

# The Economics of Labor Markets

Hotchkiss

# The Economics of Labor Markets

**Bruce E. Kaufman**

*Georgia State University*

**Julie L. Hotchkiss**

*The Federal Reserve Bank of Atlanta  
and Georgia State University*

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**The Economics of Labor Markets, Seventh Edition**  
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RRD Crawfordsville  
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Printed in the United States of America

2 3 4 5 08 07 06

Text package: ISBN 0-324-28879-4

Text only: ISBN 0-324-33575-X

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In *The Economics of Labor Markets*, we present many of the important factors affecting the market for labor, and the ever-present changes that move in tandem with our expanding global economy. One of the things students will learn from this text is to become better informed—to know what are the major events, trends, and developments in the world of work. Another is to be able to explain these real-world outcomes. Why, for example, did annual hours of work decline in the twentieth century? What factors are responsible for the earnings gap between men and women? Because these questions often have more than one answer, students should also learn why economists disagree and be able to critically evaluate alternative theories. Finally, students should learn how to apply economic theory to analysis of current events and current public policy issues.

*The Economics of Labor Markets* is intended as the basic text for a one-semester or one-quarter course at the undergraduate level in labor economics, or labor economics and labor relations. It is also suitable as a survey or reference text for a graduate level course. The level of exposition is relatively nontechnical and the main text eschews all mathematics except for present value and elasticity formulas. Although the only prerequisite for this text is a one-semester principles course in microeconomics, students with some exposure to statistics and intermediate level theory will be able to master the material more quickly.

## Distinctive Features

The text has a number of new and unique features that distinguish it from other texts:

***Pedagogical Approach*** An innovative feature of the text is the pedagogical approach to presenting the chapter material. Each chapter begins with a brief look at the empirical facts concerning a particular subject. For example, Chapter 2, on hours of work, begins with a review of the cross-sectional and time-series patterns of hours of work. Similarly, Chapter 7 begins the discussion of human capital by first looking at the shape of age/earnings profiles.

This approach has several advantages. For one, it helps fulfill the first criterion noted above—to inform students about events or trends in the labor market. A second advantage is that it provides motivation for studying the chapter material students know why they are studying the theory and what it is meant to explain. A third benefit is that students have more interest in the course if they can see that it has some application to real-world behavior.

***Balanced Presentation of Theory*** A second distinctive feature of the book is that it presents a balanced and well-rounded presentation of labor market theory.

Chapter 1 argues that every labor market outcome is the product of three forces: market forces of supply and demand; institutional forces in the form of government, union, and corporate power; and sociological forces emanating from factors such as family background, cultures, class, custom, and so on. We also stress that much of the controversy in labor economics stems from differences in opinion over the extent to which imperfections and defects exist in the market mechanism. With this framework, it is possible to distinguish between the two major schools of thought in labor economics—the neoclassical school and the institutional school—based on the different weight each gives to the roles of market, institutional, and sociological forces and on the importance of imperfections in the market process.

This approach has several advantages. First, it provides students a balanced presentation of labor market theory. Paul Samuelson and William Nordhaus said, “A conscientious textbook must present all views fairly. . . . Textbook authors must be neither prosecuting attorneys nor defense counsels. They must be friends in the court of truth.” We firmly agree with this standard and have written the text in that spirit. A number of existing labor texts, in our opinion, do not provide students with a representative cross section of thought in labor economics. While the neoclassical model is presented in great detail, alternative theories or points of view are given little, if any, treatment. The approach here provides the best exposition of the neoclassical model, but also introduces the student to more institutionally oriented theories.

A second advantage of this more balanced theoretical perspective is that it illustrates to students why economists disagree, particularly about issues of public policy. Finally, a third advantage is that a certain amount of controversy stimulates student interest and discussion. At the same time, we endeavored not to overdramatize theoretical disputes or to give excessive weight to unorthodox theories.

**Unique Topic Coverage** This text was the first among labor texts to cover a number of topics that were not the standard in most labor texts. Examples of these topics include technological change and labor demand, discrimination in promotion, human resource management, bargaining theories of household labor supply, the minimum wage debate, and the Beveridge curve. A number of other topics are also given a much expanded treatment compared with other texts—examples are the neoclassical household model of labor supply, union wage concessions, occupational segregation, and bargaining models of wage determination. In choosing topics for the text, we deliberately tried to include issues that would be of interest to students outside of economics.

