

EE311:

Factor Markets (Part 2: Monopsony)



Monopsony



A monopsonist is the “sole buyer” in the factor market.

A classical example is one company in the town where workers cannot or will not leave the area.

In the competitive factor market, firms takes W^* as given and face a horizontal labor supply curve at W^* . (See Page 3)

In the monopsonist factor market, the monopsonist faces the upward-sloping market labor supply curve.

Here, the monopsonist no longer takes w^* as given. How many workers it hire will affect the wage it faces.

Monopsony



In factor markets,

Average Factor Cost (AFC) is another name for the supply curve for an input.

AFC represents the average payment per worker to achieve any given level of employment.

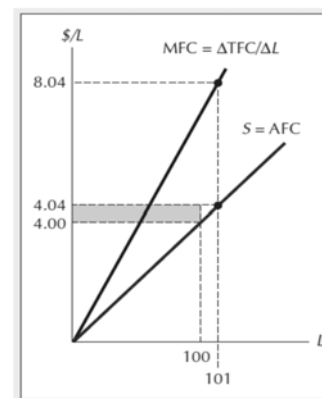
Total Factor Cost (TFC) =

Marginal Factor Cost (MFC) =

Monopsony



Labor Supply in the monopsonistic market is upward-sloping.



To hire 100 workers, the firm has to pay wage of \$4 per worker.

TFC = _____

To hire 101 workers, the firm has to increase wage to \$4.04 per worker.

However, the firm has to pay this high wage to _____.

TFC = _____ x _____ = _____

MFC is the addition cost from hiring an additional unit of worker (i.e., the 101st worker), equal to _____ 8.04.

MFC = _____

Monopsony



Average Factor Cost (AFC) and Marginal Factor Cost (MFC)

In the monopsonistic factor market, the labor supply is upward-sloping.

Suppose AFC is linear, i.e., $AFC = a + bL$.

We have $TFC =$

$MFC =$

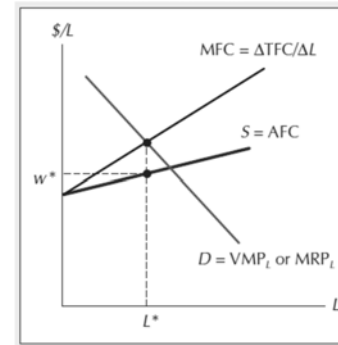
The slope of MFC is _____ that of AFC.

5

Monopsony



The monopsonist will hire the workers at the point where $VMP_L = MFC$ or $MRP_L = MFC$. This will be at L^* .



At L^* , the market supply indicates that the wage will be w^* .

This will be the wage that the monopsonist pays their workers.

6

Monopsony



Monopsonist's Profit Maximization

Firms in the competitive factor market will hire the workers at the point where $VMP_L = w$ or $MRP_L = w$.

But for a monopsonist, w is NO LONGER constant.

To hire more workers, it has to pay higher wage.

The monopsonist will hire the workers at the point where $VMP_L = MFC$ or $MRP_L = MFC$.

That is, the extra gain from hiring extra worker equals the extra cost from hiring extra worker.

7

Monopsony



CONCEPT CHECK 14.8

A monopsonist's demand for labor is given by $w = 12 - L$. If her AFC curve is given by $w = 2 + 2L$, with corresponding $MFC = 2 + 4L$, what wage rate will she offer and how much labor will she hire?



LEARNING-BY-DOING EXERCISE 11.8

Applying the Monopsonist's Profit-Maximization Condition

Suppose that a monopsonist's only input is labor and its production function is $Q = 5L$, where L is the quantity of labor (expressed in thousands of hours per week). Suppose, too, that the monopsonist can sell all the output it wants at a market price of \$10 per unit and that the supply curve it faces for labor is $w = 2 + 2L$.

Problem How much labor would the monopsonist hire, and what wage rate would it pay, to maximize profit?

Solution The monopsonist maximizes profit by hiring a quantity of labor corresponding to the point where the marginal revenue equals the marginal expenditure on labor.

