

# Section 2: How a Labour Market Works

---

## Overview

In this section, you will learn:

- to identify and distinguish between different types of markets
- to identify specific factors that influence the demand and supply in a labour market
- to forecast how a change will affect the demand and/or supply of labour, wage rates, and employment in a competitive labour market
- the uses and limitations of the theory of a competitive labour market
- the meaning of the following terms: demand, forecast, market, medium of exchange, mobility (labour), profit

## What is a labour market?

All of us have a lot of experience with markets. Every time we spend money or trade one thing for another, we have been a part of a **market**. A market is formed whenever buyers who want something meet sellers who can provide it. Negotiations take place to determine what the buyers must give up and the sellers are willing to accept. In our economy, money is used as the **medium of exchange** to facilitate the trade. The negotiations determine the market price – the amount of money buyers are willing to pay and sellers are willing to accept.

Markets do not guarantee that all those who want to buy something and all those who want to sell it will be happy. We all might want the latest fashion, the fastest skis, or the best CD player, but only those who can pay the market price will be satisfied. The market will not satisfy all sellers either. Sellers seek to make money from a market exchange. Sellers deduct their costs from their total revenue from sales to determine their **profit** – what's in it for them. Only those sellers who are satisfied with the profit they can make will be willing to supply goods and services. In a market, it is the buyers' willingness and ability to pay that creates the **demand** for something. It is the sellers' ability and willingness to sell that creates the supply. Demand and supply will determine the market price that, in turn, determines which buyers and sellers will be satisfied.



## Activity 2.1

Every time you buy or sell something, you are involved in a market. Make two lists – one of the things you bought, the other of the things you sold:

- (a) in the last 24 hours
- (b) in the last week, not including what you listed in (a)
- (c) in the last month, not including what you listed in either (a) or (b)

You probably have a long list of things you purchased and a much shorter list of things you sold. We are all involved more frequently in markets as buyers than sellers. As buyers, we enter a consumer market to purchase goods and services that satisfy our needs. When we act as sellers, we can sell just two things: either assets or resources we own. Look at the list of things you sold. Were you selling an asset such as a collection of used CDs, or were you selling a resource? What resource do we all own and are, therefore, most likely to sell? The answer is our labour. When you agree to cut someone's lawn or watch someone's children, you are selling your labour and providing a service directly to a consumer. If you sell your labour to a producer and become an employee or work in a business for a wage, you are also selling your labour. In either case, when you are negotiating the price of your labour – how much you are going to be paid for what you do – you are participating in a labour market.

In a labour market, employers hire workers. In return, those hired receive a wage or salary. The level of the wage or salary we receive is very important to us. Most of the income we receive will be earned in the form of an hourly wage or a yearly salary. It will determine our ability to pay for – or demand – goods and services to satisfy our needs. So labour markets play an important part in determining our material standard of living.

## How do labour markets work?

The function of a labour market is to establish the price of labour. That price should reflect the value labour has added to the production process and the ability and willingness of workers to provide the labour. This is most likely to occur in a competitive labour market. In such a market there are many employers seeking workers and many workers seeking work. The employers' demand for labour and the willingness of individuals to supply labour determine the level of wage or salary for a job. If demand is high or supply is low, wages and salaries will be high. Where the demand for workers is low or a great many are available to do the job, wages will be low.

To understand a labour market, one must know something about the factors that influence the employers' demand for, and the workers' willingness to supply, labour. The employers' demand for labour depends on the demand for the product the labour produces. For example, if there is an increase in the demand for automobiles, the demand for autoworkers will rise, as will their wages.



## Activity 2.2

**Forecast** how each of the following five changes would most likely affect a given labour market. Record your answers on the chart on the next page.

- (a) the number of teams in the NHL increases
- (b) hospitals are closed
- (c) the cost of a mortgage rises
- (d) the population grows older
- (e) the price of gold rises

In each of these five cases, identify:

- whether the demand for workers will go up or down;
- whether wage rates will rise or fall; and
- whether more or fewer workers will be employed.

Note that a forecast is not a prediction. It is an analysis of the most likely effects caused by a specific change.

Labour is not the only resource used in production. Natural resources and capital resources may also be needed. The demand for labour may also depend on the supply and price of these other resources. For example, a decrease in the supply of fish as occurred off the coast of Newfoundland will cause a decrease in the demand for fishers and fish processors. Fewer will find work, and those who do will have to work for a lower wage.



## Activity 2.3

Explain how each of the following changes would affect a labour market.

