

# The Labour Market

The Supply and Demand  
for Labour

**NADZIRAH ZAINORDIN**

**MSc QS [Heriot-Watt, UK], BSc (Hons) QS [IUCTT, Msia]**

# The Labour Market

- The labour market is an example of a **factor market**
- **Supply of labour** – those people seeking employment (employees)
- **Demand for labour** – from employers
  - A '**Derived Demand**' – not wanted for its own sake but for what it can contribute to production
  - Demand for labour related to productivity of labour and the level of demand for the product
  - Elasticity of demand for labour related to the elasticity of demand for the product

# The Labour Market

- At higher wage rates the demand for labour will be less than at lower wage rates
- Reason linked to **Marginal Productivity Theory**



The demand for labour is highly dependent on the productivity of the worker – the more the worker adds to revenue, the higher the demand.

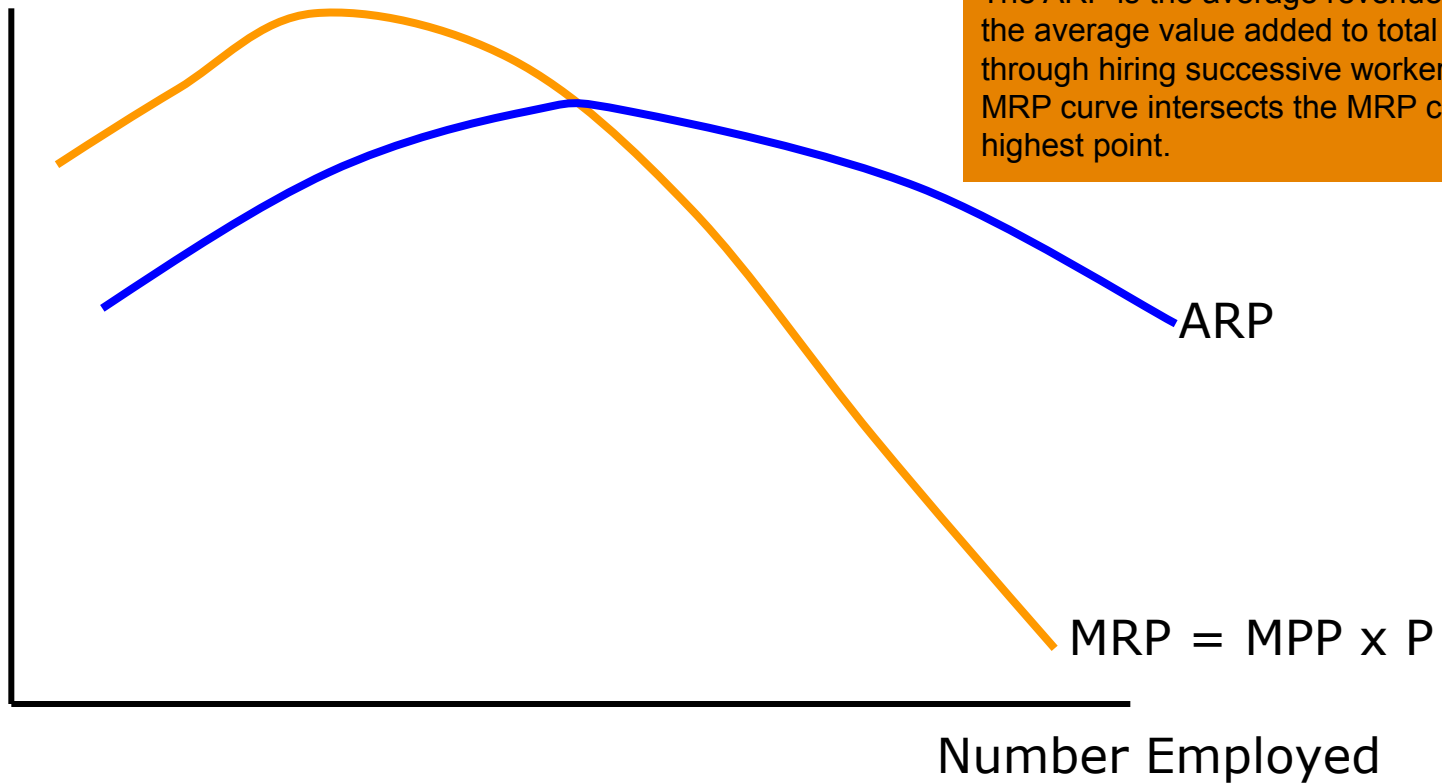
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- **Productivity refers to the amount produced per worker per period of time**
- MRP = the addition to total revenue (TR) received from the sale of an additional unit of output
  - Worker instrumental in producing that output
- **Marginal Physical Product (MPP)** – the addition to total product as a result of the employment of one additional unit of labour
  - **$MRP = MPP \times P$**
- If a good sells for £1.00 and a worker produces 300 per day, the MRP of that unit of labour is £300 per day

