

**Labor Markets**  
Derived Demand for Workers

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**Labor Markets**

- 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

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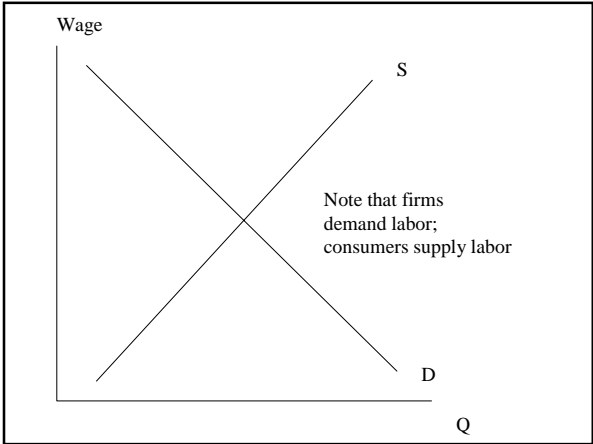
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## Wages

- 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

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## Labor Demand

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

Recall  $MP_L = \text{Marginal (Physical) Product of Labor}$   
 $= \Delta TP / \Delta L$

We must also be concerned with MRP – Marginal Revenue Product  
 $MRP = \Delta TR / \Delta L$

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## 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

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## Wage Determination

- Wages will be set so that they equal MRP

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