OCR Economics A-level

Microeconomics

Topic 5: Labour Market

5.3 The Interaction of Labour Markets

Notes

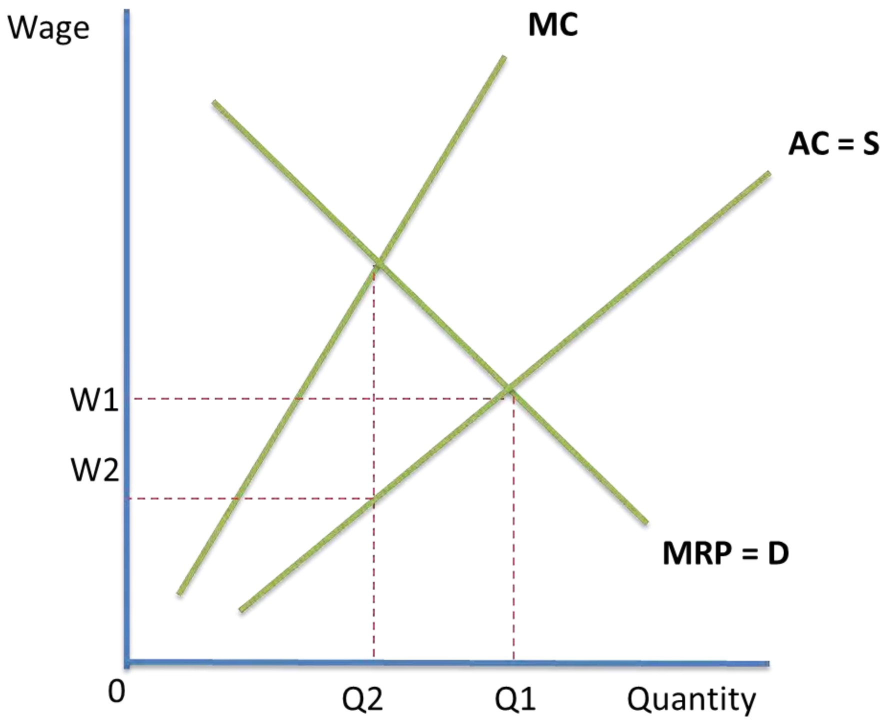
Wage differentials:

Sometimes, even in the same job, workers can be paid different amounts. This is due to:

- **Formal education.** On average, those with a degree earn more over their lifetime than those who gain just A Levels.
- **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.
- **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.
- **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.
- **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.
- **Discrimination.** Workers might be discriminated against due to age, disabilities, gender and race.

How various factors, such as monopsony power, trade unions and imperfect information contribute to imperfections in a labour market

- **Monopsony power:** When there is only one buyer of labour in the market, there is said to be monopsony power. It means the firm has the ability to set wages.



- The marginal cost of adding an extra worker is more than the average cost. This is because in order to employ another employee the firm has to pay all of their workers more.
  - At MC = MRP, the firm profit maximises. This means they employ Q2 workers. This makes the wage W2, lower than the market equilibrium competitive wage. The employment rate and the wage rate are below those that would exist in a perfectly competitive labour market.

Impacts of a Monopsony employer:

Employees are likely to lose out with lower wages. For example, those trained to be coal miners had little choice of who to work for. This meant their labour could be exploited by the employer. However, now this has been offset with the power of trade unions, which are able to negotiate higher wages and good working conditions.

Workers might become unproductive if wages are low.

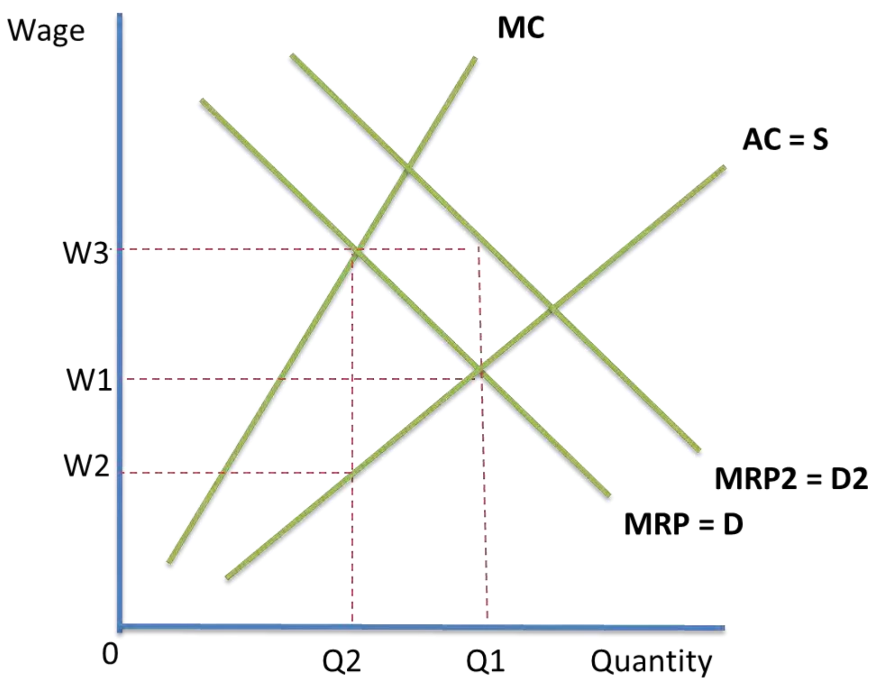
- **Trade union power:** If trade unions are pushing for higher wages above the market equilibrium, the labour market is likely to be more flexible. Trade unions can also increase job security. Higher wages can be demanded by limiting the supply of labour, by closing firms, or by threatening strike action. Higher wages could cause unemployment, however. Trade unions can counter-balance exploitative monopsony power. 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.

