Unit 9 Quiz Supplement: shift in wage-setting curve

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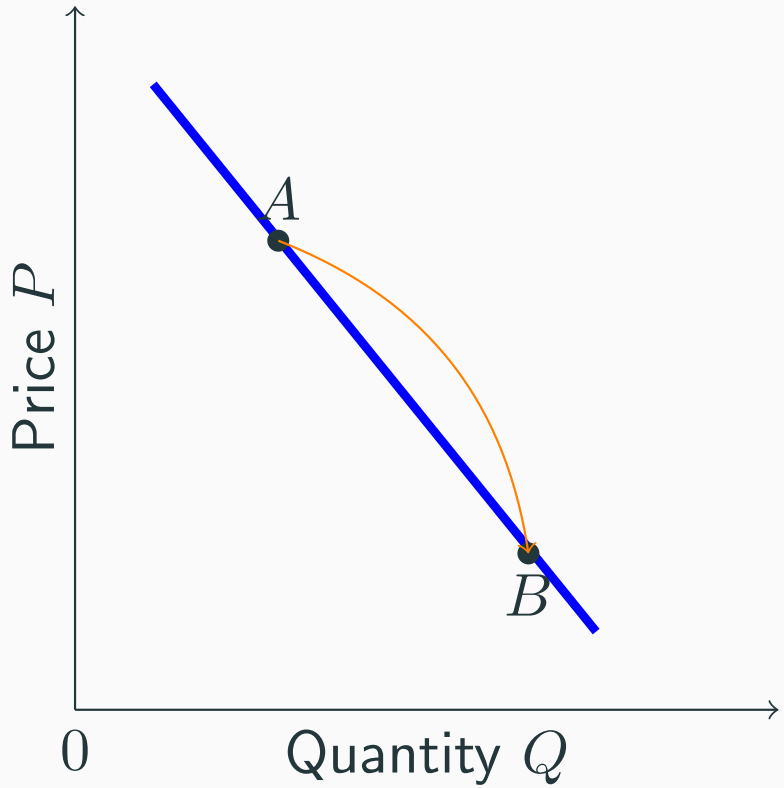
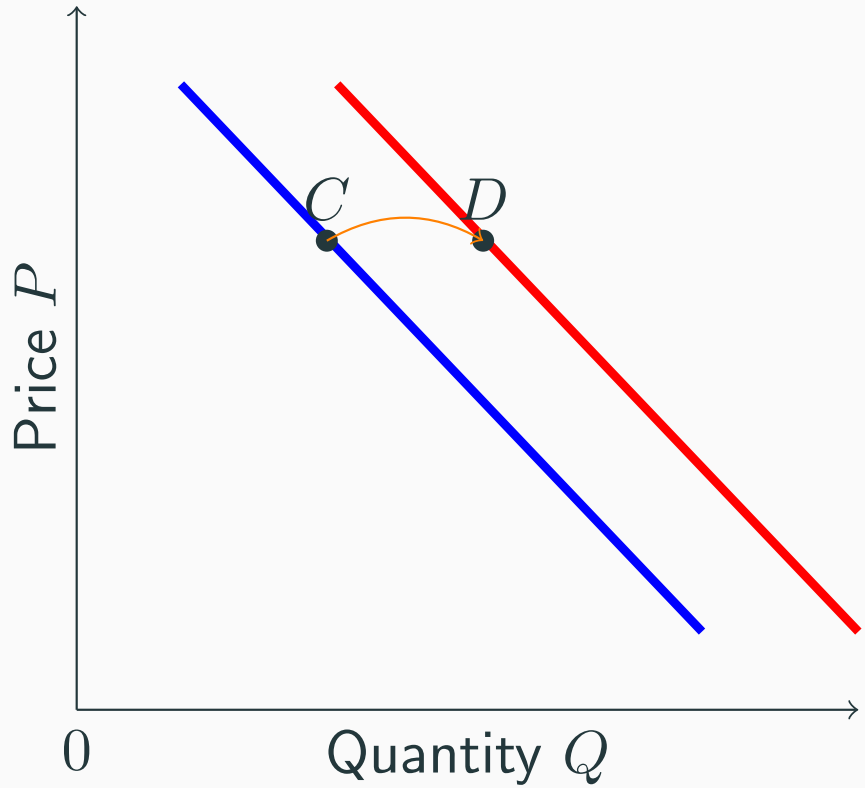
General Principle on "move" and "shift"

Move on the curve: any variation is on the x-**axis and** y-**axis**.

