OCR – A Level Economics

Component 1 – Microeconomics

5. The labour market

Revision Notes

Contents

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5.1 Demand for labour

Factors that influence the demand for labour

- The **labour market** is where jobs are bought and sold just like a real marketplace.
    - **Households** (aka people) are the **sellers of labour** — they offer their time and skills.
    - **Firms** (businesses) are the **buyers of labour** — they hire people to get work done.

Think of it like this: **You** (the worker) bring your skills to the job market like selling lemonade, and **companies** want to buy that lemonade to run their business smoothly.

The **demand for labour** is what economists call **derived demand**.
This means that businesses don't just want workers for the fun of it, they want them because of something else.

So, what does it depend on?

➡️ The demand for labour depends on the demand for the **product or service** that workers help produce.

For example:
If there's a sudden craze for bubble tea, then bubble tea shops will need more workers to blend, serve, and sell those tasty drinks. So, demand for labour increases.
But if bubble tea goes out of style? Shops may reduce staff because demand drops.

In short:

- No customers = no sales = less need for workers
- Lots of customers = more sales = businesses hire more people

🛍️ It's all connected: people buy stuff → businesses grow → more jobs.

5.1 Demand for labour

Marginal productivity theory

Ever wondered how businesses decide how many people to hire or what to pay them? It all comes down to how useful each worker is. Economists call this **Marginal Productivity Theory**.

🧠 **Two Key Concepts**

1. Marginal Physical Product of Labour (MPPL)
This is the **extra stuff** a worker helps produce when they join the team.

📦 *Example:* If hiring another warehouse worker helps ship **30 more packages** a day, their MPPL is 30.
But as more people cram into the warehouse, each one might get less done.
That's called the **law of diminishing returns**.

Formula:
MPPL = Change in output ÷ Change in workers

2. Marginal Revenue Product of Labour (MRPL)
This is the **extra money** the business makes from the extra output that one new worker creates. In a perfectly competitive market (where everyone charges the same price), the formula is:
MRPL = MPPL × Price of product

🤔 **Should They Hire?**

Let's say you're a **bike courier**. You can make **6 extra deliveries a day**, and each one earns the company **£10**.
That means your **MRPL = 6 × £10 = £60**.

The company will only hire you if your **wage is £60 or less**. Why? Because they don't want to lose money.
That's how firms decide who to hire, **if the value you bring is higher than what you cost, you're in.**

📌 **Summary:**

- **MPPL** = How much more stuff a worker produces
- **MRPL** = How much more money the firm makes from that extra stuff
- Firms hire if: **MRPL ≥ wage**

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5.1 Demand for labour

Demand curve for labour

Ever wonder why companies don't just hire everyone at any wage? The answer lies in **Marginal Productivity Theory**.

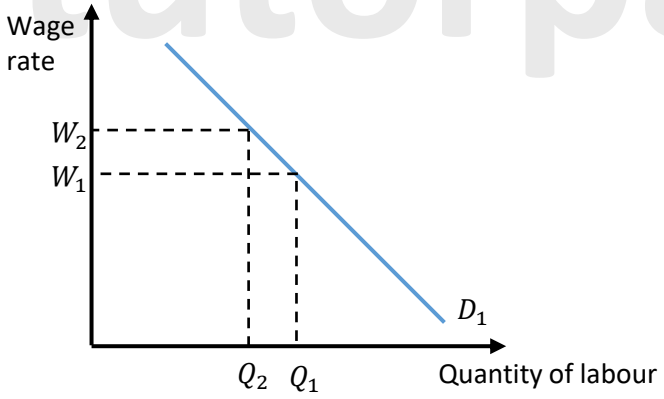
🔍 **What's That?**

Marginal Productivity Theory says:
The more you pay someone, the less likely businesses are to hire more people — unless those extra workers bring in enough extra value.

So, there's an **inverse relationship** between:

👉 **Wage rate** (how much workers are paid)
👉 **Labour demanded** (how many workers firms want)

In short: Higher wages = fewer workers hired. Lower wages = more workers hired.



5.1 Demand for labour

Demand curve for labour

📊 **What's Happening in the Diagram?**

The line you see is the **demand curve for labour**. It's sloping downwards because...

- When wages are low (W_1), firms are happy to hire more workers (Q_1).
- But if wages rise to W_2, firms can't afford as many workers — so they hire fewer (Q_2).

📉 **Why does the demand for labour slope downward?**

There are two big reasons:

1. **In the long run**, businesses can switch things up, if wages go up a lot, firms might start using **machines instead of people** (because it's cheaper).
   Example: A warehouse might buy a robot arm instead of hiring more workers.

2. **In the short run**, firms can't always change their setup (like factory size or machines). So, if extra workers don't produce enough extra value (because of diminishing returns), the only way to afford them is by **offering lower wages**.

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5.1 Demand for labour

The causes of shifts in the demand curve for labour

What Affects the Demand for Labour?

1. The Price of the Product Being Made

- When the **price of the product** (like burgers, cars, or sneakers) goes **up**, the **marginal revenue product of labour** (MRPL) increases.

MRPL = the extra money a worker helps bring in. More money = more reason to hire!

- Businesses love higher prices because it means more profit, so they'll want to make more of that product. And to make more, they need more hands-on deck = **more demand for labour**.

Example: If the price of luxury watches rises, watchmakers might hire more workers to meet the demand.

2. The Demand for the Final Product

- Demand for labour is a **derived demand;** this means firms only want workers if people want the product.
- If the economy is booming and people are spending (say, on takeaways or tech), then businesses need more workers.
- But in a **recession** (when the economy shrinks), people spend less, so businesses scale back, meaning **less demand for labour**.

Example: More demand for coffee = more baristas needed. But during a downturn, café staff might be cut.

