ECONOMICS 201: WEEK 3 LABOR AND FINANCIAL MARKETS

- **Demand and Supply in Labor Markets**

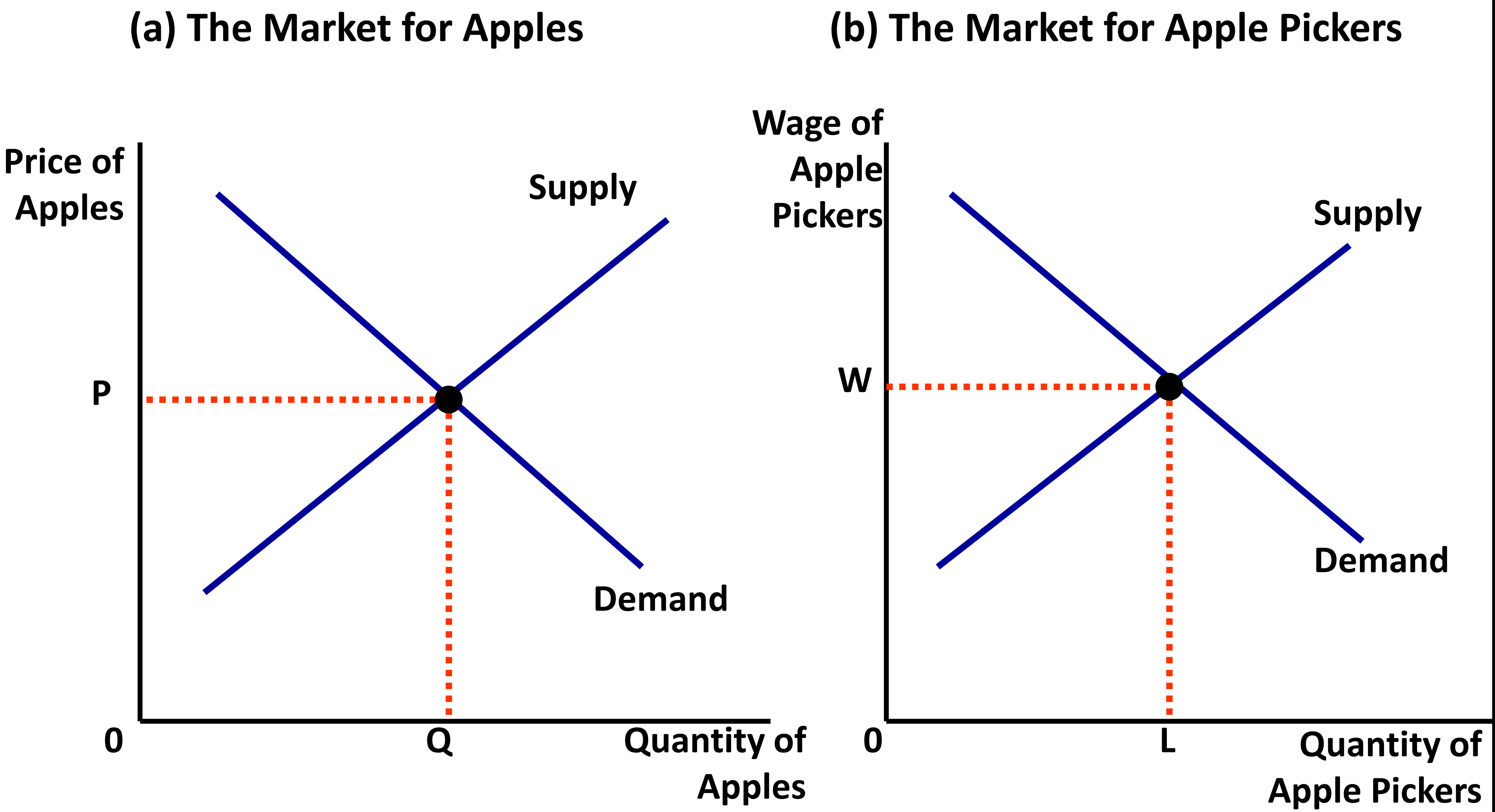
- **Demand and Supply in Financial Markets**

THE DEMAND FOR LABOR

The demand for labor (or any other resource used in the production process) is a derived demand.

A firm's demand for a factor of production is *derived* from its decision to supply a good in another market.

