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Skip to content Content Skip to main contentPerfectly Competitive Labour MarketEconomicsIn a perfectly competitive labor market, many firms compete to hire workers with identical skills, and workers have perfect information about job opportunities and wages. The market is characterized by a large number of buyers and sellers, homogenous products, and free entry and exit. Wages are determined by the intersection of the supply and demand for labor, with no individual or firm having the power to influence the market wage.Written by Perlejo with AI-assistanceindex pages curate the most relevant extracts from our library of academic textbooks. They've been created using an in-house natural language model (NLM), each adding context and meaning to key research topics, scores/ides/teachers There are certain conditions that a market has to meet to be perfectly competitive. As we mentioned before, there must be a large number of buyers and sellers, all of whom are unable to influence the market wage, and all of whom operate under perfect market information. In the long term, employers and employees would be free to enter the labour market, but a particular employer or firm would be unable to affect the market wage by its own actions. All of these conditions must take place simultaneously for a perfectly competitive labour market to exist.Think of the many secretaries supplying labour in the city. Employers have a variety of secretaries to choose from when deciding to hire at the prevailing market wage. Hence, every secretary is forced to supply their labour at the market wage as employers would just end up hiring somebody else.Note that this example is taken from the real world. However, this example only has some features of the theoretical perfectly competitive labour market, which hardly exists in the real world.One of the main things to keep in mind when considering perfectly competitive labour markets is that there are many buyers and sellers, and none of those can influence the prevailing market wage.In a perfectly competitive market for goods and services, a firm is able to sell as much as it wants. The reason for that is that the firm is faced with a perfectly elastic demand curve.A similar scenario appears in the case of a perfectly competitive labour market. The difference is that instead of the firm facing a perfectly elastic demand curve, it faces a perfectly elastic labour supply curve. The reason the supply curve of labour is perfectly elastic is that there are many workers offering the same services. If a worker was to negotiate their wage, instead of E4 (the market wage), they would ask for E6. The firm could simply decide to hire from the infinitely many other workers that would do the job for E4. This way the supply curve remains perfectly elastic (horizontal).Fig 1. - Perfectly competitive labour marketIn a perfectly competitive labour market, every employer has to pay their employees a wage that is determined by the market. You can see the wage determination in Diagram 2 of Figure 1, where the demand and the supply for labour meet. The equilibrium wage is also the wage at which we can find the perfectly elastic labour supply curve for a firm. Diagram 1 of Figure 1 shows this horizontal labour supply curve. Due to the perfectly elastic labour supply curve, the average cost of labor (AC) and the marginal cost of labor (MC) are equal.For a firm to maximise its profits, it would have to hire labour at the point where the marginal revenue product of labour equals the marginal cost of labour:MRPL= MCLAt the profit-maximising point the extra output received from hiring an additional worker is equal to the additional cost of hiring this extra worker. As the wage always equals the marginal cost of hiring an extra unit of labour in a perfectly competitive labour market, the quantity demanded of a firm looking to hire workers would be where the wage is equal to the marginal revenue product of labour. In Figure 1 you can find this at point E of Diagram 1 where it also shows the number of workers a firm is willing to employ, in this case Q1.If the firm would hire more workers than the equilibrium suggests, it would incur more marginal cost than marginal revenue product of labour, therefore, shrinking its profits. On the other hand, if the firm decided to hire fewer workers than the equilibrium point would suggest, the firm would make less profit than it otherwise would, as it can have more marginal revenue from hiring an extra worker. The firm's profit-maximising hiring decision in a perfectly competitive labour market is summarised in Table 1 below.Table 1. Firm's hiring decision in a perfectly competitive labour market If MRP > W, firm will hire more workers. If MRP < W firm will reduce the number of workers.If MRP = W firm is maximizing their profits.Another important factor you should note in a perfectly competitive labour market is that the Marginal Revenue Product of Labour is equal to the firm's demand curve at each possible wage rate.One of the main characteristics of a perfectly competitive labour market is that the supply, as well as the demand for labour, is set in the labour market where the equilibrium