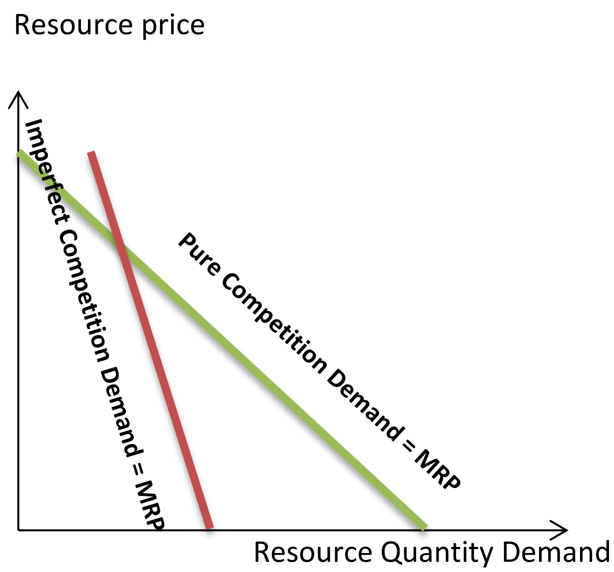
Answer on Question #60566 - Economics - Microeconomics

a) Assuming competitive factor markets, graphically illustrate and explain the difference between marginal revenue product for a competitive output market and a monopolistic output market.

Answer

Marginal revenue product (MRP) is the change in total revenue that results from each additional unit of resource. Therefore, marginal revenue product equals the change in total revenue divided by the unit change in resource quantity. Because of diminishing marginal product, marginal revenue product declines with increasing output. A firm in a competitive market that also uses factors of production that are sold in a competitive market can obtain all the resources that it wants at a constant market price and it can produce all that it wants to sell at the market price for the product. Therefore, the quantity demanded depends only on the resource price.

For firms that produce products in an imperfectly competitive market (monopolistic competition, oligopoly, or monopoly), a firm can only sell more output by decreasing the price of its products. However, if the firm lowers its price on a specific product, then it must lower its price for all of those products that it produces. Hence the demand curve for imperfect competition declines faster than for pure competition because of both declining marginal product and declining product price.



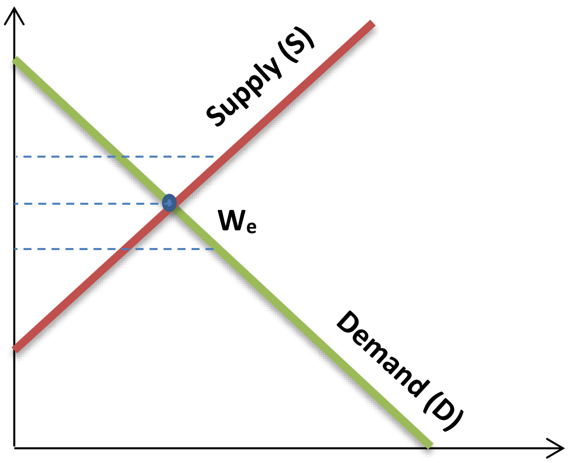
b) Assuming competitive factor markets, graphically illustrate and discuss the effect of an increase in the wage rate in a competitive labour market.

Answer

The demand for labour will be negatively sloped in all types of production for two reasons. First, a rise in the wage rate increases the costs of firms producing the commodity, forcing them to raise their selling prices. As the price of the product rises consumers will buy less of it and less output will be produced and sold. This means that less labour will be used. Second, since a rise in wages makes labour more expensive relative to capital, firms will substitute capital for labour. This means that less labour will be used to produce whatever output the firms in the industry sell.

If the wage is free to adjust in response to market forces it will move to We, where the demand for labour equals the supply. When the wage is above We, more labour will be presented for employment than firms in the industry can profitably hire. It will pay workers to lower their wages to obtain employment in the industry. And when the wage is below We, firms will find it profitable to hire more labour than is presenting itself for employment. They will offer a higher wage to obtain additional workers.

Wage Rate



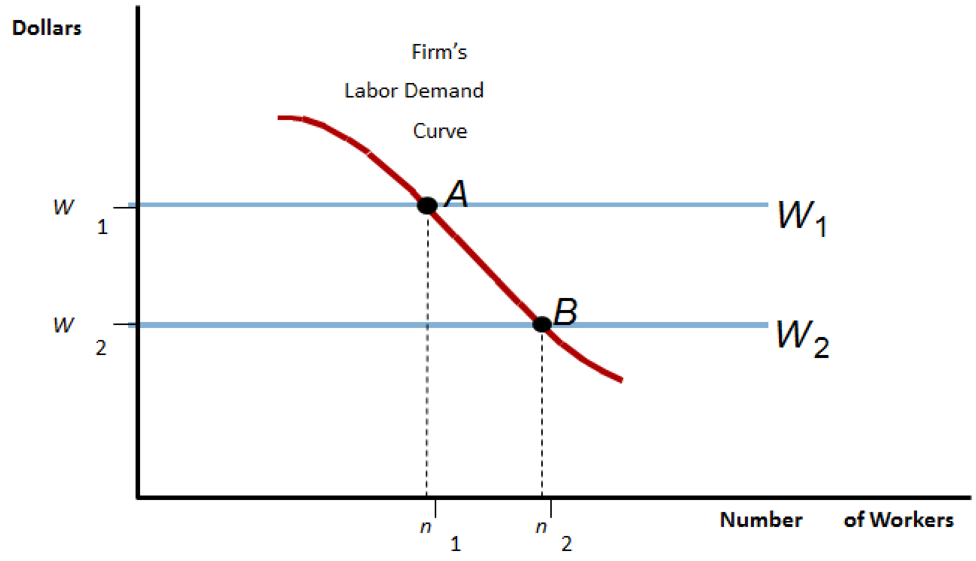
Quantity of Labour Employed

c) Graphically derive the long run demand curve in a competitive factor market and explain the underlying theory (assuming wages decrease).

Answer

Decrease in wage rate will cause an increase in employment

The Firm's Labor Demand Curve



The Employment Decision with Several Variable Inputs