Edexcel A - A Level Economics

Theme 3 – Business behaviour and the labour market

3.5 Labour market

Revision Notes

Contents

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3.5.1 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.

3.5.1 Demand for labour

Factors that influence the demand for labour

Marginal Revenue Product (MRP)

The demand for workers (labour) is mainly driven by something called **Marginal Revenue Product (MRP)**.

👉 **MRP** is the *extra money a firm earns from hiring one more worker*.
Formula:
MRP = Marginal output (what the worker adds) × Price of the product

So, if hiring an extra worker brings in more revenue, businesses are more likely to hire them. The **higher the MRP**, the more valuable the worker is to the business, and the stronger the demand for them.

🌀 **But here's where it gets interesting...**

At first, hiring more workers might really boost output, yay! 🎉
But eventually, we hit a point called the **law of diminishing marginal productivity**.

📉 This law says: *if you keep adding more workers, but don't add more tools, space, or machines*, each extra worker will add **less and less** to total output. Imagine trying to fit 10 chefs in a tiny kitchen 🍳, there's only so much room, and productivity drops.

📉 **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**.

3.5.1 Demand for labour

Factors that influence the demand 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.

3.5.1 Demand for labour

Factors that influence the demand 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**.

3.5.2 Supply of labour

Factors that influence the supply of labour

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.

3.5.2 Supply of labour

Factors that influence the supply of labour

✊ 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.

🔄 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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3.5.2 Supply of labour

Market failure

In a perfect world, the labour market should work like any other market: higher wages should attract more workers, and lower wages should encourage them to leave that industry. But real life isn't that simple, and the labour market isn't perfectly free.

Why not? A big reason is something called **immobility**.

🔒 **What is Labour Immobility?**

Labour immobility is when people can't easily switch jobs or move to new places for work. This can cause big problems in the economy, like job shortages in some areas and too many workers in others.

There are two main types:

1. 🌍 Geographical Immobility of Labour

This is when people find it hard to move from one place to another to take up a job. Imagine someone in Cornwall being offered a job in Manchester but struggling to accept it. Why? There are a few roadblocks:

- 🏠 **High cost or difficulty finding housing** in the new area
- 👨‍👩‍👧 **Family responsibilities**, like kids in school or elderly parents to care for
- ❌ **Lack of information** about job opportunities elsewhere
- 🚌 **Poor public transport**, making long commutes unrealistic

These barriers can stop people from moving for work, even if they want a job.

3.5.2 Supply of labour

Market failure

2. 🔄 Occupational Immobility of Labour

This happens when workers find it hard to switch from one type of job to another. Usually, it's because they don't have the **transferable skills** needed.

- If a person's **skills are easily transferable** (e.g. from a sales role to customer service), we say they have **high occupational mobility.**
- But if their skills are very specific and don't fit into other roles, they have **low occupational mobility**.

This becomes a bigger problem during **structural unemployment**, when entire industries change or decline (like manufacturing jobs being replaced by automation), and workers can't easily find new roles.

3.5.3 Wage determination in competitive and non-competitive markets

Diagrammatic analysis of labour market equilibrium

In the labour market, there's a sweet spot where things just balance out. This is called **labour market equilibrium**. It's the point where the number of people that **firms want to hire** (called the **demand for labour**) is exactly the same as the number of people who **want to work** (known as the **supply of labour**).

Here's how it works:

- The **demand for labour (D)** comes from businesses looking for workers. Think of a cafe hiring baristas or a game company looking for developers.
- The **supply of labour (S)** comes from people who are willing to work those jobs.

This perfect balance means no one is left unemployed *because* there are too many workers, and no jobs are left unfilled *because* there aren't enough workers.

What About Wages?

In a competitive labour market, firms are what we call **price takers**. That means they can't just decide to pay workers whatever they want. They have to go with the going wage, or they risk:

- **Paying too little**, and no one wants to work for them.
- **Offering too much**, and they get flooded with job applications.