5.1 Demand for labour

The causes of shifts in the demand curve for labour

3. Wage Rates (AKA: How much you're getting paid)

A **wage** is just the price of labour; its what workers earn. If wages go **up**, it becomes **more expensive** for firms to hire people. So, unless workers bring in **more value** than they cost (again **MRP**), firms won't hire as many.

Example: If a café has to pay baristas £20/hour, but they only generate £18/hour in sales, that's not worth it for the café.

4. Technology

Tech is a game-changer. As machines, software, and AI become smarter, some jobs disappear, but new ones also appear.

Example: Cashiers might be replaced by self-service checkouts, but IT support staff may be in higher demand as companies go more digital.

5. Government Rules (Regulation)

If there are loads of **rules and paperwork** around hiring, it might put businesses off. For example, strict laws about firing staff or costly legal requirements can **reduce the demand for labour**.

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5.1 Demand for labour

Elasticity of demand for labour (how firms react)

Elasticity of demand for labour basically looks at **how much bosses react** when wages change.

- If the demand for labour is **elastic**, a **small rise in wages** will cause a **big drop** in the number of workers businesses want to hire.
    - Imagine a café that can easily replace waiters with self-serve screens. If wages go up, the boss might sack a few waiters and just install machines.
- If the demand is **inelastic**, even if wages rise, bosses will **still need** workers nearly as much.
    - Think of brain surgeons. Even if you have to pay them more, you cannot exactly replace them with robots.

In short:

- If demand is elastic: firms hire more when wages fall, and fire quickly when wages rise.
- If demand is inelastic: firms barely change how many workers they need, even if wages rise or fall.

5.1 Demand for labour

Elasticity of demand for labour (how firms react)

What Makes Labour Demand Elastic or Inelastic?

- First, it depends on how important wages are to a business. If wages are a **huge part of total costs** (like in fast food chains), demand for workers will be very elastic and bosses react fast to wage changes. If labour costs are only a small part (like in tech companies that rely more on machines), the demand for workers is more inelastic.
- Second, it matters how easy it is to **replace workers with machines**. In big warehouses, if wages rise, companies like Amazon can quickly replace pickers with robots. That makes demand for workers elastic. But in industries like education, you can't replace teachers with machines easily, so, the demand stays inelastic.
- Third, it's about **what you are selling**. If businesses sell things like luxury handbags, and people stop buying them when prices rise, firms will react strongly to wage increases by cutting staff. But if they sell essentials like electricity, they can just pass the extra cost to customers and keep the same workers.
- Finally, **time matters**. In the short run, it's harder for firms to change how they work, so demand for workers is usually inelastic. But over time, they might invest in new technologies or move production, making demand more elastic in the long run.

5.2 Supply of labour

Monetary and non-monetary considerations

When people pick a job, it's not just about the paycheck. Their decision is shaped by both **monetary factors** (the money they'll earn) and **non-monetary factors** (how the job fits their life, goals, and values).

💰 Monetary Factors

These are the **financial rewards** you get from a job whether it's hourly pay, yearly salary, or extra perks.

1. Wages

This is pay per hour. The more hours you work, the more you earn.
Example: A student tutoring maths at £12/hour for 5 hours a day, 5 days a week would make £300/week (5×5×£12).

2. Salary

A fixed annual payment, often paid monthly or biweekly. Salary is stable, even if work hours vary.
Example: An office worker earns £36,000 a year, split into £3,000/month.

3. Flexible Earnings (Commission & Bonuses)

Earnings increase based on what you achieve.
Example: A travel agent might earn 8% commission per holiday sold. Sell more, earn more.

4. Stock or Share Options: Some companies offer a slice of ownership—giving employees shares.
Example: A startup might give its team equity that grows in value as the company grows.

5. Job Benefits: These are **non-cash extras** that still have real value.
Example: A tech company might offer free lunches, dental insurance, or a gym membership.

5.2 Supply of labour

Monetary and non-monetary considerations

💡 Non-Monetary Factors (More Than Just Money)

Sometimes, what makes a job attractive isn't the money, it's everything else around it.

1. Job Satisfaction: Enjoying the work itself makes people stay.
Example: Someone working at an animal shelter might earn less but feels happier helping animals.

2. Work-Life Balance: Flexible jobs can be more appealing.
Example: Remote roles or jobs with 4-day weeks attract people wanting more family or personal time.

3. Career Prospects: Chances to grow, get promoted, and earn more.
Example: An entry-level accountant might stick around knowing they can become a finance manager.

4. Location & Commute Time: People prefer jobs closer to home or with shorter travel.
Example: A parent might pick a nearby job to be home in time for school pickup.

5. Education or Training Required: The more training a job needs, the fewer people apply.
Example: Becoming a vet takes years of university—fewer people can or want to commit to that.

6. Job Security: How stable and long-term the job is.
Example: A permanent schoolteacher job is more secure than a 6-month retail contract.

7. Status or Prestige: Jobs with social respect can be motivating.
Example: Becoming a judge or surgeon may offer pride beyond pay.

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5.2 Supply of labour

Supply curve for labour

The **labour supply curve** shows how many people are willing to work at different wage levels.