**Empirical Evidence** We made the text as real-world oriented as possible by illustrating the theory with numerous empirical examples. Each chapter has at least one entire section devoted to a review of empirical research or evidence on one of the topics under consideration. Chapter 2, for example, contains a discussion of labor supply curves estimated from cross-sectional data; in Chapter 5 the relationship between productivity growth and employment in agriculture and telephone communications is reviewed. Empirical examples from scholarly research and

periodicals such as *Business Week* and *The Wall Street Journal* are also presented throughout the text, often in the form of short footnotes.

**Policy Applications** Each chapter also contains at least one section devoted to an application of the theory to some public policy issue or current events topic. In Chapter 4, for example, the theory of labor demand is used to analyze the impact of trade liberalization on the employment and wage rates of American workers. Chapter 12 considers the pros and cons of the Davis–Bacon Act.

**Current Events** A third way we link theory to real-world events is by including in each chapter one or more boxed examples called “In the News.” Each example contains a brief discussion of a relevant magazine or newspaper article that supplements or illustrates a particular subject contained in the chapter. Chapter 2 (“Hours of Work”), for example, contains an “In the News” section devoted to the evidence on whether Americans are overworked, while the “In the News” section in Chapter 13 (“Unemployment”) discusses the difficulties some cities have in attracting businesses to their designated enterprise zones.

**International Features** One cannot open a newspaper today without recognizing how much more globally focused the United States is becoming. Because of this, almost every chapter contains at least one internationally-focused example, illustration, or application. For example, Chapter 4 explores how growing imports affect employment in the United States; Chapter 7 compares social and private rates of return from around the world; Chapter 9 compares the degree of occupational segregation in many different countries; and Chapter 13 compares and evaluates the experience of different countries with unemployment.

**Mathematical Modeling Appendices** A unique feature of the text is appendices to each of the core chapters on labor supply and labor demand (Chapters 2–5). Each of these appendices presents the mathematical representation (using simple calculus) of the major theoretical outcome contained in the chapter. For example, the appendix to Chapter 2 derives the equilibrium condition for utility maximization in the labor/leisure choice model, showing mathematically that in equilibrium the wage is equal to the marginal rate of substitution; and the appendix to Chapter 5 derives the long-run equilibrium for the demand for labor, showing that the input price ratio is equal to the marginal rate of technical substitution between capital and labor.

**Linear Regression Appendices** Another unique feature of the text is the series of three appendices that illustrate the use of linear regression techniques to estimate economic relationships. An appendix to Chapter 2, for example, first explains how linear regression is used to estimate a labor supply curve and then presents regression results from an empirical study to illustrate the theory.

**Data and Reference Appendix** The appendix to Chapter 6 contains a detailed list of data and reference sources in labor economics, including Internet sources, to aid students in writing research reports and term papers.

## Organization and Course Outline

We organized the chapters in a logical progression so that one subject smoothly flows into another. Chapter 1 provides an overview of the major labor market outcomes examined later in the text; a detailed discussion of the role of market, institutional, and sociological forces in the labor market; and a review of the evolution of labor market theory. Chapters 2 and 3 are devoted to labor supply (hours of work and labor force participation), and Chapters 4 and 5 to labor demand (in the short run and long run). We prefer to discuss labor supply before labor demand, although instructors who prefer the opposite approach can easily change the chapter sequence. In Chapter 6 demand and supply are combined to show the process of wage determination. Although wage determination is probably the central issue in labor economics, few texts give this topic adequate coverage, and none that we know of examine the extent to which the predictions of the competitive model accord with real-world behavior. These topics are considered in detail in this book.

Chapters 7 through 10 discuss the causes of wage differentials in nonunion labor markets. Chapter 7 is devoted to human capital theory, Chapter 8 examines occupational wage differentials, Chapter 9 looks at the causes and consequences of discrimination, and Chapter 10 examines the wage structure in the context of human resource management.

Chapters 11 and 12 are devoted to the economics of unions and labor relations. Chapter 11 describes why workers join unions and examines the process of collective bargaining. Chapter 12 analyzes the impact of unions on wages, fringe benefits, productivity, income inequality, and profits. Since courses in labor economics differ considerably with respect to the amount of attention given to unions and collective bargaining, it was difficult to decide the amount of space to devote to this topic in the text. Some authors devote as little as one chapter, others use half the book. We tried to strike a balance at about 15 percent—a figure approximating the size of the organized sector in the labor market. The material on unions in Chapters 11 and 12, along with the extensive treatment of human resource management in Chapter 10 (as well as material in Chapters 2, 4, and 9), is extensive enough to make the text suitable for a course that includes a significant emphasis on labor relations, without detailed discussion of labor history, labor law, and the administration of the labor agreement.

