Monopsony

AP Microeconomics | Unit 5 | one buyer of labor: MRC, the graph, and the comparison

1. Why one more worker costs more than the wage

A **monopsony** is a market with **one buyer**; in a labor market, one employer. It faces the whole upward-sloping supply curve: to hire more workers it must raise the wage *for everyone*.

workers	wage	total labor cost	MRC
1	\$3	\$3	\$3
2	\$4	\$8	\$5
3	\$5	\$15	\$7
4	\$6	\$24	\$9
5	\$7	\$35	\$11

The 4th worker is paid \$6, and the first three each get \$1 more: $MRC = 6 + 3 \times 1 = \$9$.

Marginal resource cost = marginal factor cost (MFC)

MRC (also called MFC) is the change in *total* labor cost from one more worker. For a monopsony, $MRC > W$ after the first worker. On the graph the MRC curve lies **above** the supply curve and rises faster.

2. The monopsony graph

Example. Supply $W = 2 + L$, so $MRC = 2 + 2L$; $MRP = 14 - L$.

Two steps, in this order

1. **Quantity:** where $MRP = MRC$. Here $14 - L = 2 + 2L$, so $L = 4$.
2. **Wage:** go *down* from that quantity to the **supply curve**. $W = 2 + 4 = \$6$.

The wage is *not* read at the crossing (\$10).

3. Against a competitive labor market

A competitive market ends where supply meets MRP: $2 + L = 14 - L$, so $L = 6$ and $W = \$8$.

	competitive market	monopsony
workers hired	6	4
wage	\$8	\$6

A monopsony pays a **lower wage** and hires **fewer workers**. Deadweight loss: $\frac{1}{2} \times (10-6) \times (6-4) = \$4$, the triangle between MRP and supply from 4 to 6 workers.

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4. Monopoly in the mirror

	monopoly	monopsony
only one	seller	buyer
the extra curve	MR, below demand	MRC, above supply
quantity where	$MR = MC$	$MRP = MRC$
then go	up to demand: price	down to supply: wage
result	higher price, less output	lower wage, fewer workers

5. Minimum wage and other twists

Minimum wage \$8. Every worker now costs exactly \$8, so MFC is *flat* at \$8 until the supply curve rises above \$8 (6 workers), then it jumps back to the old MFC. $MRP = MFC$ at 6 workers, paid \$8: the wage **and** employment rise, all the way to the competitive outcome. A binding floor between \$6 and \$8 raises both, part of the way. In a monopsony a minimum wage can raise employment.

- Labor supply increases (more people willing to work at every wage): supply and MFC shift right, employment rises and the wage falls.
- A monopsonist that is also a monopolist seller has $MRP = MP \times MR$, below $MP \times P$: it hires fewer workers at a lower wage.
- A monopsonist that pays each worker his own lowest acceptable wage has $MFC =$ supply, so it hires the competitive quantity.
- One more worker changes profit by $MRP - MFC$ (not $MRP - W$); total wage bill $= W \times L$.

Where students lose points

1. Reading the wage at the $MRP = MRC$ crossing: go down to supply.
2. Drawing MRC below supply or on top of it: MRC is above supply.
3. Using wage = MRC: that is true only for a wage taker.
4. Mixing up monopsony (one buyer) and monopoly (one seller).
5. Saying a monopsony hires more or pays more than a competitive market.
6. "A minimum wage always cuts jobs": in a monopsony it can raise employment.

Now practise it

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