WJEC (Eduqas) Economics A-level

Microeconomics

Topic 3: Demand and Supply in Labour Markets

3.1 Wage determination

Notes

The main influences on demand and supply in labour markets

- The labour market is a factor market. The supply of labour is determined by those who want to be employed (the **employees)**, whilst the demand for labour is from **employers.**

- Labour is a **derived demand.** This means that the demand for labour comes from the demand for what it produces. For example, the demand for people who make cars is derived from the demand for cars. With no demand for cars, there will be no demand for car manufacturers.

- Demand is related to how productive labour is and how much the product is demanded.

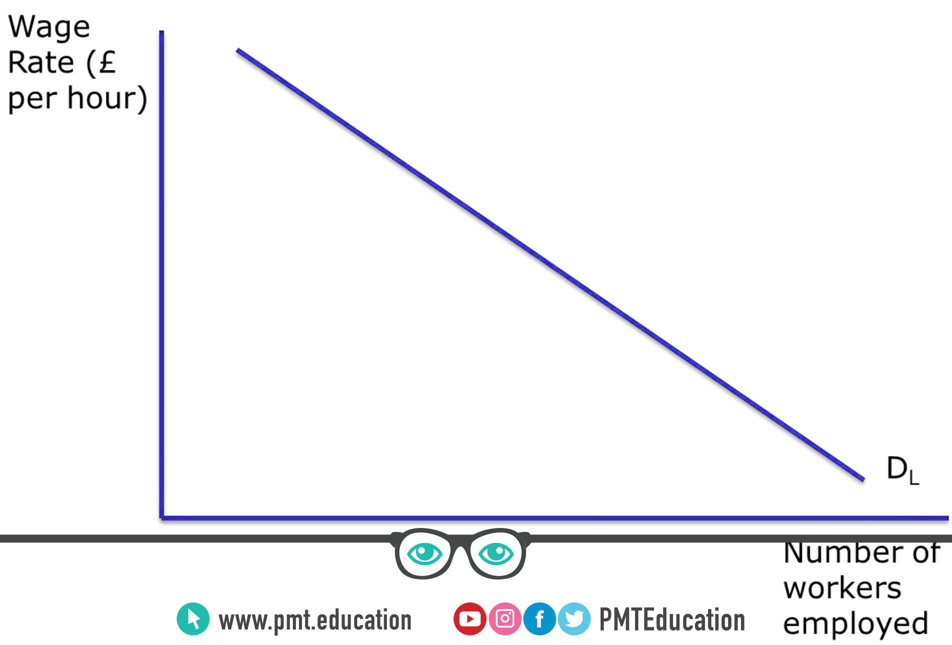
- The elasticity of demand for labour is linked to how price elastic the demand for the product is.

- The wage rate will lead to movements along the supply and demand curves for labour. All other factors will shift the curves.

Demand for labour:

- The demand for labour is affected by:

- **The wage rate:**
  - The downward sloping demand curve shows the inverse relationship between how much the worker is paid and the number of workers employed.