Trade unions aim to protect workers, secure jobs, improve working conditions and try and achieve higher wages.

If trade unions try and increase wage rates too much, firms might no longer be able to afford to employ workers. This could cause them to close down or reduce the number of workers they employ. Some workers might prefer a low paid job rather than be without employment.

In a market where an employer has monopsony power, workers are only paid W2, and only Q2 number of workers is employed. This is the profit maximising level.

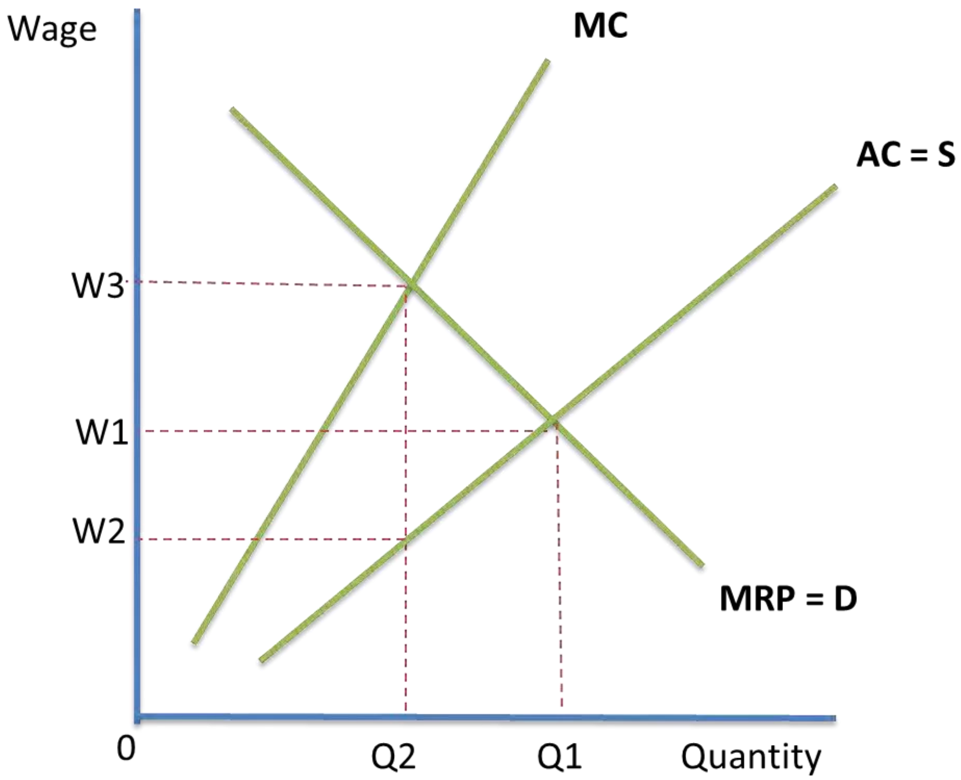
A trade union aims to increase marginal revenue product in the market, as well as increase wages to the level of MRP (W3). This is to stop the exploitation of labour. The perfectly competitive level of employment and wage rate is W1, Q1.



- Changes can take place through individual, collective or productivity bargaining.

- **Imperfect information:** Some qualified workers might not be aware of higher paying jobs in other industries or with other firms. Some workers might not understand the long term benefits of investing in improving their skills and education. This can limit the productivity and potential progression of workers. It makes the market inefficient.

