

Chapter 18 The interaction of labour markets

Answers to Knowledge checks

- 18.1** A monopsonist gains by facing lower labour costs, and makes higher profits.
- 18.2** If trade unions are successful in raising wage rates above the equilibrium rate, the demand for labour by employers will fall, so there will be fewer jobs available. Notice that the extent to which there is unemployment in the market depends upon two things. On the one hand, there are some workers who will have been employed at the market equilibrium wage W_e in Figure 18.9 (*see* page 248 in the book), but there are also other individuals who won't have offered themselves for work at W_e , but who would work at W^* . In other words, there has been an extension of labour supply.
- 18.3** When it is the firm (the employer) that is dominant in negotiations, the outcome will be closer to L_m than to L^* .
- 18.4** The more immobile labour is, the less elastic labour supply will be, and the greater wage differentials will be needed to persuade workers to move.
- 18.5** An increase in the demand for labour occurs when the new technology raises the marginal revenue product of labour.

Answers to Exercises and Case studies

Exercise 18.1

If a firm experiences a fall in the selling price of its product, this reduces the marginal revenue product of labour, so the demand curve for labour will shift to the left. This is shown in Figure A18.1. Demand shifts from D_{L0} to D_{L1} , and the result is that there is a fall in the equilibrium wage rate and a fall in the quantity of labour employed.

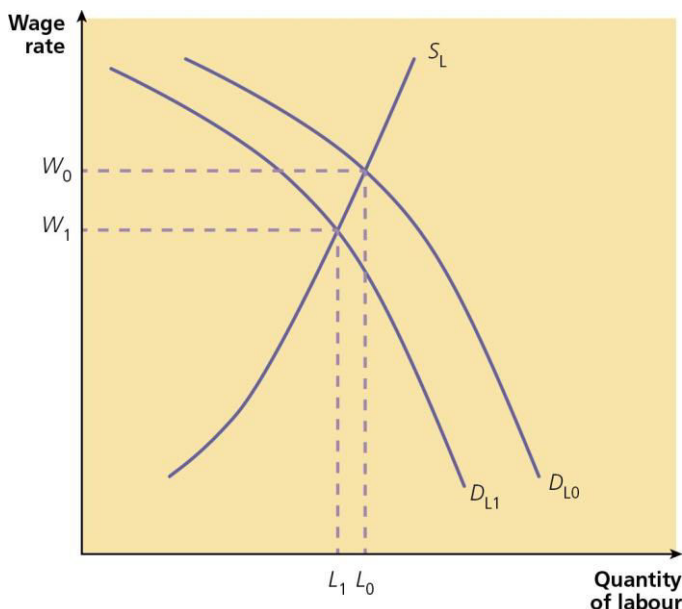


Figure A18.1 A fall in the selling price of a firm's product

Exercise 18.2

- a The demand for labour is given by the marginal revenue product of labour curve (MRP_L). Under perfect competition, the average cost of labour curve AC_L represents the supply curve of labour, so equilibrium is where supply equals demand, with the wage rate at OC , and the quantity of labour employed OJ .
- b As a monopsony, the employer is the sole buyer of this sort of labour, and will employ labour up to the point where the marginal cost of labour equals the marginal revenue product. Because the firm is a monopsony, its marginal cost of labour is higher than the average cost. In other words, as it hires more labour, it must offer higher wages not only to the additional workers that it hires, but to its existing labour force as well. It therefore hires OH workers, at a wage of OF .
- c The area $OFGH$ is the wage bill — the wage paid multiplied by the quantity of labour.
- d This generates a surplus to the firm given by the area $FABG$.

Exercise 18.3

I cannot know how you will respond to this question, as I don't know when you will be tackling it. If I were tackling it now, I would discover strike action on the trains, with unions protesting at the removal of guards from train services, but also some pay claims, such as hospital cleaners.

Exercise 18.4

- a The effects of immigration are shown in Figure A18.2. The increased number of people means an increase in labour supply from S_1 to S_2 , and a fall in the equilibrium wage from W_1 to W_2 .