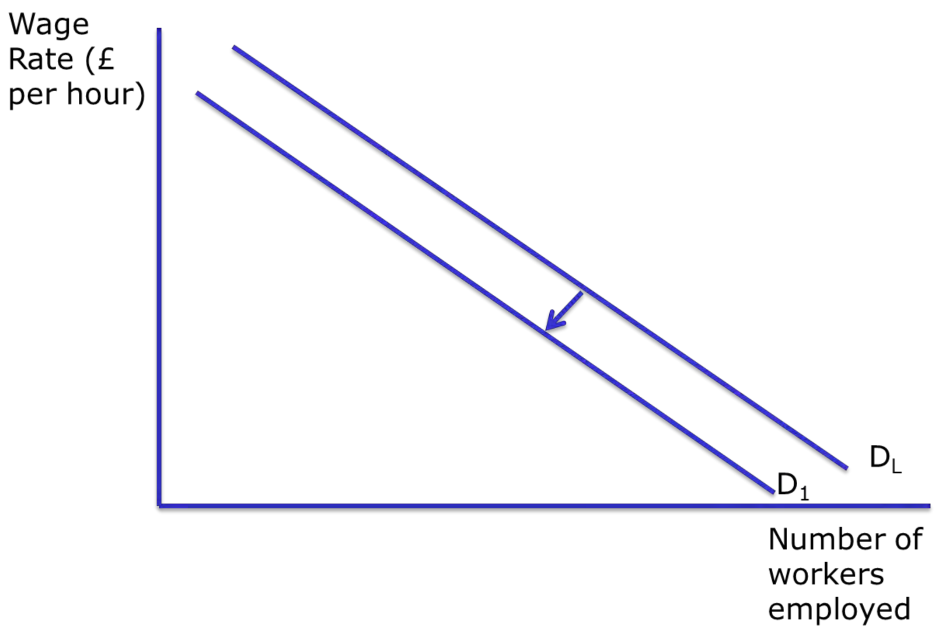


- When wages get higher, firms might consider switching production to capital, which might be cheaper and more productive than labour.

- **Demand for products:**
  - Since the demand for labour is derived from the demand for products, the higher the demand for the products, the higher the demand for labour.

- **Productivity of labour:**
  - The more productive workers are, the higher the demand for them.
  - This can be increased with education and training, and by using technology.

- **Substitutes for labour:**
  - If labour can be replaced for cheaper capital, then the demand for labour will fall. This will shift the demand curve for labour to the left:



- **How profitable the firm is:**
  - The higher the profits of the firm, the more labour they can afford to employ.

- **The number of firms in the market:**
  - This determines how many buyers of labour there is. If there is only one employer, for example the NHS, the demand for labour is lower than if there are many employers, such as in the supermarket industry.

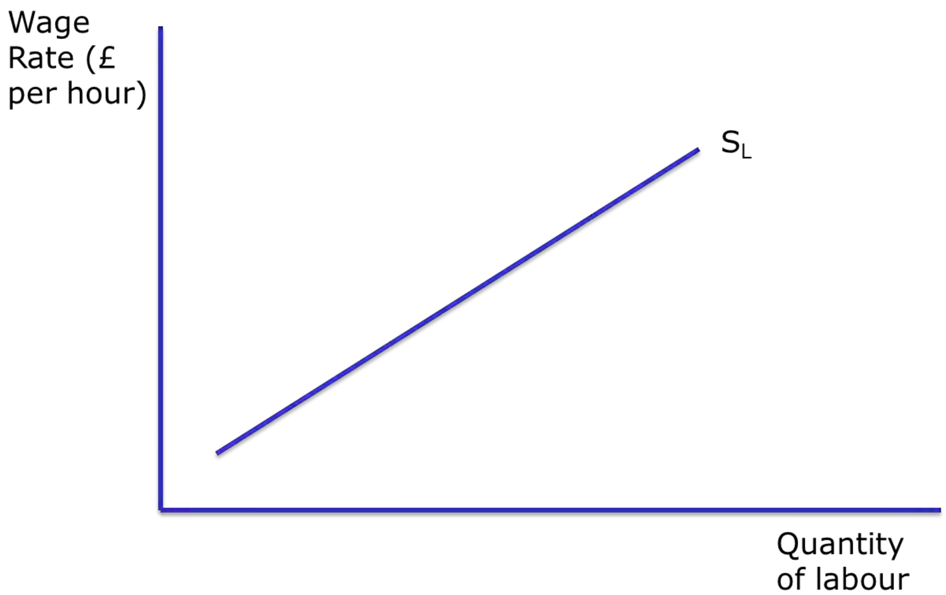
- The lower demand for labour can mean wages are lower, so trade unions try to encourage higher wages.