The final chapter of the text is devoted to the one macroeconomic issue that probably receives the most attention from the press and from policy makers: unemployment. Both the causes and consequences of unemployment receive considerable attention.

One consequence of the extensive topical coverage, the in-depth treatment of most subjects, and the presentation of alternative theories is that the text is relatively comprehensive. We believe, however, that most instructors will find this to be a virtue, not a vice. Some topics that appeal to one instructor may not appeal to another. With this text, instructors can structure the content of the course to match their needs and interests. Each chapter is written so that one or more sections can be deleted without loss of continuity. In addition, the nontechnical style of exposition allows the instructor to assign sections in each chapter as outside reading,

making it possible to cover more of the book than could be covered in class discussion alone.

## New Features of the Seventh Edition

In addition to updating statistics, data, and policy/institutional details, this edition's revision includes updated applications and the new "In-the-News" boxes. It is important to keep the applications of the theory relevant to what the student is reading about in the newspaper and seeing on the TV news.

Some of the major changes in this edition include a **completely rewritten** section on the evolution of labor market theory in Chapter 1, a new policy application on the earned income tax credit in Chapter 3, a new empirical example about the wage impact of immigration in Chapter 6, and updated Empirical Evidence 6.2 with more recent example of job losses, and a revised section on the "Firm's Demand for HRM Services" model in Chapter 10.

Additional changes include the many updated "**In the News**" features: In **Chapter 2**, two new boxes cover a comparison of hours of work in the United States and Europe, and another evaluates the success of, and problems with, welfare reform. Chapter 3 includes an "In-the-News" box discussing the implications of retiring baby boomers on the next generation. In other chapters, news features cover concerns of the middle-class, and the rising costs of health and other fringe benefits; how American manufacturers are faring in a growing global, low-wage economy; the living wage; anti-discrimination based on sexual orientation; union health benefits, and the relationship between job growth and the unemployment rate.

## Ancillary Materials

A comprehensive *Instructor's Manual and Test Bank* (ISBN 0-324-28880-8), prepared by the authors, is available in print version and electronically on the text website. The manual includes an overview of each chapter and answers to the end-of-chapter review questions, as well as Internet-based assignments relevant to the topics in each chapter.

In addition, the test bank portion for each chapter contains ten multiple choice questions, ten true/false/uncertain questions requiring explanations, and a detailed answer key.

The website at <http://kaufman.swlearning.com> is valuable resource for instructors and students, and contains the following:

- **PowerPoint slides** of key tables and figures
- **Additional readings** list to accompany each chapter
- **e-con @pps Economic Applications**—EconNews Online, EconDebate Online, EconData Online, and EconLinks Online help to deepen students' understanding of theoretical concepts through hands-on exploration and analysis of the latest economic news stories, policy debates, and data. An access card is provided with each new text.

## Acknowledgments

In writing this edition of the text, we have benefited greatly from the comments and suggestions of a number of people. We would particularly like to thank Susan Averett, Lafayette College; Christopher Geller, Deakin University; Jill Gunderson, Economic Research Services; and Sabrina Pabilonia, Bureau of Labor Statistics, for their detailed comments for this revision. We also thank the reviewers who contributed many good ideas and suggestions to previous editions of *The Economics of Labor Markets*: Steve G. Allen, North Carolina State University; John Antel, University of Houston; Thomas R. Arnold, King's College; John Barron, Purdue University; Brian Becker, State University of New York, Buffalo; Mary Ellen Benedict, Bowling Green State University; Sherrilyn M. Billger, Illinois State University; Richard Bryant, University of Missouri, Rolla; Carol Clark, Guilford College; Marie D. Connolly, Chatham College; Donald A. Coffin, Indiana University, Northwest; Betsy Crowell, University of Michigan, Dearborn; Laurence Fisher, Our Lady of the Lake University; Donald E. Frey, Wake Forest University; Paul Grimes, Mississippi State University; Wallace Hendricks, University of Illinois; Stephen M. Hills, Ohio State University; Barry T. Hirsch, Florida State University; David C. Huffman, Bridgewater College; Jerry Kingston, Arizona State University; Andrew I. Kohen, James Madison University; Anil Kumar, Syracuse University; Joseph Lee, Mankato State University; Michael A. Leeds, Temple University; Stuart Low, Arizona State University; John G. Marcis, Francis Marion University; Jorge Martinez, Georgia State University; Nan Maxwell, California State University, Hayward; Robert Moffitt, Johns Hopkins University; Edward Montgomery, University of Maryland, College Park; Robert E. Moore, Georgia State University; Roger D. Morefield, University of St. Thomas; Kevin J. Murphy, Oakland University; Peter Orazem, Iowa State University; Bruce Pietrykowski, University of Michigan, Dearborn; Solomon Polachek, State University of New York, Binghamton; Lidija Polutnik, Babson College; Jonathan F. Pingle, University of North Carolina, Chapel Hill; Elton Rayack, University of Rhode Island; John W. Ruser, Bureau of Labor Statistics; John F. Schnell, University of Alabama, Huntsville; Bruce Seaman, Georgia State University; Paula Stephan, Georgia State University; Peter von Allman, Moravian College; Susan Vroman, Georgetown University; Jennifer L. Warlick, University of Notre Dame; William W. Wilkes, Athens State University; Donald R. Williams, Kent State University.

