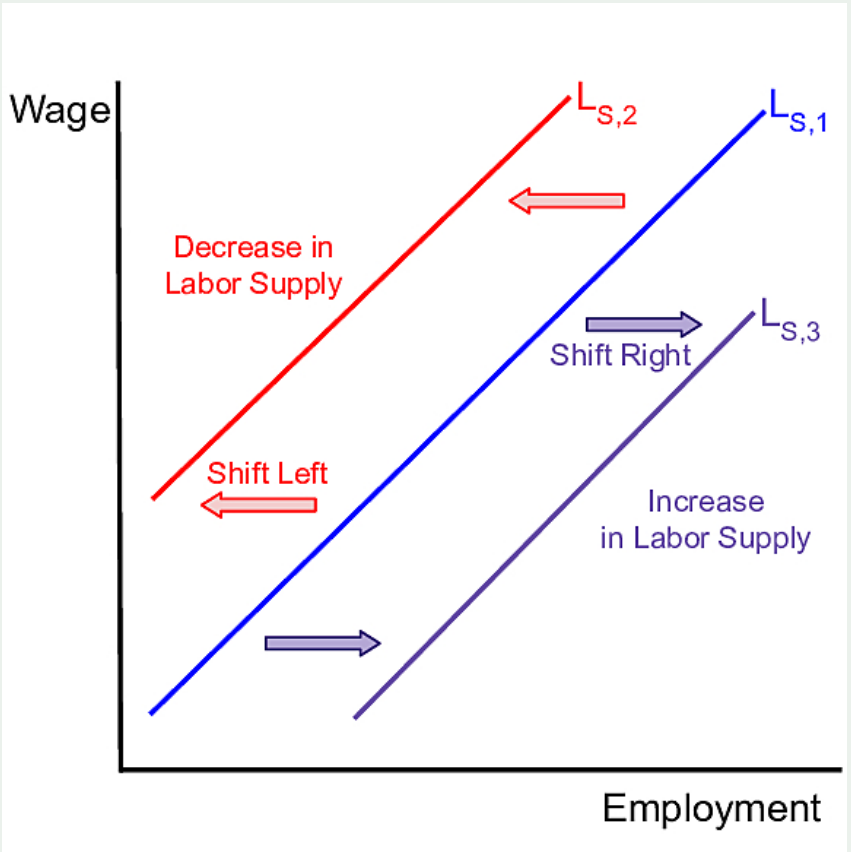

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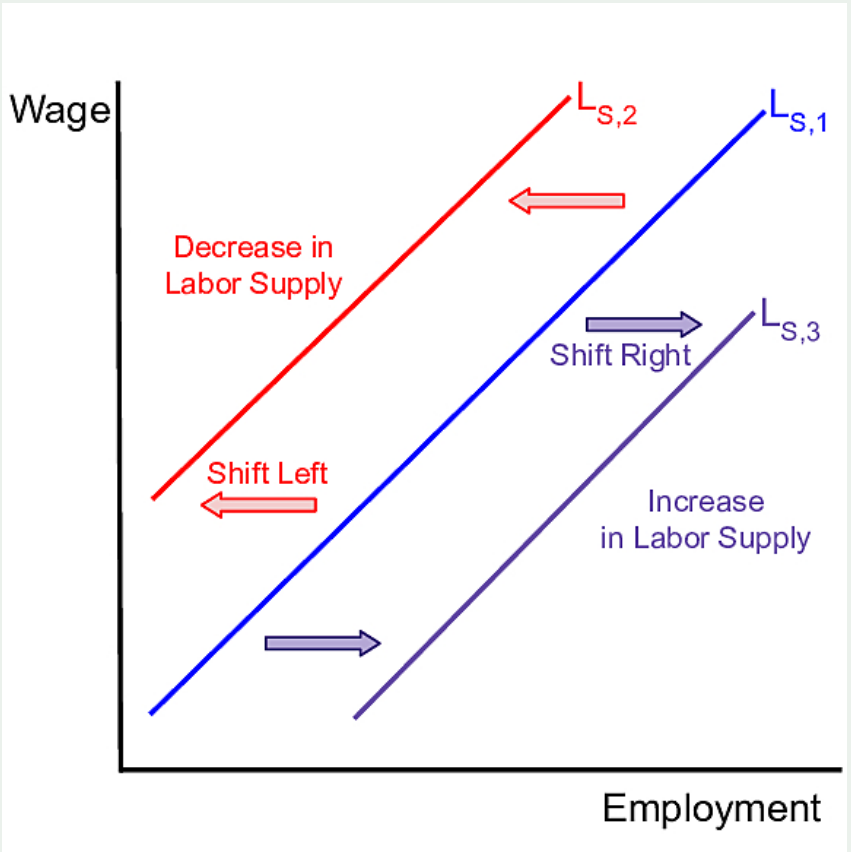

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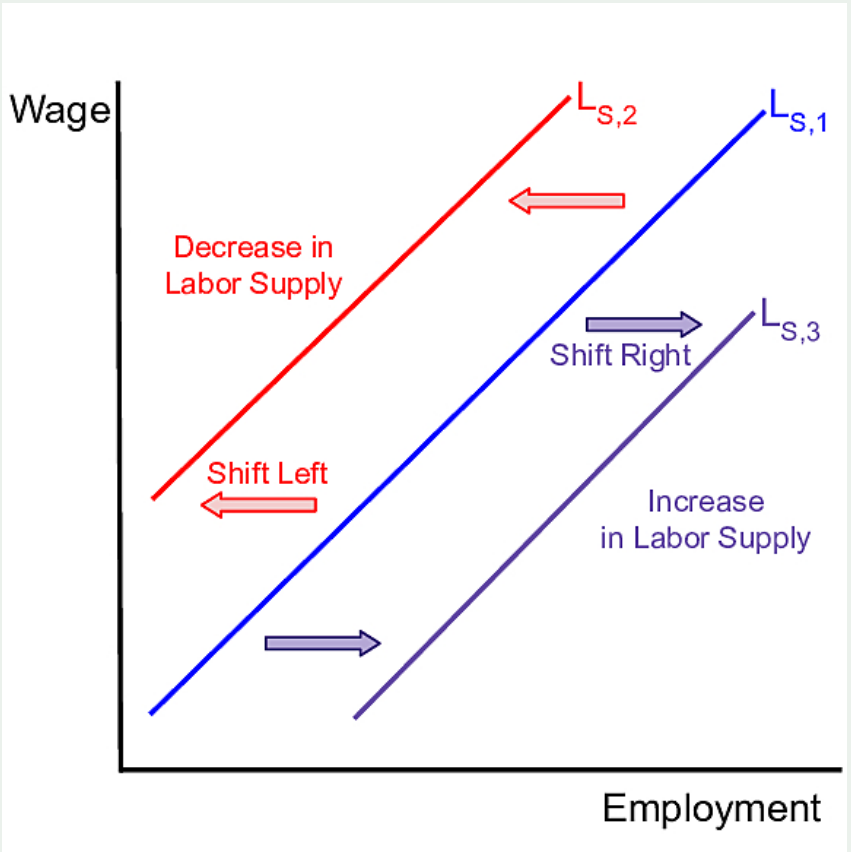

