CHAPTER CHECKLIST

1. Explain why college graduates earn more, on the average, than high school graduates.
2. Explain why union workers earn higher wage rates than nonunion workers.
3. Discuss reasons why men earn more than women and whites earn more than minorities and predict the effects of a comparable-worth program.

LECTURE TOPICS

- Skill Differentials
- Union-Nonunion Wage Differentials
- Sex and Race Wage Differentials

17.1 SKILL DIFFERENTIALS

- The Demand for High-Skilled and Low-Skilled Labor

High-skilled workers have a higher value of marginal product than low-skilled workers. Figure 17.1(a) on the next slide illustrates the demand for high-skilled and low-skilled labor.
17.1 SKILL DIFFERENTIALS

High-skilled labor has a higher VMP than low-skilled labor and a greater demand.

The demand curve for high-skilled labor, $D_H$, lies above the demand curve for low-skilled labor, $D_L$, by the VMP of skill.

17.1 SKILL DIFFERENTIALS

**The Supply of High-Skilled and Low-Skilled Labor**

Skills are costly to acquire, and a worker pays the cost of acquiring a skill before benefiting from a higher wage.

Figure 17.1(b) on the next slide illustrates the supply of high-skilled and low-skilled labor.

17.1 SKILL DIFFERENTIALS

High-skilled labor bears the cost of acquiring skill.

The supply curve of high-skilled labor, $S_H$, lies above the supply curve of low-skilled labor, $S_L$, by the compensation for the cost of acquiring skill.

17.1 SKILL DIFFERENTIALS

**Wage rates of High-Skilled and Low-Skilled Labor**

The combined effects of skill on the demand for and supply of labor generate a higher wage for high-skilled labor than for low-skilled labor.

Figure 17.1(c) on the next slide illustrates the skilled wage differential.
17.1 SKILL DIFFERENTIALS

The demand for low-skilled labor, $D_L$, and the supply of low-skilled labor, $S_L$, determine the wage rate of low-skilled labor—in this example at $10 an hour.

The demand for high-skilled labor, $D_H$, and the supply of high-skilled labor, $S_H$, determine the wage rate of high-skilled labor—in this example at $20 an hour.

17.2 UNION WAGE DIFFERENTIALS

**Labor union**
An organized group of workers whose purpose is to increase wages and influence other job conditions for its members.

**Craft union**
A group of workers who have a similar range of skills but work for many different firms in many different industries and regions.

**Industrial union**
A group of workers who have a variety of skills and job types but work for the same firm or industry.

**Collective bargaining**
Union negotiations with employers or their representatives.

**Union Objective and Constraints**
A union has three broad objectives:
- To increase compensation
- To improve working conditions
- To expand job opportunities
Unions in a Competitive Labor Market

A union can attempt to increase wages by limiting the supply of labor or by stimulating the demand for labor.

Unions Change the Supply of Labor

Unions control supply by organizing on-the-job training and limiting the number of workers who receive it.

Unions Change the Demand for Labor

The union tries to increase the demand for union labor and make the demand for union labor less elastic.

Some of the methods used by unions to change the demand for labor are:

- Increase the marginal product of union members
- Encourage import restrictions
- Support minimum wage laws
- Support immigration restrictions
- Increase demand for the good produced

In a competitive labor market, the demand for labor is $D_c$ and the supply of labor is $S_c$.

1. Competitive equilibrium occurs at a wage rate of $10$ an hour with 100 hours employed.

2. By restricting employment below the competitive level, the union shifts the supply of labor to $S_U$.

If the union can only restrict supply, the wage rate will rise but employment will fall.
3. If the union can increase the demand for labor and shift the demand curve to $D_u$, then it can raise the wage rate still higher, and increase employment.

The Scale of Union-Nonunion Differentials

Union rates are, on average, 30 percent higher than nonunion wage rates.

- In mining and financial services, wages are similar.
- In services, manufacturing, and transportation, the differential is between 11 and 19 percent.
- In wholesale and retail trades, the differential is 28 percent.
- In construction, it is 65 percent.