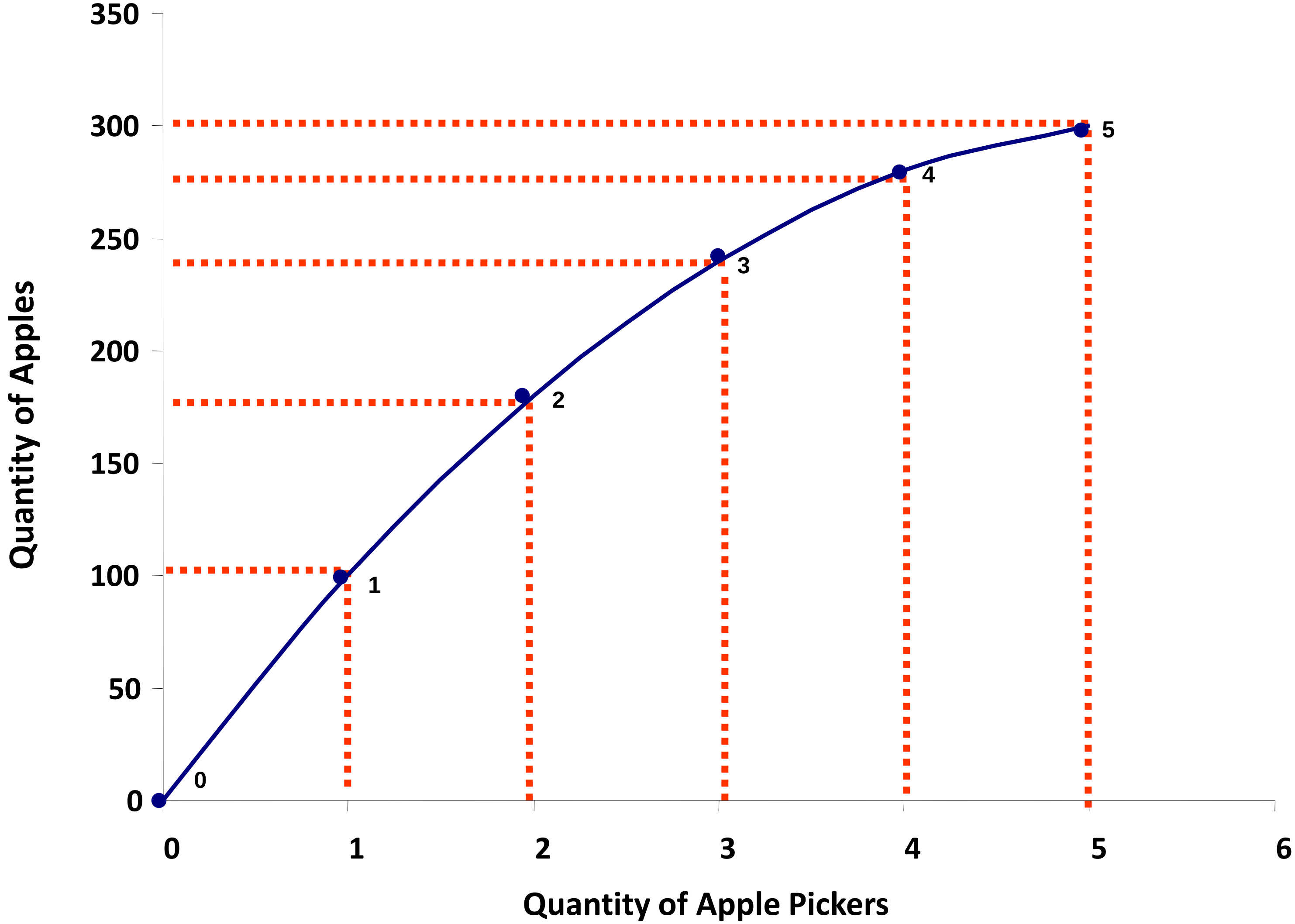
THE DEMAND FOR LABOR IS *DERIVED* FROM THE DEMAND FOR THE OUTPUT.



THE PRODUCTION FUNCTION

The production function illustrates the relationship between the quantity of inputs used and the quantity of output of a good.

THE PRODUCTION FUNCTION...



WHAT CAUSES THE LABOR DEMAND CURVE TO SHIFT?