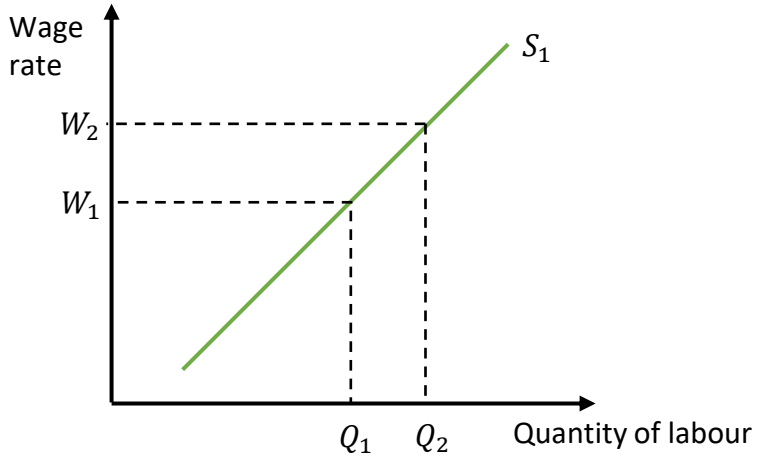
Put simply:
👩‍💰 The **higher** the wage,
💰 the **more** people want to work in that job.
So, the supply curve slopes **upwards**.

🔍 **Why Does It Slope Up?**

Let's say wages in dog grooming go from £9/hour to £14/hour. Suddenly, more people who were working part-time or in other roles might switch to grooming because it now pays better. That's the key idea.

This creates a **positive relationship** between:

- the **wage rate** (how much you're paid per hour) and
- the **quantity of labour supplied** (how many people want to work).



5.2 Supply of labour

Supply curve for labour

📊 **Diagram Breakdown – What It Shows**

- The curve goes **upwards**, showing that as the wage rate rises (from W_1 to W_2), more people want to work (from Q_1 to Q_2).
- So, higher wages = more people entering or staying in that job.

5.2 Supply of labour

The causes of shifts in the supply curve

The **supply of labour** is all about how **willing and able** people are to work at different wage rates. It's not just about money, it's also about lifestyle, job satisfaction, training, and even where your friends live.

1. Wages

Wages are basically the *price of labour*. As wages go up, more people want to work but only up to a point.
Imagine being offered £15/hour, you'd be tempted to take extra shifts. But at £150/hour, you might work *less* and take longer holidays. That's called a **backward-bending supply curve.**

In most jobs, higher wages = more workers from other industries or unemployed people joining in.

2. Training Time

Long training = fewer people applying.
If it takes years to qualify for a job (like a pilot or surgeon), fewer people will want to or be able to go for it. It's like a long obstacle course before you can even start earning.

3. Population and Age

More people = more potential workers. But age matters too. If most of the population is under 18 or retired, there won't be many available to work.

Migration plays a role, for example, if many skilled workers move to the UK, the supply of labour goes up.

5.2 Supply of labour

The causes of shifts in the supply curve

4. Trade Unions & Barriers to Entry

Trade unions can protect workers, but they might also **limit who can join certain professions**.

Example: You need a degree and teacher training to become a teacher, not everyone can just walk in and start teaching maths.

5. Working Conditions

Happy jobs = more people apply.
Laid-back workplaces with fun perks (like Google offering free food and games) attract lots of people. If a job offers flexible hours, wellness programs, and a good work-life balance, the supply of labour tends to rise.

7. Government Rules (Legislation)

The government can change the game with new rules.

Example: If the retirement age is increased from 65 to 68, more older people stay in work = higher supply of labour.
Or if students can leave school earlier, they might start working sooner.

8. Social Trends

What's happening in society matters.
Trends like remote work or changes in safety perceptions (like after COVID-19) can shift the labour market. For example, many people didn't return to hospitality jobs after lockdowns because they found more stable or flexible work elsewhere.

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5.2 Supply of labour

Elasticity of the supply of labour

Definition:
Elasticity of labour supply is about how responsive the number of workers willing to work is when wages change.

In other words: if wages go up, do lots of people rush to apply, or do only a few?

🔑 **Factors that affect it:**

- **Skills of the workforce** 🎓
  - Skilled jobs (like doctors 👩‍⚕️ or engineers 👷) usually have **low elasticity**. Even if wages rise, not many extra people can jump in, because few have the training.
  - Unskilled jobs (like retail assistants 🛒) tend to have **higher elasticity**. If pay rises, more people can apply since little training is needed.
- **Length of training** ⏳
  - The longer it takes to qualify for a job, the **lower** the elasticity.
  - Example: If wages for brain surgeons suddenly doubled, you wouldn't get lots of new surgeons overnight; it takes years of study.
- **Sense of vocation** ❤️
  - Some jobs are done for reasons beyond money, like teaching 👩‍🏫, nursing 🏥, or charity work. These tend to have **inelastic supply**, because people do them out of passion or duty, not just wages.
- **Time period** ⏱️
  - In the **short run**, labour supply is usually inelastic because people can't retrain or switch jobs instantly.
  - In the **long run**, supply becomes more elastic; people can retrain, move cities, or change careers if wages are attractive.

5.2 Supply of labour

Economic rent and transfer earnings

1. Transfer earnings
Definition: The *minimum reward* (or wage) needed to keep a worker in their current job.
Think of it as the "don't quit" wage. If you earn at least this, you'll stay; if not, you might leave.

Example: A teacher 👩‍🏫 might need at least £30,000 a year to stay in teaching. That £30,000 is their transfer earnings.

2. When supply is perfectly elastic (flat line)
If wages are the same across the board (like minimum wage jobs 🍔🛒), what workers get = just their transfer earnings. There's no "extra bonus" above what's needed to keep them in the job.

3. When supply is upward sloping (most jobs)
Here, wages are made up of **two parts**:

- **Transfer earnings** → the minimum needed to keep someone in the job.
- **Economic rent** → any extra income earned *on top* of that.

✨ Example: Imagine a footballer ⚽ who would happily play for £100k a year, but clubs bid up to £5m for him. His transfer earnings are £100k, but his economic rent is a huge £4.9m.

4. Economic rent
Definition: Any income a worker earns *above* their transfer earnings.
Basically, it's the bonus pay for being in demand, unique, or hard to replace.

