3.5 Labour markets

Firms demand labour households are the suppliers of labour

Higher the wage rate, the less demand for labour

Elasticities

Elastic supply of labour means **lower wages -** Unskilled labour (more elastic) - Capacity of labour (more available, more elastic) - Time (less time it takes to train, more elastic)

Inelastic supply of labour means **higher wages -** skilled labour (eg, doctors, lawyers, football players)

The more indispencible the labour are, the higher wage rate they can negotiate

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Marginal Revenue product

MRP **- Marginal revenue product** is the extra revenue generated when an additional worker is hired

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MRP = MPP x MR
Marginal revenue product = Marginal physical product x Marginal revenue
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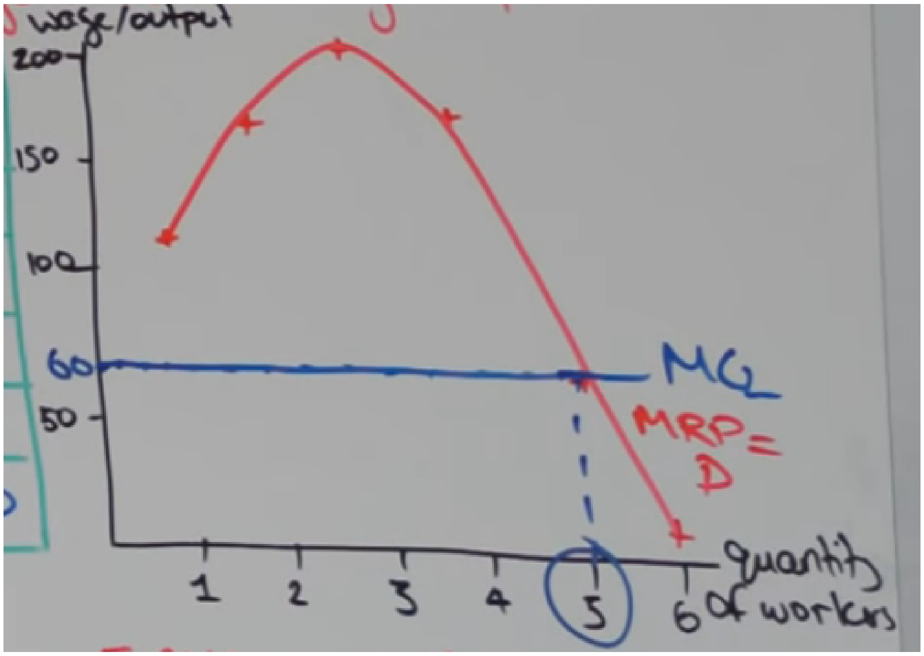
MRP = D because the demand of labour is directly related to the product they will make

MRP curve for a firm (in a perfect market)



- MRP is shaped as such due to diminishing returns
- Firms are wage takers not makers, so they must accept the prevailing wage (in this graph 60)
- **Firms will hire workers up untill MRP = W** (in this graph 5)

(The MRP curve for a whole industry is a straight line linear demand curve, it is just simplified.)

The MRP is downward sloping because: - SR -> law of diminishing returns - LR -> Substituion of labour and capital (replaced by machines etc)

Criticisms of MRP theory

- Productivity is very difficult to measure, thus MRP is not possible to determine (eg teachers dont produce products thus a price cannot be associated)
- Teamwork makes it difficult to measure individual productivty, thus MRP is not possible to determine
- Self employed dont pay themselves according to MRP
- Real world isnt a perfect labour market, trade unions distaught the theory.

Shifts of the labour demand curve

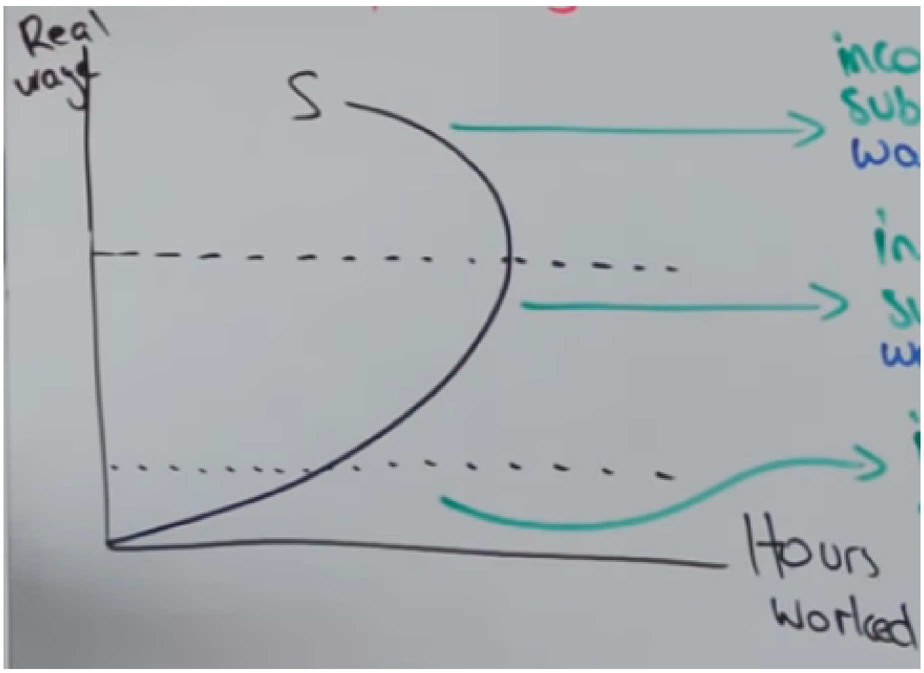
- Change in the final price of the product the labour is making.
- Change in demand for the final product
- Changes in labour productivity
- Change in the price of capital

Individual labour supply curve

Key choice, Do you work? or do you take leisure?

Income effect is the rise in income as wages rise but with the potential of individuals reaching a target income

Substituion effect is as wages rise, the opportunity cost of leisure time increases providing an incentive to work



As the wage increases there is a positive income effect and positives substition effect. *untill* a specific point in which the income effect becomes negative as they no longer care about wages compared to leisure time

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Shifts of the labour supply curve

- Wage on offer in substitute occupations

- Barrieers to entry
- Non-monetary characteristics of the job
- Improvements in occupational mobility of labour
- Overtime
- Size of the working population
- Value of leisure time