Price of the output:

- Higher demand for cars ➡ higher demand for auto workers

Technological Change

- More automation ➡ lower demand for low skill workers
- More automation ➡ higher demand for skilled technical workers.

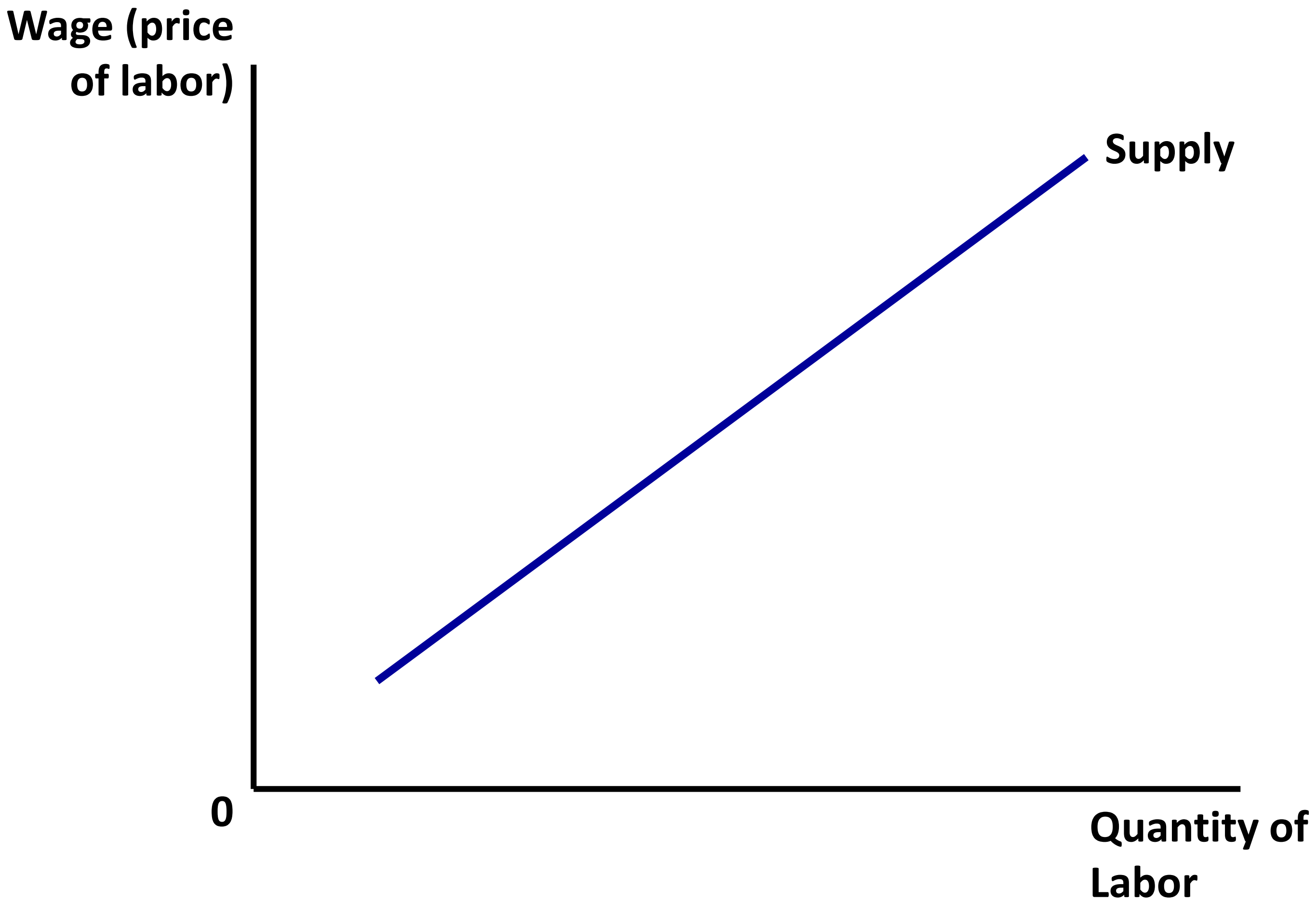
Supply of Other factors

- Parts and materials used to produce cars become cheaper ➡ higher demand for auto workers.

THE LABOR SUPPLY CURVE

- An upward-sloping labor supply curve means that an increase in wages induces workers to increase the quantity of labor they supply.