Example: A famous singer 🎤 might only need £40k a year to keep performing but earns £1m from concerts. The £40k = transfer earnings, while £960k = economic rent.

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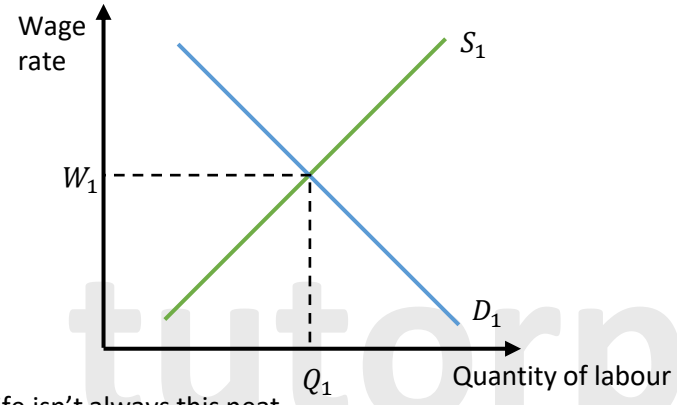
5.3 The interaction of labour markets

Economists' model of wage determination

In a **perfectly competitive labour market**, wages (pay per hour or job) are decided where the number of people **wanting to work** (supply) equals the number of workers that **businesses need** (demand). This is where:

Demand for Labour (DL) = Supply of Labour (SL)



But real life isn't always this neat...

Not All Workers Are the Same!

In theory, perfect competition assumes that:

- Every worker has the **same skills**
- Everyone gets paid the **same wage**

In reality, though:

- Some are trained chefs, others are IT experts.
- Some people want money; others care more about work/life balance.

So, what happens when there's too much or too little labour for a certain job?

5.3 The interaction of labour markets

Economists' model of wage determination

When There Aren't Enough Workers (Excess Demand)

If there's a **shortage of workers** for a job, employers start **offering higher wages** to attract more people.

Example:
If too few plumbers are available in a town, local companies might raise the hourly rate from £15 to £25 to bring more plumbers in.

That higher pay makes it more attractive, so more people start training or applying to become plumbers.
This **increases the supply of labour** for that job.

When There Are Too Many Workers (Excess Supply)

If there are **too many people** wanting a certain job, businesses don't need to pay as much.

Example:
Let's say 100 people apply for one barista role. Cafés may lower the hourly wage from £12 to £9 since they have a surplus of applicants.

This lower wage might cause some people to switch industries, Work fewer hours or leave the job market for that role entirely

So, the **supply of labour falls** until things even out again.

Back to Balance: Labour Market Equilibrium

The labour market eventually settles at a point where:

- There's **no shortage** of workers (no excess demand)
- There's **no surplus** of workers (no excess supply)

At this point, wage rates are stable, and supply equals demand.

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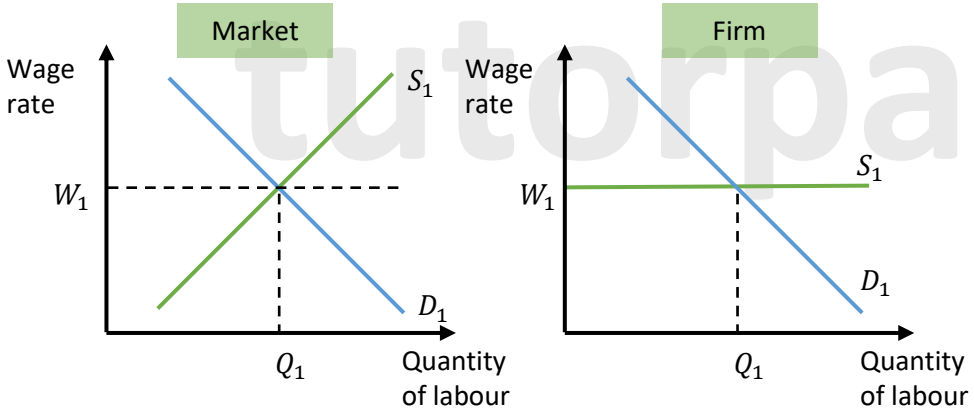
5.3 The interaction of labour markets

Economists' model of wage determination

In a **perfectly competitive labour market**, no single firm can set wages; they're all **price takers**. That means the wage is determined by the entire market, and individual businesses just go along with it.

This type of labour market is part of a **factor market**, which means:

- Workers are the "factors" being bought and sold (labour in this case)
- Prices (wages) are influenced by **supply and demand**
- It's similar to how goods are bought and sold, just with people instead of products



5.3 The interaction of labour markets

Economists' model of wage determination

📈 **Diagram Breakdown: The Market vs The Firm**

🔶 **In the labour market (left graph):**

- The **demand for labour (D1)** comes from firms — they want workers.
- The **supply of labour (S1)** comes from people — they want jobs.
- Where D1 meets S1 is where the **equilibrium wage (W1)** is set. At this point, the **quantity of labour (Q1)** balances and there's no surplus or shortage.

🔷 **For an individual firm (right graph):**

- The firm can hire as many workers as it wants **at the market wage (W1)** and it can't pay more or less.
- The labour supply is **perfectly elastic** at this wage, meaning any change up or down will lose or gain a lot of workers fast.

💡 **Let's Make It Real:**

Imagine you own a bakery and you need bakers. The market wage for bakers is £12/hour. If you offer £10/hour, no one will apply because other bakeries are paying £12. But if you offer £14/hour, every baker in town will be lining up at your door.

So, you hire based on:

- **Wage rate** = £12 (set by the market)
- **How many bakers you need** = depends on how many loaves of bread you want to sell

The **demand** for workers depends on what they can produce and the money you make from it. This is called the **Marginal Revenue Product of Labour (MRPL)**.

