**Equilibrium in the labor market and minimum wages**

Macro Perspective: Homogeneous labor, Equilibrium in the labor market

A statutory (obligatory) minimum wage applies to the whole economy.
More realistic case: Minimum wage only applies for part of the economy (this is the covered sector). In the other part (uncovered sector), there is wage flexibility, so there will be adjustment to the labor market equilibrium in this sector.

- In Sector 1, the wage increases and employment decreases.
- Therefore, labor supply increases in sector 2 and wage decreases and employment increases

⇒ Marginal product in sector 2 is smaller than in sector 1, that means the welfare loss in sector 1 is bigger than the welfare increase in sector 2.
Monopsony in the labor market

Also, with market power of the firm in the labor market (here single monopsony), profit maximization implies

\[
\text{Value marginal product} = \text{Marginal cost of labor}
\]

i.e.

\[
P \cdot q_E = w \cdot (1 + \eta_{w,E}) > w
\]

\[E_0\] employment under monopsony < \[E^*\] equilibrium employment

- Introduction of a minimum wage \(w_m\) between \(w_0\) and \(\bar{w}_m\) increases the employment ⇒ employment under minimum wage \(E_m^* > E_0\)

since marginal cost of labor is now equal to \(w_m\) and not \(w \cdot (1 + \eta_{w,E}) = \bar{w}_m\) at \(E_0\)

Reasons, why employment effects of minimum wages may not be negative or even positive ⇒ Card and Krueger „Myth and Measurement“, 1994.