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## Social Interactions in the Labor Market

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### Abstract:

We examine theoretically and empirically social interactions in labor markets and how policy prescriptions can change dramatically when there are social interactions present. Spillover effects increase labor supply and conformity effects make labor supply perfectly inelastic at a reference group average. The demand for a good may also be influenced by either a spillover effect or a conformity effect. Positive spillover increases the demand for the good with interactions, and a conformity effect makes the demand curve pivot to become less price sensitive. Similar social interactions effects appear in the associated derived demands for labor. Individual and community factors may influence the average length of poverty spells. We measure local economic conditions by the county unemployment rate and neighborhood spillover effects by the racial makeup and poverty rate of the county. We find that moving an individual from one standard deviation above the mean poverty rate to one standard deviation below the mean poverty rate (from the inner city to the suburbs) lowers the average poverty spell by 20–25 percent. We further consider overall labor market outcomes by examining theoretically the socially optimal wealth distribution. Interdependence in utility can mitigate the need to transfer wealth to low-wage individuals and may require them to be poorer by all objective measures. Finally, we quantify how labor market policy changes when there are household social interactions. Labor supply estimates indicate positive economically important spillovers for adult U.S. men. Ignoring or incorrectly considering social interactions can mis-estimate the labor supply response of tax reform in the United States by as much as 60 percent.

**Text:** See [Discussion Paper No. 5934](#)



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