Monopsony

A monopsony is a market in which there is a single buyer.

Historically, coal mines, steel and textile mills, and car makers became major employers in some regions.

A monopsony employer decides how much labor to hire and pays the lowest wage at which it can attract the chosen quantity of labor.

Figure 17.3 on the next slide illustrates monopsony.

1. Competitive equilibrium occurs at a wage rate of $15 an hour with 75 hours employed.

The monopsony finds the marginal cost of labor, $MCL$.

(The supply curve shows the average cost of labor and the relationship between the $S$ and $MCL$ curves is like that between a firm’s $ATC$ and $MC$ curves.)
The monopsony maximizes profit by hiring the quantity of labor that makes the marginal cost of labor equal to the value of marginal product.

2. The monopsony pays the lowest wage for which that labor will work, which is $10 an hour.

**Monopsony Tendencies**

Monopsony is rare.

**Monopsony and Unions**

A union is like a monopoly.

**Bilateral monopoly**

A market in which a monopoly seller faces a monopsony buyer.

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**Monopsony and the Minimum Wage**

In a monopsony labor market, a minimum wage can increase both the wage rate and employment.

Figure 17.4 on the next slide illustrates this outcome.

In a competitive labor market, the supply curve is $S$ and the demand curve is the $VMP$ curve. A minimum wage of $7.50 an hour has no effect on the market.
In a monopsony labor market, the wage rate would be $5 an hour with 50 hours per day hired.

The minimum wage law increases the wage rate to $7.50 an hour and increases employment to 75 hours per day.

**17.3 SEX AND RACE WAGE DIFFERENCES**

We examine four possible explanations for sex and race earnings differences:

- Job types
- Discrimination
- Differences in human capital
- Differences in degree of specialization

**Job Types**

Some of the sex differences in wages arise because men and women do different jobs and the jobs that men do are better paid.

**Discrimination**

Suppose that black females and white males have identical abilities as investment advisors.

But suppose also that black females are discriminated against.

Figure 17.5 on the next slide shows how such discrimination affects both the wages and employment opportunities for black female investment advisors.
17.3 SEX AND RACE WAGE DIFFERENCES

With no discrimination, the wage rate is $40,000 a year and 2,000 black female advisors are hired.

With discrimination against blacks and women, the value marginal product curve becomes $VMP_{DA}$.

The wage rate for black women falls to $20,000 a year, and only 1,000 are employed.

With no discrimination, the wage rate is $40,000 a year and 2,000 white male advisors are hired.

Discrimination in favor of whites and men shifts the value marginal product curve for that group to $VMP_{DF}$.

The wage rate for white men rises to $60,000 a year, and 3,000 are employed.

17.3 SEX AND RACE WAGE DIFFERENCES

Differences in Human Capital

The more human capital a person possesses, the more that person earns.

Three indicators that measure human capital are:

- Years of schooling
- Years of work experience
- Number of job interruptions

Differences in the Degree of Specialization

Many women do a wider range of jobs—both in the home and in the job market—than men.

Never-married men and never-married women are more similar than married men and women.

When they have the same amount of human capital, the wages of never married men and women are not significantly different.

So the degree of specialization seems important.
17.3 SEX AND RACE WAGE DIFFERENCES

- **Comparable-Worth Laws**

  **Comparable worth**
  Paying the same wage for different jobs that are judged comparable.

  Congress passed the Equal Pay Act in 1963 and the Civil Rights Act in 1964, which require equal pay for equal work.

  Minnesota and Wisconsin have stronger comparable worth laws.

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**Figure 17.6** shows the problem of comparable worth laws.

Part (a) shows the market for oil rig operators and part (b) shows the market for teachers.

In competitive markets, oil rig operators earn more than teachers.
A comparable wage law that enforces an equal wage for these two groups creates a shortage of oil rig operators, ...

...and a surplus of unemployed teachers.

Effective Wage Policies

The most successful workers are those who are able to repeatedly retool and actively embrace each new technological advance.

An effective wage policy is one that emphasizes ongoing education and training.