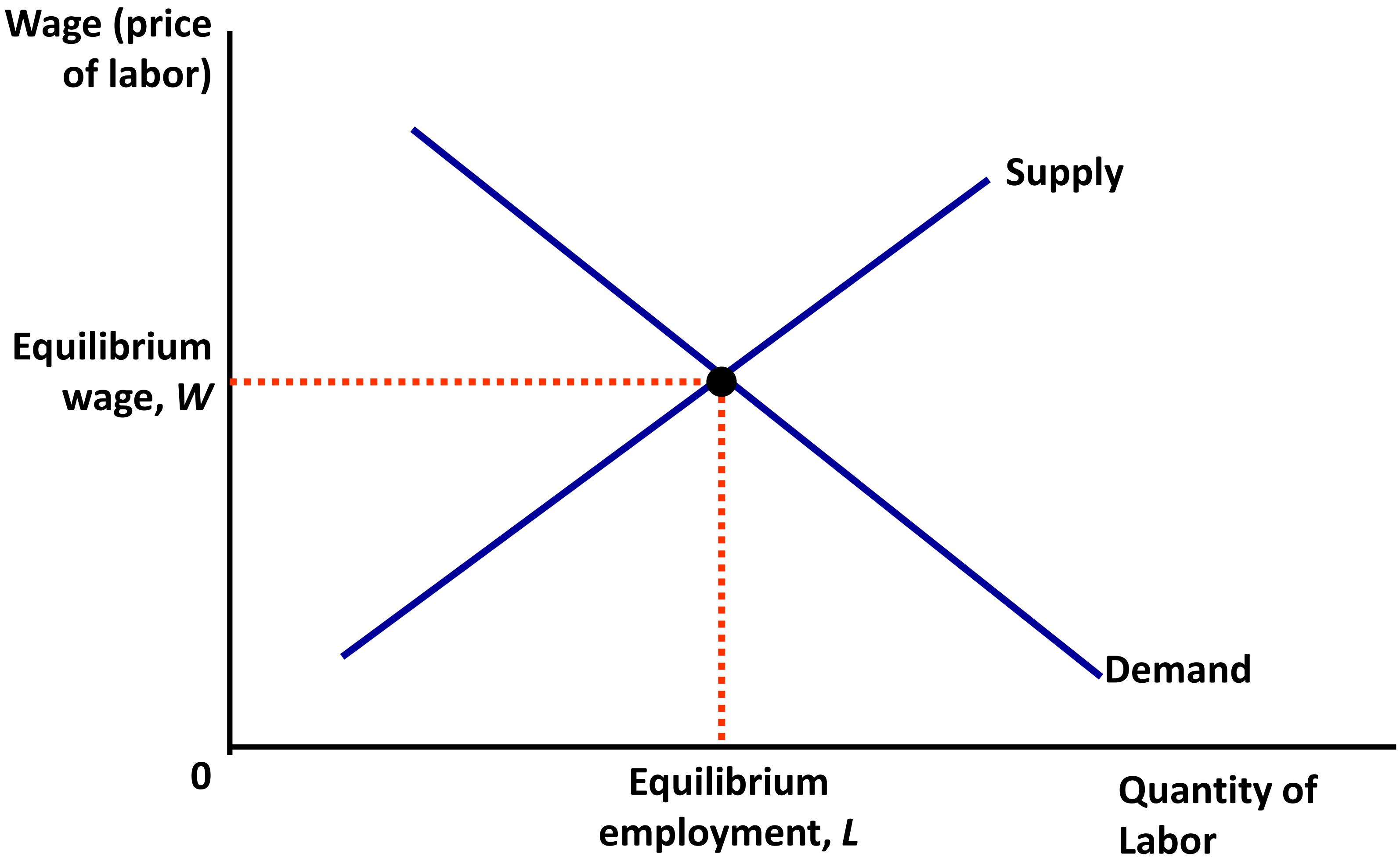
THE LABOR SUPPLY CURVE…



WHAT CAUSES THE LABOR SUPPLY CURVE TO SHIFT?