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- Suppose a healthy stock market causes more people to decide to retire
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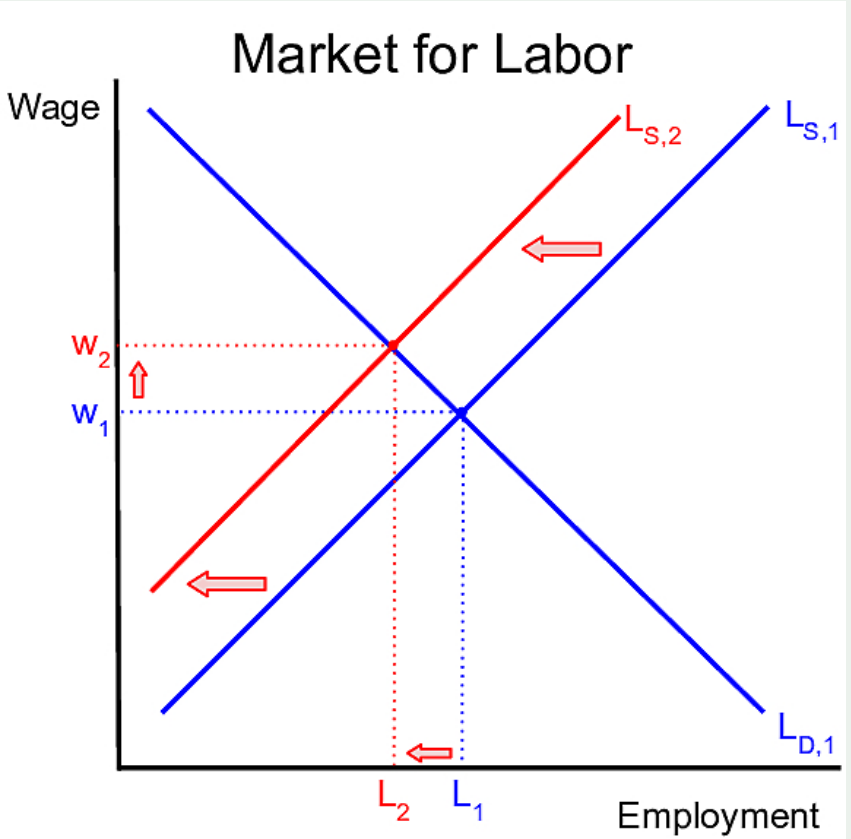

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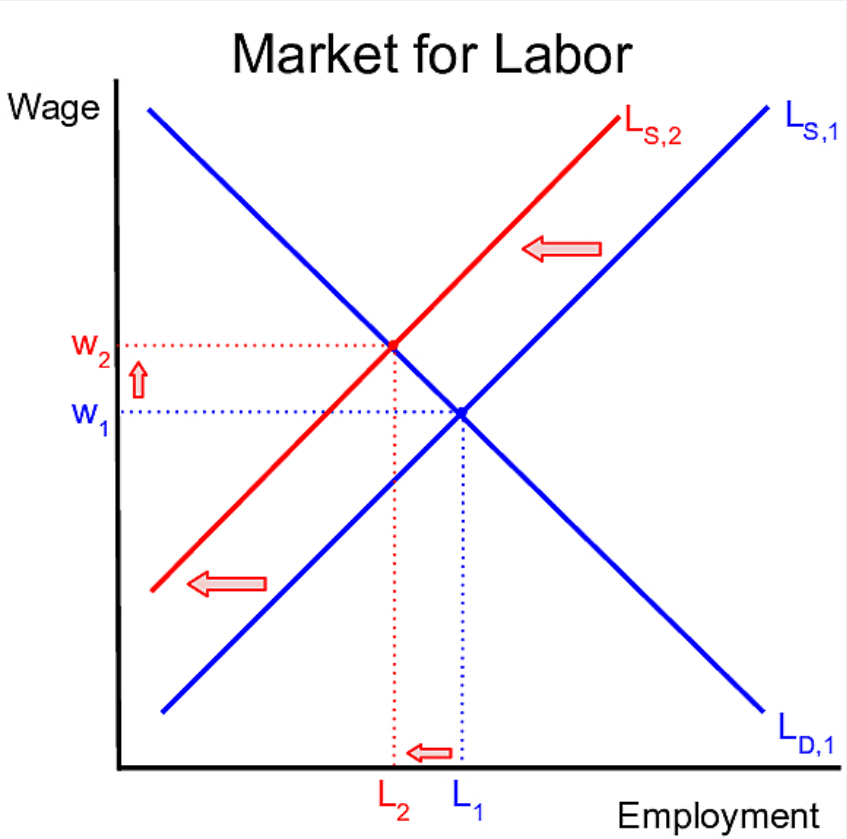

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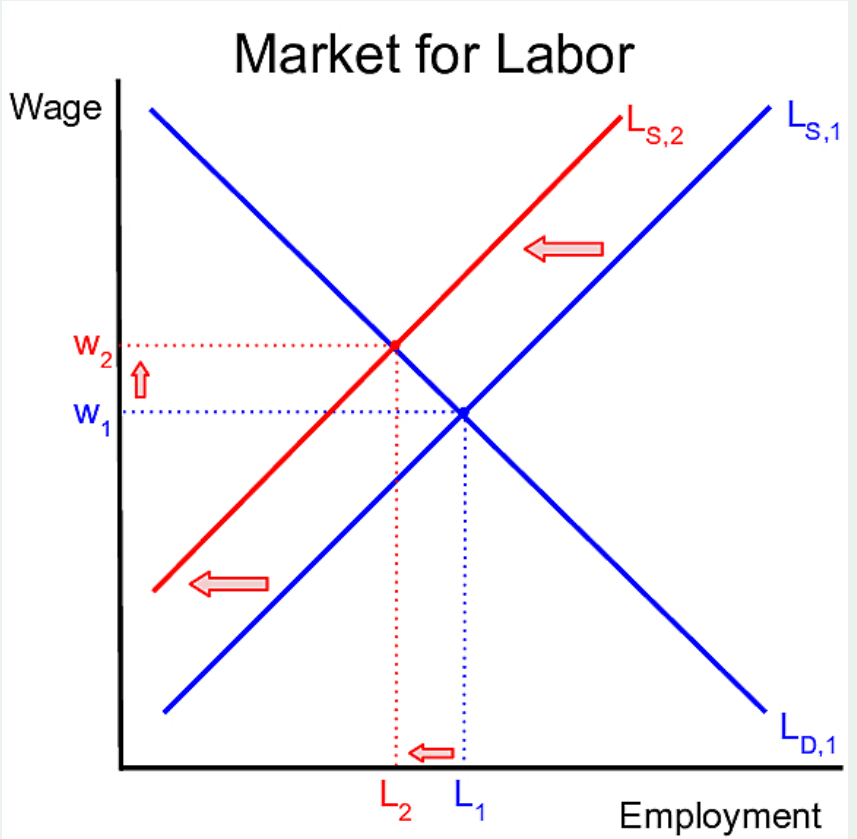