wage is determined.To understand the characteristics of perfectly competitive labour markets, we need to first understand what influences the supply and the demand for labour. Two factors influence an individual's supply of labour: consumption and leisure. Consumption includes all the goods and services that an individual buys from the income they earn from supplying labour. Leisure includes all the activities that someone would do when they are not working. Let's recall how an individual chooses to supply their labour. Meet Julie. She values the quality time she spends at a bar with her friends and she also needs an income to cover all her expenses. Julie will determine how many hours of work she wants to supply based on how much she values the quality time she spends with her friends. In a perfectly competitive labour market, Julie is one of many workers who is supplying labour. As there are many workers employers can choose from, Julie and others are wage-takers. Their wage is determined in the labour market and it is non-negotiable. There aren't just many individuals supplying labour, but there are also many firms demanding labour. What does this mean for the demand for labour? How do firms choose to hire? In a perfectly competitive labour market, a firm chooses to hire labour up to the point where the marginal revenue received from hiring an additional person is equal to the market wage. The reason for that is because that is the point where the firm's marginal cost equals its marginal revenue. Hence, the firm can maximise its profit. Regardless of how many workers or employers enter the market, in a perfectly competitive labour market, the wage is determined by the market. None can influence the wage. Both the firms and workers are wage-takers.Both buyers and sellers are wage-takers in a perfectly competitive labour market. However, this does not mean that the wage isn't subject to change. The wage can change only when there is a shift in either market labour supply or labour demand. Here we explore some factors that could cause the market wage to change in a perfectly competitive labour market by either shifting the supply or the demand curve.There are several reasons that could cause the market labour demand curve to shift:The marginal productivity of the labour force. An increase in the marginal productivity of labour increases the demand for labour. This translates to a quantity increase of the hired labour and wages are pushed up to higher rates.The quality demanded for all firms' output. If the demand for all the firms' output drops, then this would cause a leftward shift in the demand for labour. The quantity of labour would drop and the market wage rate would decrease.A new technological invention that would be more efficient in production. If there was a new technological invention that would help in the production process, the firms would end up demanding less labour. This would translate into a lower quantity of labour and the market wage would drop.Price of other inputs. If the prices of other inputs become cheaper, then firms may end up demanding more of those inputs than labour. This would lower the quantity of labour and bring the equilibrium wage down.Fig 2. - Labour demand curve shiftFigure 2 above shows a shift in the market labour demand curve. There are several reasons that could cause the market labour supply curve to shift:Demographic changes such as migration. Migration would bring many new workers into the economy. This would shift the supply curve rightwards where the market wage would decrease, but the quantity of labour would increase.Changes in preferences. If workers' preferences changed and they decided to work less, this would shift the supply curve leftwards. As a result, the quantity of labour would decrease but the market wage would increase.A change in government policy. If the government started making it mandatory for some job positions to have certain certifications that a big part of the labour didn't have, the supply curve would shift leftwards. This would cause the market wage to go up, but the quantity of labour supplied would decrease.Fig 3. - Labour supply curve shiftFigure 3 above shows a shift in the market labour supply curve.It is extremely difficult to find perfectly competitive labour market examples in the real world. Similar to a perfectly competitive goods market, it is almost impossible to meet all the conditions that make up a perfectly competitive market. The reason for that is that in the real world, firms and workers have the power to influence the market wage. Although there aren't perfectly competitive labour markets, some markets are close to what a perfectly competitive one would be. An example of such a market would be the market for fruit-pickers in some regions of the world. Many workers are willing to work as fruit-pickers and the wage is set by the market.Another example is the labour market for secretaries in a big city. As there are many secretaries, they have to take the wage as given by the market. Firms or secretaries are unable to influence the wage. If a secretary asks for a wage of E5 and the market wage is E3, the firm could quickly find another one that would work for E3. The