CHAPTER 9:

WAGES

INTRODUCTION
The purpose of this lesson is to establish how wages are reached in markets which are in perfect competition as well as in markets where a monopsony is present. Union strategies are categorized, and the special case of bilateral monopoly is studied. Wage differentials are explained. The role of human capital is analyzed.

WAGE
Wage includes all forms of remuneration for all human productive activities using one's skills. Thus, wage is the combination of salary, bonus and other forms of compensation. Wage is paid for work as various as that of a blue-collar mechanic, as well as that of a lawyer. The dollar amount received is referred to as nominal wage. The purchasing power of amount received work is real wage.

> In economics, wage is a general term. For instance, the work performed by a medical doctor may result in a fee, and various other names are used for different professions. For economists, the different types of work do not matter: it is all labor, and the price or payment is wage.

REAL WAGE
The dollar amount received for an hour's work is referred to as nominal wage. Real wage is the nominal wage adjusted for inflation. It is calculated by dividing the dollar amount by one plus the rate of inflation. The rate of change in unit labor cost is equal to the rate of change in real wage less the rate of change in productivity. Thus unit labor cost does not increase as long as the rate of growth of real wage is just equal to the growth of productivity.

> What a salary can buy in terms of various goods and services is real wage. It is only used as a comparison to some prior time period. The consumer price index is often used as the rate of inflation.

PRODUCTIVITY
The higher productivity of labor is the major explanation of higher wages. This is true for the higher wage and productivity of American workers. Their higher productivity is attributable to 1) large capital, 2) advanced technology, 3) skills and education, and 4) motivation and culture.

American workers are highly paid because of their productivity. This can be observed in agriculture: using combines on large fields, American farmers are able to produce some of the highest output per man-hour in the world.

PRODUCTIVITY DECLINE

The advantage of the American worker's higher productivity, which has been experienced in the past, is recently eroding. Some of the reasons for the decline are tied to slower rate of capital formation and technological progress, as well as erosion in education.

Loss of competitiveness of American products has recently received much publicity. While it is true that we are importing an increasing number of products, it is an indication of the prosperity of the American economy as well as the ingenuity and motivation of the people of several nations (such as Japan and Korea). There are also purely monetary reasons for the U.S. trade deficit.

WAGE DETERMINATION

The wage paid by an employer is given by the supply curve at the optimum level of labor for the firm. The optimum quantity of labor is determined first. This is established by the equality MRC=MRP (marginal resource cost equals marginal revenue product) in both competitive and monopsonistic markets. But the wage determination itself is different in the two types of markets.

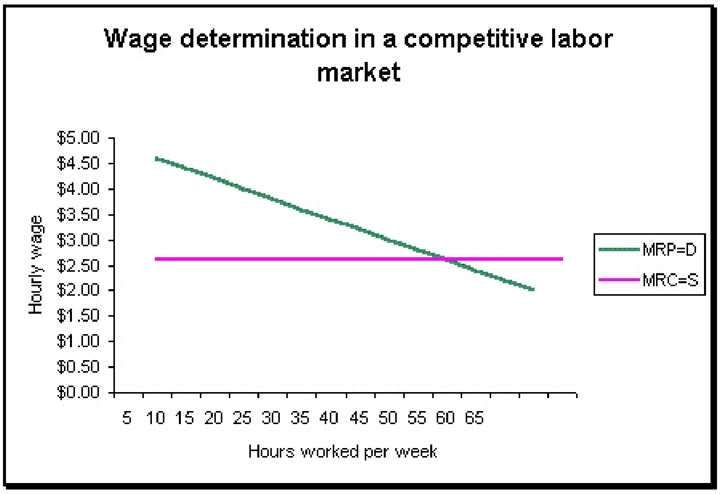
All businesses determine their need for additional employees on the basis of what they want to produce or sell. Finding the wage is a two step process: first the number of employees is calculated, then the firm knows what it can afford to pay an additional employee.

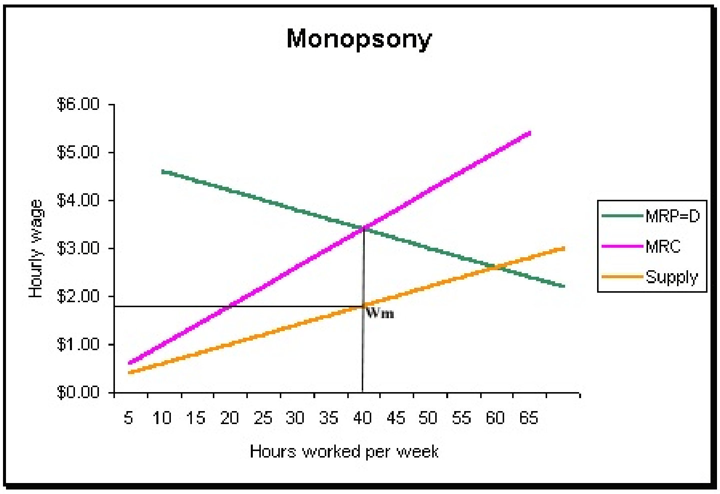
WAGE DETERMINATION IN PERFECT COMPETITION

Perfect competition in a resource market means that there are many small buyers of the resource, and that none can influence the market. The supply curve is identical to the marginal resource cost curve (MRC), and is horizontal. The wage is given directly by the intersection of the supply line and MRP curve (which is the demand for labor).

