Competition versus Monopsony in Labor Markets

Introduction and Description

Lesson 2 asks students to compare a labor market that is perfectly competitive with one that is a monopsony. A *monopsony* is the sole buyer of labor and must offer a higher wage to attract more workers. The firm's marginal resource cost from adding another unit of labor is greater than the wage paid to that labor unit. Students work with graphs of perfectly competitive and monopsonistic labor markets to analyze the effects of changes in economic conditions, government policies, and union activities.

Objectives

1. Demonstrate the differences between a competitive labor market and a monopsonistic labor market.
2. Analyze the effect of a *minimum wage* in a perfectively competitive labor market and in a monopsonistic labor market.
3. Show graphically the impact of changes in economic conditions, government policies, and union activities.

Time Required

Two class periods or 90 minutes

Materials

1. Activities 4-5 and 4-6
2. Visuals 4-4 and 4-5

Bell Ringer

What happens to the level of unemployment when the government establishes a minimum wage? Who benefits from such a policy? Who is harmed by it?

Teacher Alert: **The basic hiring rule applies to any firm, regardless of whether it buys labor in a perfectly competitive or a monopsonistic labor market: Hire where MRP = MRC. Since the firm pays the market wage to all workers in a perfectly competitive labor market, that firm can also use the hiring rule of MRP = wage. A monopsony must stick with the MRP = MRC rule because the wage is less than the MRC for a monopsonist.**

Procedure

1. Display Visual 4-4 as a review of how a firm is a "wage taker" if the labor market is perfectly competitive. Ask students why the market labor demand curve is downward sloping and why the market labor supply curve is upward sloping. Ask them why the labor supply to a firm is horizontal. *(The firm can hire all the labor it wants at the market wage; it does not have to raise the wage to attract more labor.)*
2. Display Visual 4-5 to illustrate the decisions made by a monopsony. The firm determines its profit-maximizing quantity of labor where MRP = MRC and its optimal wage comes from the labor supply curve at that quantity of labor.
3. Assign Activity 4-5.
   (A) What are the equilibrium wage and quantity of labor in the competitive labor market? *($8.00 and 4,000 hours of labor)*
   (B) What is the impact of a minimum wage placed in a competitive labor market? *(The wage rises and there is unemployment in the labor market.)*

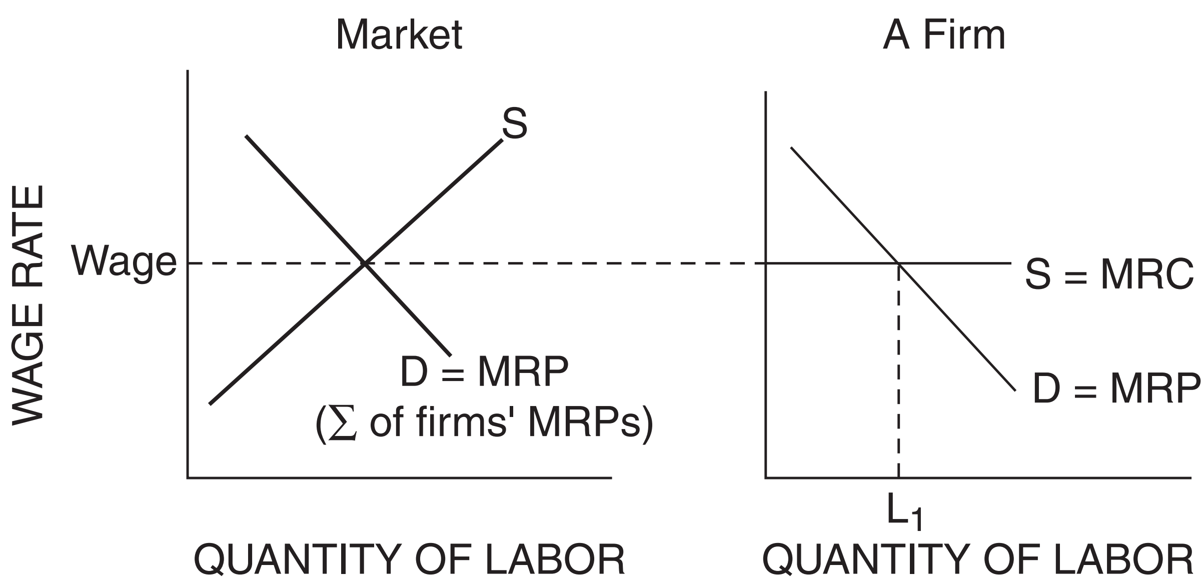
(C) Why is the monopsony's labor supply curve upward sloping? *(It must raise the wage to attract more workers.)*

(D) Why is the monopsony's MRC curve above its labor supply curve? *(Because it pays the higher wage to all workers, the actual cost to the firm of an extra worker exceeds the wage paid to that worker.)*

(E) Is the MRP curve of a monopsony also the firm's demand curve for labor? *(No, because the wage is not equal to MRC.)*

4. Assign Activity 4-6 and have students explain their answers. This activity asks student to analyze the impact of changes in economic conditions, government policies, and union activities.

The Supply of and Demand for Labor in a Competitive Labor Market



A Monopsonistic Labor Market