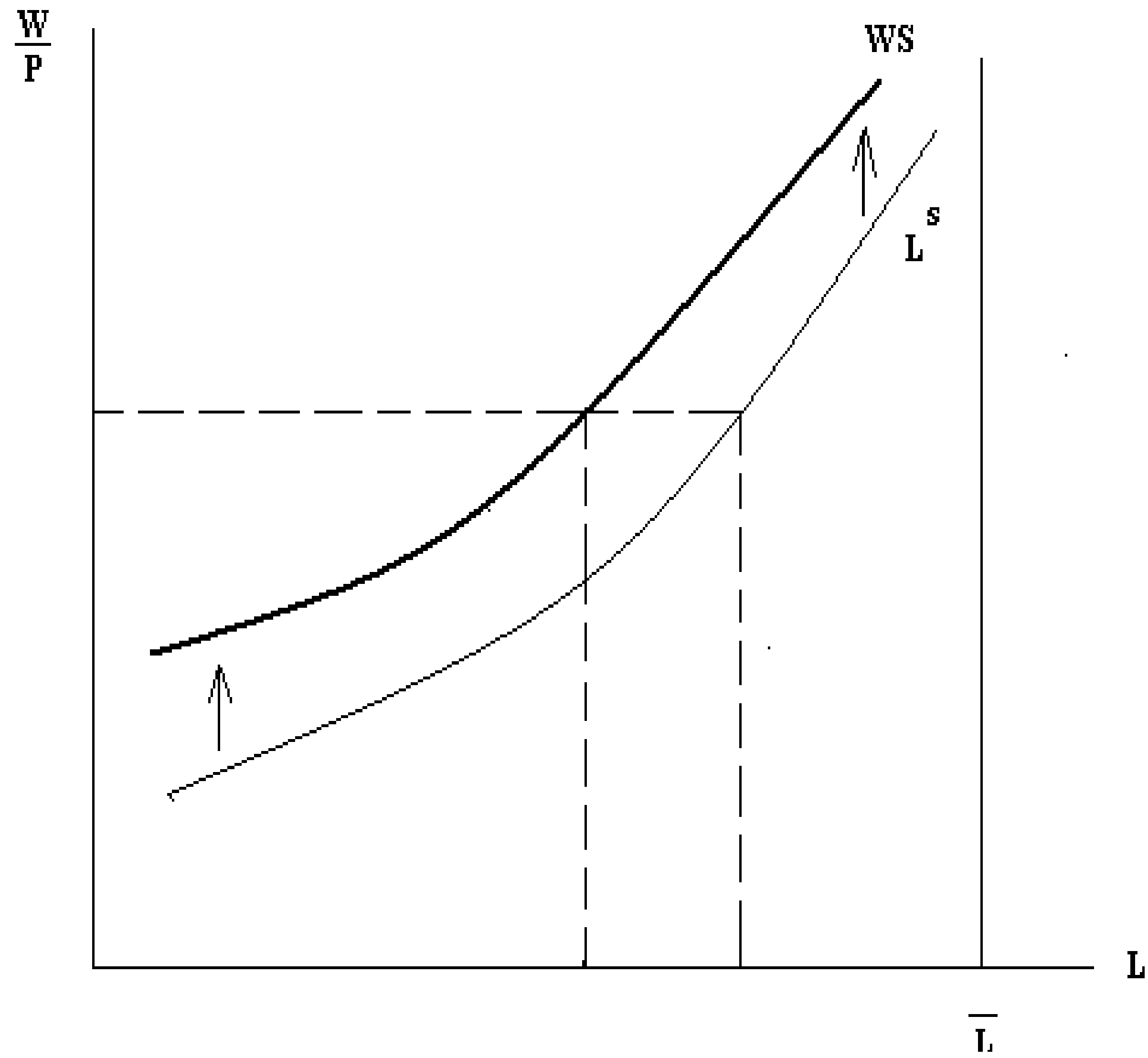
A step forward:

equilibrium unemployment in a non-competitive setting

wages and product prices set by **wage setters** (employers, unions or through bargaining) and **price setters** (firms)

⇒ no market-clearing equilibrium on the labor market, but equilibrium unemployment determined by real forces and institutional features, consistent with wage and price setting

Wage setting



$\frac{W}{P}$ on the wage-setting curve higher than real wage on the labor supply curve for any level of employment

Why?