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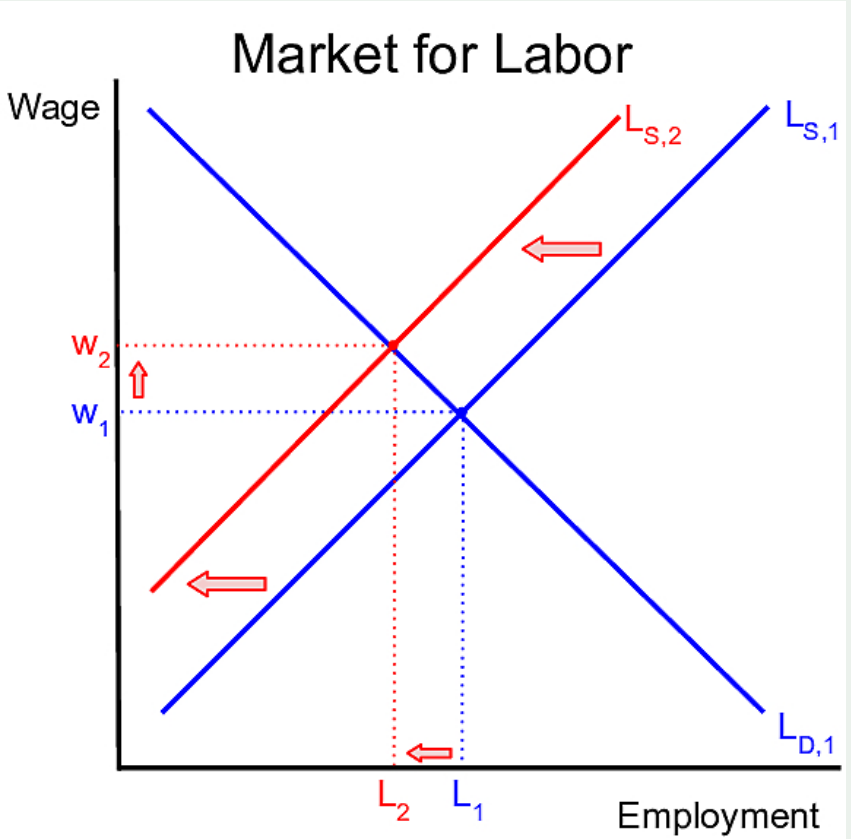

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- U.S. labor force participation rate is about 62% (2021)
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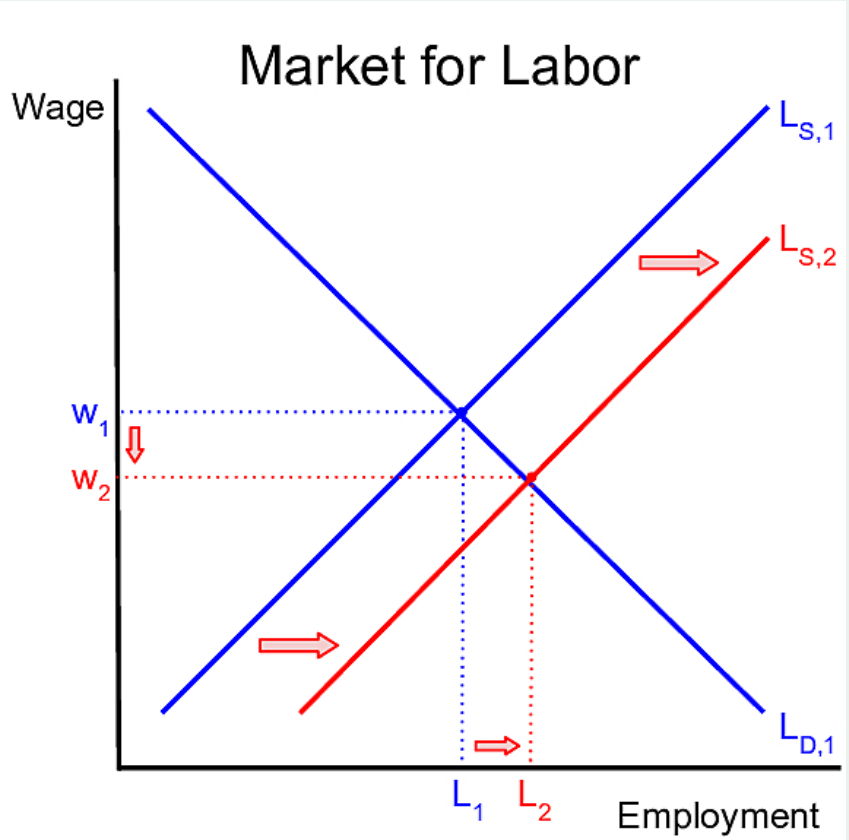