- **Changes in Tastes and Preferences**
- **Changes in Alternative Opportunities**
- **Changes in population**

EQUILIBRIUM IN THE LABOR MARKET…



EQUILIBRIUM IN THE LABOR MARKET

- **Labor supply and labor demand determine the equilibrium wage.**
- **Shifts in the supply or demand curve for labor cause the equilibrium wage to change.**

THE LABOR MARKET

The labor market is similar to other markets in many respects:

- There are buyers.
- There are sellers.
- There is a commodity being sold.
- Buyers and sellers must reach an agreement on the price of this commodity.
- There is a market transaction in which the commodity is exchanged for the agreed upon price.

A NOTE ABOUT LABOR MARKETS.

- The supply and demand graph tells a simple story about the labor market.
- But, keep in mind that labor markets do not always “behave” as expected.

Labor Markets are Different…

HOW ARE LABOR MARKETS DIFFERENT?

1. **Commodity being sold?**

- In the market for shoes, it is very clear what product is being sold.
- But, it’s not as clear in a labor market.
- What is the commodity: A worker? Labor Time? Labor Effort? Skill?

HOW ARE LABOR MARKETS DIFFERENT?

2. What is the nature of the market transaction?

- Buying a pair of shoes vs. hiring a worker.
  - When buying a pair of shoes, there is only a relatively brief interaction between the buyer and the seller. Once you have purchased the shoes, you need have no further contact with the seller.
  - In the labor market, there is an ongoing relationship between the buyer and the seller. It is not possible to separate the "labor" from the person providing the labor services.

THE LABOR MARKET

3. Rights of the "buyer"

- The treatment or disposal of the commodity in a labor market is not solely the concern of the buyer.
    - i.e. What I do with the shoes after I have bought them is my own business. I now <u>own</u> them and have exclusive rights to determine what happens to them.
- What the employer does with the labor (and the laborer) is subject to **limitations**.

THE LABOR MARKET

- These **limitations** are determined by:
  - Laws and regulations.
  - Social conventions.
  - The relative bargaining power between employer (buyer) and employee (seller)
- These limitations are often the subject of considerable dispute.

HOW ARE LABOR MARKETS DIFFERENT?

4. What is the “price” of labor?

- The “price” of labor is a “cost of production for the firm.
- *But, it is also “income” for a household.*
- What’s a “fair” price?
- What’s a “fair” income?
- What’s considered “fair” often depends on one’s point of view.

WHAT'S A FAIR WAGE?

1. High School Teacher
2. Auto mechanic
3. Registered Nurse
4. Baseball Player
5. Religious leader
6. CEO of Apple
7. Grocery checker
8. Plastic surgeon
9. Divorce Lawyer
10. US Senator

OTHER LABOR MARKET CONTROVERSIES.

- Long-term Unemployment
- Minimum Wage.
- Executive Pay & bonuses.
- College wage premium – skill or credential?
- high school dropout rates
- Job training
- Declining wages for unskilled workers
- Immigration.
- Discrimination
- Job security.
- Pensions.
- Worker's Compensation
- Sick leave

GOVERNMENT INTERVENTION IN THE MARKET

Buyers look to government for ways to hold prices down.

Sellers look to government for ways to hold prices up.

PRICE CEILINGS

A ***price ceiling*** **is a government-imposed limit on how high a price can be charged.**

GOVERNMENT INTERVENTION IN THE MARKET

Buyers look to government for ways to hold prices down.

Sellers look to government for ways to hold prices up.

PRICE CEILINGS

A *price ceiling* is a government-imposed limit on how high a price can be charged.