# The Labour Market

## Marginal Productivity Theory

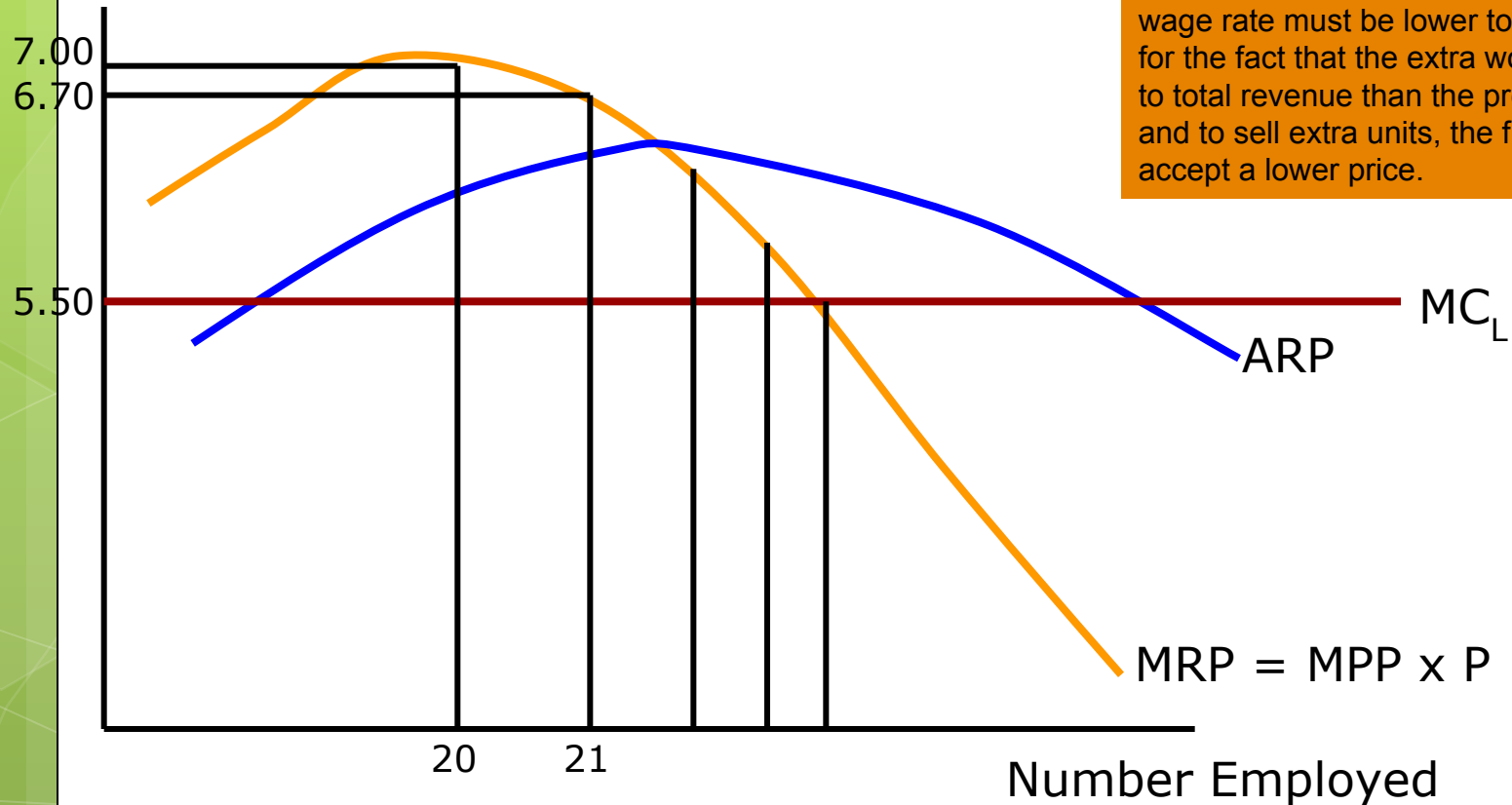
Wage Rate



The law of diminishing returns would cause the MRP curve to intersect the ARP curve at its highest point.

# The Labour Market

Wage Rate (£ per hour)



For the employer to be persuaded to employ additional workers, therefore, the wage rate must be lower to compensate for the fact that the extra worker adds less to total revenue than the previous one and to sell extra units, the firm must accept a lower price.

# The Labour Market

Wage Rate (£ per hour)



There is an inverse relationship between the wage rate and the number of people employed by the firm.

illustrating the derived demand relationship.