In addition, valuable assistance was provided by John Stavick and Velma Zahirovic-Herbert.

Bruce E. Kaufman  
Julie L. Hotchkiss  
Atlanta, Georgia  
March 2005

## ABOUT THE AUTHORS

**Bruce E. Kaufman** is Professor of Economics, and Senior Associate of the W. T. Beebe Institute of Personnel and Employment Relations at Georgia State University. He received his Ph.D. in Economics from the University of Wisconsin, Madison. Professor Kaufman has authored several dozen articles on labor markets, industrial relations, and human resource management in scholarly journals and has written or edited fifteen books. His book, *The Origins and Evolution of the Field of Industrial Relations in the United States*, won the “Best Book in Labor Economics and Industrial Relations” award in 1992; his most recent book (2004) is *Theoretical Perspectives on Work and the Employment Relationship*. Professor Kaufman’s research interests include wage determination, the economics of firm employment practices, labor law, collective bargaining, behavioral and institutional economics, and the history of thought in labor economics.

**Julie L. Hotchkiss** is Research Economist and Policy Advisor at the Federal Reserve Bank of Atlanta, and adjunct Professor of Economics in the Andrew Young School of Policy Studies at Georgia State University. She received her B.A. degree from Willamette University and her Ph.D. in Economics from Cornell University in 1989 and has published numerous articles on a variety of topics including the relationship among state-level unemployment rates, wage differentials in Jamaica, labor supply behavior and welfare of two-earner families, the impact of unemployment insurance programs on individual job search behavior, and wage determination of part-time workers. She has written one book, *The Labor Market Experience of Workers with Disabilities: The ADA and Beyond*. Current research projects include the impact of intermittent labor force participation of lifetime earnings and wealth accumulation, successful transition from welfare to work, and the dynamics of jobs and workers across the business cycle.

*To Diane, Lauren, and Andrew*

Bruce Kaufman

*To Bob, Roberta, and Nathan*

Julie Hotchkiss

# BRIEF CONTENTS

Preface	xvii	APPENDIX 7A Estimating a Human Capital Earnings Function	382
About the Authors	xxiii		
<b>1 The Labor Market</b>	<b>1</b>	<b>8 Occupational Wage Differentials</b>	<b>387</b>
<b>2 Hours of Work</b>	<b>44</b>	APPENDIX 8A Measuring Occupational Segregation—The Duncan Index	442
APPENDIX 2A The Hours of Work Decision for Salaried Workers	97	<b>9 Discrimination in the Labor Market</b>	<b>447</b>
APPENDIX 2B Constrained Optimization and the Labor/Leisure Choice Model	103	APPENDIX 9A The Measurement of Discrimination	504
APPENDIX 2C Estimating a Labor Supply Curve with Linear Regression	107	<b>10 The Economics of Human Resource Management</b>	<b>505</b>
<b>3 Labor Force Participation</b>	<b>114</b>	<b>11 Union Membership and Collective Bargaining</b>	<b>558</b>
APPENDIX 3A The Allocation of Time to Market Work, Home Work, and Leisure: A Graphic Exposition	165	APPENDIX 11A A Comparison of Monopoly, Efficient Contract, and Median Voter Models of Union Wage Determination	616
APPENDIX 3B Constrained Optimization and the Participation Decision	170	<b>12 The Economic Impact of Unions</b>	<b>626</b>
<b>4 The Demand for Labor in the Short Run</b>	<b>172</b>	APPENDIX 12A Estimating Union–Nonunion Wage Differentials	661
APPENDIX 4A The Short-Run Equilibrium Level of Employment	218	<b>13 Unemployment</b>	<b>666</b>
<b>5 The Demand for Labor in the Long Run</b>	<b>219</b>	APPENDIX 13A International Unemployment Statistics	708
APPENDIX 5A The Long-Run Equilibrium Level of Employment	257		
<b>6 The Determination of Wages</b>	<b>260</b>	<i>Glossary</i>	<i>713</i>
APPENDIX 6A Data, Reference, and Internet Sources in Labor Economics	319	<i>Name Index</i>	<i>723</i>
<b>7 Education, Training, and Earnings Differentials: The Theory of Human Capital</b>	<b>326</b>	<i>Subject Index</i>	<i>733</i>