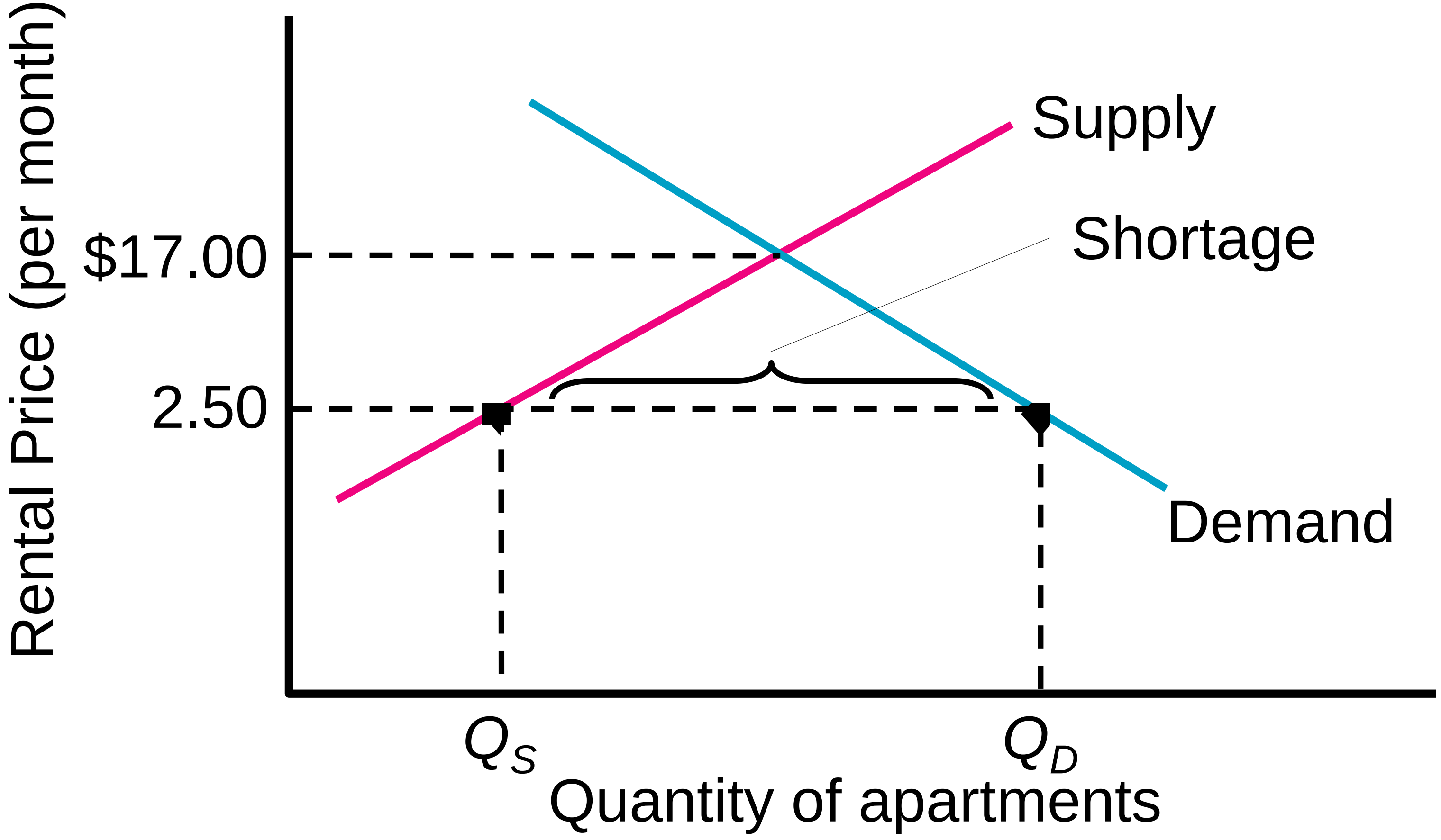
- Relatively rare. Sometimes used in emergencies. For example, a local government might impose a ceiling on water or other supplies after a natural disaster in order to prevent price gouging.
- After World War II, rent controls were imposed in a number of European cities. Rent control is not common in the United States.

PRICE CEILINGS

The impact of price ceilings depends on where price is set relative to the "free market price."

- If the price is set below the equilibrium market price, there will be a shortage.
- If the price is set at or above the equilibrium price, there will be no impact.

PRICE CEILING BELOW EQUILIBRIUM



PRICE FLOORS

A *price floor* is a government-imposed limit on how low a price can be charged.

- The most common price floor in the US is a minimum wage or living wage law.
- Price floors have also been common in agricultural markets.
- Price floors (or quantity restrictions) are also used in carbon pricing.

MINIMUM WAGE

The minimum wage is an example of a price floor.

-- The US Federal minimum wage law was passed in 1938. Since then, 29 states have also passed minimum wage laws that are higher than the federal minimum wage. In some states (like Oregon), the minimum wage varies depending on location.

--The Living Wage refers to requirements that employers who are receiving benefits from city and county taxes be required to pay a “living” wage. For example, some states and counties have provided “tax holidays” to certain employers in an effort to attract new companies (or to prevent others from leaving).