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5.3 The interaction of labour markets

Wage differentials

Wage differentials = the differences in pay between workers, even if they are in similar jobs or industries.
These differences exist for lots of reasons:

🎓 **1. Formal Education**

The more education you have, the more you're likely to earn over your lifetime.

- Example: A doctor 👩‍⚕️ with a medical degree will earn more than someone who left school after GCSEs because of the years of study and specialist knowledge.

🛠️ **2. Skills, Qualifications & Training**

Jobs that require specialist training usually pay more. Why? Because firms don't have to pay to train you from scratch.

- Example: A qualified electrician ⚡ can demand higher wages than someone who just started as a trainee, since they're already skilled.

💡 **3. Wages & Skills**

Skilled workers are usually more productive (they produce more output in the same time), so firms are willing to pay them more.

- Example: A skilled carpenter 🪑 who can craft 10 chairs a day will earn more than an unskilled worker who struggles to build one.

5.3 The interaction of labour markets

Wage differentials

📈 **4. Pay Gaps (Skilled vs Unskilled)**

The gap between skilled and unskilled workers has grown in places like the UK. This is linked to **globalisation** (jobs moving overseas) and **technology** (machines replacing low-skilled work).

- Example: A software engineer 💻 is likely to earn far more than a factory worker because coding skills are scarce and in high demand.

🚻 **5. Gender**

Even today, women on average earn less than men, despite equal pay laws. This could be due to:

- Career breaks (e.g., maternity leave 👶)
- Working fewer hours
- Being concentrated in lower-paid jobs
- Barriers to promotion (a "glass ceiling").

⚠️ The gender pay gap is shrinking, but it's still there in many industries.

🚫 **6. Discrimination**

Sometimes wages differ because of unfair treatment based on **age, race, gender, or disability**. This is illegal in many countries, but unfortunately, it can still happen.

- Example: Two workers with the same skills and experience might get different pay if one is discriminated against due to their background.

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Factors that contribute to imperfections in a labour market

Let's be real, labour markets are not perfect. Economists have this idea of a *perfectly competitive labour market*, but it only exists in theory. In the real world, **all labour markets have some level of imperfection**.

These imperfections are what make wages and employment levels different from what we'd expect in a perfect world.

🚦 **Main Reasons for Imperfections in the Labour Market**

1. Monopsony Power

A monopsony is when there's only one big employer in a market.
That employer has the power to decide how many people to hire and what wages to offer; kind of like being the only shop in town.

- **Why it's a problem:** Workers have fewer choices, so the employer can offer lower wages.
- **What could happen:** Unhappy workers, strikes, or even people leaving the profession.

Example: A mining town where only one company offers jobs. If you want work, that's your only option.

2. Trade Unions

A trade union is a group of workers who come together to stand up for better pay, working conditions, and rights.

- **What they do:** Negotiate with employers (this is called **collective bargaining**) to get better deals for workers.
- **How it affects wages:** Unions can push wages higher than what a free market would normally pay.

Example: A teachers' union fighting for better pay and smaller class sizes.

5.3 The interaction of labour markets

Factors that contribute to imperfections in a labour market

3. Imperfect Information

This happens when people don't have all the facts they need to make good decisions.

- **For workers:** They might not know what jobs are out there or how much they should be paid.
- **For employers:** They might not understand a worker's true skill level or value.
- **What it leads to:** Bad job matches, **wage discrimination**, and unfair pay (some people get paid more or less than they should).

Example: A highly skilled person takes a low-paying job because they didn't know better jobs existed.

📌 **The Big Picture**

- Wages aren't always based on how much value a worker adds (what economists call **Marginal Revenue Product**).
- Employers and workers can both influence pay.
- The less competition there is for jobs, the more control employers have over what people earn.

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5.3 The interaction of labour markets

Monopsony labour market

Monopsony = A market where there's only **one buyer** of labour (aka one big employer). Because workers have no alternative, that employer has a lot of control.

💼 **How Monopsony Power Impacts Wages and Jobs**

Here's the deal:

- In a monopsony, **one employer sets the wages**. Everyone gets the same offer, and there's little room to negotiate.
- Since workers don't have many options, the employer has **market power**. That means they decide both:
  - How many people to hire
  - What wage to offer

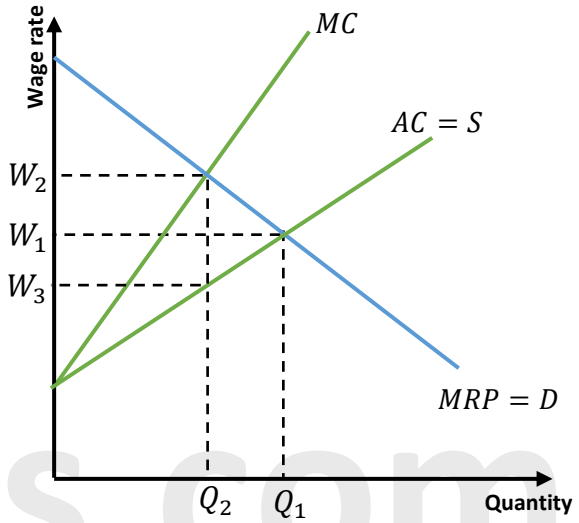
📉 **Understanding the Costs: Two Key Terms**

- **Average Cost of Labour (AC)**
  This is basically the **wage per worker**—what you'd normally think of as a salary.
- **Marginal Cost of Labour (MC)**
  This is the **extra cost** of hiring **one more worker**.
  But here's the twist: to get one extra worker, the employer often has to raise wages **for everyone**, not just the new hire.

➡️ So, the **MC is higher than the AC**. Why? Because every time the employer raises pay to attract one more person, they end up paying **all their workers** more.