- unions
- "efficiency wages"

Price setting

Firms with market power (e.g. under monopolistic competition) set prices as a mark-up over marginal costs

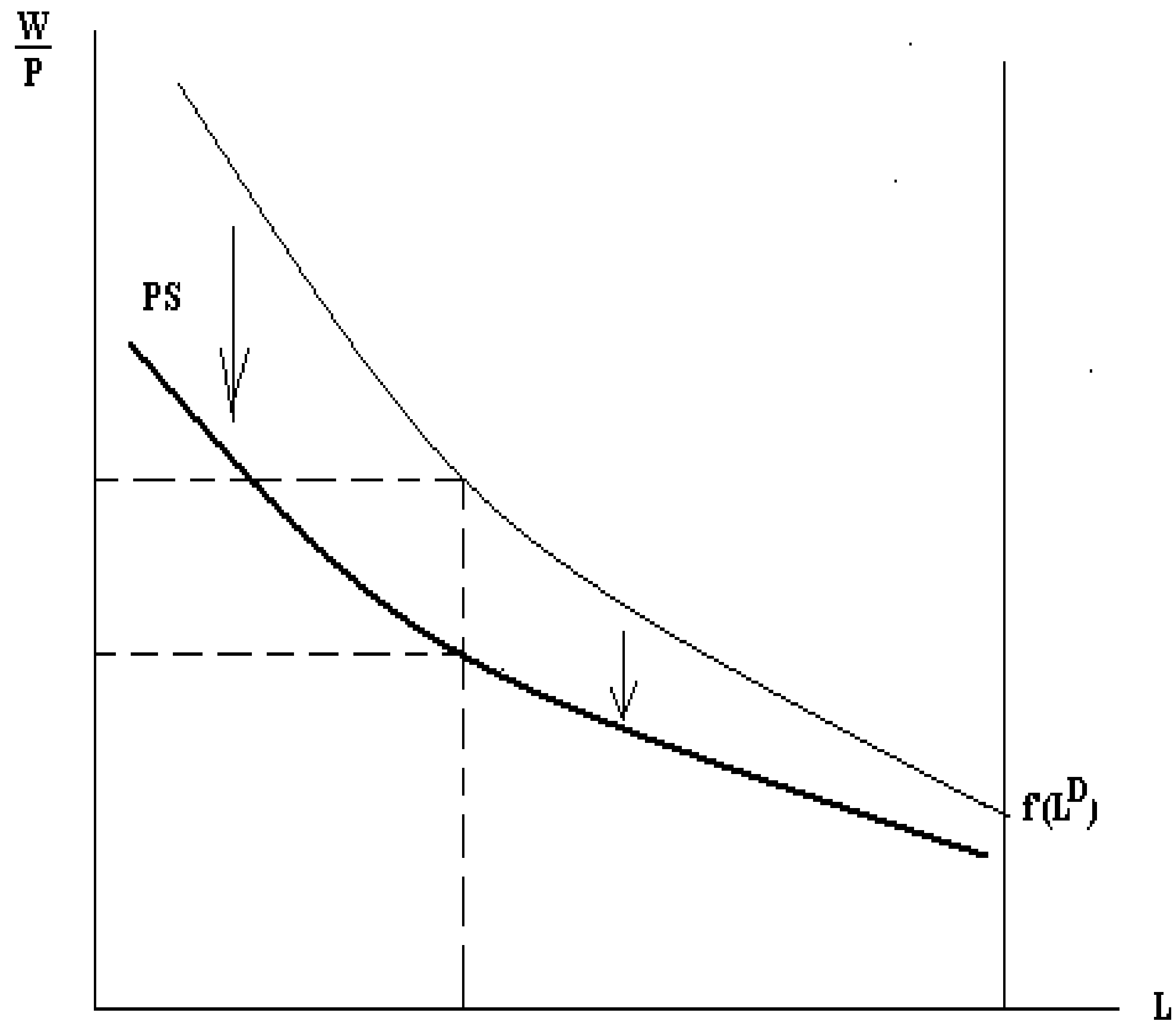
$$P = \underbrace{\left(\frac{\varepsilon}{\varepsilon - 1} \right)}_{\text{mark-up}} \frac{W}{f'(L)}$$

with $\varepsilon > 1$ being the (absolute value of) product demand elasticity (assumed constant)