Graph G-MIC9.1

Take clerical work, for instance. All businesses need someone to do typing, filing and keeping records. Many potential employees are available. There is no need for the firm to offer a higher wage than the currently prevailing wage for that type of work. Nor should the firm offer less, because if it did, it would find no one willing to work.





WAGE DETERMINATION IN MONOPSONY

A firm has a monopsonistic power when it is able to pay a lower price for a larger quantity of a resource used. A monopsony typically exists when a firm is the sole employer in a region or a profession. For a monopsony, the marginal resource cost curve is above the supply curve. The optimum quantity of labor is determined by the intersection of MRC and MRP. The wage is obtained by extending that quantity level down to the supply curve.

Graph G-MIC9.2

The news media has reported instances where employees have complained of being underpaid as a result of a company being the dominant or only employer in a town. For instance, such reports appeared about the General Electric, Hormel (a meat packaging plant) and WestPoint-Pepperel (textile manufacturer) in the United-States. In each of these cases, the employer is able to offer a lower wage because local residents have little choice but to work for that employer.

WAGE DETERMINATION IN MONOPSONY

The wage paid by a monopsony is lower than the wage paid by firms in perfect competition in the labor market. In addition, the quantity of labor used is also smaller.

UNION STRATEGY

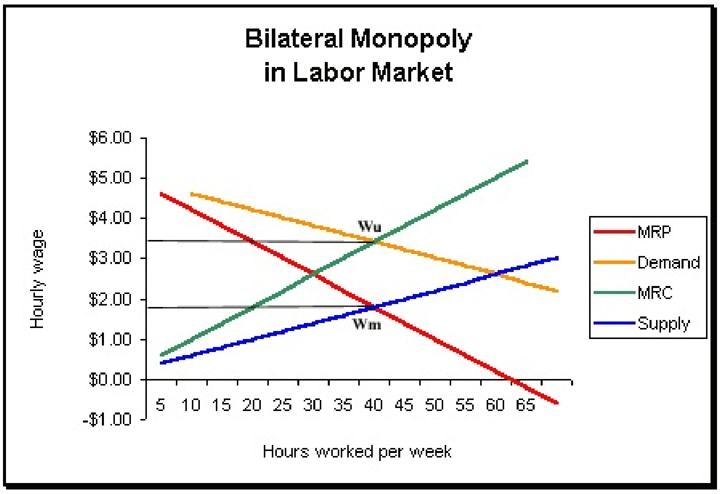
Unions seek to improve the wages and working conditions of their members; this can be accomplished by
- increasing the demand for the product manufactured by the members (for instance, by discouraging imports),
- decreasing the supply of labor (e.g. craft unions),
- acquiring power over all employees (e.g. industrial unions).

The American union IGLWU (International Ladies Garment Workers Union) periodically used advertisement to encourage purchases of American made garments. The purpose is obviously to boost the sales of the clothing made by their members and therefore their salaries.

BILATERAL MONOPOLY

A bilateral monopoly exists when a monopsonist (a dominant employer) faces a monopolist (an all inclusive union). The employer will offer the monopsonist lower wage Wm (given by the intersection of MRP and the supply curve). The union will demand from the monopolist a higher wage Wu (determined by the intersection of MRC and the demand curve). The disparity between the two can only be resolved by external power: this explains lasting bitter strikes and other labor conflicts.

Graph G-MIC9.3



The use of violence in strikes by both, strikers and the company, can be explained by the analysis of bilateral monopoly. The demands of the union and the offer of the employer are irreconcilable in economic terms. To prevail, each side has to revert to means other than economic.

MINIMUM WAGE

The minimum wage is necessary to avoid hardship and poverty of low skilled individuals. The minimum wage (as any minimum price) has contributed to a surplus of the labor resource: that is, unemployment. However, some additional positive effects are argued to exist: such as

- forcing employers to be more efficient
- encouraging automation and providing employees with such means
- forcing employers to improve workers' skills and health

Small business owners, especially store owners, often complain that they cannot afford to hire employees at the minimum wage, and that, if the minimum wage were to be lifted, there would be less unemployment.

WAGE DIFFERENTIALS

Differences between wages are explained by

- different levels of skills and education,
- non-monetary aspects such as risk and seasonality,
- market imperfections: lack of knowledge,

lack of geographical and socio-economic mobility.

It is rather obvious that a medical doctor would receive a high salary because of his/her knowledge and skills. High salaries of workers in construction or on oil rigs can be explained by the very real hazard these occupations present for workers' safety.

HUMAN CAPITAL

Human capital refers to the investment individuals make in their education and health, as well as to their attributes (skills, knowledge) which make them better employees. Statistical studies clearly show a direct relationship existing between education and income levels. The causal explanation of the relationship has, however, been challenged by the observation that the level of education is primarily determined by socio-economic group belonging.

Studies show that some groups in society inculcate their children with a need to achieve. These groups are often the new immigrants in a nation. An example of this can be observed in the number of Westinghouse Science High School awards given to children of newly arrived Asian groups: that number is much higher than that for the general population.

PRODUCTIVITY AND REAL WAGES

According to Department of Labor studies, a close relationship exists between real wages and productivity. Real wages generally do not rise unless productivity increases. An increase in output will translate into increased real income. Increased productivity causes the demand for labor to increase in relation to supply, which in turn causes real wages to increase. Increased productivity in the United States has been largely responsible for higher real incomes.

Review Quiz

Assignments

[Your opinion is important to us. If have a comment, correction or question pertaining to this chapter please send it to comments@peoi.org .]

Previous: Economic_resources Next: Rent-interest-profit