Exam Papers Practice

The Determination of Relative Wage Rates and Levels of Employment in Perfectly Competitive Labour Markets

AQA AS Level Economics Revision Notes

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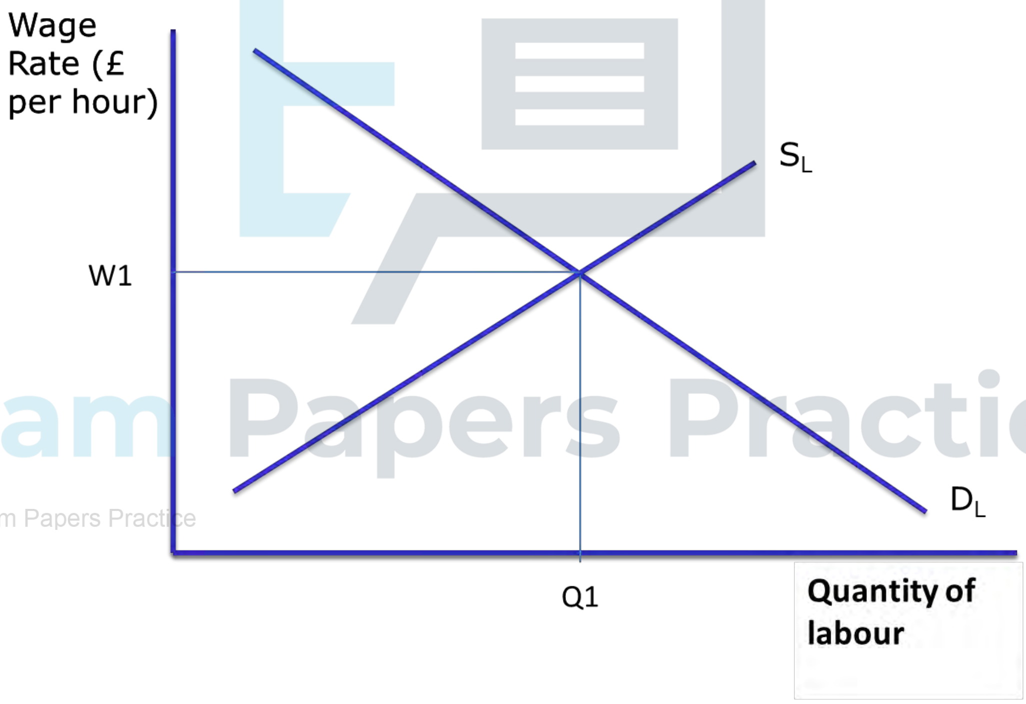
The economists' model of wage determination in a perfectly competitive labour market and the role of market forces in determining relative wage rates

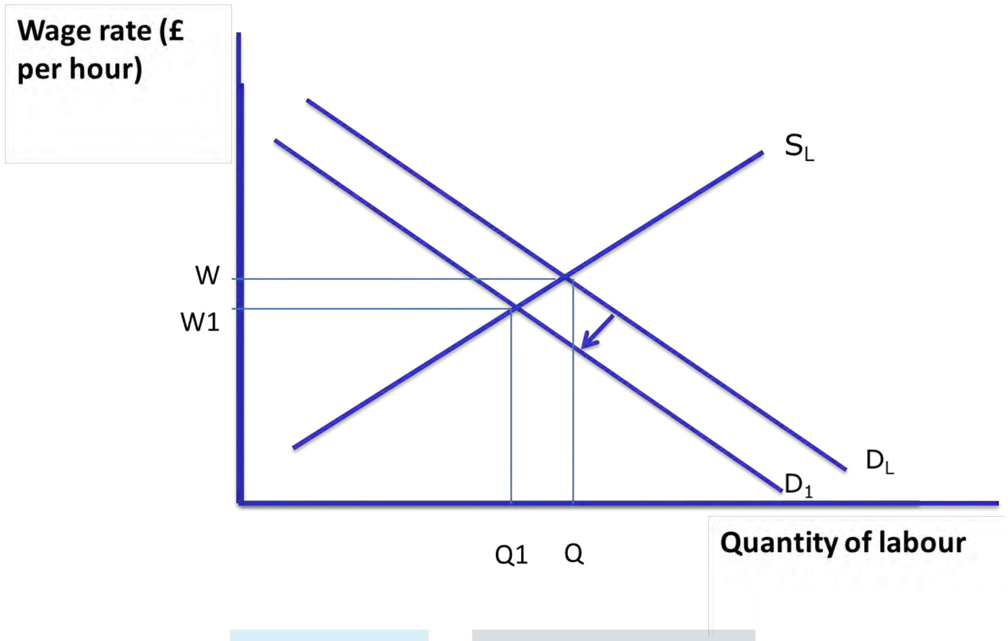
Labour market equilibrium:

