

Mondragón, a Spanish firm operating in manufacturing, retail, and finance, caps executive pay at approximately six times the lowest-paid employee's salary, creating a maximum wage.

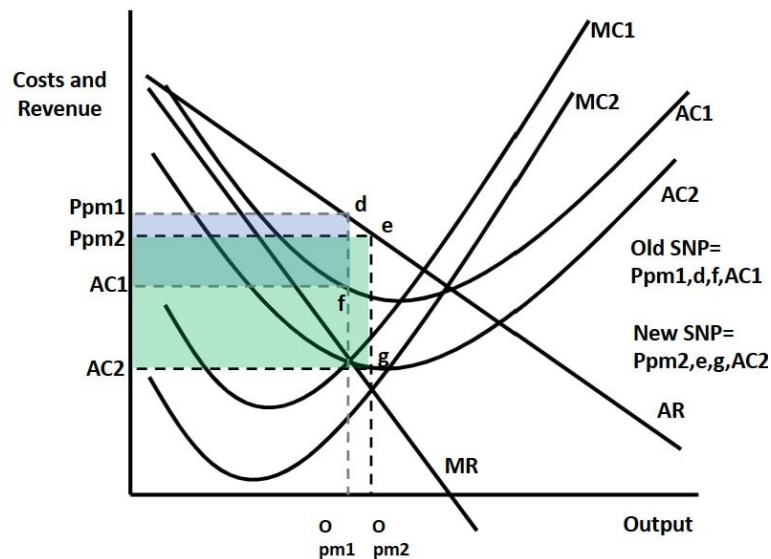
Evaluate the likely microeconomic effects of a maximum wage. Refer to an industry of your choice in your answer. [25 marks]

A maximum wage is a legally enforced wage ceiling.

One likely microeconomic effect of a maximum wage is a reduction in income inequality within a firm or industry. In the banking industry, senior executives often earn significantly more than lower-paid workers. By capping executive pay, firms like Mondragón reduce wage differences, which may improve worker morale and motivation. Lower-paid workers may feel the wage system is fairer, which could increase productivity and reduce labour turnover, lowering firms' recruitment and training costs.

However, a maximum wage may reduce incentives for highly skilled workers. In industries such as banking, executives and senior managers are often rewarded with very high wages due to the level of responsibility and skill involved. If wages are capped too low, talented individuals may be unwilling to take on these roles or may move to firms or countries without such restrictions. This could lead to a fall in labour quality and productive efficiency.

Another microeconomic effect is that a maximum wage could reduce cost pressures for firms. In the banking industry, executive pay makes up a significant part of total costs. Limiting top salaries could allow firms to lower average and marginal costs, resulting in an increase in SNP. The diagram below shows a decrease in AC and MC as labour is a variable cost, this increases SNP which means firms in the banking industry could use the higher SNP to become dynamically efficient, possibly investing in technologies to improve customer experience.



However, firms SNP may not increase. This is because instead of offering high wages, they offer non-wage benefits such as bonuses, shares or perks, reducing the effectiveness of the policy. This could increase average and marginal costs. In addition, if firms struggle to attract top executives, overall firm performance may fall, leading to lower profits and potentially higher prices for consumers.

In conclusion, the most significant impact of a maximum wage for bankers is lower costs for banks, especially considering bankers salaries are likely very high. The overall impact depends on the level of the wage cap and how easily firms can avoid it.

Marker Feedback:

- Don't include a long introduction. You can start with a short definition, but you don't have to. Knowledge can be shown throughout the answer.
- Include 5 paragraphs: KAA, EV, KAA, EV, conclusion
- Your evaluation must be a counter-argument to your points made (it must be linked to your KAA)
- Conclusions must include a judgement. Do not repeat your points made
- Use hedging words such as "likely to lead to" rather than "will lead to" – do not make assertions.
- Use phrases such as "this is likely to be significant/not significant"
- If the question asks to refer to an industry you must only include ONE industry.
- Context must be used throughout your answer in all paragraphs.



- Avoid listing lots of points. Fewer points, developed in context score higher than lists.
- Diagrams can be used to support analysis – you must integrate these into your answer to support your points.
- If the question doesn't ask for a diagram, you don't have to include one but generally it is recommended if it will support your answer.

SAMPLE