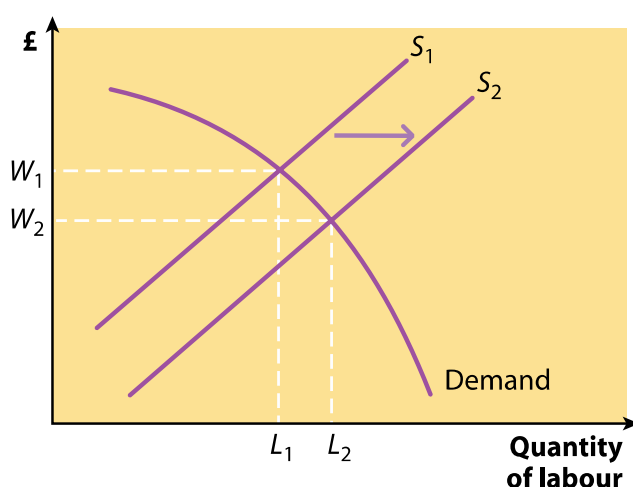


Figure A18.2 The effect of immigration

- b A reduction in the rate of the Jobseeker's Allowance has a similar effect, in that when the Jobseeker's Allowance is low, the opportunity cost of unemployment is high, and more people will be prepared to accept jobs — which can be seen as a rightward shift in labour supply.
- c An improvement in technology that raises labour productivity will increase the marginal productivity of labour, causing a rightward shift in the demand for labour curve. This is shown in Figure A18.3, where demand increases from D_1 to D_2 , the equilibrium wage increases from W_1 to W_2 , and the quantity of labour demanded also rises, from L_1 to L_2 .

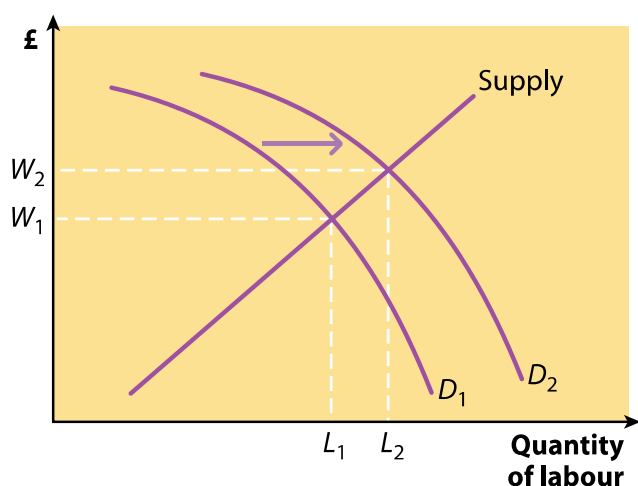


Figure A18.3 The effect of an improvement in labour productivity

- d** A new health and safety regulation raises firms' labour costs. In Figure A18.4, the effect is to move labour supply, by the cost of the regulations (assumed to be C). The firm will therefore employ fewer workers (L_2 instead of L_1), and offer a lower wage (W_2 instead of W_1). As it is the firm that incurs the additional cost, the supply curve S still shows the amount of labour that workers are prepared to supply at any wage, which is why the new equilibrium wage is W_2 .

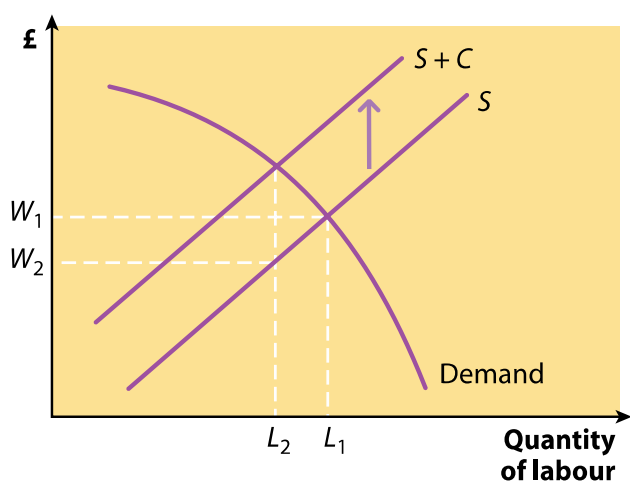


Figure A18.4 The effect of health and safety regulation

- e** As people are retired, the size of the working population falls, reducing labour supply. This is shown in Figure A18.5. Here the supply curve moves from S_1 to S_2 , the equilibrium wage increases from W_1 to W_2 , and the amount of labour employed falls, from L_1 to L_2 .

