Homework 10 357 Answers 15 points

1. (3) Explain why the firm specific demand for labor is downward sloping. Explain why the firm specific demand is different for a monopolist than a perfectly competitive firm.

The firm specific demand is downward sloping because it is comprised of the marginal product of labor times the marginal revenue of the output. As the use of labor increases, the marginal product of labor decreases (and the marginal revenue either remains constant or falls). Thus, as you increase labor, the demand (or marginal benefit of labor should fall). The demand is different for a monopolist because the marginal revenue for a monopolist falls as you increase quantity (while a perfectly competitive firm faces a constant marginal revenue curve). Thus, a monopolist’s firm specific demand should fall faster than a perfectly competitive firm (all else being equal).

2. (6) Use a consumption versus leisure graph to illustrate a portion of an individual’s labor supply curve that is upward sloping. Explain what must be true about the income and substitution effects for this individual. Provide an intuitive explanation for why an individual would choose to work less when there is an increase in the wage.

The income effect must be less than the substitution effect because the income effect suggests that you purchase more leisure with an increase in the wage and the substitution effect suggests that you would purchase less leisure because it is relatively more expensive. An individual would choose to work less with an increase in the wage if he/she valued the additional leisure time more than the potential gains in consumption. With any increase in labor, there is a tradeoff between increasing consumption levels and decreasing leisure time. An individual must put enough importance on the increased leisure time to chose to leisure more.
3. (4) Is the existence of different wages for different groups of people proof of discrimination in the labor market (make sure to explain the factors that contribute to different wages)?

Economic discrimination occurs when equivalent factors of production receive different payments for equal contributions to output. Thus, one should examine whether different wages for different groups of people are being paid when factoring in contribution to output. Many factors serve as predictors of contribution to output such as education, work experience, etc. In addition, it is important to do the comparison across similar occupations because we discussed why different occupations would offer different wages and that could be a main factor of wage differences.

4. (2) Describe two possible explanations for the increase in income inequality in the United States over the last 35 years.

There will be many acceptable answers. As long as your answers address how wages to higher income individuals would grow faster than lower income individuals (and assuming they are historically accurate), they will be correct.