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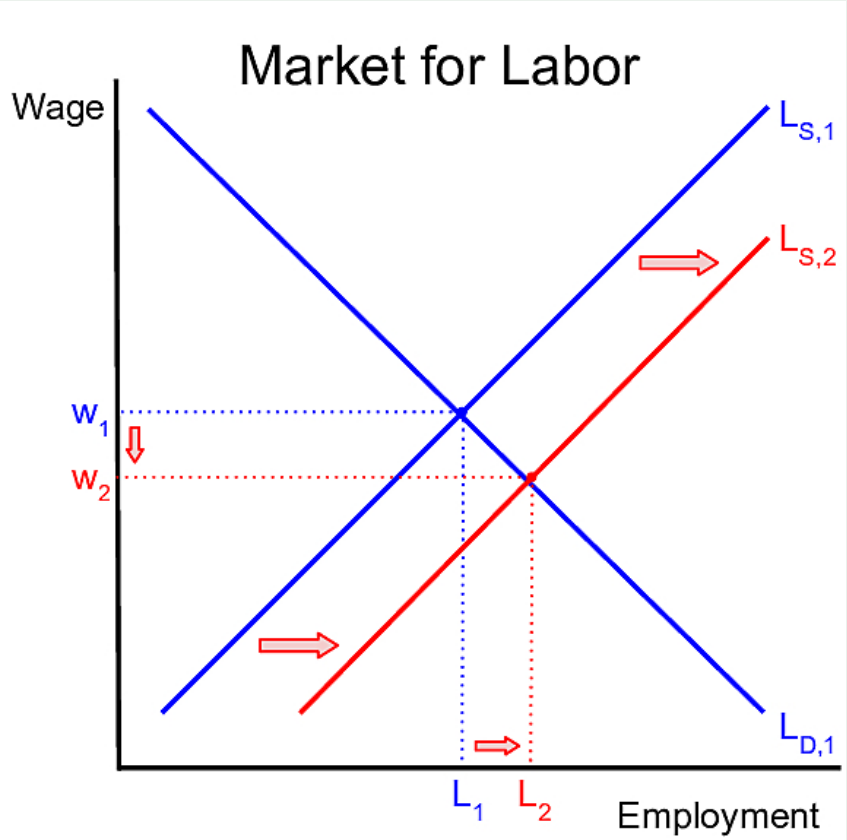

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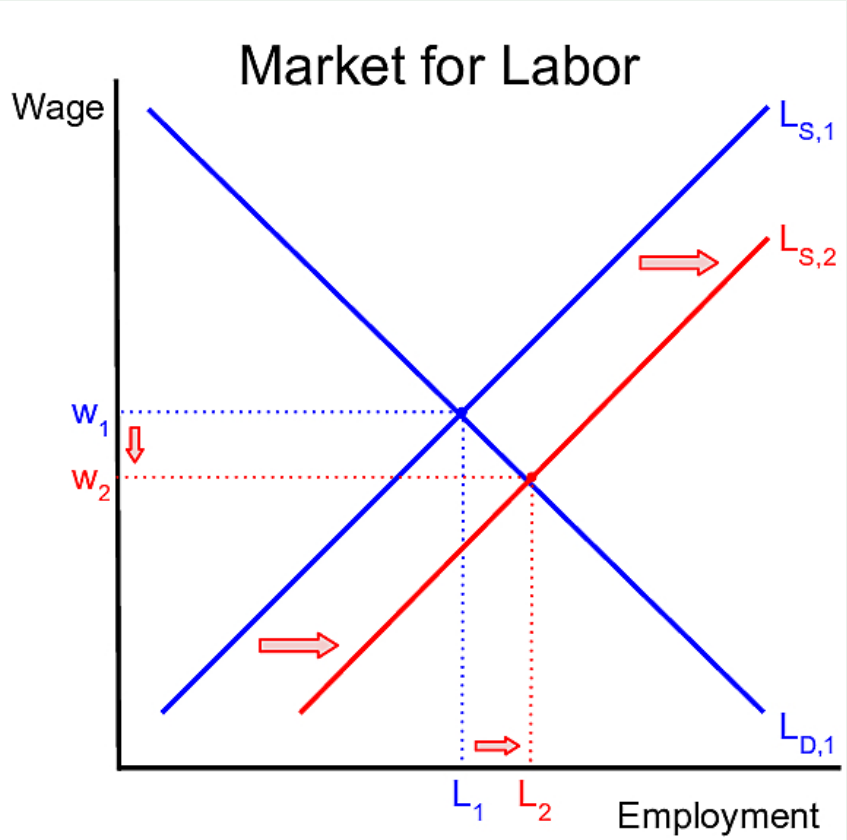

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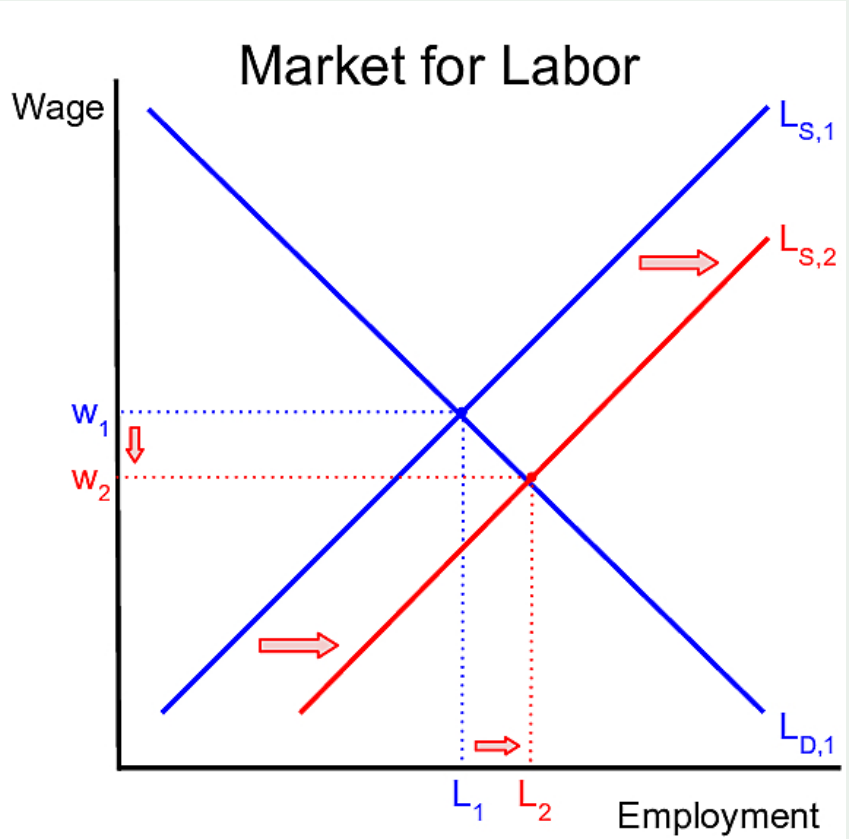

