(a) Discuss how wage rates are determined in a perfect market. [12]

(b) If the labour market is imperfect, is the determination of wage rates still better left to that market? [13]

a). Define perfect market

Perfect labor market is where there are a lot of firms willing to hire labor and abundant supply of people willing to provide their labor services.

Perfect labor market has following characteristics:

1. Firms are wage takers, which means that whatever wage is determined through market forces of demand and supply of labor each firm will pay its workers the same wage.
2. There is no government intervention as no firm or worker is being exploited and therefore the government does not feel the need to regulate the market.
3. Absence of labor union
4. Labor is homogeneous which means that workers possess similar skills and therefore they all could be paid similar wages
5. Labor is mobile which means that people can easily switch between occupations and move to other areas for jobs.

Then explain who wages are determined through market forces of demand and supply and whatever wage rate is determined like this will be the supply of labor for each firm.

b). Define imperfect labor market

Imperfect labor market is where there is limited demand for labor because of few firms willing to hire and / or limited supply of labor due to few people willing to work.

Imperfect labor markets have following characteristics:

1. Wages are not determined solely by market forces of demand and supply and instead other factors are also important in determining wages like the existence of trade union, government intervention, and firms and workers' bargaining powers.
2. Labor does not have homogenous skills which means some people deserve more wages than others based on their skills set.
3. Labor is immobile which means it is hard for labor to switch between occupations and area for jobs.

Types of Imperfect Labor Markets

a. Monopsony Market
b. Presence of Trade Union
c. Government Intervention

Monopsony is a labor market with a single employer. Which means that there is one firm which is willing to hire a certain type of labor.

The government will intervene and make sure that such workers are paid good enough for them to continue working in their own home countries.

In 2002 in the UK public sector fire-fighters threatened to go on strike because they stated that their earnings were very low compared with other workers. In the same year Robbie Williams, a singer from the UK, signed the largest ever recording deal in the music industry, worth millions of pounds.

Discuss whether the economic theory of wages can explain how workers in a vital industry such as the fire-fighting service can have lower pay than workers in a less vital industry such as entertainment. [25]

Answer) Define how wages are determined in free markets.

Define Labor Market
Define Labor Supply

Labor demand is derived demand which means labor is demanded to produce goods and services which are sold to customers and therefore it helps a business earns revenue.

Labor demand refers to the total quantity that is being demanded by a firm at different wage rates.

Labor Supply is defined as the total number of people who are willing and able to work at different wages rates.

Then explain why you would expect the demand for firefighters to be less than the demand for singers because firefighters do not generate much revenue for the companies they work for as these are government organizations which cannot charge much to their customers given the fact that these services are considered basic rights of the country's citizens. On the other hand, singers generate huge revenue for companies they are hired by because the concert ticket prices are huge and therefore the demand for singers is much more than demand for firefighters.

Then explain why the supply of singers is more than the supply of firefighters. Since becoming a signer requires unique talent which not many people can possess and therefore there are expected to be less singers than firefighters which technically anyone with basic education and skills can become.

Other factors that affect wages of occupations:

1. Wage elasticity of labor demand and labor supply

Between 1995 and 2000 there was a change in work patterns in Mauritius. Fewer people worked in agriculture and fisheries as the country diversified away from its staple crop, sugar, and more worked in restaurants and hotels as the tourist industry increased. However, in 2000 the government stated that the economy still suffered from an inadequately trained workforce with a lack of skills.

How far can the economic theory of wages explain the implications of this situation for the wages of an agricultural labourer **and** a hotel manager? [25]

Answer: You should start with identifying reasons for wage differential between agricultural workers and hotel managers.

Demand for agricultural workers is expected to be low due to lower marginal revenue product of labor compared to hotel managers who generate more revenue for their hotels. Since tourists have higher spending power and they are often looking for luxurious hotel to reside in they do not mind paying higher charges and therefore as the result hotel managers make more revenue.

Whenever there is a question related to wage differential do mention the concepts of wage elasticity of labor supply and wage elasticity of labor demand.

Since trained labor force is more required in hotel industry therefore lack of skilled workforce in Mauritius will affect hotel industry more than agriculture sector. For agriculture sector anyone who is physically fit and is willing to work can be engaged in work which is not the case for hotel industry.