same situation would happen if a firm was trying to hire a secretary for E2 instead of the market wage of E3. The secretary could quickly find another company that would pay the market wage.One thing you should keep in mind when it comes to examples of perfectly competitive labour markets is that they often occur where there is a huge supply of unskilled labour. These unskilled laborers can't negotiate for wages as there are plenty of workers who would do the job for the determined market wage.Although perfectly competitive labour markets do not exist in the real world, they provide a benchmark for assessing the level of competition in other types of labour markets that do exist in the real world. Perfectly Competitive Labour Markets - Key takeawaysA perfectly competitive labour market happens when there are a lot of buyers and neither can influence the market wage. It rarely exists in the real world because firms and workers can influence the market wage in practice.In the long run, there are many workers and employers that could enter the market but none of them is able to influence the prevailing market wage.In a perfectly competitive labour market, the supply curve of labour is perfectly elastic. The wage is determined in the whole market and it equals average cost and marginal cost of labour.For a firm to maximise its profits, it would have to hire labour to the point where its marginal revenue equals the marginal cost. As the wage always equals the marginal cost of hiring an extra unit of labour in a perfectly competitive labour market, the demand of a firm looking to hire workers would be where the wage is equal to the marginal revenue product of labour.The marginal revenue product of labour is equal to the firm's demand curve at each possible wage rate.In a perfectly competitive labour market, workers and firms are wage-takers. The prevailing market wage can change only if there's a shift in either the market demand or market supply of labour. In the realm of economics, the concept of a perfectly competitive labour market serves as a theoretical benchmark to understand how wages and employment are determined. It's a scenario where numerous firms compete for workers, and countless workers vie for jobs, resulting in a highly efficient and transparent market. While this ideal scenario rarely exists in its purest form in the real world, it provides a valuable framework for analyzing labor market dynamics. Defining the Characteristics of a Perfectly Competitive Labor Market To grasp the essence of a perfectly competitive labor market, it's crucial to understand its defining characteristics: Many Buyers (Firms) and Sellers (Workers): The market is characterized by a large number of firms seeking labor and a vast pool of workers willing to supply their services. This ensures that no single entity has the power to influence wages or employment levels. Imagine a bustling city with countless businesses needing employees and a vast population eager to work. Homogeneous Labor: The labor supplied is considered identical or interchangeable. This means workers possess similar skills, experience, and productivity, making them essentially indistinguishable from one another. Think of a large call center where all agents perform the same tasks and have comparable training. Perfect Information: Both firms and workers possess complete and accurate information about wages, job opportunities, and worker skills. This transparency allows for informed decisions and prevents any information asymmetry that could distort the market. In a perfectly informed market, workers know the exact wage offered by every firm, and firms are aware of the skills and qualifications of every worker. Free Entry and Exit: Firms can easily enter or exit the labor market without facing significant barriers. This ensures that the market is dynamic and responsive to changes in demand and supply. If a new industry emerges with high demand for labor, firms can readily enter the market to fill the need. Similarly, firms can exit the market if demand for their labor decreases. Mobility of Labor: Workers can freely move between jobs and locations without encountering significant obstacles. This allows them to seek out the best wages and working conditions. In a perfectly mobile labor market, workers can easily relocate to areas with higher wages or better job prospects. Equilibrium in a Perfectly Competitive Labor Market The equilibrium point in a perfectly competitive labor market is reached when the supply of labor equals the demand for labor. This equilibrium point determines the equilibrium wage rate and the equilibrium quantity of labor employed. Let's break down how this equilibrium is achieved: Demand for Labor: Firms demand labor based on the marginal revenue product (MRP) of labor. MRP represents the additional revenue generated by employing one more worker. Firms will hire workers as long as the MRP exceeds the wage rate. In essence, firms will continue to hire workers as long as the additional revenue they generate is greater than the cost of employing them. Supply of Labor: Workers supply labor based on their opportunity cost. This is the value of the next best alternative use of their time. For