Shift the curve: any variation is NOT on the x-**axis and** y-**axis**. (Represent "movement" on a 3-D object using the shift of 2-D curve)





Recap: labor-discipline model

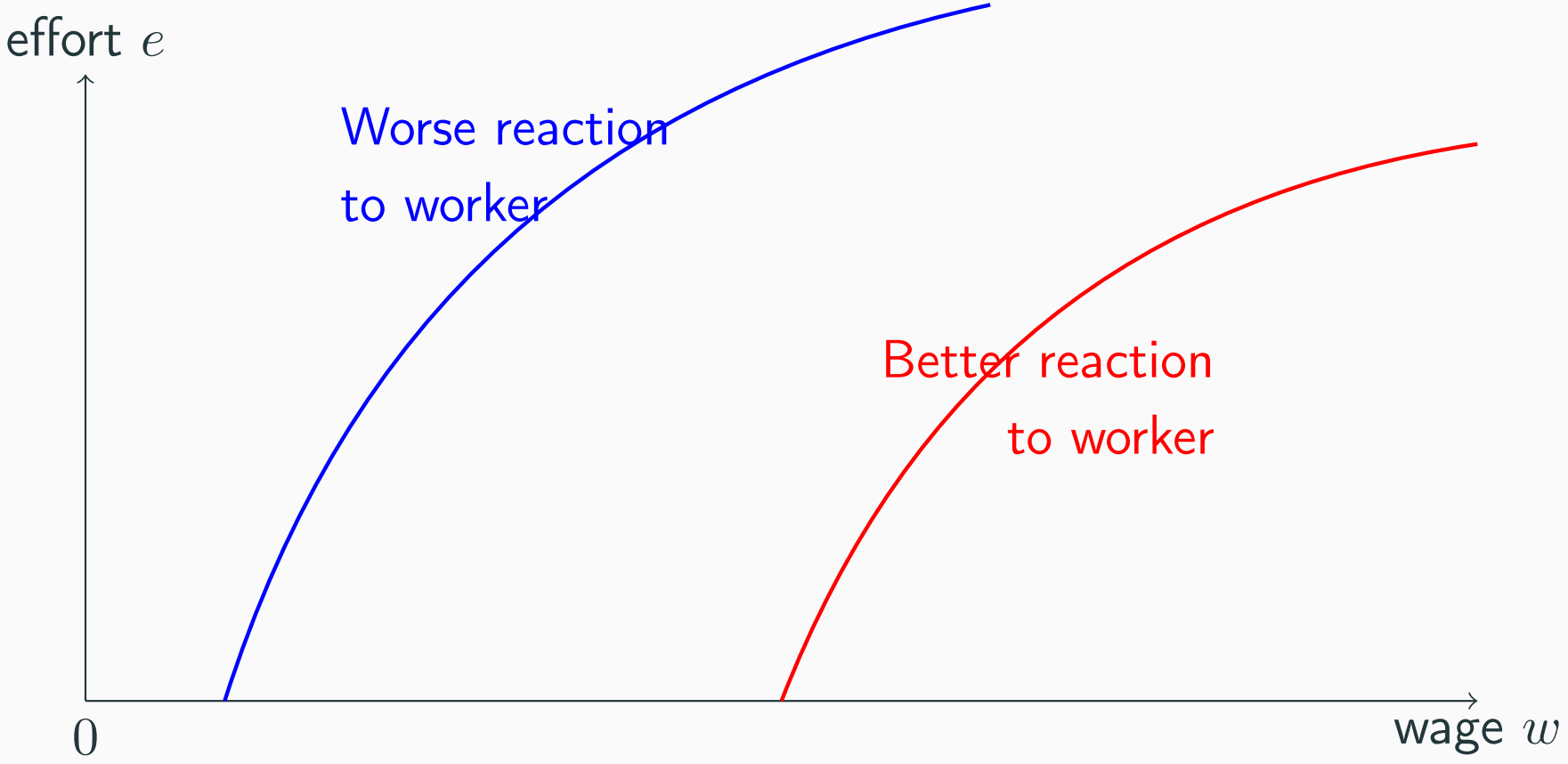
[Page 31 in Unit 9 slide] What shifts the best response curve of workers?