- (a) businesses have little money to invest in capital goods
- (b) new deposits of oil are found
- (c) the price of new machinery drops rapidly
- (d) labour-saving machines are developed and used

Change	Labour Market	Demand	Wage Rates	Employment
(a) more NHL teams	hockey players			
(b) hospitals closed	nurses			
(c) mortgage rates increase	construction workers			
(d) population ages	medical workers			
(e) gold price rises	gold miners			

The demand for labour also depends upon how much value labour can add to production. Labour can add value by producing more or improving the quality of products. The term productivity is used to describe a worker's contribution to the production process. Employers will not hire workers who cannot contribute more than they are paid. The more productive the workers, the greater the demand for them will be. A larger demand will lead to higher wages and numbers employed. Many factors influence workers' productivity. These include:

- the workers' skills, experience, health, and attitudes;
- their working conditions; and
- the quantity and quality of other resources (capital resources, in particular) they have to work with.



## Activity 2.4

Identify whether each of the following would increase or decrease the productivity of workers.

- (a) clean, bright, and well-designed work stations
- (b) a well-designed program of skills retraining
- (c) a lack of good tools to work with
- (d) a lack of incentives and recognition for work well done
- (e) widespread addictions and poor health
- (f) workers who value and take pride in their work
- (g) a positive (or negative) labour-management relationship
- (h) too heavy workloads or short staffing

Many of the factors that affect workers' productivity will also affect the willingness of workers to supply their labour. For example, poor working conditions that involve health risks or dull, repetitive jobs reduce the willingness of workers to do them. That is one of the reasons why some low-skill jobs still pay well. No one with a choice would want to do them except for the good pay.

Some factors may affect only a few markets. Others may have some effect on all labour markets because they influence the total labour supply. Some other factors that can affect the supply of labour are:

- the size of the labour force, which determines the number who are ready and willing to work
- the amount of training and length of time it takes to acquire the skills to do the job
- the availability of other sources of income (for example, transfer payments or income from the sale or ownership of assets)
- expectations of finding a job
- labour **mobility** (or the willingness to move to where the job is)
- personal income tax rates
- social and cultural factors (for example, attitudes about gender and age)
- quality of life factors in the community where the job is located



## Activity 2.5

Explain how and why each of the following would affect the supply of labour, its wage rate, and the number employed. Identify the labour market(s) that would be affected in each case.

- (a) greater workloads with no increase in wages or any other benefits in one sector of the economy
- (b) a population with a growing percentage of senior citizens
- (c) an increase in the time and money required to train to do the job
- (d) a rising unemployment rate

Competitive markets and the price system have proven to be the best way to produce and distribute many consumer goods and services. But fortunately, since the abolition of slavery, workers cannot be considered just another commodity. They cannot be treated like other resources or the goods and services they produce. Labour may be employed, but it cannot be owned by anyone other than the individual worker.

In theory, competitive labour markets in which there are many employers bidding for labour should ensure that workers receive their fair share of the value they have produced. They will also ensure the fair share will be earned in a safe and supportive workplace. Any worker thinking he or she can do better is free to move to another job. Low wages or a dangerous workplace will reduce the willingness of workers to supply labour. Employers would have to raise wages and improve working conditions. This provides the incentive to keep the wages fair and the workplace safe in the first place.

Such theory is based on the assumption that both buyers and sellers have real choices. In slow economic times, workers may have little choice. Even in good times, the freedom to move to a better job may be very limited. Few may have the specialized training required. The risks and human and financial costs involved in uprooting one's family may be substantial. Labour's mobility may be the least of any of the economic resources. Labour cannot flow as freely within an economy or around the world as financial capital does. With the growth of freer trade, even natural resources and finished goods and services face fewer barriers to movement than labour. And when the market is global, how can a Canadian worker compete with a foreign worker whose labour may be exploited by a lack of both legal protections and competitive labour markets?

The theory of competitive labour markets provides a description of how wage rates and conditions of labour may, and perhaps even ought to, be determined. It provides a good perspective from which to analyze conditions in the workplace. It should, however, never be assumed that labour markets are naturally evolving in accordance with the theory or that the theory presents an accurate description of current reality.

## Glossary

**Demand:** 1. The willingness and ability to purchase an economic resource, good, or service. 2. The total number of units buyers wish to purchase at each price level.

**Forecast:** An estimate of the most likely future effects of a specific change or cause.

**Market:** An economic institution composed of buyers with a demand and producers with a supply who negotiate a price so that a mutually satisfactory exchange may take place.

**Medium of exchange:** That which is widely accepted in exchange for the use or purchase of a resource, good, or service or to pay a debt.

**Mobility (labour):** The ease with which labour can move from one job to another.

**Profit:** That which remains after the producer has deducted all costs of production from the total revenue received from sales.