instance, a worker might choose to work if the wage offered is higher than the value of their leisure time or the income they could earn from another job. As wages increase, more workers are willing to supply their labor, leading to an upward-sloping supply curve. Equilibrium: The intersection of the demand and supply curves for labor determines the equilibrium wage rate and the equilibrium quantity of labor employed. At this equilibrium point, the MRP of labor equals the wage rate, and the quantity of labor supplied equals the quantity of labor demanded. This means that all workers who are willing to work at the equilibrium wage rate will find employment, and firms will hire all the workers they need at that wage. Implications of a Perfectly Competitive Labor Market The perfectly competitive labor market model has several significant implications: Efficient Allocation of Resources: In a perfectly competitive labor market, resources are allocated efficiently. Workers are employed in jobs where their skills are most valuable, maximizing productivity and output. This efficiency arises from the fact that firms hire workers until the MRP equals the wage rate, ensuring that the value of the last worker hired is equal to the cost of employing them. Wage Equality: All workers with identical skills and productivity receive the same wage. This eliminates wage discrimination based on factors unrelated to productivity, such as gender, race, or religion. The assumption of homogeneous labor ensures that all workers are paid based solely on their contribution to production. No Market Power: No single firm or worker has the power to influence the market wage rate. This prevents exploitation of workers by firms or vice versa. The large number of buyers and sellers ensures that no single entity can dictate terms or influence the market price of labor. Limitations of the Perfectly Competitive Labor Market Model While the perfectly competitive labor market model provides a valuable framework for understanding labor market dynamics, it has certain limitations: Imperfect Competition: In reality, most labor markets are not perfectly competitive. Firms often have some degree of market power, allowing them to influence wages and employment levels. For example, a large corporation might be able to pay lower wages than smaller firms due to its size and bargaining power. Heterogeneous Labor: Workers are not homogeneous. They possess different skills, experience, and productivity levels. This heterogeneity makes it difficult to establish a single equilibrium wage rate for all workers. Imperfect Information: Workers and firms often lack complete information about wages, job opportunities, and worker skills. This information asymmetry can lead to inefficiencies in the labor market. For example, workers might not be aware of all the job opportunities available, or firms might not be aware of the skills and qualifications of all potential employees. Barriers to Entry and Exit: Firms may face barriers to entry and exit, such as licensing requirements, regulations, or high start-up costs. These barriers can limit competition in the labor market and reduce its efficiency. Labor Unions: Labor unions can negotiate wages and working conditions for their members, potentially leading to wages that are higher than the equilibrium wage rate in a perfectly competitive market. This can create inefficiencies by reducing the number of jobs available and increasing the cost of labor. Conclusion The perfectly competitive labor market model is a powerful tool for understanding the forces that determine wages and employment. However, it's essential to recognize its limitations and acknowledge that real-world labor markets are often more complex and less perfect than the theoretical model suggests. By understanding the assumptions and limitations of the model, we can gain a more nuanced understanding of how labor markets function in the real world. Labour markets, like other markets in economics, can function under different competitive structures that significantly influence how wages are determined and employment decisions are made. Understanding these structures gives us insight into why workers with similar skills may earn different wages across industries and why some sectors experience labour shortages while others face unemployment. The distinction between perfectly competitive and imperfectly competitive labour markets reveals the economic forces that shape our working lives. Table of Contents A perfectly competitive labour market exists when neither employers nor workers have enough market power to influence wages. This theoretical model serves as a baseline for understanding more complex market structures. Key characteristics of perfect competition For a labour market to be perfectly competitive, several conditions must be met: Many buyers and sellers: There are numerous employers seeking workers and many workers offering their labour. Homogeneous labour: Workers have identical skills, abilities, and productivities. Perfect information: Both employers and workers have complete knowledge about wages, job conditions, and alternative opportunities. Free entry and exit: Workers can freely move between jobs, and