Supply of labour:

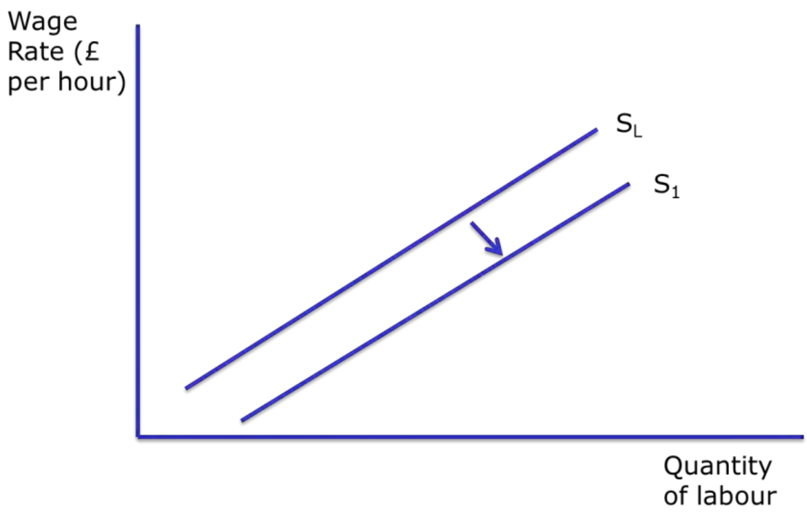
- The supply of labour is calculated by the number of workers willing and able to work at the current wage rate, multiplied by the number of hours they can work.

- The supply of labour is affected by:

- **The wage rate:**
  - The upward sloping supply curve shows the proportional relationship between how much the worker is paid and the number of workers willing and able to work.



- **Demographics of the population:**
  - The more people there who are able and willing to work, the higher the supply of labour. This changes with retirement and school leaving ages, the number of university students and immigration.
  - It can be illustrated with a shift to the right of the supply curve.



- **Migration:**
  - Migrants are usually of working age, so the supply of labour at all wage rates tends to increase. Migration particularly affects the supply of labour at the lower wage rates, because migrants are usually from economies with average wages lower than the UK minimum wage.

- **Advantages of work:**
  - This can influence how much people prefer to work, and is linked to non-monetary advantages. If the cost of working is lower, so families can afford childcare, people are more likely to work. If the benefits of working are high, such as holiday entitlements and the potential to be promoted, the supply of labour is likely to increase.

- **Leisure time:**
  - Leisure is a substitute for work, which is why part-time work and early retirements are attractive options for some people.
  - People have to choose whether to spend their time on work or leisure. This is influence by age, the amount of taxes paid, how many dependents the worker has and income from not working.

- **Trade unions:**
  - These could attract workers to the labour market, because they know their employment rights will be defended. However, the limits on workers, such as limiting their ability to strike, might cause some people to withdraw from the labour market.

