

9

Labour Demand and Supply

Multiple Choice Answers

- | | | | | | |
|---|---|----|---|----|---|
| 1 | B | 6 | C | 11 | B |
| 2 | C | 7 | A | 12 | D |
| 3 | B | 8 | D | 13 | B |
| 4 | A | 9 | D | 14 | A |
| 5 | D | 10 | C | 15 | D |

Short Answer Questions

Question 1

- (a) The demand for labour is derived from the demand for goods and services in the economy. To increase production in response to higher demand, firms must demand more labour.
- (b) An increase in economic activity is likely to raise demand for goods and services, and therefore the demand for labour. However, a time lag is likely to occur between an upturn in the economy and a fall in unemployment because firms will first attempt to use their existing employees more efficiently before turning to hiring more workers.
- (c) Improvements in productivity may have a mixed impact upon the demand for labour. In the short run, improved productivity may in fact reduce demand for labour since firms are able to rely on existing labour to meet increased demand. However in the long run, firms will be more likely to substitute labour for capital due to the higher productivity, increasing demand for labour.
- (d) Capital is often a substitute for labour in the production of goods and services. Therefore employers compare the relative prices of the two when determining the ratio of labour to capital. A decrease in the price of capital compared to labour would encourage employers to switch to capital-intensive production and demand less labour. However, the switch to capital-intensive production may create new demand for labour to operate the capital equipment, however the labour required to operate capital is likely to be less than the labour it replaced.

Question 2

- (a) 14 million
- (b) 5 million + 2 million = 7 million
- (c) Labour Force Participation Rate = $\frac{7}{14} \times 100 = 50\%$

- (d)** The level of economic activity and the labour force participation rate are linked by the likelihood of finding a job. Higher levels of economic activity will improve the prospects of finding a job. Those workers who had previously become discouraged from being unable to find a job will now begin to actively seek work, entering the labour force and raising the labour force participation rate. Conversely, during an economic downturn, it becomes more difficult to find work, discouraging job-seekers who may stop looking for work, reducing the participation rate.
- (e)** A correct answer may include any two of the following:
- Increased higher school retention rates will lead to a lower participation rate, as young people of working age choose to continue their education rather than entering the labour force. Although this means the labour force will be smaller, the economy's labour resources will be of a better quality due to increased education and skills levels.
 - Changing social attitudes can also decrease the participation rate. For example, an increasing trend for parents to leave work to raise their children would reduce membership in the labour force, lowering the participation rate.
 - An increase in the number of people who choose to retire early, or have early retirement forced upon them would see persons who would have otherwise remained in employment dropping out of the labour force, lowering the participation rate.

Question 3

- (a)** \$10
- (b)** 400 000
- (c)** Wages are determined through the interaction of demand and supply in the labour market. The equilibrium wage will be set at the level where the demand for labour equals the supply of labour. At a wage rate below this level the demand for labour exceeds the supply and firms competing for scarce labour resources will push the wage level up to equilibrium. Meanwhile, at any wage rate above equilibrium the excess supply of labour will prompt workers to lower their wage demands, thereby reducing wages to the equilibrium level.
- (d)** A decrease in the demand for labour will see a leftwards shift of the labour demand curve, which will result in a lower equilibrium wage rate and lower employment levels in the labour market.
- (e)** A reduction in the supply of labour caused by reduced participation in the labour force (e.g. due to an increasing trend to early retirement and higher school retention rates) would reduce the number of available workers in the labour market. Firms would offer higher wages to attract the scarce quantity of workers, pushing up the equilibrium wage. Similarly, if there were an increase in demand for labour (e.g. due to higher labour productivity raising the attractiveness of labour, or due to an increase in economic activity) firms would find increased competition for the limited quantity of workers, increasing the wage rate.