# The Labour Market

## □ **The Supply of Labour**

- The amount of people offering their labour at different wage rates.
  - Involves an opportunity cost – work v. leisure
  - Wage rate must be sufficient to overcome the opportunity cost of leisure



# The Labour Market

## □ **Income effect of a rise in wages:**

- As wages rise, people feel better off and therefore may not feel a need to work as many hours

## □ **Substitution effect of a rise in wages:**

- As wages rise, the opportunity cost of leisure rises (the cost of every extra hour taken in leisure rises). As wages rise, the substitution effect may lead to more hours being worked.
- The net effect depends on the relative strength of the income and substitution effects

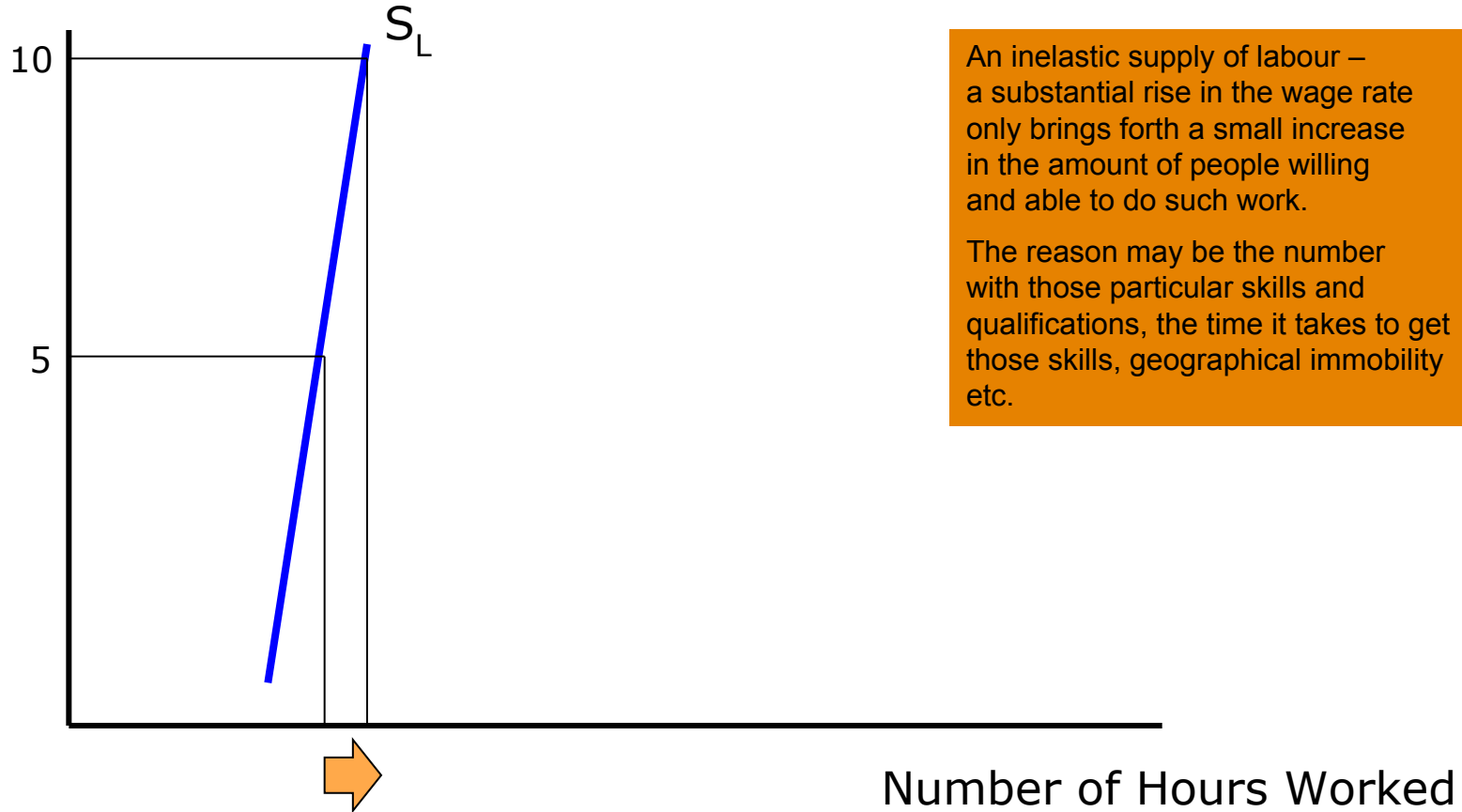
- ## The Labour Market
- The elasticity of supply of labour depends upon:
    - **Geographical mobility of labour:**
      - The willingness of people to move
      - The cost and availability of housing in different areas
      - The extent of social, cultural and family ties
      - The amount of information available to workers about jobs in other areas
      - The cost of re-location
      - Anxiety of the idea of re-location

# The Labour Market

- ▣ **Occupational Mobility of Labour:**
  - ▣ Lack of information of available jobs in other occupations
  - ▣ Extent and quality of remuneration packages
  - ▣ Extent of skills and qualifications to do the job
  - ▣ Anxiety at changing jobs

# The Labour Market

Wage Rate (£ per hour)