- the utility of the things that the wage can buy
- the disutility of effort
- the reservation wage
- the probability of getting fired at each effort level

$\Rightarrow$ NO one-to-one relationship between best response curve and unemployment rate

First confusing concept: Shift of best-response curve

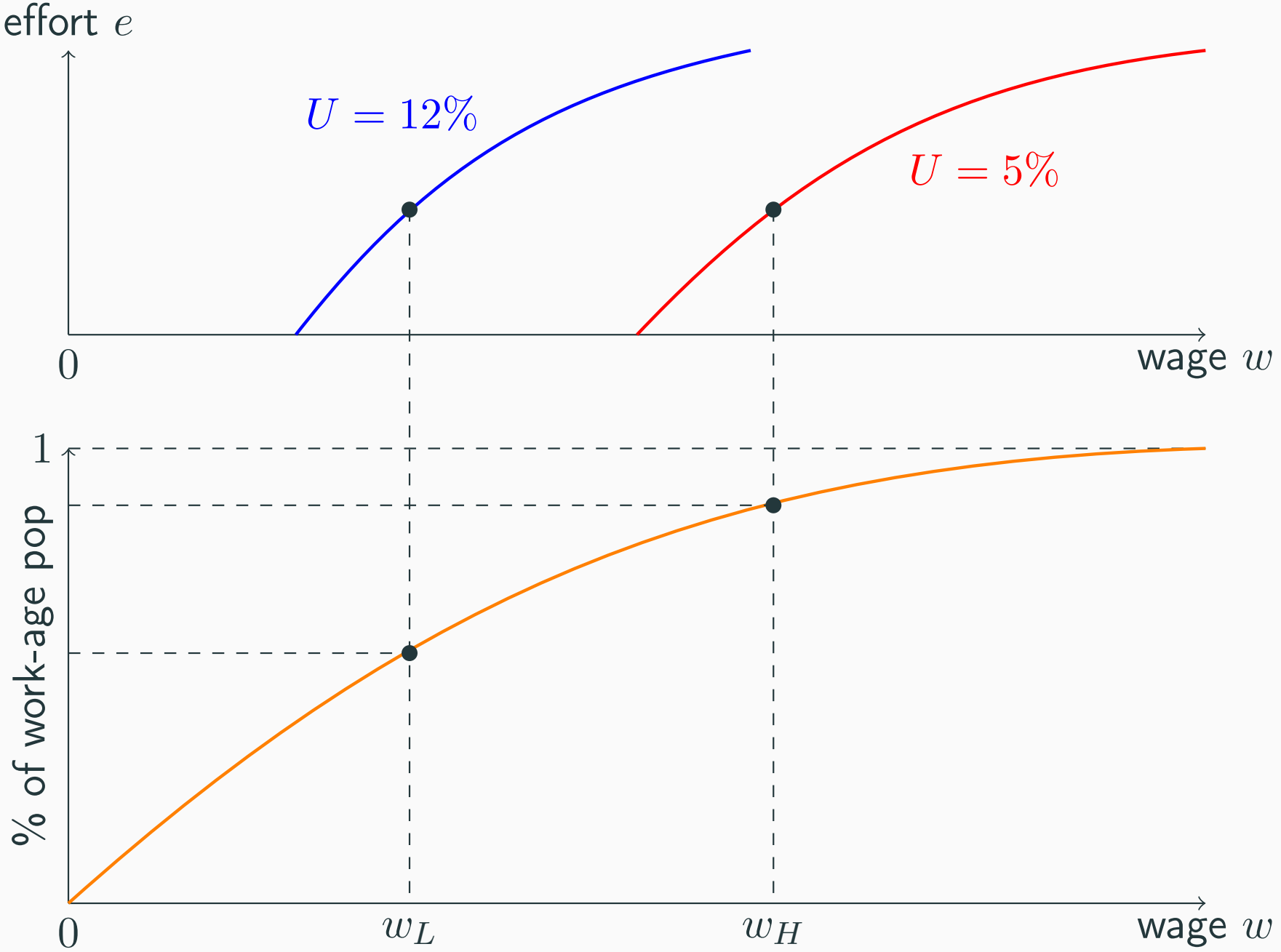
Both "better" and "worse" is for individual workers, which means both best response curve below can represent the **same** level of unemployment.



Recap: Derivation of wage-setting curve

IF now the shift of best-response curve is driven by change in unemployment, we can depict the **relationship between wage and unemployment**, and thus derive the wage-setting curve in the whole economy.

The figure below **switches the x-axis and y-axis** so that both the figure from labor-discipline model and wage-setting curve can be directly linked.