The "price setting real wage" is

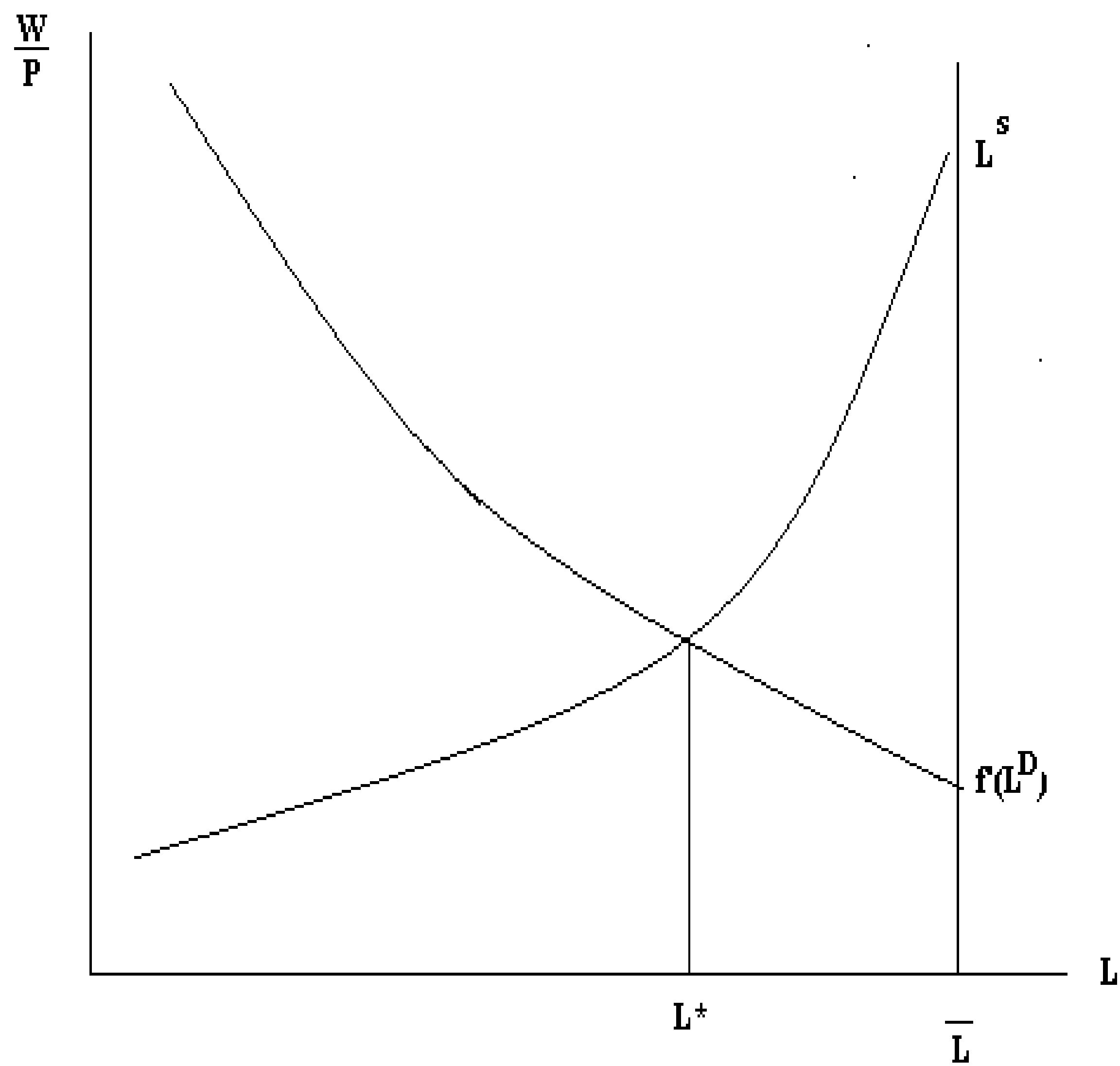
$$\frac{W}{P} = \underbrace{\left(\frac{\varepsilon - 1}{\varepsilon}\right)}_{<1} f'(L) < f'(L)$$

$\frac{W}{P}$ on the price-setting curve lower than marginal productivity of labor for any level of employment



W/P
PS
f'(L^D)
L

Equilibrium under perfect competition



Equilibrium under imperfect competition