5.3 The interaction of labour markets

Monopsony labour market



📊 **Let's Break Down the Graph**

- **What's going on here?**
- In a **perfectly competitive market**, the wage would be **W1** with **Q1** workers employed.
- But in a monopsony:
  - The employer looks at where **MC = MRP** (that's where they make the most profit).
  - That gives them employment at **Q2**.
  - But they don't pay **W2**—they set wages lower at **W3**.
- 👀 This means fewer people get hired **and** everyone gets paid less than they would in a competitive market.

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Monopsony labour market

Why Do Monopsonists Do This?

Simple: **to save money and boost profits**.

Let's take a real-life example:

- In a small town, there's one big call centre. If someone wants a job, that's their only choice. The company knows it, so it offers low wages. People take the jobs anyway because what else can they do?

The company:

- Hires fewer people than it could
- Pays less than it would in a fair, competitive market
- Saves on labour costs and makes more money

5.3 The interaction of labour markets

Monopsony labour market

Continue to the next page

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5.3 The interaction of labour markets

Trade union

Trade unions are like worker superheroes; groups of employees who team up to fight for better pay, safer working conditions, and fair treatment. But just how powerful a trade union is depends on a bunch of factors.

📣 **Collective Bargaining Power – What's That?**

Collective bargaining is when a trade union negotiates with an employer on behalf of all the workers. The stronger the union, the better deal they can strike.

🧱 **What Affects a Union's Power?**

1. How Many Workers Are in the Union (at the company)

The more employees that are union members in a business, the louder the voice of the union.
✅ **Example:** If 90% of workers in a warehouse are in a union, the boss is more likely to take them seriously.

2. How Many Workers Are Unionised (nationwide)

If lots of people in the whole economy are in unions, the government is more likely to listen to them.
✅ **Example:** If teachers, nurses, and bus drivers all belong to big unions, governments will pay attention during pay negotiations.

🔍 **Other Factors That Shape Union Strength**

Here's a list of what else can make a union stronger—or weaker:

- **Unemployment Level**
  - High unemployment = weak union power (bosses can easily replace workers)
  - Low unemployment = strong power (good workers are harder to find)
    ✅ Example: During a recession, a union has less power; in a worker shortage, they can push for more.

5.3 The interaction of labour markets

Trade union

- **The Economy's Health**

In tough times, unions may hold back; in boom times, they push harder.
✅ Example: During COVID lockdowns, unions were more focused on keeping jobs than raising pay.

- **Company Profits**

Big profits = stronger case for pay rises.
✅ Example: If a supermarket chain made record profits, the union might say, "Share the success."

- **Wages as a % of Company Costs**

If wages are a small part of the company's total costs, bosses are more likely to say "yes" to raises.
✅ Example: A tech company spending more on software than on staff might agree to pay hikes more easily.

- **Can Labour Be Replaced by Machines?**

If a company can replace people with machines, union power is weaker.
✅ Example: A factory might say, "If wages go up, we'll just use robots."

- **Worker Productivity**

Productive workers = more valuable = more bargaining power.
✅ Example: If a group of coders can do in a day what others take a week to do, they're in a great position to negotiate.

5.3 The interaction of labour markets

Trade unions impact on a perfectly competitive labour market

In theory, a **perfectly competitive labour market** means:

- Loads of employers competing for workers
- Workers being paid exactly what they're "worth" (based on demand and supply)
- Everyone gets a fair wage... but real life isn't always that tidy.

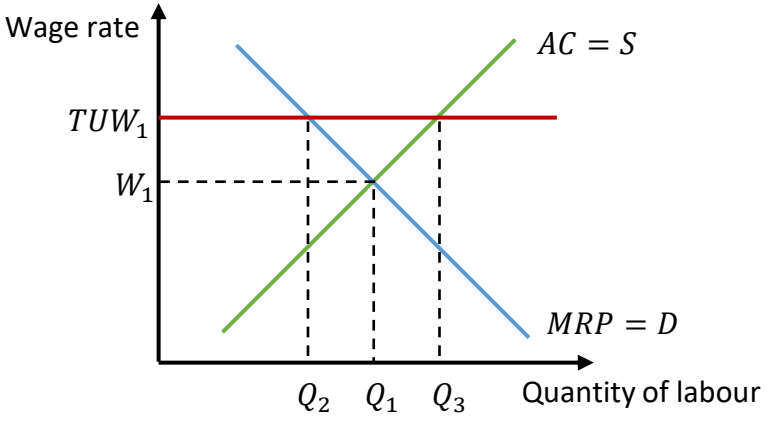
Now enter let's see the impact of **Trade Unions**.

🛠️ What Happens When Trade Unions Intervene?

In a perfect market, **equilibrium wage** is where the demand for workers equals the supply.
That's the point **W_1** on the graph, with **Q_1** workers employed.

But unions say, "Hold on—that's too low. We want better pay."

So, they negotiate a higher wage, let's call it TUW_1 (trade union wage).



5.3 The interaction of labour markets

Trade unions impact on a perfectly competitive labour market

📈 The Impact on the Labour Market

Here's how things change after the wage rises:

- **More people want to work**
  - Higher wages are attractive. Workers who didn't want to work at W_1 are now interested.
  - Supply of labour increases from Q_1 to Q_3.
- **Firms want fewer workers**
  - But at that higher wage, businesses can't afford to hire as many people.
  - Demand for labour drops to Q_2.
- **Result? Unemployment**
  - You now have more people wanting jobs (**Q_3**) than jobs available (**Q_2**).
  - That gap between Q_2 and Q_3 = **excess supply of labour**, aka **unemployment**.