The labour market is a factor market. The supply of labour is determined by those who want to be employed (the **employees)**, whilst the demand for labour is from **employers.**

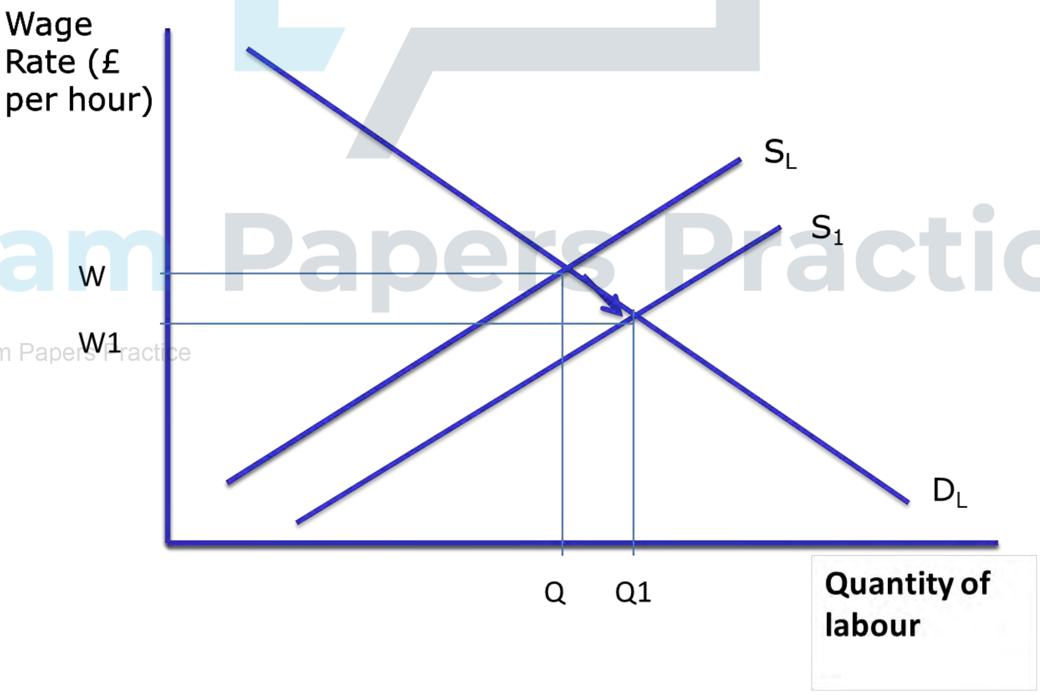
Labour market equilibrium is determined where the supply of labour and the demand for labour meet. This determines the equilibrium price of labour, i.e. the wage rate.



When the demand for labour falls, such as during a recession, in a free market the wage rate would fall from W to W1.



If the supply of labour increases, such as if the retirement age was raised, the wage rate would fall from W to W1.



However, in the real labour market, wages are not this flexible. Keynes coined the phrase 'sticky wages'. Wages in an economy do not adjust to changes in demand. The minimum wage makes wages sticky and means that during a recession, rather than lowering wages of several workers, a few workers might be sacked instead.