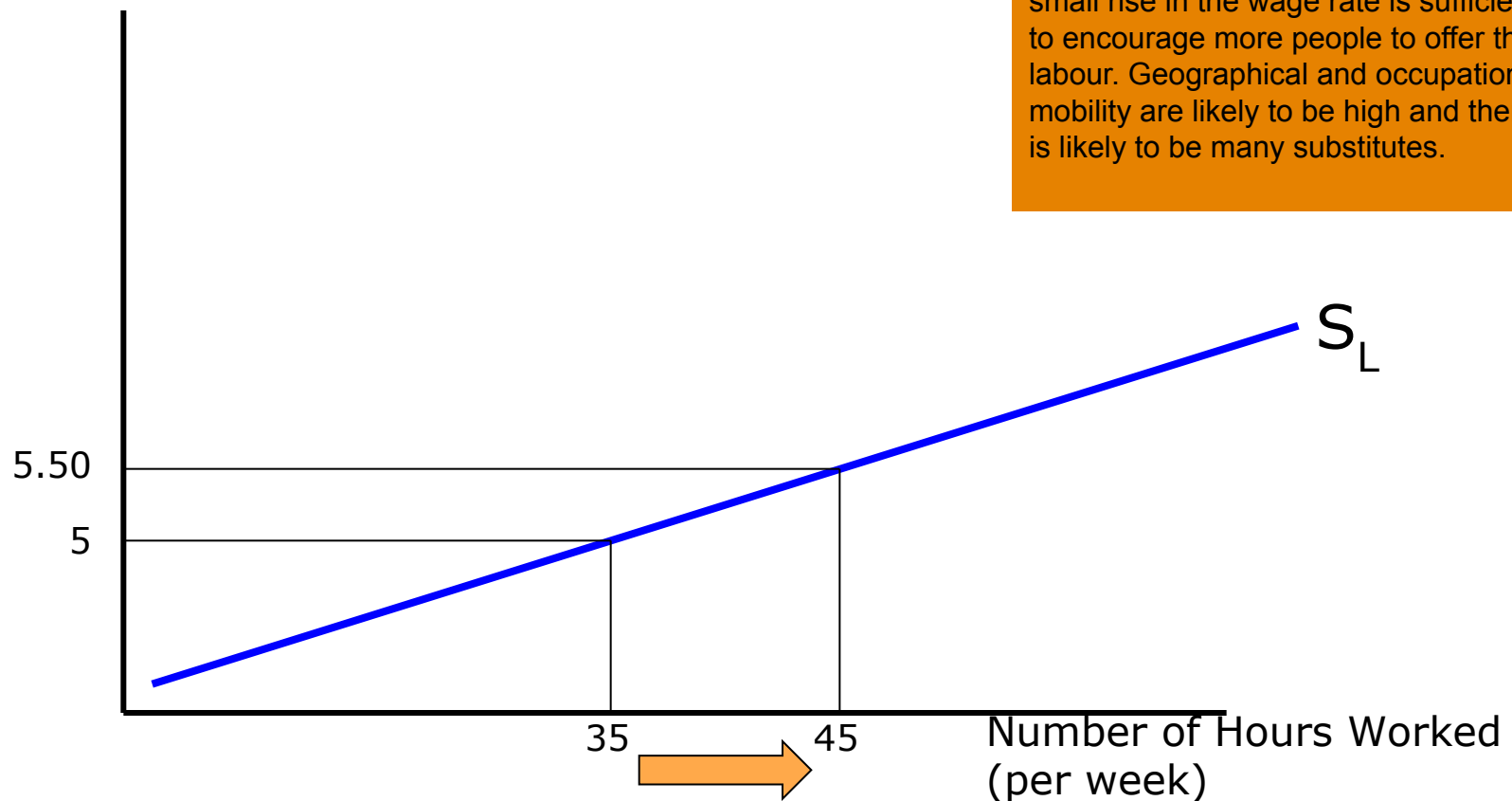
An inelastic supply of labour – a substantial rise in the wage rate only brings forth a small increase in the amount of people willing and able to do such work.

The reason may be the number with those particular skills and qualifications, the time it takes to get those skills, geographical immobility etc.