📊 Think of It Like This:

🎓 Imagine you run a tutoring centre. You usually pay tutors £10 an hour and hire 10 of them.
A tutor union demands £15 an hour.
At that price, 15 tutors want to work, but you can only afford to hire 6.
Now there are 9 tutors who want jobs... but won't get them. That's excess supply (unemployment).

Trade unions impact on a monopsony labour market

Let's say before the union gets involved:

- The employer (monopsonist) pays a low wage **W_1**
- They hire a smaller number of workers **Q_1**

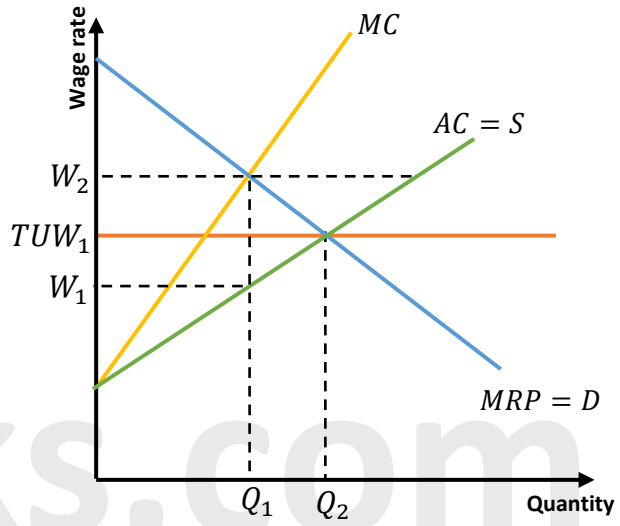
Why? Because they've got all the power.

🔧 **But Then... the Union Steps In**

- **The union negotiates a higher wage**: Let's call it TUW_1 (TU = Trade Union)
- **Good news…**
  - At this new higher wage, **more people want to work**
  - And surprisingly, the monopsonist is now willing to **hire more people too**
  - Employment rises from **Q_1 to Q_2**
- **The market becomes fairer**:
  - Wages go up
  - More people get hired
  - The employer can't push wages down as easily anymore
- **A new supply curve appears**:
  - The wage is now fixed at TUW_1, which flattens out the supply curve
  - This makes the employer face a new cost structure when deciding how many workers to hire

5.3 The interaction of labour markets

Trade unions impact on a monopsony labour market



🧠 **What Does the Graph Show?**

- Before unions: wage = **W_1**, employment = **Q_1**
- After unions: wage = TUW_1, employment = **Q_2**
- That yellow line? That's the **Marginal Cost of Labour (MC)** and it still rises faster than the average cost (because hiring more still means paying everyone the higher rate).

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5.3 The interaction of labour markets

The effects of a national minimum wage

The UK Government sometimes **steps into the labour market** to make things fairer and to **protect workers from being underpaid or exploited**.

Maximum Wage:

- A maximum wage is when the government sets a limit on how much someone can be paid.
- It would be **below the natural market wage.**
- **Example:** In some European football leagues, there have been talks about **salary caps** to stop players from earning millions every year.
- The goal is to **reduce income inequality** and **make pay fairer** across workers.
- But in real life, maximum wages are **very rare** because they can cause talented people to move abroad.

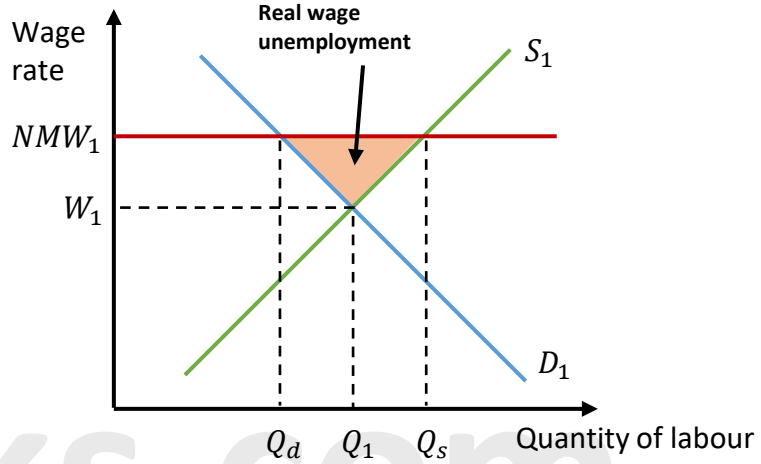
Minimum Wage:

- A minimum wage is a **legal rule** saying employers cannot pay workers less than a certain amount.
- It is set **above the market wage** to make sure people get a fair basic income.
- In the UK, the minimum wage changes **depending on your age**.

5.3 The interaction of labour markets

The effects of a national minimum wage

Understanding the diagram



Let's say we are looking at the market for **baristas** in coffee shops:

- At the start, the market wage is W_1, where the number of baristas needed by cafes matches the number willing to work.
- Then the government sets a **new national minimum wage** at $\boldsymbol{NMW_1}$ (higher than W_1).

What happens after that?

- **More people want to be baristas** because the pay is better (supply rises from Q_1 to Q_s).
- **Cafes want to hire fewer baristas** because the new wage is more expensive (demand falls from Q_1 to Q_d).
- Result: **More people are looking for jobs than there are jobs available,** this is **real wage unemployment**.

At wage $\boldsymbol{NMW_1}$, the gap between Q_d and Q_s shows how many baristas are now unemployed despite wanting to work.