At the **equilibrium wage rate**, everything's just right. Let's say, for example, in the software developer market:

- The **equilibrium wage** is **£W**
- The **number of developers employed** is **Q**

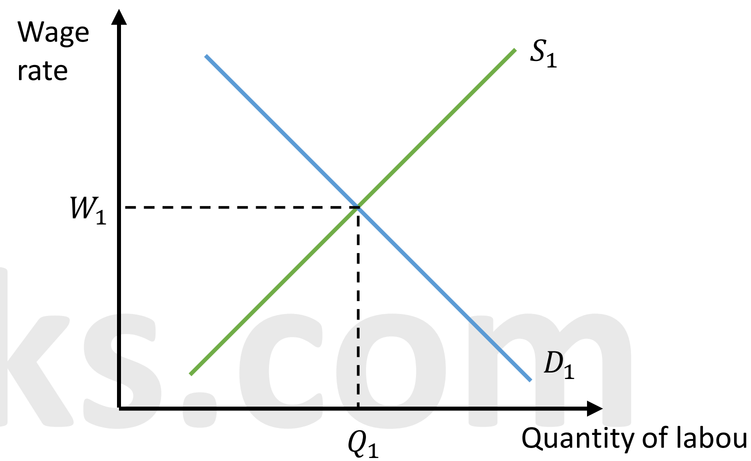
At this point, everyone wins. There's:

- **No excess supply** which means no group of developers is standing around with no jobs.
- **No excess demand** so companies aren't scrambling to fill positions either.

3.5.3 Wage determination in competitive and non-competitive markets

Diagrammatic analysis of labour market equilibrium

The diagram:



The graph you see shows two curves:

- The S_1 **line (supply of labour)** slopes upward. The higher the wage, the more people want to work.
- The D_1 **line (demand for labour)** slopes downward. As wages go up, companies want to hire fewer people because it costs more.
- They meet in the middle at point W_1Q_1. That's your **equilibrium**.

3.5.3 Wage determination in competitive and non-competitive markets

Current labour market issues

The labour market is always changing, and it's got a few hot topics worth knowing about. These are things that affect real people, real jobs, and how the economy ticks.

Skills Shortages

A skills shortage happens when businesses need workers with specific skills but can't find enough of them. Imagine needing a plumber urgently, but none are available in your town, that's a classic case. In the UK, we often have loads of people who want to work, but not in the right places or with the right training, this is called **geographical** and **occupational immobility**. So, we might have engineers in Scotland but not enough in London where they're needed.

Youth Unemployment

Youth unemployment is when people aged 16 to 24 can't find work.

- Starting a career during a recession? Tough luck. Young workers entering the job market during hard times often get stuck with lower-paying jobs and might earn less throughout their lives.
- Companies don't want to fire their older, more experienced staff, so young people can find it hard to get a foot in the door.
- Many young people also leave school without the skills employers want, this is the **skills gap**.
- Employers often want **experienced** staff, not fresh grads.

Imagine this: You've just left school, but every job wants "3 years experience"... sound familiar?

3.5.3 Wage determination in competitive and non-competitive markets

Current labour market issues

Changes to Retirement Ages

Retirement age = when you can stop working and get a **state pension**.

- It used to be 60 for women and 65 for men.
- Now it's gradually rising to **68 for everyone**.
- Why? People are living longer, so pensions cost more.
- The government is trying to manage this by keeping people in work longer.

Zero-Hour Contracts

These are contracts with **no guaranteed hours,** you only get paid for the work you do.

- Good for employers: they save money.
- Risky for workers: no income security or benefits like holiday pay.
- These contracts **mess with unemployment stats** because you might be working one hour a week and not counted as unemployed.

3.5.3 Wage determination in competitive and non-competitive markets

Current labour market issues

🎓 **School Leaving Age**

The **school leaving age** affects how skilled the workforce is.

- In England, you can leave school at 16, but you must do something (like college or an apprenticeship) until you're 18.
- **More time in education = higher skills**, but it also puts pressure on **training providers** to offer enough courses.
- There's a **lack of apprenticeships** for those who want to go down that route.

🧘 **Flexible/Temporary Working**

This refers to jobs where people can work part-time, from home, or on short-term contracts.

- Covid changed the game – now many people prefer **working from home**.
- Employers like it because it **reduces office costs**, but some want staff back for **control**.
- Workers love the **well-being boost** and freedom that comes with flexibility.

