Introduction to the Labor Market

MAJOR QUESTIONS OF LABOR ECONOMICS
- Concern with PRICING & ALLOCATION of Labor
- 4 Practical Questions
  - Who works?
  - What determines how much people are paid and in what form?
  - Who can move where & why?
  - Why is there unemployment & scarcity of workers?

Components of an Economic Model
- 3 Parts
  - Underlying assumptions, including ceteris paribus assumption
  - Theory of behavior
  - Predictions
- Positive Model: value free
CONTRADICTIONS IN THE MARKET

- Employer need for flexibility vs. Employee need for income security
- Demand for skilled workers vs. Failed Public Schools & Aging Work Force
- Worker demand for non-wage benefits vs. Increasing cost of those benefits
- Globalization of production & markets

NEOCLASSICAL APPROACH TO LABOR MARKETS
An Introduction

LABOR MARKET THEORIES

- **Neoclassical Market Theory**
  - Governed by Supply & Demand
  - Use of Efficiency Decision Rule
- **Institutional approach:**
  - **Internal Labor Market Theory**
  - Governed by Administrative Rules
CLASSICAL DEFINITION OF THE MARKET

Three Basic Problems Solved by Economy:

- What is Produced
- How it is Produced
- How Output & Income is Distributed

MARKET PROCESS

FEATURES OF THE SYSTEM

- Motivation: Self-Interest
- Constraint: Competition
- Mechanism: Prices

OUTCOMES OF MARKET PROCESS

SOLUTIONS

- What: Consumer Sovereignty (“Willingness to Pay”)
- How: Least Cost Production
- Who: Supply & Demand for factors of Production
- Perfect market: one with infinite number of small consumers and producers
UNDERLYING ASSUMPTIONS
- Individuals are rational (prefer A to B and B to C, etc.)
- Information is perfect & costless
- More is better
- Instant adjustments
- Zero transaction costs
- People know their trade-offs

UNIQUENESS OF LABOR
- Labor Services Rented not Purchased
- Use of Labor Services - Time-Specific
- Workers Heterogeneous (Asset specificity)
- Chronic Excess Supply & Shortages
- Continuity of Employment Relationship
- Rare that individual can increase demand by dropping wage
- Labor Concern with non-pecuniary factors