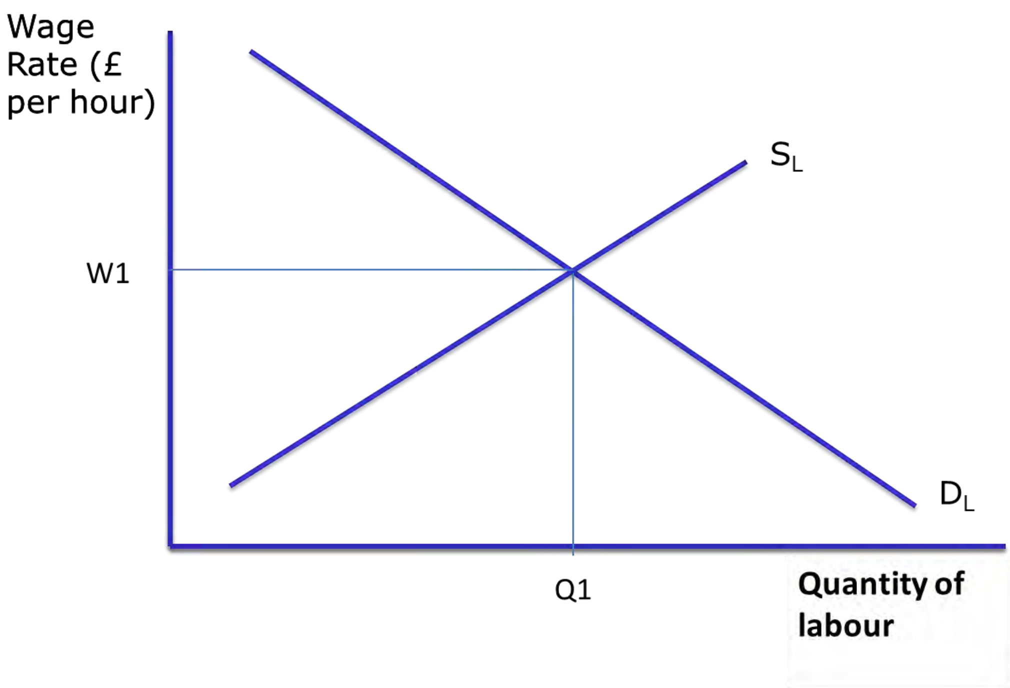
- **Bilateral monopoly:** This is where there is only one buyer and only one supplier. In other words, there is a monopsony and a monopoly in the same market. For example, in the coal mining industry, there is likely to only be one buyer of labour (the coal mine) and one supplier of labour (the trade union).



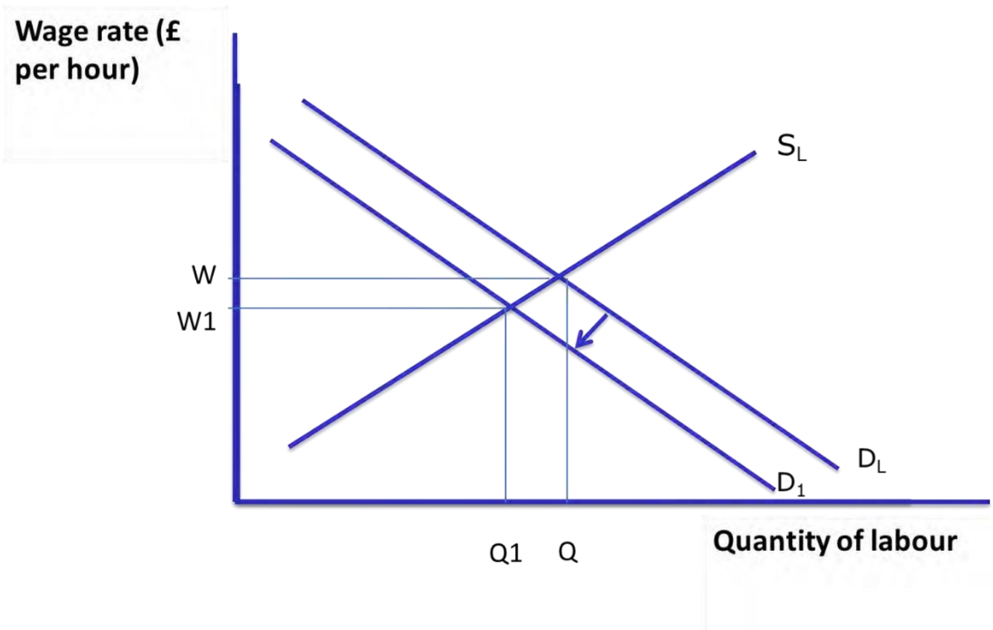
- In a monopsony, the buyer pays a wage of W2 and employs a quantity of Q2. This is where MRP = MC.
- Trade unions try and negotiate a higher wage of W3 without causing the quantity of labour employed to fall.