🚗 **The Gig Economy**

Think Deliveroo drivers and Uber drivers. These are self-employed workers who pick up short jobs (or "gigs"). While it sounds flexible, many gig workers have little protection and their income can be very unpredictable.

3.5.3 Wage determination in competitive and non-competitive markets

Government intervention in the labour market

Maximum and minimum wages

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.

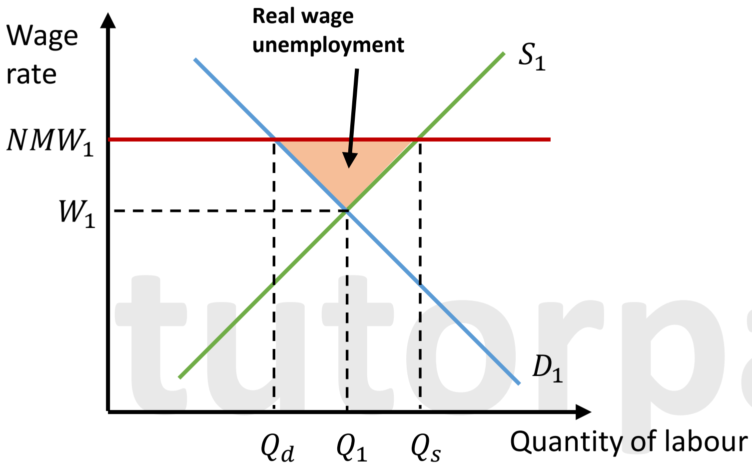
Minimum Wage:

- 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**.

Government intervention in the labour market

Maximum and minimum wages

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).

3.5.3 Wage determination in competitive and non-competitive markets

Government intervention in the labour market

Maximum and minimum wages

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.

3.5.3 Wage determination in competitive and non-competitive markets

Government intervention in the labour market

Maximum and minimum wages

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.

3.5.3 Wage determination in competitive and non-competitive markets

Government intervention in the labour market

Maximum and minimum wages

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.

3.5.3 Wage determination in competitive and non-competitive markets

Government intervention in the labour market

Public sector wage setting

The **UK government** is actually the biggest boss in the country when it comes to employing people.

In lots of industries (such as healthcare, education, etc…), the government is the **dominant employer**, meaning it has serious **monopsony power**.
(Monopsony = when there's only one big buyer – in this case, the government buying labour.)
Because of this, it can heavily influence **how much workers are paid**.

This is because, in the **short run** (which basically means right now, not thinking too far ahead), the **UK government** has a lot of control over public sector wages.
Because **trade unions** (groups that fight for workers' rights) are relatively **weak**, the government can pretty much **set wages how they like** to help balance the budget.

What happens because of public sector wage setting?

- If the government **raises the National Minimum Wage (NMW)**, they also **raise their own costs**. Paying millions of workers more gets very expensive very quickly.
- Lots of **private companies** look at what the public sector pays and use it as a **benchmark** for setting their own wages. If the government raises public sector pay, private firms often feel pressured to do the same.
- If public sector wages go up, but private sector ones stay the same, it can create **bad feelings**.
  Workers may feel it's unfair, leading to frustration between sectors.

3.5.3 Wage determination in competitive and non-competitive markets

Government intervention in the labour market

Public sector wage setting

- And guess what? Higher public sector wages usually mean the government needs **more tax money** to pay for it, which can mean **higher taxes** for everyone.
- But in the **long run** (thinking further into the future), things balance out.
  If **private sector** workers keep getting pay rises but **public sector** workers do not, workers will start **switching jobs** to the private sector for better money.
  This **forces the government** to eventually **increase public sector wages** to keep people from leaving jobs like teaching, healthcare, or public administration.
- **Over time**, the wages of both public and private sector workers tend to **rise by similar percentages**.

What's been happening recently?

In **June 2022**, lots of public sector workers (like teachers, nurses, and civil servants) went on **strike**. Why?

- Their **wages had been frozen** between **2010 and 2015**, following the 2008 financial crash.
- Meanwhile, the cost of living kept rising because of **inflation** (basically, prices going up for everything), but their pay didn't keep up.

