

## UNIT III: FACTOR MARKETS

### *AP Content Summary*

- III. Factor Markets (10-18%)
- A. Derived factor demand
  - B. Marginal revenue product
  - C. Labor market and firms' hiring of labor
  - D. Market distribution of income

### **Primary and Supporting Concepts:**

<b>Module</b> (Krugman)	<b>Chapter</b> (McConnell)	<b>Concepts</b>
69	12	Derived Factor Market and MRP <ul style="list-style-type: none"><li>• Labor, Financial, Land, and Competitive Factor Markets</li><li>• Derived Demand</li><li>• Value of MP (or, more commonly, MRP)</li><li>• Market income distribution</li></ul>
71	13	Labor Market and hiring of workers <ul style="list-style-type: none"><li>• Supply of Labor</li><li>• Equilibrium</li></ul>
70	14	Financial (Capital) and Land (Natural Resources) Markets
72	***	Cost-Minimizing Input Combination
73, 78	***	Income Distribution (Subsidies, Taxes, Entitlements, etc)

## TOPIC 1

### Resource Demand

Read Krugman Module 69

#### *Objectives*

1. Identify resources that are used in the productive process.
2. Explain the concept of derived demand as it applies to resource demand.
3. Determine the Value of the Marginal Product schedule for an input when given appropriate data.
4. State the principle employed by a profit-maximizing firm in determining how much of a resource it will employ.
6. Explain why the VMP schedule of a resource is the firm's demand schedule for the resource in a purely competitive product market. (VMP=MRP in Perfectly Competitive Labor Markets; MRP is in Topic 2)
7. List the determinants of demand for a resource and explain how a change in each of the determinants would affect the demand for the resource.

#### *Vocabulary*

Factors of Production	Factor Payments (WIRP)
Derived Demand	Value of the Marginal Product (VMP)
Derived Demand	Factor Distribution of Income
	Determinants of Resource Demand

#### *Key Conceptual Questions*

1. What determines the demand for a factor of production in a competitive firm and in a monopolistic firm?
  2. List and explain three factors that would increase the demand for a resource.
  2. If a firm wants to maximize profits, how much of each factor should be hired (or bought)?
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## TOPIC 2

### The Supply of Labor and Wage Determination

*Read Krugman Module 71*

#### *Objectives*

1. Analyze the relationship between leisure and work.
2. Define the Substitution and Income Effects on the labor Supply curve.
3. List and explain the determinants that shift Labor Supply curves.
4. Apply the  $MRP = MRC$  (also known as  $MFC$ ) principle to find the quantity of a resource a firm will employ when given the necessary data.
5. Determine the equilibrium wage rate and employment level when given appropriate data for a firm operating in a purely competitive labor market and a Monoposony.
6. Illustrate graphically how wage rates are determined in purely competitive and Monopsonistic labor markets.

#### *Vocabulary*

Income Effect	Substitution Effect
Determinants of Labor Supply	Equilibrium in the Labor Market
MRP	MFC
Purely Competitive Labor Market	Monoposony
$MRP = MP * MR$	$MRP = W$ (Perfectly Competitive Labor Market)
$MRP = MFC$ in Monoposony	

#### *Key Conceptual Questions*

1. How is an industry wage rate determined?
  2. Compare and contrast the wage rates and levels of employment in a purely competitive industry with that of an imperfect competitor.
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## TOPIC 3

### **Rent, Interests, and Profits**

*Read Krugman Module 70*

#### *Objectives*

1. Determine Supply and Demand in the markets for land and capital
2. Find the equilibrium price and quantity in the markets for land and capital
3. Analyze how the demand for factors leads to the marginal productivity theory of income distribution

#### *Vocabulary:*

Economic Rent (Rental Rate)                      Interest  
Marginal Productivity Theory of Income Distribution

#### *Key Conceptual Questions*

1. What is rent?
  2. What are interest rates and profits and what are their economic functions?
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## TOPIC 4

### **Cost Minimizing**

*Read Krugman Module 72*

#### *Objectives*

1. State the rule for determining the least-cost combination of resources.
2. When given necessary data, find the quantities of two or more resources a profit-maximizing firm will hire.

#### *Key Terms*

Capital-intensive  
Cost-Minimizing Rule

Labor-intensive

#### *Key Conceptual Questions*

1. Determine the optimal input combination given the necessary information.
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## TOPIC 5

### Theories of Income Distribution

*Read Krugman Module 73*

#### *Objectives*

1. Explore the ways in which the Marginal Productivity Theory affects wage disparities between workers.
2. Determine the role of discrimination in wage disparities.
3. List the methods used by labor organizations to increase wages and the impact each has on employment.
4. Present the major points in the cases for and against the minimum wage.
5. Using a Lorenz Curve, analyze the trends of income inequality (rich-poor gap) in the United States.

#### *Key Terms*

Compensating Differentials  
Collective Bargaining  
Discrimination  
Lorenz Curve

Unions  
Efficiency-wage Model  
Wage Disparities