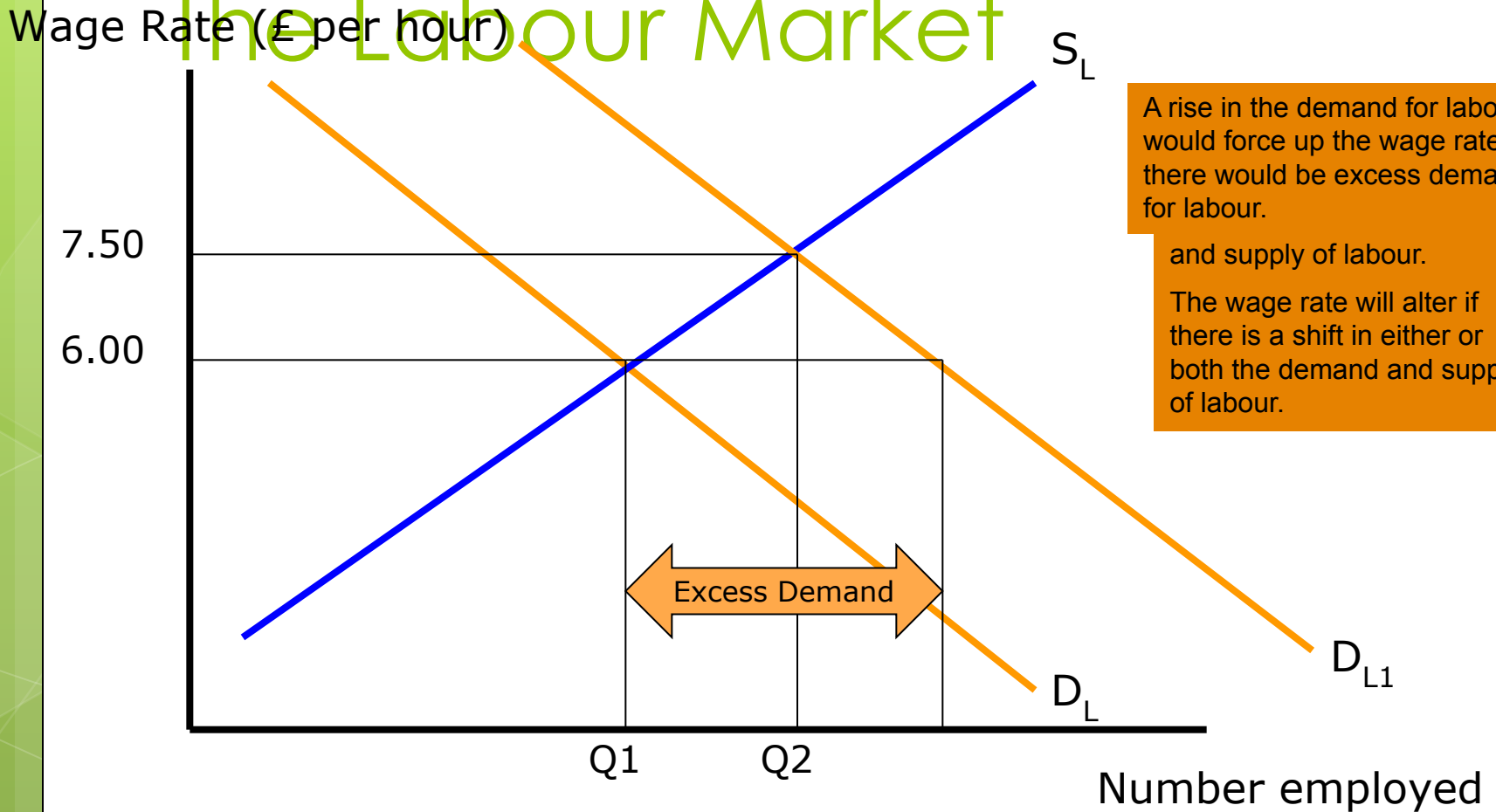
# The Labour Market

Wage Rate (£ per hour)

If the supply of labour is elastic, a small rise in the wage rate is sufficient to encourage more people to offer their labour. Geographical and occupational mobility are likely to be high and there is likely to be many substitutes.



