OCR Economics A-level
Microeconomics

Topic 5: Labour Market

5.1 Demand for Labour

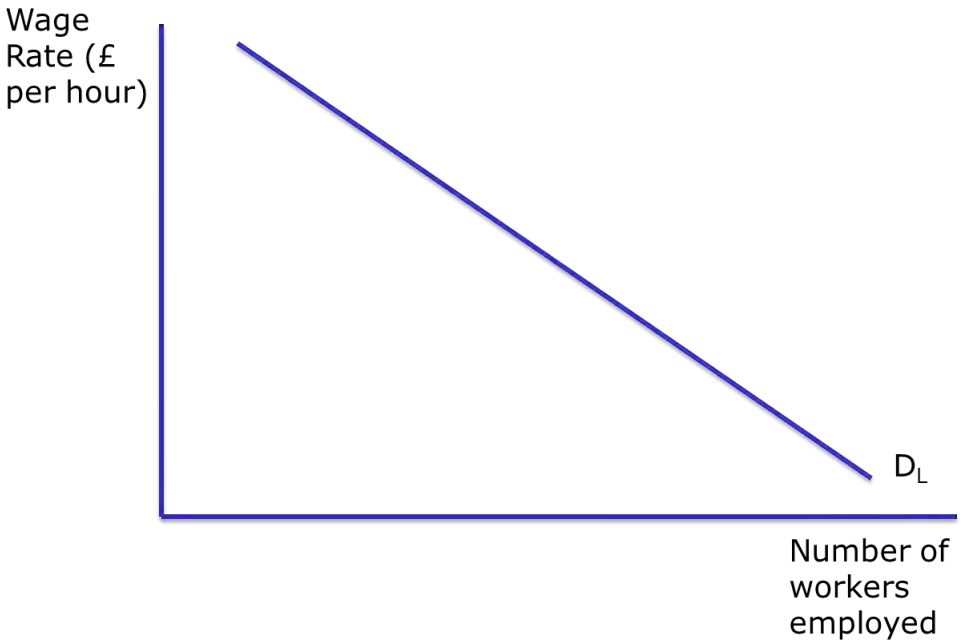
Notes

Labour Demand

- 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.
- **Nominal wages** are the monetary value of wages. For example, if someone receives £10 per hour, their nominal wage is £10.
- **Real wages** are wages adjusted for inflation. If inflation is 2% then the real wage is £10 minus 2%.

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:

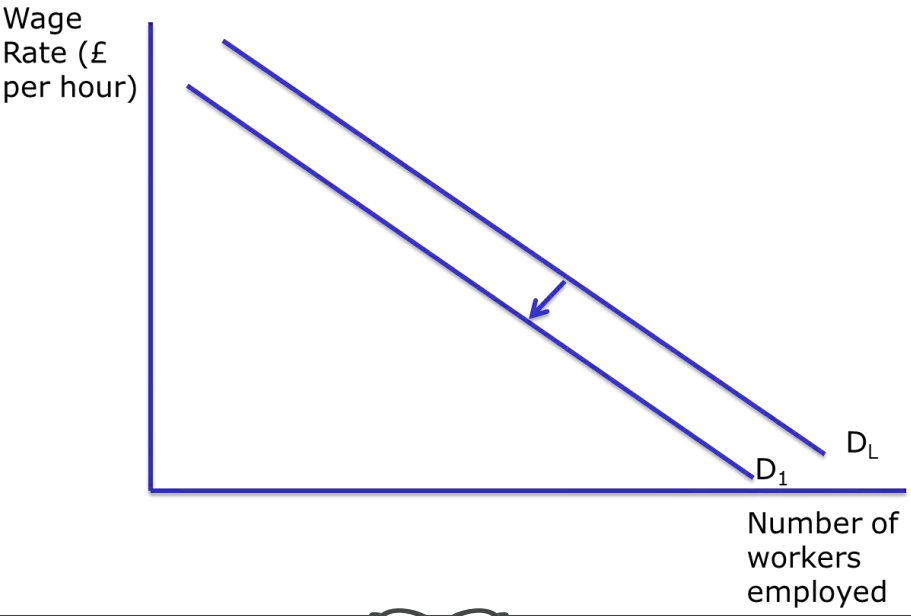
- Since the demand for labour is derived from the demand for products, the higher the demand for the products, the higher the demand for labour.