firms can easily enter or leave the market. No transaction costs: Changing jobs or hiring workers involves minimal costs. While these conditions are rarely fully met in reality, some agricultural labour markets and markets for unskilled workers approximate this model. Wage determination under perfect competition In perfectly competitive labour markets, wages are determined by the interaction of labour supply and demand. Employers act as "wage takers" rather than "wage setters." This means they accept the prevailing market wage rate without ability to influence it. The demand for labour in these markets is driven by two critical factors: Worker productivity: How much output a worker can produce. Market price for output: The value of goods or services the worker helps to create. This relationship is captured by the Value of Marginal Product (VMP) curve, which shows the additional revenue generated by hiring one more worker. Employers in perfectly competitive markets will hire workers up to the point where the wage equals the VMP of the last worker hired. Examining imperfectly competitive labour markets Imperfect competition in labour markets occurs when either employers or workers (or both) have some degree of market power that allows them to influence wages. This is actually the norm rather than the exception in real-world labour markets. Monopsony: When employers have market power A monopsony exists when there is only one buyer of labour in a market—a single employer. While pure monopsonies are rare, many labour markets exhibit monopsonistic characteristics when there are few major employers in an area or industry. Examples include: A mining company in a small town Hospitals hiring specialized medical staff in rural areas Universities hiring specialized professors In these scenarios, the employer can act as a "wage setter," paying workers less than their marginal productivity. This occurs because the employer recognizes that to attract more workers, they must raise wages not just for new hires but often for existing employees as well. Consequently, monopsonistic employers face a marginal cost of labour that exceeds the wage rate. They maximize profits by hiring fewer workers and paying lower wages than would occur in a perfectly competitive market. Oligopsony: When a few employers dominate Oligopsony describes markets with a small number of dominant employers. These employers may compete for workers but still maintain significant market power. Tech hubs like Silicon Valley, where a handful of large technology companies compete for software engineers, represent oligopsonistic conditions. In oligopsonistic markets, employers may engage in tacit collusion to suppress wages or implement non-compete agreements that restrict worker mobility, further dampening wage growth. Monopolistic competition in labour markets This structure emerges when many employers compete for workers, but each offers slightly different working conditions, cultures, or benefits. Workers have preferences among these differentiated employers, giving each firm some degree of market power. For instance, some workers might accept slightly lower wages to work for companies with better work-life balance, stronger environmental credentials, or more engaging projects. Marginal Revenue Product (MRP) vs. Value of Marginal Product (VMP) The distinction between MRP and VMP highlights a fundamental difference between perfect and imperfect competition in labour markets. Value of Marginal Product (VMP) In perfectly competitive markets, firms sell their output at market prices they cannot influence. Thus, the value of a worker's marginal product is simply: VMP = MPP × P Where MPP is the Marginal Physical Product (additional output produced by an additional worker) and P is the market price of the output. The VMP curve slopes downward due to diminishing marginal returns—each additional worker typically adds less to total production than the previous worker. Marginal Revenue Product (MRP) In imperfectly competitive markets, firms can influence the price of their output. As they produce more, they typically must lower their prices to sell the additional output. Thus, the Marginal Revenue Product is: MRP = MPP × MR Where MR is Marginal Revenue—the additional revenue from selling one more unit of output. Since MR is less than the price in imperfect competition (due to the downward-sloping demand curve for the firm's product), MRP is less than VMP at any given employment level. [Image: A graph showing two downward-sloping curves—the higher VMP curve for perfect competition and the lower MRP curve for imperfect competition, with employment level on the x-axis and wage/value on the y-axis.] How market structure affects employment decisions Employment level determination The different demand curves for labour under various market structures lead to different employment outcomes: Perfect competition: Firms hire workers until wage = VMP, maximizing both profits and employment. Monopsony: Firms hire until wage = MRP, but since they pay a wage below MRP, they hire fewer workers than under perfect competition. Oligopsony: Employment levels typically fall between perfect competition and monopsony, depending on the degree