Exercise walk-through

6.2
Labour markets and government intervention

Pearson Edexcel · International A-Level · Economics

Government intervention in product markets (5)

- limits on the power of large buyers (monopsony);
- **nationalisation** : in February 2008 the UK government took over the failing bank Northern Rock.
- **regulatory capture** : the regulator comes to serve the firms it regulates. After the 2010 Deepwater Horizon oil spill, investigators found that the US offshore drilling regulator had grown too close to the oil companies;

Government intervention in labour markets (2)

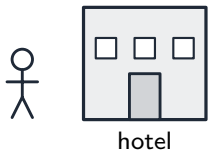
- policies to reduce immobility: training, relocation grants and more housing;
- laws against discrimination and exploitation.
- **Minimum wage of 9 yuan** (above the equilibrium of 8): labour supplied $= (9-4)/0.02 = 250$; labour demanded $= (16-9)/0.04 = 175$. 75 workers who want jobs cannot find them, but the 175 who are employed earn more.
- **Maximum wage of 6 yuan** (below the equilibrium): labour demanded $= (16-6)/0.04 = 250$; labour supplied $= (6-4)/0.02 = 100$. There is a shortage of 150 workers, and jobs stay empty.

Common errors (2)

- Mixing up **geographical immobility** (cannot move place) with **occupational immobility** (cannot change job).
- Describing an RPI − X cap as a fixed price. It allows prices to rise, but by less than inflation.
- Listing government measures without judging their effect on price, profit, efficiency, quality and choice.

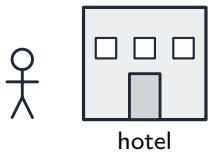
Exercise 2.1

2.1 Explain two factors that would make the demand for hotel cleaners more wage-elastic. [4]



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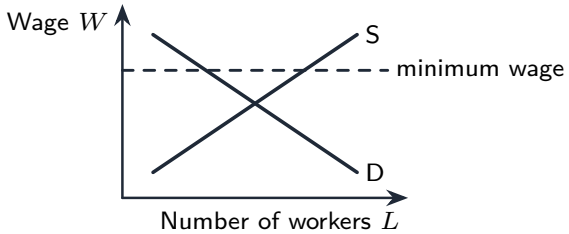
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2.1 Demand is more elastic when machines or self-service can replace cleaners easily, because a wage rise then triggers substitution; and when labour is a large share of the hotel's total costs, because a wage rise then raises total cost sharply and forces stronger cuts. Also credit: price-elastic demand for hotel rooms, longer time to adjust. Authored marking guidance (original, not an official scheme): B1 per factor identified, B1 per linked development.

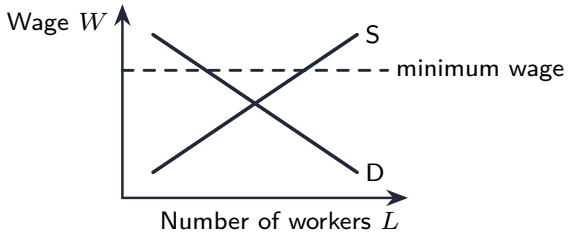
Exercise 2.2

2.2 A labour market has demand $\mathrm{W} = 20 - 0.05\mathrm{L}$ and supply $\mathrm{W} = 2 + 0.03\mathrm{L}$. Calculate the equilibrium wage and employment. The government then introduces a minimum wage of 11. Calculate the resulting surplus of labour. [6]



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2.2 Equilibrium: $20 - 0.05L = 2 + 0.03L$, so $0.08L = 18$ and $L_e = 225$ workers; $W_e = 20 - 0.05 \times 225 = 8.75$ per hour. The floor at 11 binds because $11 > 8.75$. Quantity demanded: $11 = 20 - 0.05L$ gives $L = 180$; quantity supplied: $11 = 2 + 0.03L$ gives $L = 300$. Surplus $= 300 - 180 = 120$ workers. Authored marking guidance (original): M1 method, A1 answers, B1 binding check.

Exercise 2.3

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occupational immobility

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occupational immobility

2.3 Causes: skills gained in a declining industry do not match growing industries; long or costly retraining and required qualifications block movement. Consequence (any one, B1 + B1 development): structural unemployment while vacancies stay unfilled; persistent wage differences between occupations; lost output and higher welfare spending. Authored marking guidance (original): B1 identification, B1 development per point.

Exercise 3.1

3.1 In 2024 the fictional island state of Aldara capped pay for all senior public-sector managers at 9 000 Aldaran dollars per month, below the previous market rate. Within a year, 12% of hospital and utility executives had resigned for private or overseas posts. Evaluate the impact of imposing a maximum wage. Illustrate your answer with an appropriate diagram(s). [20]



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3.1 Model response (original; official WEC13 essays are marked 12 for knowledge, application and analysis plus 8 for evaluation, with a Level-3 cap when no appropriate diagram is offered).

Definition and diagram: a maximum wage is a legal ceiling on pay, binding when set below the free-market equilibrium. Draw labour demand falling and supply rising, mark the equilibrium, then a horizontal ceiling below it: quantity demanded exceeds quantity

Full solution on next slide

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Full solution 3.1 (1/2)

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Definition and diagram: a maximum wage is a legal ceiling on pay, binding when set below the free-market equilibrium. Draw labour demand falling and supply rising, mark the equilibrium, then a horizontal ceiling below it: quantity demanded exceeds quantity supplied, giving a labour shortage. Aldara's cap binds because executives previously earned more than 9 000 dollars.

Analysis: the intended gain is fairness and lower pay inequality between executives and ordinary public workers, plus budget savings for the state. But the diagram's shortage is real: hospitals and utilities cannot fill senior posts at the capped wage, shown by the 12% resignation rate. Effort and morale of remaining managers may fall; some pay may move

Full solution 3.1 (2/2)

into untaxed benefits, creating evasion; and the best candidates may emigrate, lowering the quality of public services that poorer households rely on most.

Evaluation: the damage depends on how far below equilibrium the cap sits, how mobile these executives are (their resignations suggest high mobility), and whether non-pay motives (public service, job security, pensions) retain staff. The policy may work better where private alternatives are few; caps could also be paired with performance pay within the rules. Government failure is possible: ministers lacked information about the true reservation wages of specialist managers.

Judgement: in Aldara's case the cap probably costs more than it gains – the measured 12% resignation shows the shortage is not theoretical – so a narrower, sector-tested cap or a pay ratio rule would achieve fairness with less loss of skill. (≈340 words; allow supported alternative judgements with conditions.)