(a) Explain whether there is a link between the marginal revenue product of labour and the wage rate in an occupation. [10]

(b) The price of a firm's product is above the average total cost. Discuss whether the firm should stop production if its price falls. [15]

Define marginal revenue product of labor: is the additional revenue that each additional unit of labor generates.

b) Define Average Total Cost: the cost of producing a typical unit of the good is known as average total cost.

Total Cost = Fixed Cost + Variable Cost

Average Total Cost = Total Cost / Output

Profit = Revenue - Cost

As long as the firm's price is higher than its average total cost it would be making a profit.

In the long

(a) Discuss how wage rates are determined in a perfect market. [12]

(b) If the labour market is imperfect, is the determination of wage rates still better left to that market? [13]

B) The market supply of labor shows the total number of people who are willing to work at different wage rates. Market supply of labor is made up of individual labor supply curves.With horizontal summation of individual supply curves we extract the market supply curve.

Individual labor curve shows the number of hours someone is willing to work at certain wage rate. Initially the curve slopes upwards and after a certain wage rate it starts to bend backwards. For the upward sloping part substitution effect is stronger meaning someone would want to work longer hours with increase in wage rate and vice versa. And for the backward bending part the income effect is stronger meaning the individual prefers leisure time over work given he /she would already be earning more in total with higher wage rate per hour.

b) Define imperfect labor market

Imperfect labor market is when due to the presence of factors like government intervention, existence of trade unions or monopsony, the wage rates are not solely determined by market forces of demand and supply and instead they are dependent on other factors.

Government might intervene in labor markets to achieve a more equitable outcome through policies like minimum wages, labor laws regarding working conditions etc. When the government intervenes and makes such policies then the cost of hiring labor increases and that would decrease the demand for labor. Eventually lower demand for labor would adversely affect employment levels.

Trade unions are organizations / platforms that represent workers belonging to a certain firm, industry or sector. Trade unions collectively bargain with employers for the rights of their members and therefore would take ***industrial action*** in case their demands are not being met to pressurize the firm/ employer to accept their demands.

Industrial action is when a trade union relies on strike, protest or any other form of bargaining to get their demands from the employer met. With increased labor cost, firms are likely to demand less labor and instead try to replace labor with capital.

Monopsony is a single employer in a region or market which means that it is the only employer for a certain type of labor. For instance, a nuclear research lab is the only organization that can hire nuclear scientists.

Monopsonist is exploitative as it knows that it is the only employer for a certain labor therefore it can afford to pay employees less and still retain them. To control monopsony the government would want to intervene and make labor laws to protect labor rights and therefore in this case it would be better if wage rate determination is not left to market forces.

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Wage Differential: difference in the earnings of different occupations

The primary reason for the wage differential is the difference in demand and supply of a certain type of labor.

Demand for Labor: is based on marginal revenue product of labor.

Economic theory often produces a definite outcome but in reality events are much less certain.

(a) Explain the economic theory of wage determination in perfect competition. [12]

(b) Discuss whether this theory is useful in explaining how wages are determined in reality. [13]

a) Define perfect competition

- It is a market structure where there are a lot of firms and many consumers willing to buy the good.

- The products are homogenous (similar)

- There are no entry and exit barriers
- Firms are price takers which means that they will sell all products at the prevailing market price.
- Consumers have complete information

In perfect competition there will be a perfect labor market since there are many firms that are willing to hire labor and many people who are looking for work.

The wages in a perfect labor market are determined by market forces of labor demand and labor supply.

Market demand for labor is the sum of individual firms labor demand curves. Market demand for labor shows the total quantity of labor demanded by all firms in that industry at different wage rates.

Market supply of labor is the total quantity of labor available to work at different wage rates.

b) In reality, wage determination is based on a couple of other factors apart from demand and supply of labor including government labor policies, trade unions, monopsony conditions, wage discrimination, nepotism etc.

Firstly government labor laws can influence the labor market outcome through its policies of minimum wages.

Trade unions also influence the labor market outcome through collective bargaining. They ask for higher wages and better working conditions for all of their members and in case their demands are not being met then they take industrial action like going on a protest, or a strike etc.

This makes labor supply inelastic as trade union is able to control labor supply and therefore that forces the company to pay labor more.

Monopsony is a single employer in the market which gets to exploit employees.

Wage Discrimination is when someone is being paid less than his / her counterpart with similar skills, qualifications and experience. Wage discriminations is commonly faced by female workers, people of color and other foreign workers who do not belong to a certain country.