of competition among employers. These differences explain why similar workers can face very different employment prospects in different market structures. Wage determination across market structures Market structure significantly impacts how wages are determined: Perfect competition: Wages equal the VMP of the last worker hired, ensuring workers receive the full value of their contribution. Monopsony: Wages are set below the MRP, creating a gap between worker productivity and compensation that becomes employer profit. Oligopsony: Wages tend to be higher than in monopsony but lower than in perfect competition, with the exact level depending on the intensity of competition among employers. Real-world examples of different labour market structures Near-perfect competition While pure perfect competition is rare, some markets approximate its conditions: Freelance marketplaces: Platforms like Upwork or Fiverr for certain standardized services. Entry-level positions in large cities: Numerous employers competing for relatively homogeneous skills. Seasonal agricultural work: Many farms hiring workers with similar skills during harvest seasons. Imperfect competition in action Most labour markets exhibit some degree of imperfect competition: Monopsony: Coal mining towns where one company employs most workers, nursing in rural hospitals. Oligopsony: Automobile manufacturing in Detroit, tech workers in Silicon Valley, academic positions in specialized fields. Monopolistic competition: Retail chains competing for sales associates, restaurants hiring waitstaff. Policy implications of different market structures Understanding labour market structures helps inform effective policy decisions: Addressing monopsony power When employers have significant market power, policies that might help include: Minimum wage laws: Can potentially increase both wages and employment in monopsonistic markets, contrary to perfectly competitive models. Strengthening collective bargaining: Unions can counterbalance employer power and push wages closer to productivity levels. Restrictions on non-compete agreements: These can enhance worker mobility and reduce employer market power. Policies that enhance labour market competition include: Antitrust enforcement: Preventing excessive employer concentration in local labour markets. Improved information: Promoting wage transparency and job matching services. Reducing barriers to job mobility: Portable benefits, enhanced job training, and relocation assistance. Current trends in labour market structures Several trends are reshaping labour market structures globally: Rising employer concentration: In many industries and regions, mergers and acquisitions have reduced the number of distinct employers. Gig economy growth: Creating new market structures that don't fit neatly into traditional categories. Remote work expansion: Potentially increasing competition for certain jobs by widening geographic labour markets. Skill-biased technological change: Creating more specialized labour markets where certain workers may have increased bargaining power. These trends suggest that understanding the implications of different market structures will become increasingly important for workers, employers, and policymakers alike. Conclusion The structure of labour markets—whether perfectly or imperfectly competitive—fundamentally shapes how wages are determined and employment decisions are made. Perfect competition, where wages equal the value of marginal product, represents an ideal benchmark but rarely exists in its pure form. Most real-world labour markets exhibit some degree of imperfect competition, where employer market power leads to wages below worker productivity and potentially lower employment levels. Recognizing these market dynamics can help explain persistent wage differences across industries and regions, inform more effective labour market policies, and guide individual career decisions. As labour markets continue to evolve with technological change and globalization, the ability to analyze these structures becomes increasingly valuable for understanding the economics of work. What do you think? Have you observed examples of different labour market structures in your own work experience? How might understanding these market dynamics influence your future career decisions? A hypothetical ideal, in which the following conditions are met: Many suppliers of labour and many buyers of labour, none with any market power, therefore workers are all wage-takers and no employers are wage-makers Homogeneous labour supply (i.e. all workers have identical skills and abilities, and can transfer between jobs easily) No government intervention Perfect knowledge The demand for factors of production is derived from the demand for the products these factors make. For example, if mobile phones are in greater demand, then the demand for workers in the mobile phone industry will increase, ceteris paribus. The demand for labour will vary inversely with the wage rate. To understand this we need to consider the law of diminishing returns. This states that if a firm employs more of a variable factor, such as labour, assuming one factor remains fixed, the additional return to extra workers