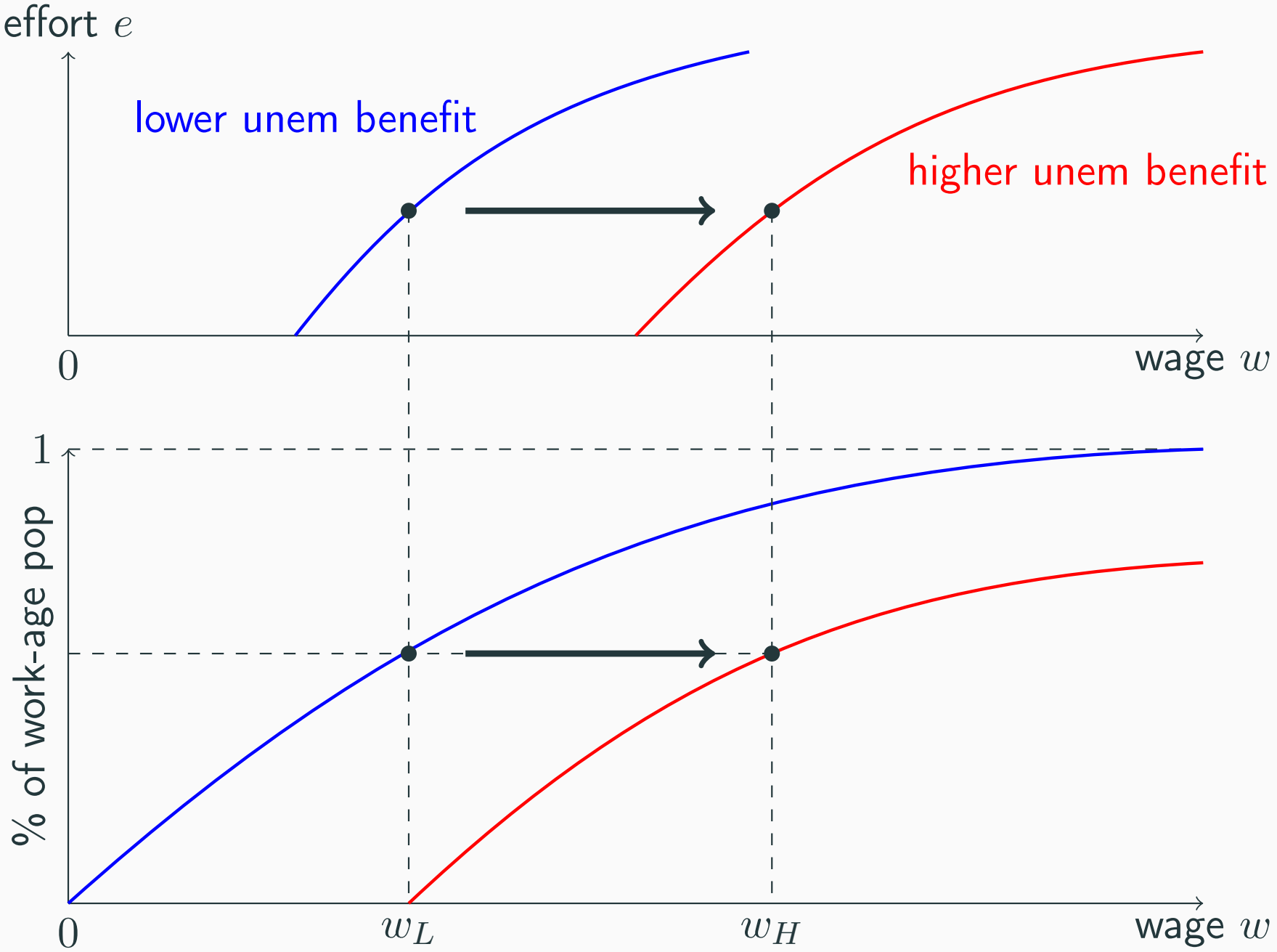

effort e
$U = 12\%$
$U = 5\%$
0
wage w
1
% of work-age pop
0
w_L
w_H
wage w

Second confusing concept: Shift of wage-setting curve

Even though wage-setting curve is derived by IMPOSING the change of best-response curve is because of change in unemployment, yet as I mentioned before, **other factors** can also shift the best-response curve, and **change in any factors other than (un)employment and wage will also shift the wage-setting curve**.

Assume the shift in curves within the figure in next slide is originated from *more generous unemployment insurance scheme*, which is NOT related to unemployment rate.

$\Rightarrow$ higher unemployment benefit$\Rightarrow$ workers better off $\Rightarrow$ best response curve shift **rightward/downward** $\Rightarrow$ equilibrium wage is **higher** $\Rightarrow$ wage curve shift **rightward/downward**.


effort e
lower unem benefit
higher unem benefit
0
wage w
1
% of work-age pop
0
w_L
w_H
wage w

Correction of confusion: Flip the figure back!

Before: shift **rightward/downward** is better for workers.

Now: shift to the **leftward/upward** is better for workers.