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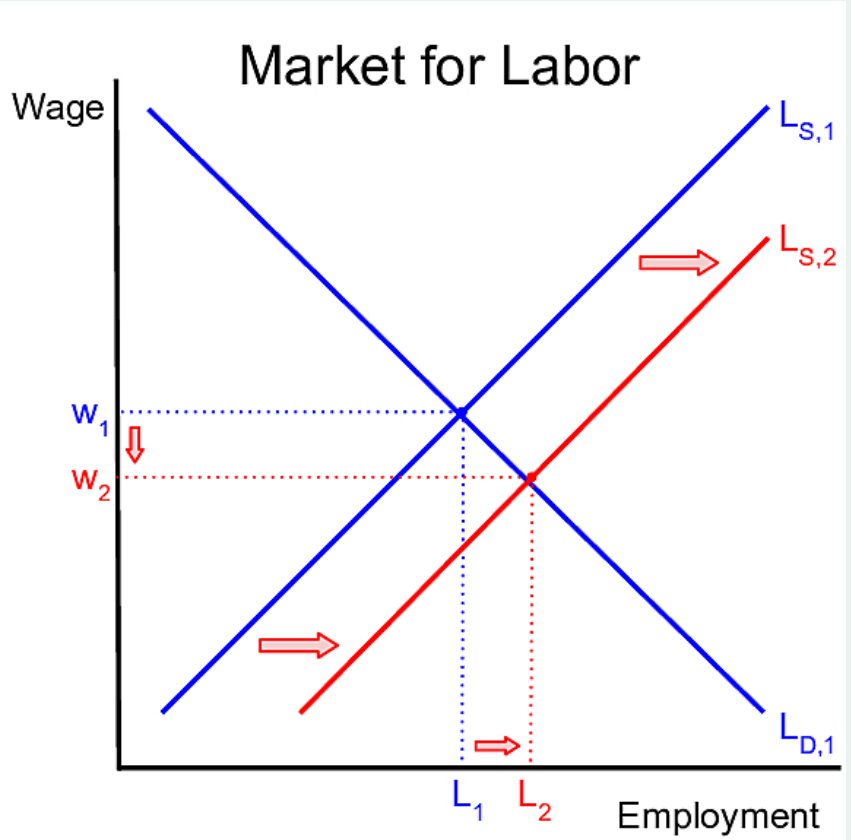

Sticky Wages

- Usually, wages do not quickly adjust to new equilibrium levels
- Employers are hesitant to change wages until they recognize market wages have permanently changed
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Unemployment with Sticky Wages

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

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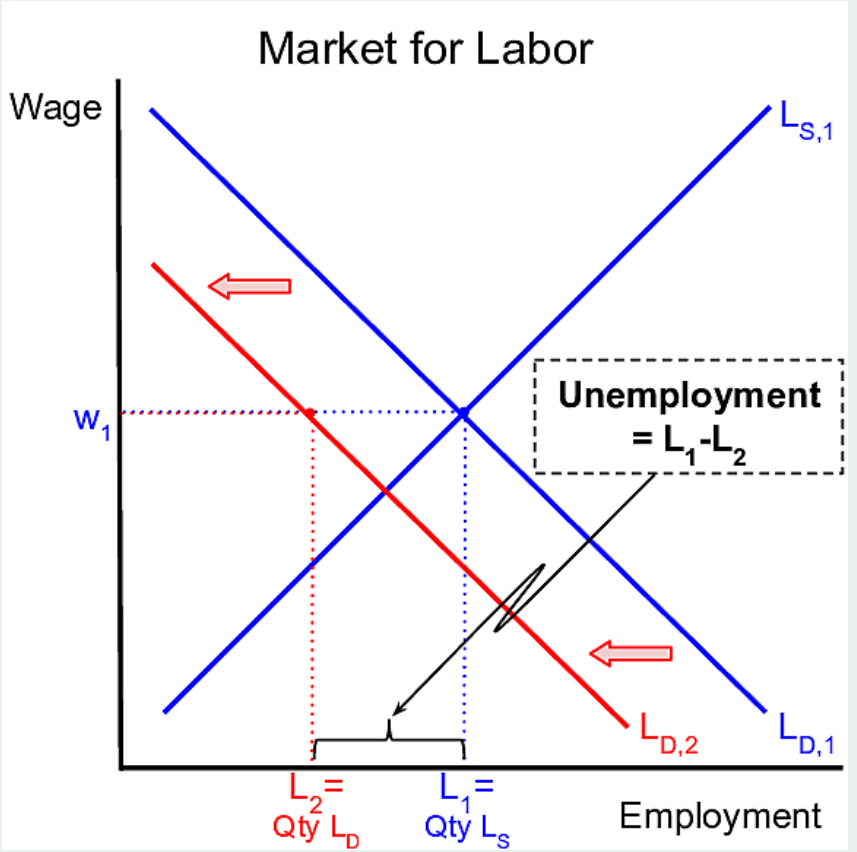

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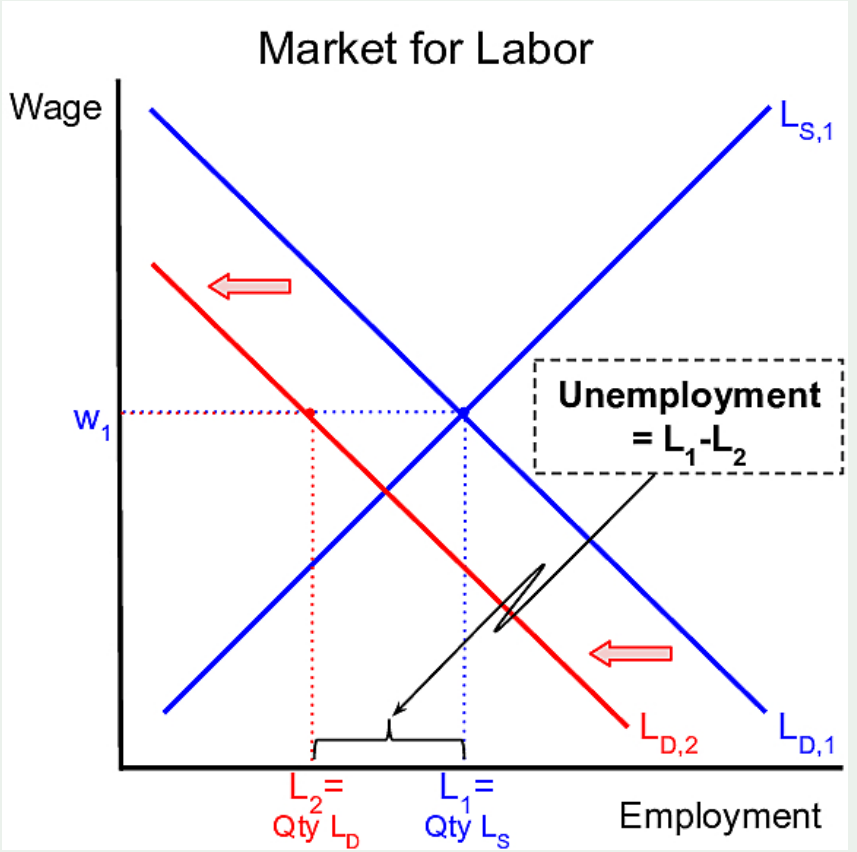

