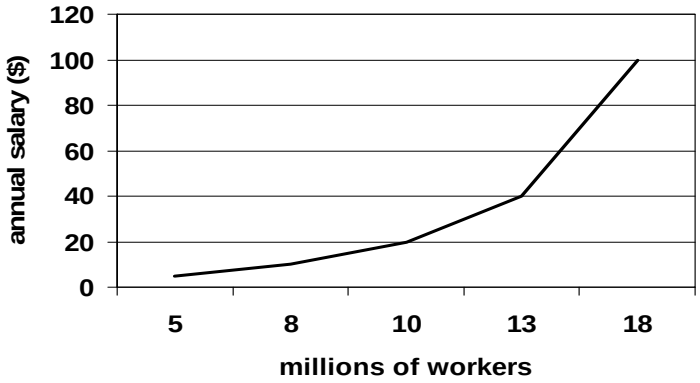
Lecture 3: Earning

1. First, background on a "supply curve" - shows how much is produced, or offered, of something compared to price of that something. Idea is, if producers can receive more from the price, they'll want to produce and sell more.

Can also think of this for labor. Labor supply shows how many people want to work at a job when different salaries are offered for that job. Expect that the higher the salary, the greater the labor supply:



2. Fundamentals

Salary (or wage) is a price, just like the price of a bushel of corn or the price of a gallon of gasoline. A salary is the price of labor - the price paid to hire someone for a stated time period.

Like any price, a salary is determined by the interaction of the supply of labor and the demand for labor. These supply and demand curves look like any supply and demand curve. More people will offer their labor for hire the *higher* the salary of the job, and more businesses will want to hire labor the *lower* the salary of the job. Where demand and supply curves come together - intersect - gives *equilibrium in the labor market* - the salary paid and the number of people hired.

From the perspective of a business, its demand for labor depends on the *revenue the worker can earn for the business.* So, the demand for labor is a "derived demand" from what the business can make and sell using the workers. Workers who earn more revenue for the business are more valuable, and demand for these workers will be greater.

3. Determinants of salary levels

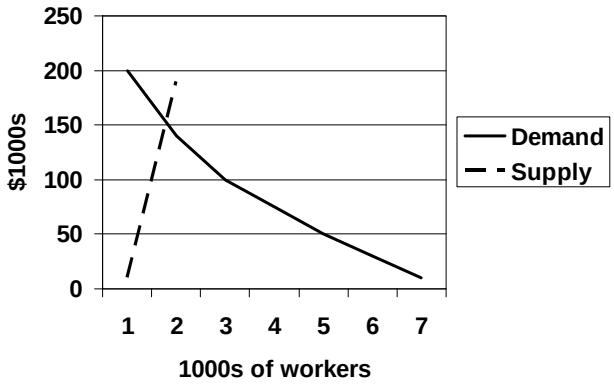
High salaries will result in labor markets where demand for the workers is high because the workers earn large revenues for the business *and* where few people can do that work.

Low salaries will result in labor markets where demand for the workers is low because the workers earn small revenues for the business *and* where many people can do that work.

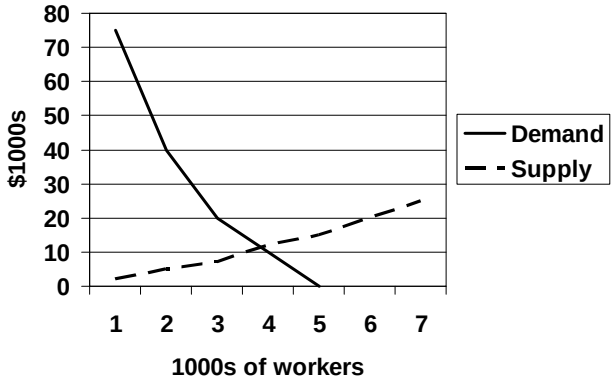
Medium salaries - in between high salaries and low salaries - occur in labor markets where demand is high and supply is high (revenue earned by workers is high but many people can do the work) or where demand is low and supply is low (revenue earned by workers is low but few people can do the work).

