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BA Economics Honours | Semester V | Calicut University

Economics of Labour Market

Course Code: ECO5EJ304 • Module 3

Module III: Wage Determination, Wage Differential and Discrimination

Wage rates across professions, industries, and social demographics deviate significantly from uniform competitive equilibriums due to compensating wage premiums, efficiency wages, and systemic labor market discrimination.

Unit 12, 13, 14 & 15: Wage Determination and Efficiency Wage Theory

- **Law of One Wage vs. Monopsony:** Competitive markets tend toward uniform wages for homogeneous work. In contrast, a monopsonistic employer sets wages below marginal revenue product, creating deadweight loss.
- **Minimum Wage Legislation:** The Code on Wages, 2019 in India sets statutory floor wages across regions to eliminate starvation wages.
- **Efficiency Wage Theory (Shapiro-Stiglitz / Akerlof):** Employers voluntarily pay wages above market-clearing levels to:
  - Reduce worker shirking and moral hazard by increasing the economic cost of job loss.
  - Minimize expensive employee turnover and hiring/training costs.
  - Attract a higher-quality applicant pool (countering adverse selection).
  - Boost worker nutrition, health, and morale.

Unit 16, 17, 18, 19 & 20: Compensating Differentials and Discrimination

- **Adam Smith's Compensating Wage Differentials:** Higher wages are paid to offset non-pecuniary disamenities of employment (dangerous working conditions, unpleasant environments, high probability of injury, seasonal instability).
- **Hedonic Wage Theory (Sherwin Rosen):** Models worker preferences for safety against firm costs of providing clean/safe working environments, determining equilibrium wage-risk gradients.
- **Occupational Segregation and Duncan Index:** Measures the uneven distribution of demographic groups across occupations:

$$D = \frac{1}{2} \sum_{i=1}^{n} |m_i - f_i|$$

  where m_i and f_i are proportions of male and female labor forces employed in occupation i.

- **Labor Market Discrimination Models:**
  - *Gary Becker's Taste for Discrimination:* Employers, co-workers, or customers have an exogenous distaste for hiring certain demographic groups, acting as an implicit tax on discriminatory firms.
  - *Statistical Discrimination (Phelps & Arrow):* Employers possess imperfect information on individual worker productivity and use group demographic averages (race, gender, caste) as a proxy.
  - *Oaxaca-Blinder Decomposition:* Econometric technique separating observed wage gaps into human capital endowment differences (education, experience) and unexplained residual discriminatory treatment.

Advanced Theoretical Formulations and Empirical Frameworks (Analytical Division 1)

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Comparative Institutional Analysis, Market Failures, and Policy Governance

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Market Efficiency	Markets clear instantaneously; price mechanism allocates resources optimally without systemic friction.	Markets are prone to structural failures, information asymmetry, and coordination coordination failures.	Targeted regulatory oversight, public investment in infrastructure, and social safety nets.
Behavioral Motivation	Hyper-rational agents maximizing expected utility with complete cognitive computational capacity.	Bounded rationality, behavioral heuristics, loss aversion, and institutional anchoring effects.	Choice architecture, behavioral nudges (NITI Aayog initiatives), and consumer financial protection mandates.
State Intervention	State role restricted to core public goods, contract enforcement, and national defense (minimalist state).	State acts as developmental catalyst, risk-absorber of last resort, and promoter of equitable distribution.	Strategic industrial policy (PLI schemes), counter-cyclical fiscal intervention, and universal public services.
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Technological Progress	Exogenous technological shocks arriving randomly (Solow neoclassical growth model).	Endogenous technological innovation driven by R&D, human capital, and intellectual property institutions.	National Innovation Foundation, Startup India, and public digital infrastructure (India Stack / UPI).

Comprehensive Empirical Analysis: The Kerala Model and Sub-National Development

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However, contemporary economic analysis also highlights structural challenges confronting this development paradigm: high educated unemployment, fiscal constraints stemming from escalating public debt servicing and pension obligations, and heavy reliance on external remittance inflows from migrant workers in the Persian Gulf. Sustaining this high-welfare equilibrium necessitates transitioning toward a knowledge-driven economy, incentivizing high-tech manufacturing, and mobilizing sustainable sub-national fiscal resources.

Policy Synthesis and Analytical Evaluation

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