# The Labour Market



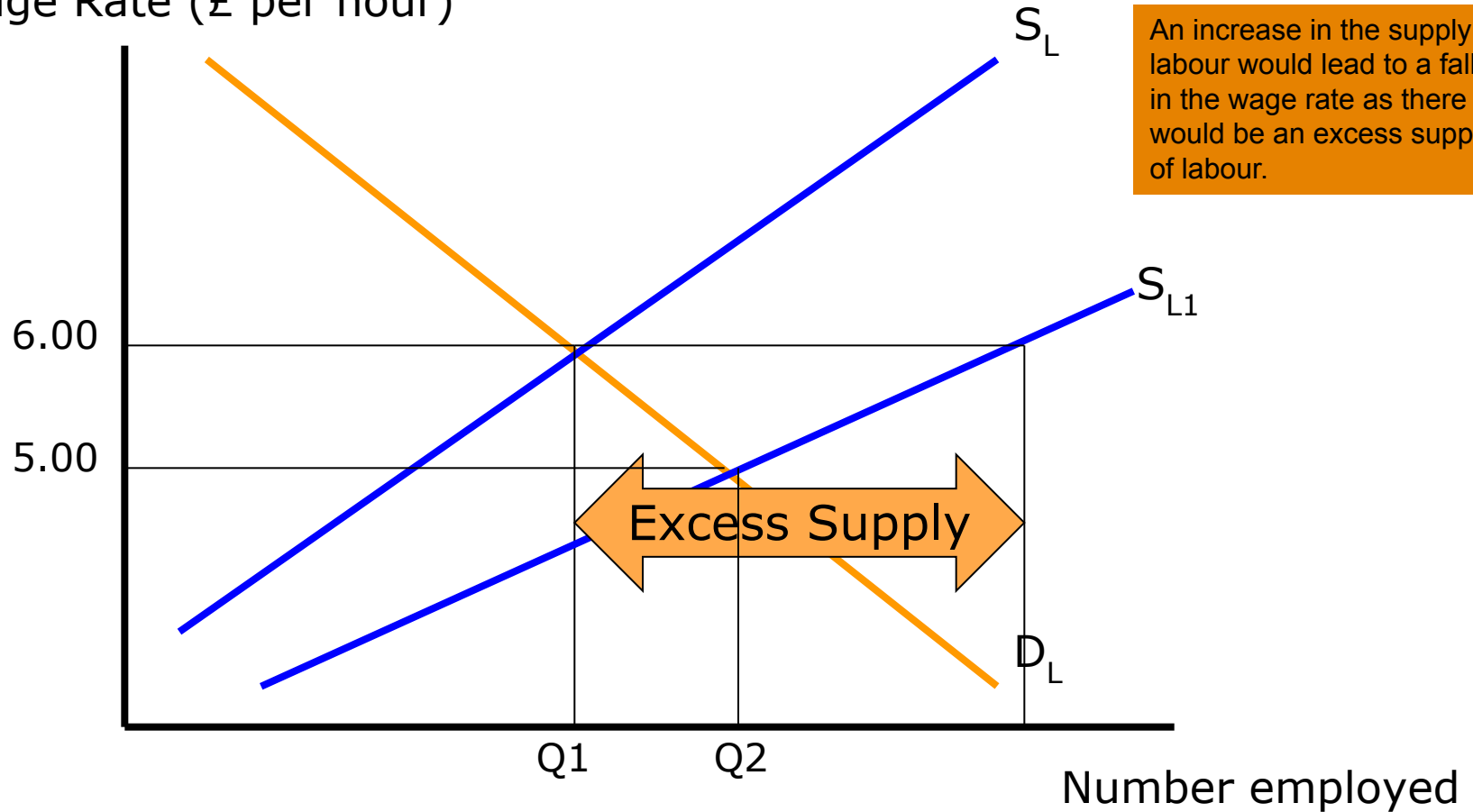
A rise in the demand for labour would force up the wage rate as there would be excess demand for labour.

and supply of labour.

The wage rate will alter if there is a shift in either or both the demand and supply of labour.

# The Labour Market

Wage Rate (£ per hour)



An increase in the supply of labour would lead to a fall in the wage rate as there would be an excess supply of labour.