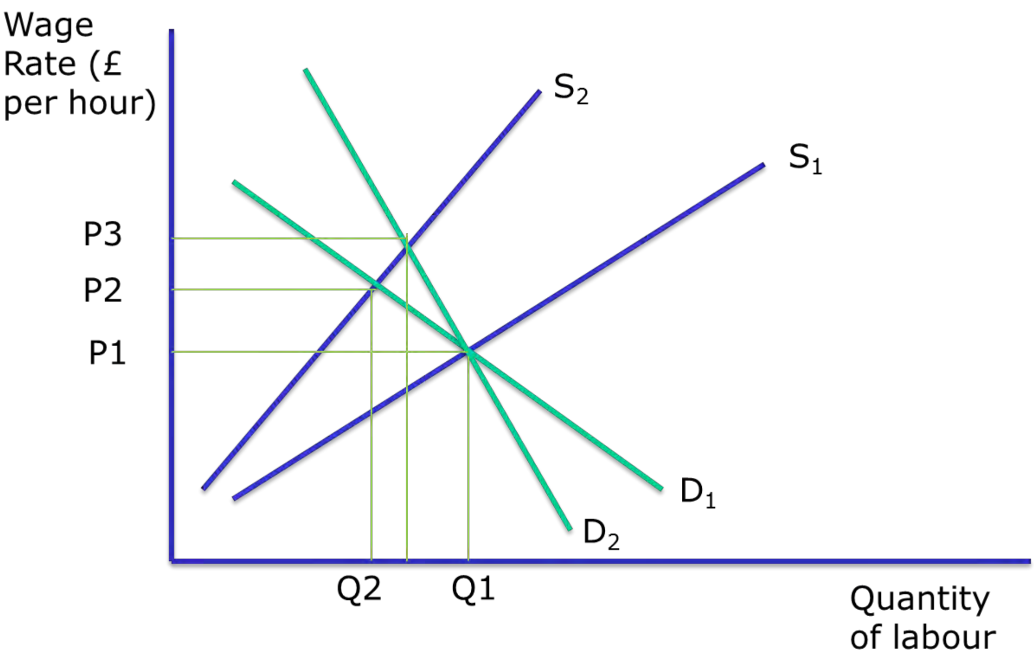
- **Taxes and benefits:**

- If taxes are too high and benefits are too generous, people might be more inclined to withdraw from the labour market.

- **Training:**
  - If a lot of training or high qualifications are required for a job, then the supply of labour may fall. However, if the government subsidise training, it is easier for workers to gain the necessary skills for a job, so the supply of labour could increase.

Determinants of the elasticity of the demand and supply of labour

- How the wage rate and level of employment are affected by shifting the demand or supply curve depends on the elasticity of the other curve.
- If labour demand is inelastic, because there are few or no substitutes, strikes will increase the wage rate but not affect the employment rate significantly.
- Where there is an inelastic demand for labour, a lower supply will lead to a higher increase in the wage rate (P1 → P3), than where there is a more elastic demand (P1 → P2).



- The elasticity of demand for labour measures how responsive the demand for labour is when the market wage rate changes. This is affected by:

- How much labour costs as a proportion of total costs. The higher the cost of labour as a proportion of total costs, the more elastic the demand. Labour costs are high as a proportion of total costs in the services.
- The easier it is to substitute factors, the more elastic the demand for labour, because firms can easily to switch to cheaper forms of production, such as capital.
- The PED of the product also affects labour. The more price elastic the product, the more price elastic the demand for labour.

- The elasticity of supply of labour is the responsiveness of the quantity of labour supplied to a change in the wage rate.
- This is affected by:
  - The skills of the workforce. Skilled jobs have lower elasticities than unskilled jobs, because it is more difficult to attract workers, since only a few have the necessary skills.
  - Length of training. The longer the training period for a job, the lower elasticity of labour supply.
  - Sense of vocation. Some jobs have rewards which are not financial, such as teaching. These will have inelastic supplies.
  - Time period. In the short run, the supply of labour is more inelastic than in the long run.

The causes and implications of wage differentials

- Sometimes, even in the same job, workers can be paid different amounts. This is due to:
  - **Skills, qualifications and training.** Jobs which require more training and education offer higher wages. Training workers is expensive for firms, so they compensate for this by offering workers, who have already undergone education and training, higher wages.
  - **Formal education.** On average, those with a degree earn more over their lifetime than those who gain just A Levels.
  - **Wages and skills.** Skilled workers produce higher outputs than unskilled workers because they are more productive, so the demand for their labour is higher. This means they can demand higher wages.
  - **Pay gaps.** The wage gap between skilled and unskilled workers has increased in the UK recently. This is due to technological change and globalisation, which has shifted production abroad.

- **Discrimination.** Workers might be discriminated against due to age, disabilities, gender and race.
- **Gender.** Even with equal pay laws, women still earn less than men on average. This could be due to career breaks and fewer hours worked on average than men, or because women are crowded into low-paid or part-time jobs, which may only require low skill levels. Women could also be discriminated against when it comes to promotions, which effectively locks out higher paying jobs. Although a gap still exists, it is narrowing.

Wages in Wales compared to the rest of the UK

- In London, the median income was £27,560 in 2011, whilst the average for Wales was only £19,472.

- Wales makes up 4.2% of the UK's workforce.