Case 2.5 Reducing child labour: which policy works best?

Summary

This case study uses the example of comparing the efficacy of alternative (supply-side and demand-side) policies to illustrate that the price elasticity of demand and supply is an important determinant of the magnitude of changes to equilibrium price and quantity when demand and/or supply change.

Suggested answers

1 For each of the following goods, which good would you expect to have the higher degree of own-price elasticity of demand? Why?

a car-repair manuals – mystery novels

Mystery novels are likely to have higher price elasticity than car repair manuals. Car repair manuals are probably more necessary and there are fewer substitutes for a specific car repair manual.

b soft drink – water

Soft drink is likely to have a higher price elasticity than water, as water is more necessary and there are fewer substitutes for water.

c pharmaceutical drugs for heart conditions – personal fitness trainers

Personal fitness trainers are likely to have a higher price elasticity than pharmaceutical drugs for heart conditions. Pharmaceutical drugs are more necessary, and there are more substitutes for personal fitness trainer (for example, gym membership).

2 What is the relative efficacy of demand-side and supply-side policies if labour demand is relatively wage inelastic and labour supply if relatively wage elastic? How would you expand this finding?

Making the opposite assumptions on wage elasticities of labour demand and supply reverses the conclusion on the relative efficacy of demand-side and supply-side policies. Policies that cause a reduction in demand for child labour will cause a larger reduction in usage of child labour than policies to reduce the supply of child labour.

Reducing demand for labour causes excess supply, due to which the wage for child labour decreases. With the supply of labour being relatively wage elastic, this will cause a relatively large reduction in usage of child labour. On the other hand, reducing the supply of labour will cause excess demand, due to which the wage for child labour increases. But with demand for child labour being relatively wage inelastic, there will not be a large decline in usage of child labour.

Wage

Wage

LS

LS1

LS2

Supply-side policy

Demand-side policy

L1\*

L2\*

L2

\* L1\*

LD1

LD2

LD

Qty child labour

Qty child labour

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•

•

•

A

B

A

B

3 Alan Accountant and Edwina Economist are debating the optimal policy for government to apply to reduce illicit drug use. Alan says: ‘We know that the demand for illicit drugs is own-price inelastic, and that the supply of those drugs is own-price elastic. Therefore, the government will have most impact in reducing illicit drug use if it puts more emphasis on policies that reduce supply rather than policies that reduce demand.’ Edwina says: ‘I agree with your description of the price elasticity of demand for and supply of illicit drugs. But you have made the wrong policy recommendation. The government can have most impact in reducing illicit drug use if it puts more emphasis on policies that reduce demand rather than policies that reduce supply.’

Who is correct, Alan or Edwina?

Edwina is correct and Alan is incorrect. When the demand for drugs is own-price inelastic and supply of drugs is own-price elastic then a given shift in the supply curve will cause a smaller decrease in quantity traded than the same given decrease in demand. Hence, for a given size of decrease in demand or supply, the demand-side policy will cause a large decrease in usage of illicit drugs than a supply-side policy.

P

P

Q

Q

Q2\*

Q1\*

S1

D

S2

Supply side policy

Q2\*

Q1\*

S

D1

D2

Demand side policy