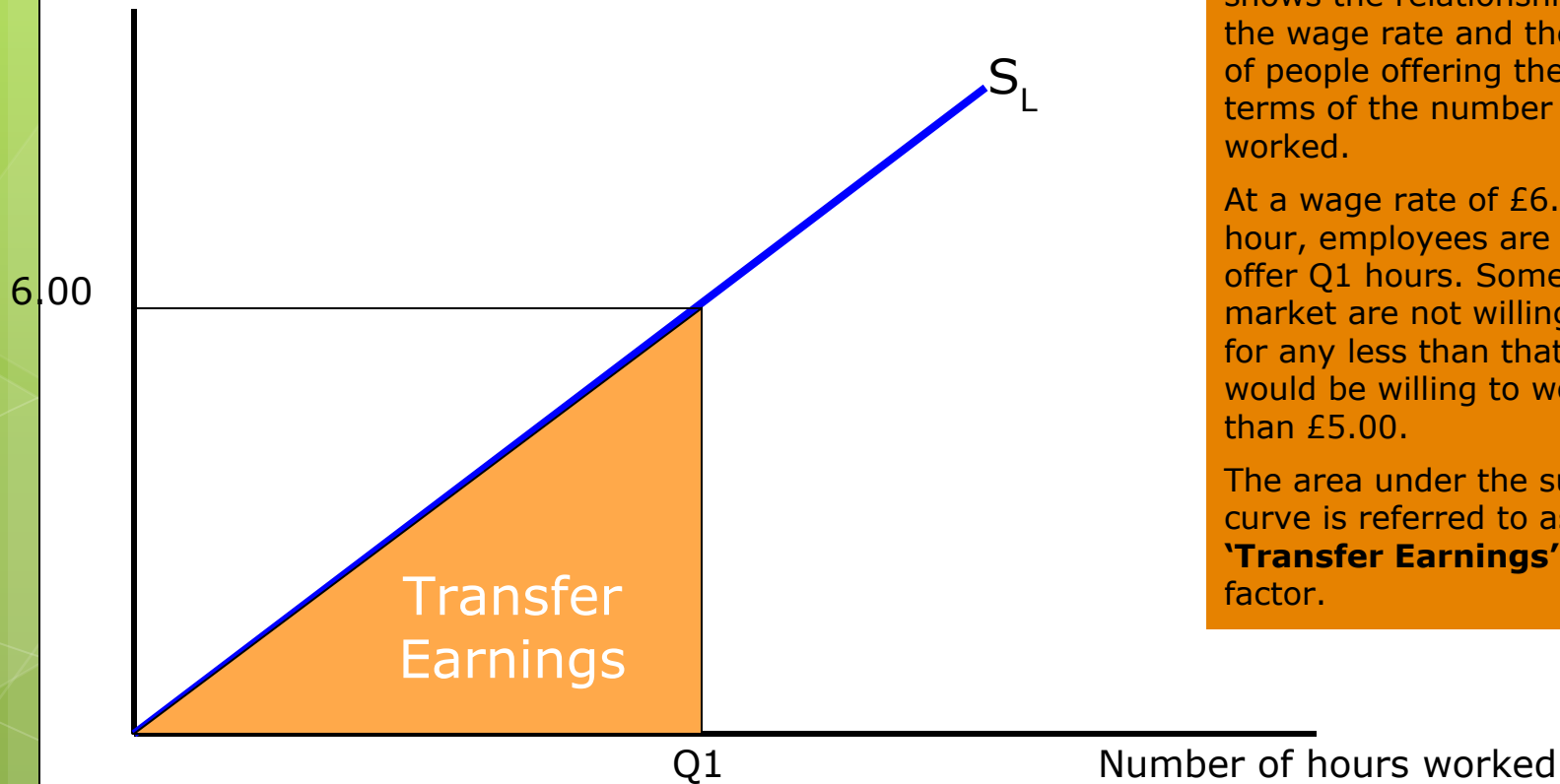
# The Labour Market

- **Economic Rent** The value of the wage earned over and above that necessary to keep a factor in its current employment



# Economic Rent

Wage Rate (£ per hour)



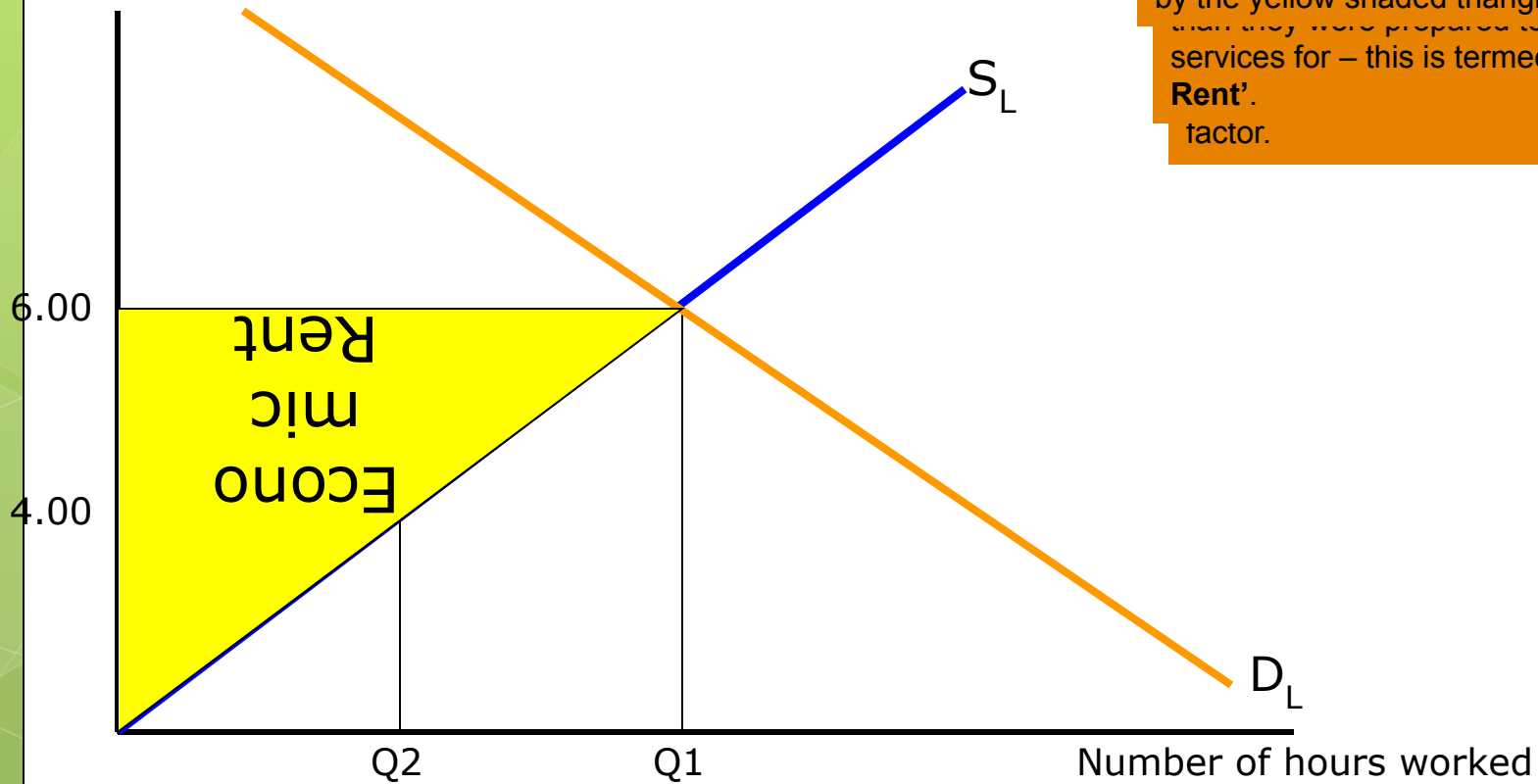
The supply of labour curve shows the relationship between the wage rate and the number of people offering their labour in terms of the number of hours worked.