How wages are determined in a highly competitive market

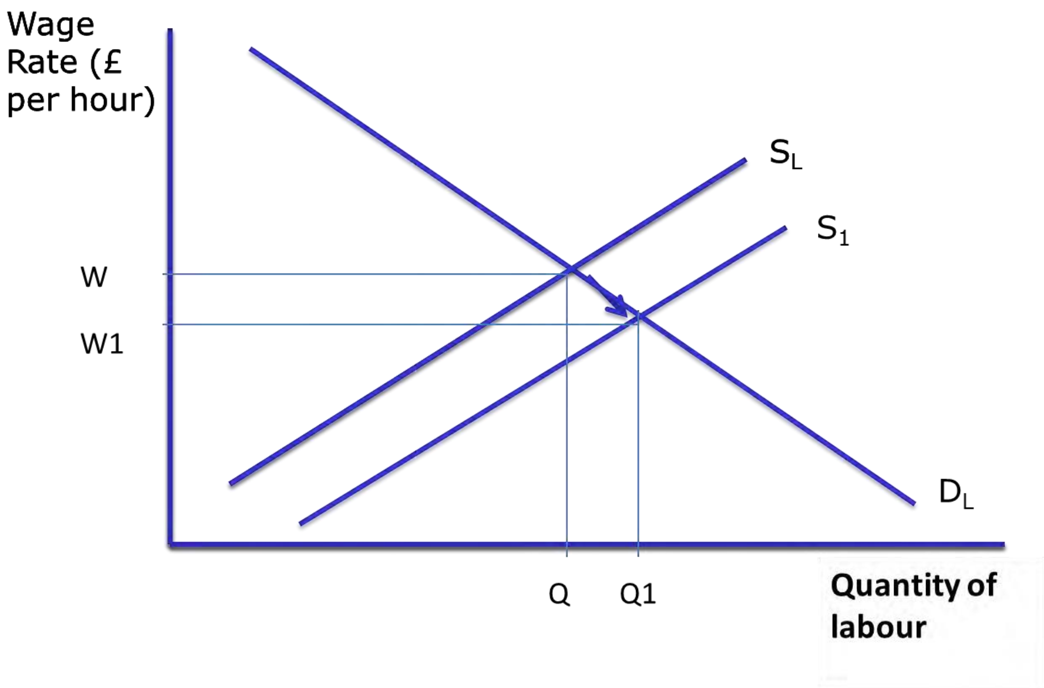
- Labour market equilibrium is determined where the supply of labour and the demand for labour meet. This determines the equilibrium price of labour, i.e. the wage rate.



- When the demand for labour falls, such as during a recession, in a free market the wage rate would fall from W to W1.



- If the supply of labour increases, such as if the retirement age was raised, the wage rate would fall from W to W1.



- However, in the real labour market, wages are not this flexible. Keynes coined the phrase 'sticky wages'. Wages in an economy do not adjust to changes in demand.

The minimum wage makes wages sticky and means that during a recession, rather than lowering wages of several workers, a few workers might be sacked instead.

Labour market flexibility and mobility, and government policies to improve them

- The geographical immobility of labour refers to the obstacles which prevent labour from moving between areas. For example, labour might find it hard to find work due to family and social ties, the financial costs involved with moving, imperfect market knowledge on work and the regional variations in house prices and living costs across the UK.

- The occupational immobility of labour refers to the obstacles which prevent labour from changing their use. For example, labour might find it difficult to change the occupation. This occurred in the UK with the collapse of the mining industry, when workers did not have transferable skills to find other work. The causes include insufficient education, training and skills.

- The flexibility of the labour market is how willing and able labour is to respond to changes in the conditions of the market. It is important for labour to be able to adjust to changes in demand, and it is vital for the supply-side of the economy.

- **Trade union power:** If trade unions are pushing for higher wages, the labour market is likely to be more flexible. Trade unions can also increase job security. If trade unions limit the rights of a worker to strike, there could be a decline in flexibility.

- **Regulation:** The more freedom firms have to hire and fire workers and the more freedom workers have in terms of their rights, the more flexible the labour market. Excessive regulation will limit flexibility.

- **Welfare payments and income tax rates:** The reward for working should be high. If welfare payments are generous and income tax rates are high, labour market flexibility is likely to be lower.

- **Training:** More widely available training opportunities and a more skilled workforce makes the labour market more flexible. The quality and price of education should be improved, so more people can afford a good education.

- **Infrastructure:** Improving infrastructure might help the geographical immobility of labour, since it becomes easier to move around the country.

- **Housing:** If housing became more affordable, then people might be more able to move around the country for work, which improves the geographical mobility of labour.