This meant that even though workers were earning the same on paper, in reality, their **money didn't stretch as far** at the supermarket or when paying bills.

3.5.3 Wage determination in competitive and non-competitive markets

Government intervention in the labour market

Policies to tackle labour market immobility

The UK Government uses loads of clever policies to help people move more easily between jobs and places. Why? Because when people get stuck (immobile), the whole economy suffers.

Helping People Move to New Places (Geographical Mobility):

- **More affordable homes:** 🏠
  Building more houses and making renting cheaper would make it easier for people to move for new jobs.
  Think about teachers or nurses starting out, they often need to move cities but can't afford crazy housing costs.

- **Relocation help:** 📢
  Moving for work can be expensive. 🏡 So the government can **offer money** (relocation subsidies) to workers who need to move cities for a new job. This helps with both **geographical immobility** (moving places) and **occupational immobility** (changing jobs).

- **Better transport links:** 🚂 🚌
  Improving trains, buses and roads means people can live further from where they work.
  For example, new rail lines between Manchester and Leeds help people commute easily without needing to move house.

- **Subsidies in shortage areas:** 🎯
  In places where there aren't enough workers (like rural hospitals), the government could offer help with housing costs or lower taxes to **attract people** there.

- **Moving public services:** 🏢
  Sometimes whole departments are moved out of expensive cities.

3.5.3 Wage determination in competitive and non-competitive markets

Government intervention in the labour market

Policies to tackle labour market immobility

Helping People Switch Careers (Occupational Mobility):

- **Better education and training:** 🎓
  Giving people access to good education and training means they gain a **broader set of skills**. This makes it **easier to switch** between different types of jobs. For example, if someone trains in coding, they could move from retail into tech without too much trouble.

- **Encouraging further study:** 🎒
  Supporting people to go to university, college, or even technical schools can boost their chances.
  Engineering degrees, for example, are in super high demand right now.

- **Training at work:** 🛠
  Sometimes businesses don't want to hire someone who needs extra training. To fix this, the government gives **"per hire" subsidies,** basically paying employers a bit of money for every worker they hire and train. This is especially useful for hiring groups that might face challenges, like long-term unemployed workers.

- **Fixing skills shortages:** 💼
  The government spots industries with **urgent skills gaps** (like electricians or nurses) and **trains people** specifically for those jobs. This way, it's easier for workers to move where they're needed most. Think of emergency training schemes during a shortage of HGV drivers. 🚚

- **Fighting discrimination:** ✋
  Discrimination can trap people in low-paid jobs. By **stopping unfair hiring** practices (for example, race, gender, disability bias), the government can make it easier for more people to **move up** and **move around** in the labour market.

3.5.3 Wage determination in competitive and non-competitive markets

Significance of the elasticity of demand and supply of labour

Elasticity of Demand for Labour (how much 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.

3.5.3 Wage determination in competitive and non-competitive markets

Significance of the elasticity of demand and supply of labour

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.

3.5.3 Wage determination in competitive and non-competitive markets

Significance of the elasticity of demand and supply of labour

Elasticity of Supply of Labour (how much workers react)

Elasticity of supply looks at **how quickly workers respond** to changes in wages.

- If supply of labour is **elastic**, a small pay rise attracts a lot more workers.
    - Example: retail jobs. Pay a bit more and loads of people will apply.
- If supply of labour is **inelastic**, even a big pay rise won't attract many new workers.
    - Example: airline pilots. Even if you pay double, you still need years of training.

Generally, in **low-skilled jobs**, supply is elastic because lots of people can jump into these roles quickly. In **high-skilled jobs** that need years of education and qualifications, supply is inelastic because you can't just produce more workers overnight.

Quick recap:

- **Elastic demand:** Firms fire and hire workers quickly when wages change.
- **Inelastic demand:** Firms barely react to wage changes.
- **Elastic supply:** Workers flood in when pay rises.
- **Inelastic supply:** Even big pay rises don't bring in enough workers fast.

3.5.3 Wage determination in competitive and non-competitive markets

Significance of the elasticity of demand and supply of labour

Continue to the next page…

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