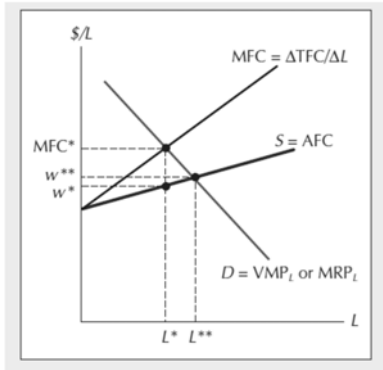
The marginal expenditure on labor is $L(\Delta w/\Delta L)$, where $\Delta w/\Delta L$ is the slope of the supply curve. In this case, $\Delta w/\Delta L = 2$. Now find this value for $\Delta w/\Delta L$ and the value for

8

Monopsony



Comparison b/w Competitive Factor Market and Monopsony



In the competitive factor market, wage is determined by market demand (D) and market supply (S).

Therefore, the competitive equilibrium is at (L^{**}, w^{**}) .

However, for Monopsony, the equilibrium is (L^*, w^*) .

Workers are paid lower wage, and fewer workers are hired.

Monopsony



Comparison b/w Monopsony and Competitive Factor Market

This shows exploitation of workers and inefficiency.

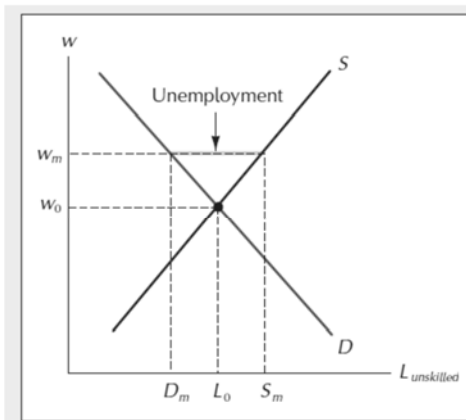
The **main cause** is that if the monopsonist wants to hire more workers, it has to increase wage, but it also has to pay this high wage for all other workers. This causes it to hire less workers.

In the competitive factor markets, one firm hiring more workers does not raise the market wage, so all firms can hire more.

Monopsony



Standard Model for Minimum Wage Law

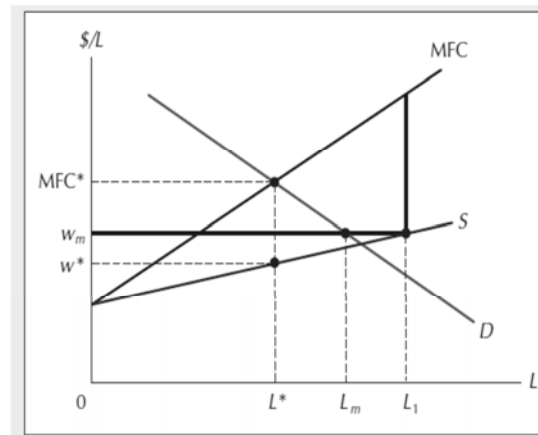


A Statutory Minimum Wage
The effect of the minimum wage is to reduce employment of unskilled labor from L_0 to D_m , while increasing supply from L_0 to S_m . The resulting difference, $S_m - D_m$, is the unemployment attributable to the minimum wage.

Monopsony



Monopsonist Model for Minimum Wage Law



The Minimum Wage Law in the Case of Monopsony
The effect of a minimum wage at w_m is to make the monopsonist's MFC curve horizontal in the region from 0 to L_1 , which increases employment from L^* to L_m .



Monopsony



Monopsonist Model for Minimum Wage Law

CONCEPT CHECK 14.9

A monopsonist's demand curve for labor is given by $w = 12 - L$. If she originally faced an AFC curve given by $w = 2 + 2L$, with corresponding $MFC = 2 + 4L$, how will her wage and employment offers be affected by the passage of a law requiring $w \geq 8$? A law requiring $w \geq 10$?