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5.3 The interaction of labour markets

Pros and cons of national minimum wage

Arguments for the National Minimum Wage

- **Reducing poverty**: A minimum wage helps lift the lowest earners above the poverty line, making sure they have enough income to cover basics like food, shelter, and heating. For example, in New Zealand, introducing a minimum wage boost helped thousands avoid falling into severe hardship.
- **Reducing gender wage gaps**: Since women are often overrepresented in lower-paid roles (think childcare workers or shop assistants), a decent minimum wage helps narrow the income gap between men and women.
- **Fairness**: Everyone deserves a fair wage that reflects their effort and prevents exploitation, especially in sectors like cleaning or hospitality where low pay was common before minimum wage laws came in.
- **Avoiding the "unemployment trap"**: If people earn more working than they would on welfare benefits, they are more motivated to find and keep a job. This helps reduce long-term unemployment. In places like Canada, stronger minimum wages have been linked to increased workforce participation.

5.3 The interaction of labour markets

Pros and cons of national minimum wage

Arguments against the national minimum wage

- **Risk of job losses**: If wages are pushed up too high, some businesses might cut jobs to save money, or even close down. For example, some small cafes in the USA closed after a sudden hike in minimum wages.
- **Higher costs for businesses**: Companies may face bigger wage bills, leading them to raise prices. This could make everything from burgers to haircuts more expensive.
- **Ignoring regional differences**: A single national wage might not fit everywhere. Living costs in London are way higher than in rural Wales, for instance. A flat minimum wage could either be too low in expensive cities or too high in cheaper areas, affecting jobs unevenly.

5.3 The interaction of labour markets

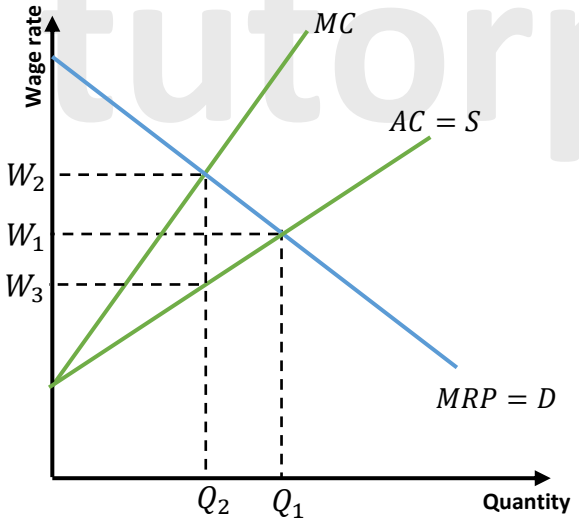
Bilateral monopoly

A **bilateral monopoly** happens when there is **only one buyer** and **only one seller** in a market.

- The buyer = **a monopsony** (single buyer of labour or goods).
- The seller = **a monopoly** (single supplier of labour or goods).

So basically: one-on-one. No competition on either side.

Example:
Imagine a small mining town 🔨. There's only one coal mine (the sole employer/buyer of labour), and the workers are all represented by **one trade union** (the sole supplier of labour). That's a bilateral monopoly in action.



5.3 The interaction of labour markets

Bilateral monopoly

⚙ **How it works**

- In a **monopsony** (one employer, many workers):
  - The firm pushes wages down to **W3**.
  - They employ only **Q2** workers.
  - This happens because the firm sets wages where **MC = MRP**.
- But with a **trade union** (acting like a monopoly supplier of labour):
  - Workers can negotiate for higher wages.
  - For example, they may push for **W2** instead of W3.
  - Ideally, they want higher wages **without reducing jobs** too much.

🎯 **Why it's interesting**

- The employer wants to pay the **lowest wage possible**.
- The union wants to push for the **highest wage possible**.
- The final outcome? Usually somewhere **between W2 and W3**. It depends on bargaining power.

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5.3 The interaction of labour markets

Labour market flexibility and mobility of labour

Labour market flexibility means how easily workers and businesses can respond to changes in the economy like wage changes, demand shifts, or new opportunities.

Labour mobility is about how easily workers can move between jobs (occupational mobility) or locations (geographical mobility).

🚗 Geographical immobility of labour

This happens when workers can't (or won't) move to different places for jobs. **Example:** Imagine someone in rural Wales gets a great job offer in London. They might not move because:

- Housing in London is super expensive 🏠💸
- Family and friends are nearby ❤️
- Moving costs a lot 💰
- They don't know much about the job market in the new place 🤔

🔧 Occupational immobility of labour

This happens when workers can't easily switch careers or industries because their skills don't transfer. **Example:** After the UK mining industry collapsed, many miners struggled to find new jobs since their skills weren't useful in other industries. Causes include:

- Lack of education 🎓
- Limited training opportunities 🛠️
- Very job-specific skills 🏭

5.3 The interaction of labour markets

Labour market flexibility and mobility of labour

⚡ Labour market flexibility

This is how responsive the workforce is to changes in demand. A flexible labour market means workers can move into new jobs or industries when needed.
Why is it important? Because it helps the economy grow and adapt.

Factors Affecting Flexibility

📜 Regulation

- **More freedom = more flexibility**. If firms can hire/fire easily and workers have clear rights, the labour market adjusts better.
- **Too much regulation** can make the market rigid.

🎓 Training

- More affordable and better training makes workers more adaptable.
- **Example:** Digital skills training lets older workers move into tech jobs.

🏗️ Infrastructure

- Better transport systems (like new train lines 🚆 or faster broadband 🌐) make it easier for people to move or work remotely.

💷 Welfare payments & income tax rates

- If welfare benefits are too generous or taxes are too high, people might have less incentive to work.
- This reduces flexibility because fewer people are motivated to move into jobs.

💪 Trade union power

- **Good side:** Trade unions can push for better wages and job security.
- **Bad side:** If unions limit strikes or restrict flexibility, it can actually make the labour market less adaptable.

🏘️ Housing

- If housing is affordable in different areas, people are more likely to move for work.
- **Example:** If homes near Manchester are cheaper than London, people might move there for jobs, improving mobility.

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Please see the ‘5.1 The labour market Worked Examples’ pack for exam style questions.

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