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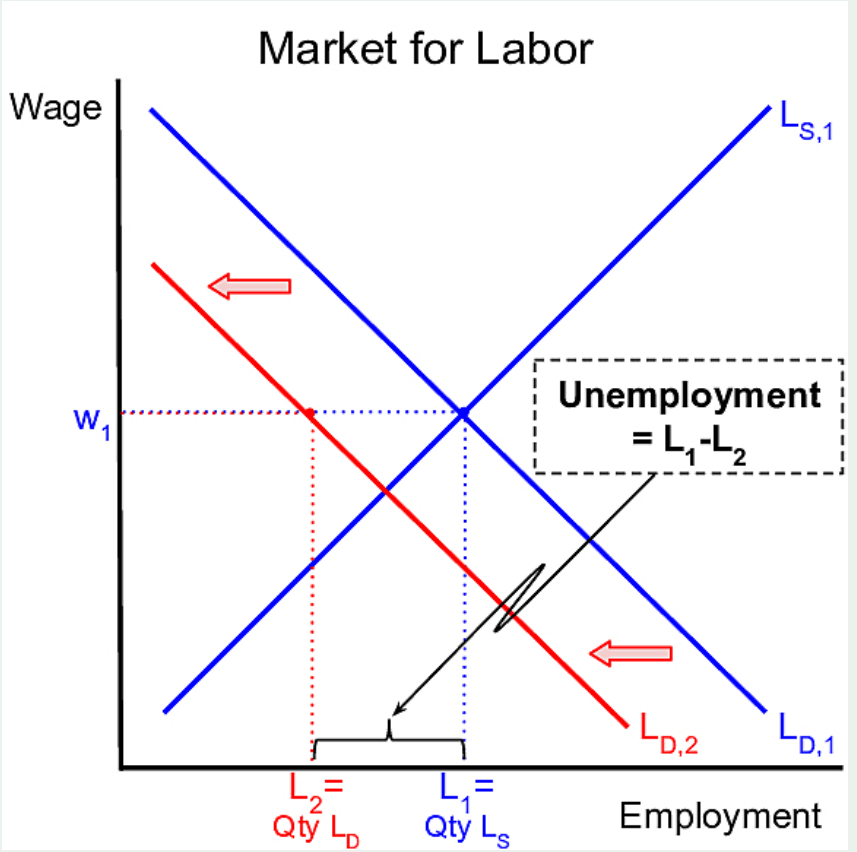

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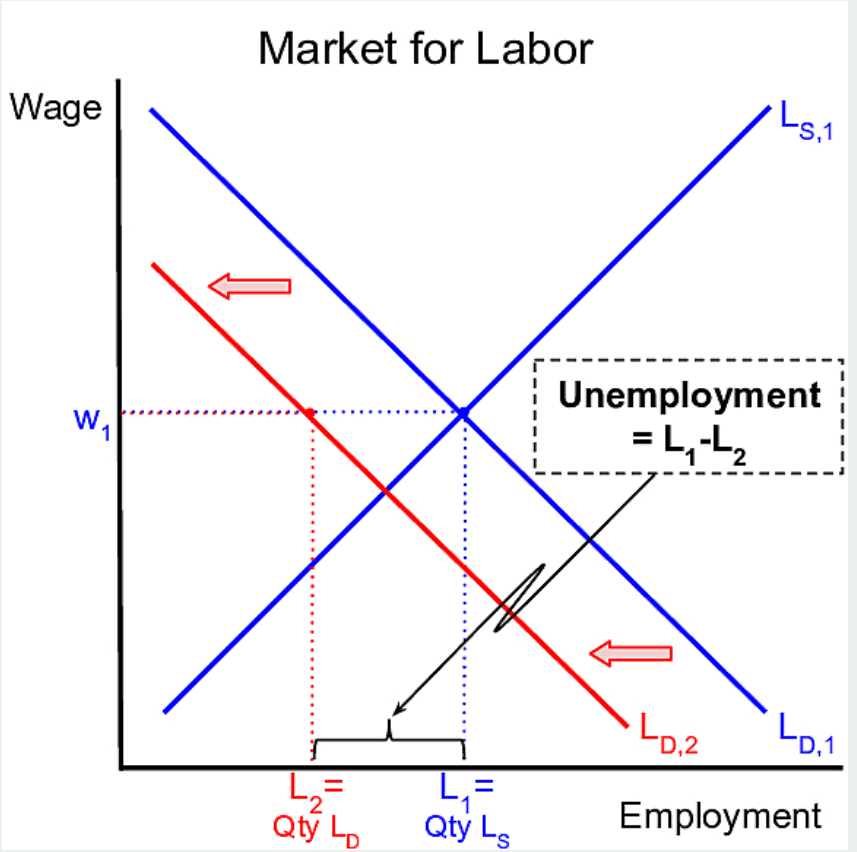

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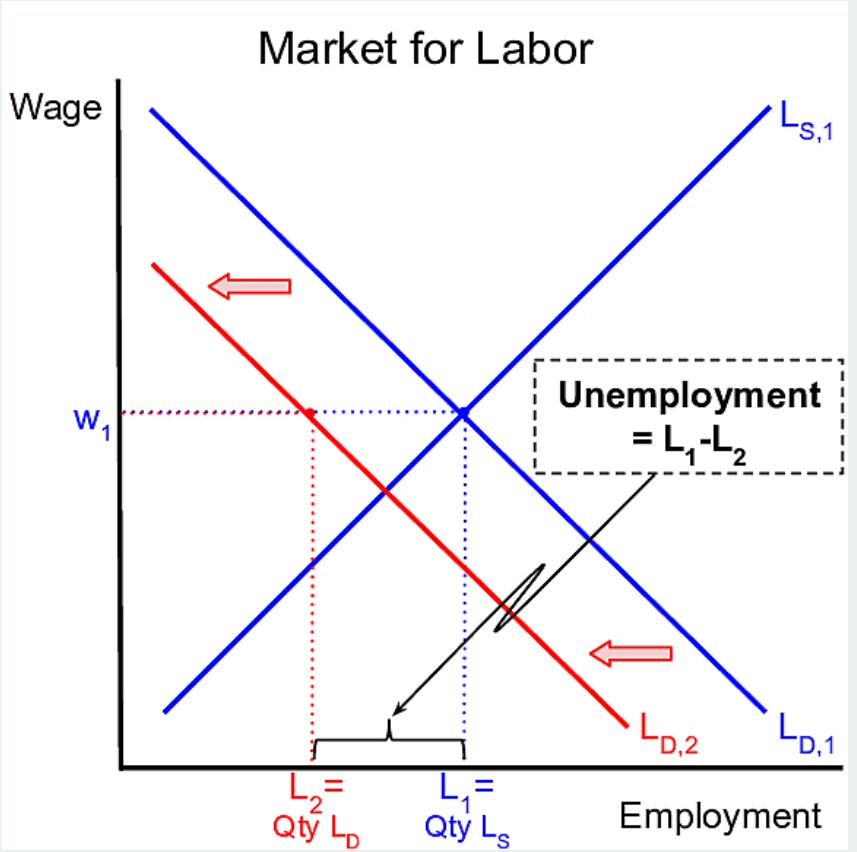