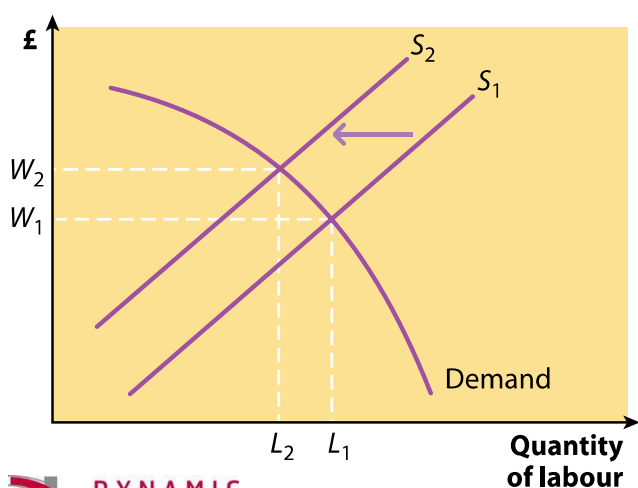


Figure A18.5 A fall in labour supply

Case study 18.1

Valuing professional footballers

- a** The marginal revenue product of a player is the additional revenue received by the club that signs him.
- b** By saying that team revenues tend to be win-elastic, the author is arguing that the revenues received by a club are sensitive to whether the team wins. Wins bring extra revenue.
- c** This phrase refers to the fact that top players can bring revenue to the club through their activities off as well as on the field. David Beckham is a prime example because of his high profile off the pitch.
- d** The most skilled footballers are in inelastic supply because of their innate talent and ability. This coupled with the high *MRP* helps to explain why they should command high wages.

Notice that there may be many difficulties in trying to estimate the *MRP* in practice. For example, there may be externality effects, where one player may perform better in partnership with another. This makes it difficult to isolate the incremental impact of a player on overall team performance.

Answers to end-of-chapter questions

A Multiple-choice questions

- 1** c. It will pay higher wages than in a competitive labour market
- 2** b. There is a trade union and a monopsony employer of labour
- 3** a. The loss of labour from a country

B Knowledge and understanding questions

- 4** A monopsony will produce where $MC = MR$, using its market dominance over the labour market and pushing wages down.

An explanation of the impact of a monopsony on a market	up to 2 marks
A diagram showing the impact of a monopsony on a market	up to 2 marks

- 5** A trade union will restrict supply below certain wage rates, pushing wages up in a market.

An explanation of the impact of a trade union on a market	up to 2 marks
A diagram showing the impact of a trade union on a market	up to 2 marks

- 6** Factors may include:
 - Training
 - Education
 - Infrastructure (public transport etc.)
 - Trade union reform
 - Information provision

Two factors explained	4 marks
One factor explained AND one factor identified	3 marks
One factor explained OR two factors identified	2 marks
One factor identified	1 mark

C Stimulus response question

7 a An employer who is the single buyer of a labour in a market or industry.

A full explanation of a monopsony employer	2 marks
A vague or partial explanation of a monopsony employer	1 mark

b

AO1 Knowledge	1 mark
AO2 Application	1 mark
AO3 Analysis	5 marks
AO4 Evaluation	5 marks

Knowledge (1 mark) is likely to include:

- Supply of labour to a market/industry

Application (1 mark) is likely to include:

- Application to the market for teachers

Analysis (5 marks) is likely to include:

Analysis that a low wages impacts the supply of teachers to the market, for example:

- Impact of low wages on the supply curve for teachers
- Opportunity cost of training/becoming a teacher

Evaluation (5 marks) is likely to include:

Evaluation that low wages is not the greatest impact, for example:

- Wage elasticity of supply of teachers
- Sunk costs of becoming a teacher

Evaluation that other factors will have a greater impact than low wages, for example:

- Working conditions
- Cost of training
- Skills required
- Media coverage of the profession

A judgement of whether low wages are likely to have the greatest impact on the supply of teachers to the market

D Essay question

8

AO1 Knowledge	6 marks
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AO2 Application	6 marks
AO3 Analysis	6 marks
AO4 Evaluation	7 marks

Knowledge (6 marks) is likely to include:

- Government intervention into the labour market
- Methods of improving labour market flexibility, for example:
 - Training, skills and information provision
 - Trade union reform

Application (6 marks) is likely to include:

- Application of the labour market in the UK
- Examples of UK labour markets

Analysis (6 marks) is likely to include:

Analysis of how government intervention may improve labour market flexibility, for example:

- Impact of government intervention on the supply curve for labour

Evaluation (7 marks) is likely to include:

- Evaluation of why government intervention may not improve labour market flexibility
- Evaluation of the effectiveness of other methods of improving labour market flexibility other than government intervention.

A judgement of whether government intervention is the best method of improving labour market flexibility in the UK