In pictures:

High Demand & Low Supply = High Salary:



Low Demand & High Supply = Low Salary:



The first graph would be an example of the labor market for professional athletes, movie and TV stars, CEOs, and surgeons. Demand is high because these workers can earn large revenues for the business. Supply is low because few people have the innate skills or training to do the work.

The second graph would be an example of the labor market for cashiers, fast food workers, waiters and waitresses, and day laborers. Demand is low because the workers earn relatively small revenues for the business. Supply is high because many people can do these tasks with little training.

The "distribution of income" refers to the percentages of workers in various income categories. It will be determined by the mix of worker skills and demand for those skills. Recently, workers with more education have seen the fastest increases in their incomes

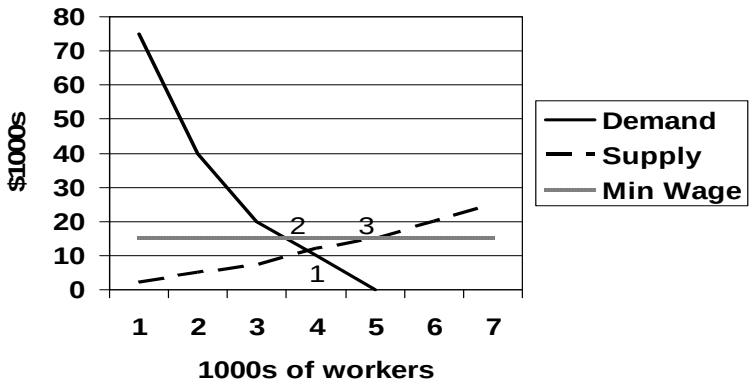
4. Labor market issues:

a) Teacher salaries: Salaries are in the "moderate" range. Supply is moderate because teaching does require a college degree, but many people have the ability to complete the degrees. Demand is moderate for two reasons. First, because the government controls most K-12 education through the public schools, parents who would be willing to pay a high salary for an exceptional teacher are restricted in their ability to do so. But second, it's difficult to draw a connection between a student's performance in K-12 and their ultimate career and salary. This is easier to do at the college level, which is one reason why college teachers earn more than K-12 teachers.

b) Immigration: Recent immigration has been predominantly of lower skilled workers. So this has increased the supply of lower skilled workers and decreased their equilibrium wage rate.

c) Minimum wage impacts

With a minimum wage, the government says businesses must pay a higher salary (or wage) than would result from the interaction of supply and demand.



In the above demand & supply figure, the *equilibrium salary* is $10,000, at point 1. However, the government imposes a minimum wage of $15,000. Notice that one result of the minimum wage is businesses hire fewer workers, corresponding to point 2.

d) Unions: unions try to increase the wage rate of members by restricting supply (only union members can do certain kinds of work). Unions are more effective in "closed shop" states that allow unions to control an industry - that is, they are allowed to require membership. They are less effective in "open shop" states where unions are not allowed to require membership.

e) Labor and technology: technology that makes workers more productive can reduce total employment. This has been happening in manufacturing

f) Market work vs. "home" work: work in which you are directly paid is called "market work. Work where you aren't directly paid is called "home work". One of the biggest societal changes in the last 50 years has been the movement of adult women out of home work to market work. Main reason: changing nature of work, where women can do more jobs and are paid competitively - meaning the cost of not working has increased.

g) Will an increase in the wage rate always cause someone to work more? Usually, but not always. May use some of increased income to "buy" more free time - more leisure. The "substitution effect" of a higher wage rate motivates more work time; the "income" effect motivates less work time and more leisure time. Depends which dominates

h) Don’t ignore the value of "middlemen" - people who don't directly make something, but put buyers and sellers together, or gather and present information. They perform services that people value. Good examples: real estate agents, insurance agents.