will begin to diminish. To explore this process, we need to consider the total physical product (output) produced by a series of workers, which will enable us to measure the individual output from each additional worker—the marginal physical product (MPP). Consider the following data for a small firm producing handmade wax candles. Workers Total physical product Marginal physical product 1 1000 2 1900 900 3 2700 800 4 3400 700 5 4000 600 6 4500 500 7 4900 400 8 5200 300 Demand is based on the value to the firm of the marginal physical product produced by each worker. For example, if candles are £2 each, the firm can calculate the revenue derived from each worker's physical output. The value of the extra output is called marginal revenue product (MRP), and this is calculated by multiplying MPP and price, as follows: Workers Total physical product Marginal physical product Marginal revenue product 1 1000 2 1900 900 3 2700 800 4 3400 700 5 4000 600 6 4500 500 7 4900 400 8 5200 300 Deriving a demand curve We can now find the number of workers that would be employed by a profit maximising firm at various wage rates. The total maximising firm will employ workers up the point where the marginal benefit, in terms of the MRP, equals the marginal cost of labour (MCL), which in this case is the wage rate (W). For example, at a wage rate of £1,200, the firm will employ 5 workers, because at 5 workers, MRP = MCL. At a lower wage of £800, the firm will employ 7 workers, and so on. This means that a demand curve can be derived. In labour market theory, the demand for labour is identified as MRP=D. The supply curve of labour in a competitive market, where the wage rate is determined in the industry, rather than by the individual firm, each firm is a wage taker. This means that the actual equilibrium wage will be set in the market, and the supply of labour to the individual firm is perfectly elastic at the market rate. Equilibrium wage in the labour market, and supply for the individual firm. The simple model of market wage The competitive market wage rate, and the quantity of labour employed, is determined by the interaction of demand and supply. The equilibrium wage rate is the rate that equates demand and supply, as illustrated below. Equilibrium wage rate Labour supply for the whole market is assumed to be positively related to the wage rate, and the market supply curve slopes upwards. Changes in market wage Market wage may change following a change in an underlying condition of demand or supply. Demand can change, and the demand curve will shift, under a number of circumstances, including changes in: The productivity of labour. The price of the product. Demand for the product. Shifts in the demand for labour Labour supply can change under a number of circumstances, including changes in: The length of the working week. Participation rates. Demographic factors, such as migration, and changes in the age structure of the population. Qualifications and skills required. The length of training. Shifts in the supply curve See: monopsonists An explanation of how wages are determined in a perfectly competitive labour market.A perfectly competitive labour market will have the following features:Many firmsPerfect information about wages and job conditions.Firms are offering identical jobsMany workers with the same skillsDiagram of wage determination The equilibrium wage rate in the industry is set by the meeting point of the industry supply and industry demand curves.In a competitive market, firms are wage takers because if they set lower wages, workers would not accept the wage.Therefore they have to set the equilibrium wage We.Because firms are wage takers, the supply curve of labour is perfectly elastic therefore AC = MC.The firm will maximise profits by employing at Q1 where MRP of Labour= MC of LabourComparing wage of lawyers and McDonalds workersLawyers get higher pay for two reasons.Supply of lawyers is inelastic because of the qualifications required.The Marginal Revenue Product (MRP) of lawyers is high. If they are successful they can make firms a lot of revenue.McDonald's workers, however, get lower pay because:Supply of cleaners is elastic because there are many thousands of people who are suitable for working, qualifications are not really required.The MRP of a McDonald's worker is much lower because there is a limited profit to be made from selling Big Macs.Diagram of wage determination for lawyers and McDonald's workers The wage rate on the right is higher because supply is more inelastic and demand is higher.How realistic is the model of perfect competition in labour markets?In practice, it is difficult for workers to shift between employers. There are significant costs and immobilities to moving between jobs.Firms have a degree of monopsony power which enables them to pay wages lower than a competitive equilibriumExistence of unemployment gives firms more monopsony powerSome workers have only a limited choice of employer. For example nurses, firemen, train-drivers will face one main employer (monopsony power).Wage determination by geographical area Related?What determines wages?pay?Labour marketsPerfect competition

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