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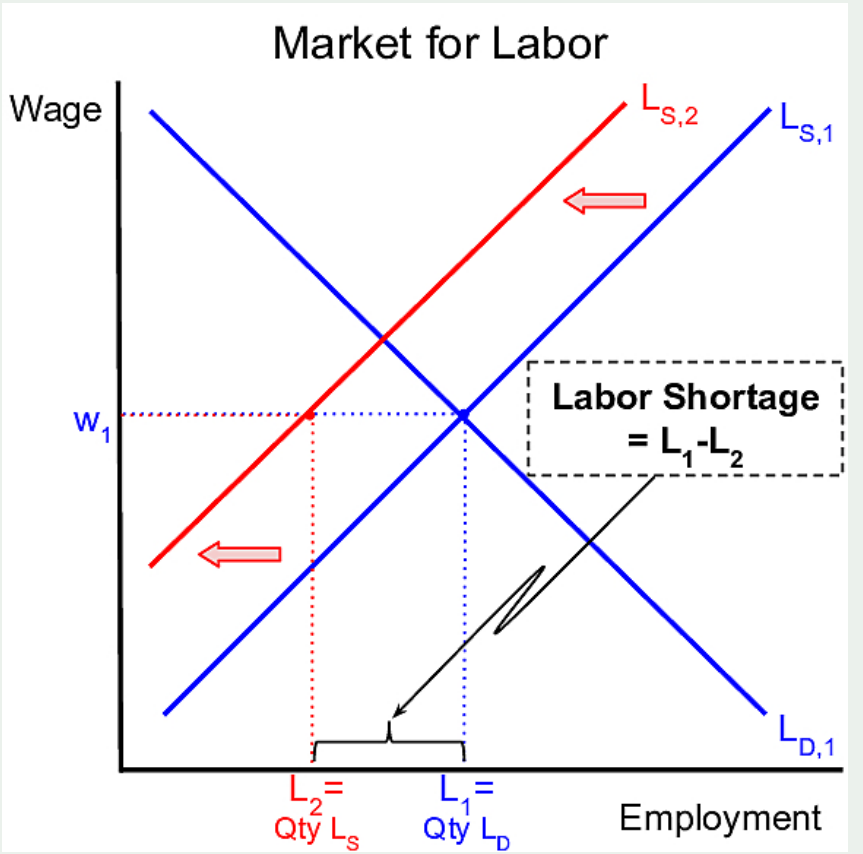

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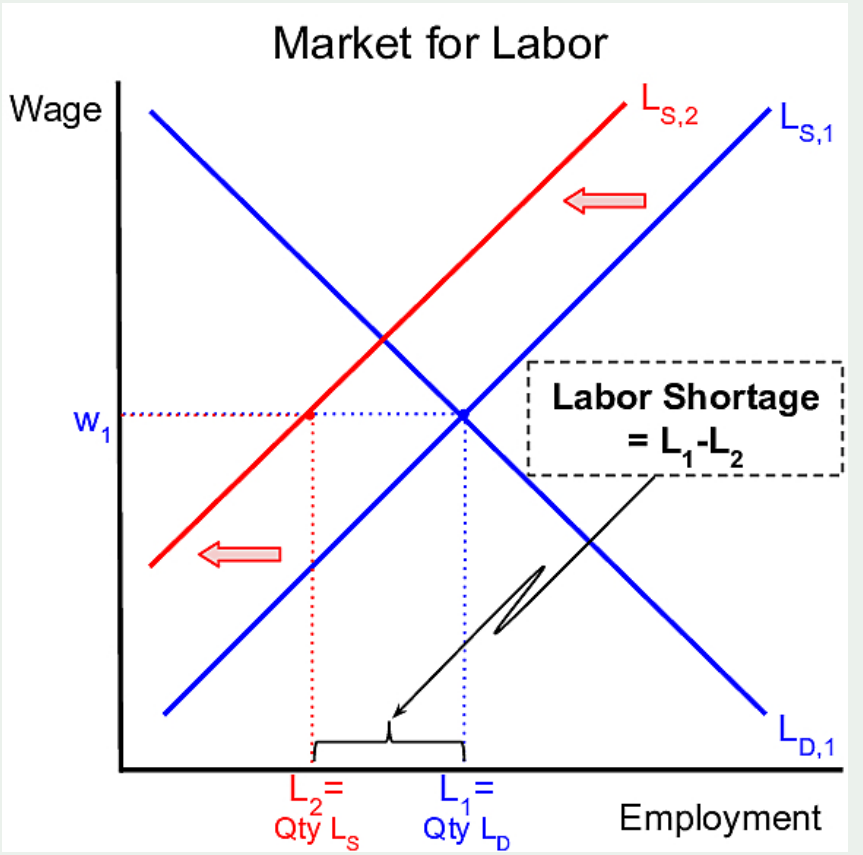

