Labor Markets

Derived Demand for Workers

- Demand for Labor is derived from the demand for a firm’s product
- Firms hire/fire workers based on the demand for its products
- Demand and Supply of labor can be modeled like a goods market with one change: price is now called wage

![Diagram of labor market with demand (D) and supply (S) curves, indicating wage (W) and quantity (Q).]

Note that firms demand labor; consumers supply labor.
Wages

- The wage that a firm is willing to pay for a unit of labor is based on the dollar value of the labor's productivity.

An employee's daily wage should not rise above their dollar contribution to the firm.

Wages are tied to the individual's Marginal Revenue product

Labor Demand

- Labor demand is subject to the "Law of Diminishing Marginal Product"

Recall $MP_L = \frac{\Delta TP}{\Delta L}$

We must also be concerned with $MRP$ – Marginal Revenue Product

$MRP = \frac{\Delta TR}{\Delta L}$

Labor Demand

- Note that except for perfect competition, firms face downward sloping demand curves,
- This means that the $MRP$ declines as more output is produced
- This indicates a declining value of labor productivity
Wage Determination

• Wages will be set so that they equal MRP