

Pinky Rani
Assistant Professor (Guest Faculty)
Department of Economics
Maharaja College
Veer Kunwar Singh University, Ara
Class: B.A.Sem (01)
Paper: MJC-1
Topic: Demand for labour

Demand for labour

The labour market is a **factor market** – it provides a means by which employers find the labour they need, whilst millions of individuals offer their labour services in different jobs.

The demand for labour is a derived demand, meaning that it depends on the demand for the goods and services that labour produces. The following are some of the factors that influence the demand for labour:

- **The price of the good or service:** The higher the price of the good or service, the more profitable it is for firms to produce it, and the more labour they will demand.
- **Productivity of labour:** The more productive workers are, the more output they can produce per hour, and the more labour firms will demand.
- **The cost of labour:** The higher the cost of labour, the less profitable it is for firms to hire workers, and the less labour they will demand.
- **The cost and availability of substitutes:** If there are good substitutes for labour, such as capital or automation, firms will be less likely to demand labour.
- **The level of technology:** The higher the level of technology, the more productive workers can be, and the more labour firms will demand.
- **The level of government regulation:** The more regulations there are on businesses, the more costly it is for them to operate, and the less labour they will demand.
- **The level of economic activity:** The higher the level of economic activity, the more goods and services are being produced, and the more labour firms will demand.

The demand for labour is a complex issue, and the factors that influence it can vary depending on the specific industry or sector.

A Competitive Firm's Demand Curve for an Input

A profit-maximizing firm hires variable input till that point at which MC of input equals the VMP or (MRP). Here, by MC of input, we mean price of the input. Since we consider labour as the variable input, its MC is nothing but wage rate. If labour market is characterized by perfect competition, wages will remain fixed.

Since wage rate is fixed, average cost (AC_L) and marginal cost (MC_L) coincide. At a given wage rate, the supply of labour, S_L , (i.e., $AC_L = MC_L$) becomes horizontal. Assuming perfect competition in both product market and labour market, a profit-maximizing firm reaches equilibrium when $VMP (= MRP)$ equals the price of labour, i.e., wage rate.

Thus,

$$VMP_L = MRP_L = AC_L = MC_L = W$$

In Fig. 6.1, we have drawn a horizontal supply curve of labour ($S_L = AC_L = MC_L$). We have also drawn $VMP = MRP$ curve as the downward sloping curve. Equilibrium occurs at point E, where $VMP_L = MRP_L = W$. Corresponding to this equilibrium point, OL amount of labour is demanded.

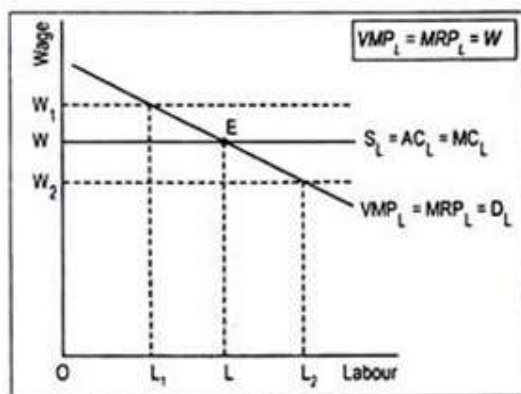


Fig. 6.1: The Labour Demand Curve: Perfect Competition

If the firm decides to employ OL_1 units of labour, then $VMP_L > OW$. It would be wise if the firm hires more labour. It will continue to employ labour until wage equals VMP_L . Similarly, the firm will not be maximizing profit if it employs OL_2 units of labour where wage exceeds VMP_L . Therefore, to have more profit, it must reduce employment of labour until OL is reached where $W = VMP_L$.

Thus, at OW wage rate, OL amount of labour is demanded by the firm. If wage rate is OW_1 , the firm will hire OL_1 units of labour, and it will demand OL_2 units of labour if wage rate is reduced to OW_2 . Thus, $VMP_L = MRP_L$ curve can be thought of as the demand curve for labour under perfect competition. In Fig. 6.1, $VMP_L = MRP_L = D_L$ curve is drawn as a negatively sloped labour demand curve.

Demand Curve for Labour: Imperfect Competition

Under imperfect competition, VMP curve is not the demand curve for a variable input. In this branch of market, labour demand is governed by MRP, and not VMP. Let us further assume that labour market is perfectly competitive. Therefore, supply curve, MC_L , would be horizontal.

A profit-maximizing non-competitive firm which purchases labour input from the competitive labour market will employ labour up to that point at which $MC = W$ equals MRP i.e., $VMP_L > MRP_L = MC_L = W$.

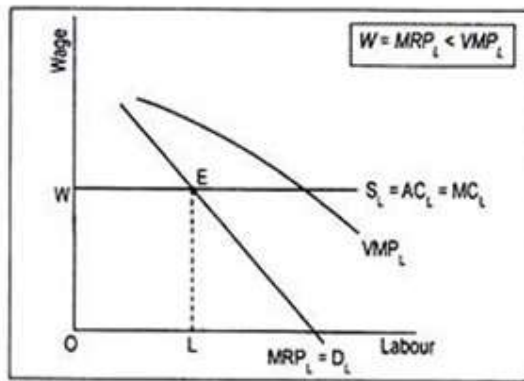


Fig. 6.2: The Labour Demand Curve : Monopoly

At the given wage rate OW , the monopoly firm reaches equilibrium at point E . At this wage rate, the firm hires OL units of labour since $W = MRP_L$. If wage rate is increased, less labour will be demanded. More labour will be demanded if wage rate is lowered down. Thus, under imperfect competition, $MRP_L = D_L$ curve is the firm's demand curve for labour (Fig. 6.2).