At a wage rate of £6.00 per hour, employees are willing to offer  $Q_1$  hours. Some in the market are not willing to work for any less than that and some would be willing to work for less than £5.00.

The area under the supply curve is referred to as the '**Transfer Earnings**' of the factor.

# Economic Rent

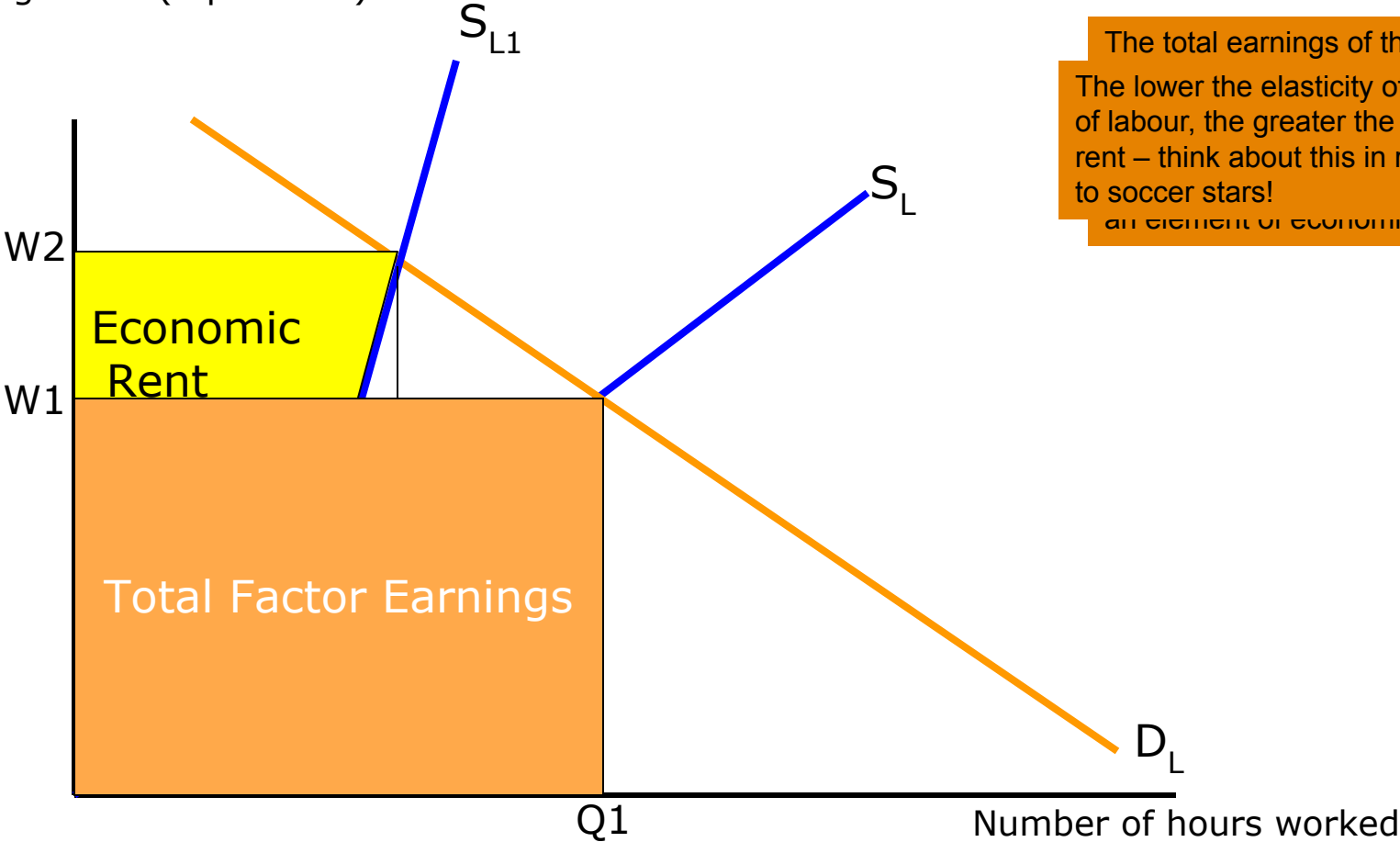
Wage Rate (£ per hour)



The total value of economic rent is shown by the yellow shaded triangle. This represents the value of the labor factor that they were prepared to offer their services for – this is termed '**Economic Rent**'.

# Economic Rent

Wage Rate (£ per hour)



The total earnings of the factor is  
The lower the elasticity of supply  
of labour, the greater the economic  
rent – think about this in relation  
to soccer stars!  
an element of economic rent.