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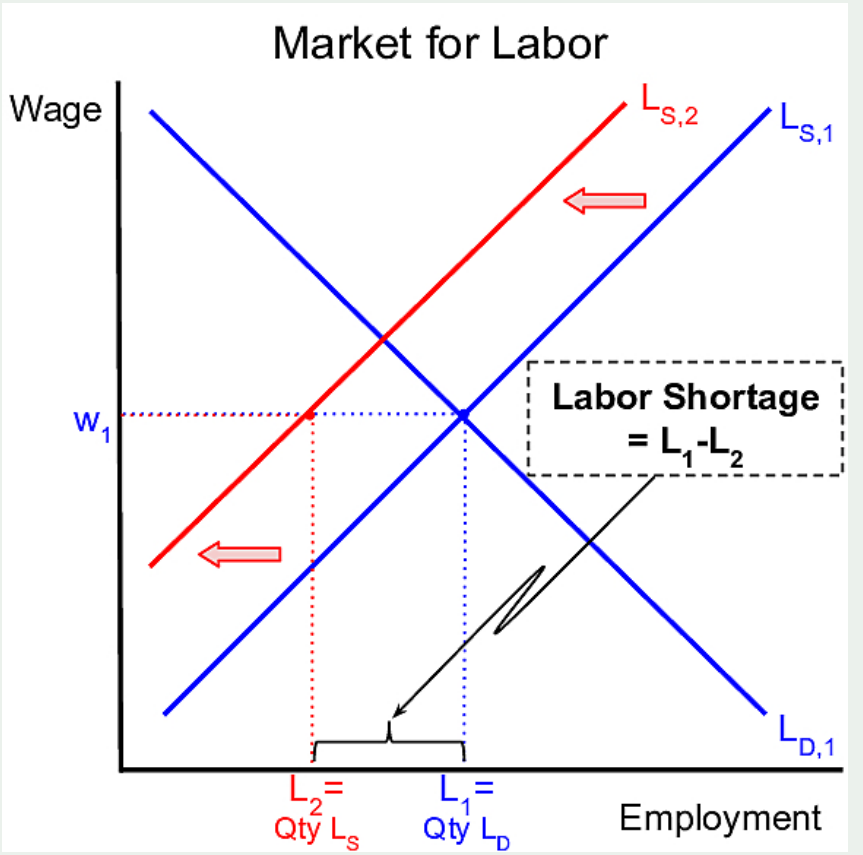

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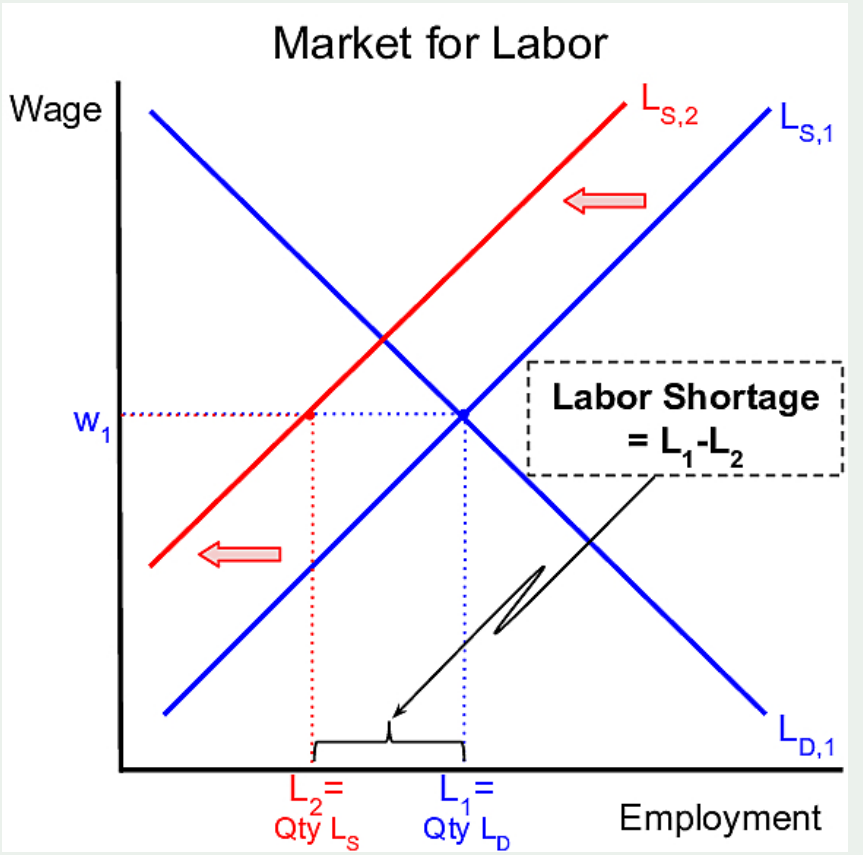

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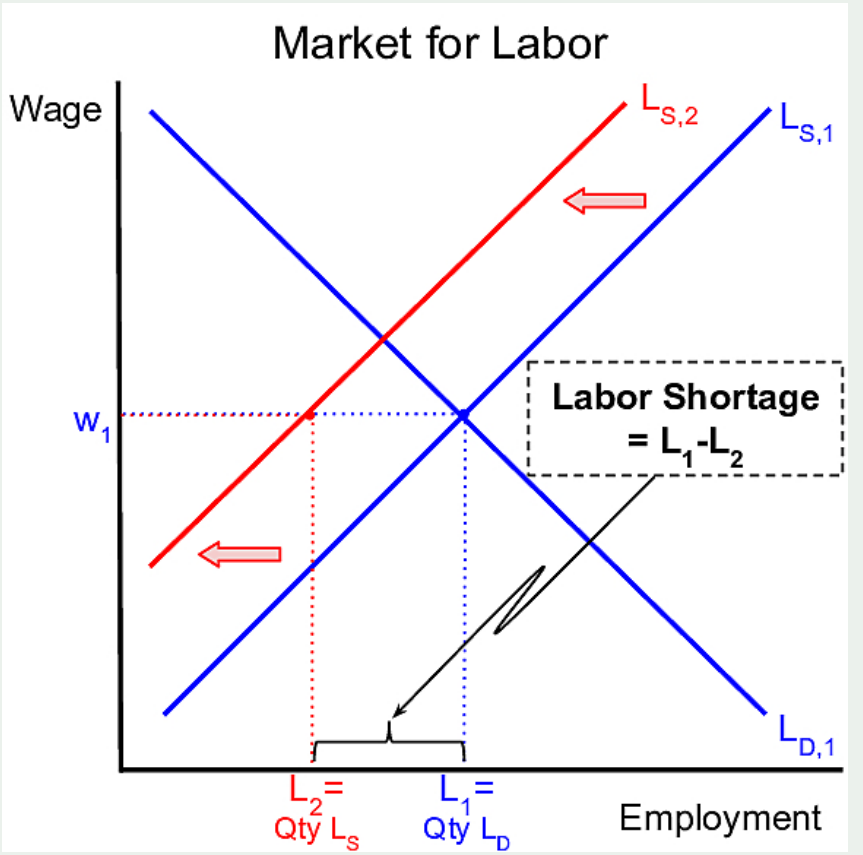

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