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:

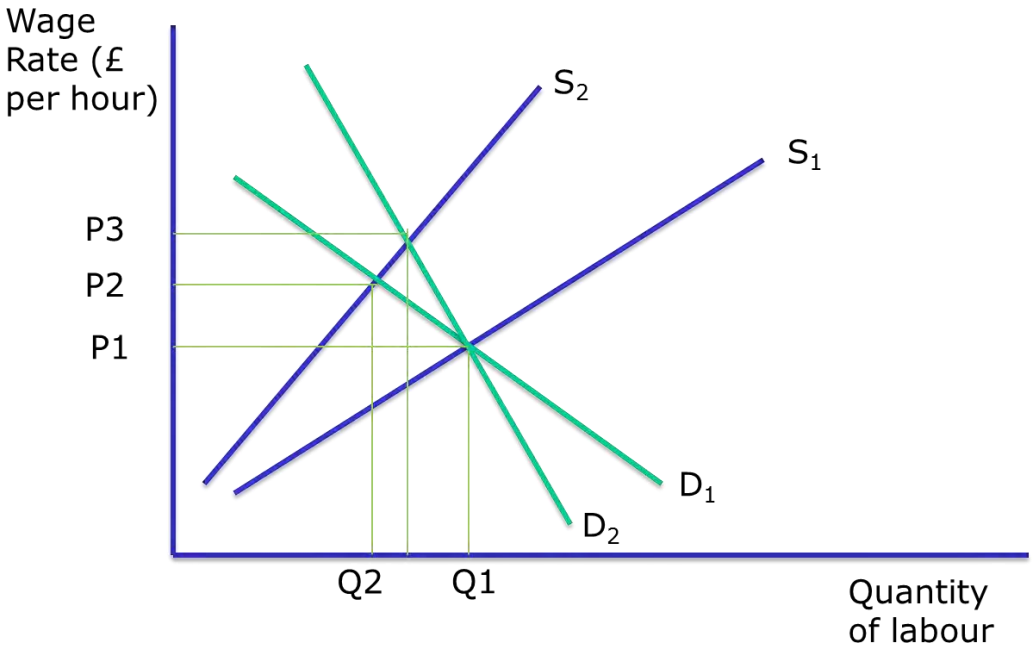


- **How profitable the firm is:**
  - The higher the profits of the firm, the more labour they can afford to employ.

- **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.

Determinants of the elasticity of the demand 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.

Productivity and unit labour costs:

Productivity is calculated by output per worker per period of timer. Productivity can be increased by training workers or using more advanced capital machinery. Being more productive means the same input, such as the number of workers, produces more output, over the same period of time. This lowers average costs per unit of output.

The unit labour cost is how much labour costs per unit of output.

Generally, the cheaper the relative unit labour costs, the more competitive the country in manufacturing. For example, countries such as China, India and Bangladesh have lower labour costs than countries such as the UK and US, which means that a lot of production requiring manufacturing, such as textiles, clothes and technology, has moved abroad.

However, higher prices could compete if a niche market is targeted or by using product differentiation. Quality is also important: German cars are famous for their quality, so consumers might be willing to pay more for them.

The more productive a country becomes, the lower its unit labour costs. This makes the country more internationally competitive.

The impact of substitution and income effects on an individual's supply of labour

An individual's supply of labour is affected by the income and substitution effect.

- The backward bending labour supply curve can be derived from these effects. When the wage rate passes a certain amount, people choose to take more leisure time, which is a substitution for working longer hours. Therefore, higher wages lead to fewer hours worked. People consume more leisure time and do things which are assumed to maximise their satisfaction, rather than work which is deemed to not be pleasant.
- As incomes rise, people choose to partake in more leisure time because it is deemed more affordable. Leisure is seen as a normal good, so demand for leisure increases as incomes increase.