# CONTENTS

Preface	xvii
About the Authors	xxiii

## CHAPTER 1 The Labor Market 1

<b>The Labor Market and the Economy</b>	<b>1</b>
<b>Unique Features of the Labor Market</b>	<b>4</b>
Labor Is Embodied in the Seller	4
The Long-Term Nature of the Employment Relationship	5
Heterogeneity of Workers and Jobs	6
The Multiplicity of Markets	7
<b>Labor Market Outcomes</b>	<b>7</b>
The Changing Level and Composition of Labor Supply	8
The Changing Level and Composition of Labor Demand	8
The Structure of Earnings	11
Labor-Management Relations and Collective Bargaining	12
Changes in the Level and Composition of Unemployment	14
<b>The Labor Market Process</b>	<b>15</b>
Market Forces	15
Institutional Forces	20
Sociological Forces	22
<b>The Evolution of Labor Market Theory</b>	<b>26</b>
The Neoclassical School	27
The Institutional School	31
Modern Labor Economics: A Pragmatic Blend?	34
<b>The Importance of Theory and Hypothesis Testing</b>	<b>35</b>
<i>In the News</i> Different Views on the Merits of Ergonomics Standards	36
<b>The Importance of Theory for Public Policy</b>	<b>38</b>
EMPIRICAL EVIDENCE 1-1 The Market for Teachers: 1971–2001	40
<b>Summary</b>	<b>42</b>
<b>Review Questions</b>	<b>42</b>

## CHAPTER 2 Hours of Work 44

<b>The Pattern of Hours of Work</b>	<b>44</b>
<b>The Theory of the Labor/Leisure Choice</b>	<b>46</b>
Preferences and Indifference Curves	47

Wages, Income, and the Budget Constraint	51
The Equilibrium Hours of Work	54
Hours of Work and Changes in Nonlabor Income	55
Hours of Work and Changes in the Wage Rate	57
A Graphic Derivation of Income and Substitution Effects	60
The Supply Curve of Labor	61
<b>Income Maintenance Programs and Labor Supply</b>	62
Types of Income Transfer Programs	63
TANF: The Successor to AFDC	63
TANF and Hours of Work	65
<i>In the News Welfare Reform: Success with Trouble Spots</i>	68
Issues in Welfare Reform	70
<b>Qualifications to the Labor/Leisure Model</b>	71
Employer-Mandated Work Schedules	71
<i>In the News Work Hour Differences between the United States and Europe: Economic, Legal, or Cultural Explanations?</i>	75
Time and Money Costs of Working	76
<b>The Time-Series Pattern of Hours of Work</b>	79
The Process of Hours Reduction	81
The Slower Decline of Work Hours in the Postwar Period	83
The Recent Increase in Work Hours	85
POLICY APPLICATION 2-1 Supply-Side Economics and Labor Supply	87
EMPIRICAL EVIDENCE 2-1 Labor Supply Curves Estimated from Cross-Sectional Data	91
<b>Summary</b>	94
<b>Review Questions</b>	95
APPENDIX 2A The Hours of Work Decision for Salaried Workers	97
APPENDIX 2B Constrained Optimization and the Labor/Leisure Choice Model	103
APPENDIX 2C Estimating a Labor Supply Curve with Linear Regression	107

---

## CHAPTER 3 Labor Force Participation 114

<b>Definition and Measurement of the Labor Force</b>	114
<i>In the News The Work Force in the Twenty-First Century: The Challenge Facing Employers</i>	117

<b>CHAPTER 4</b>	<b>The Demand for Labor in the Short Run</b>	<b>172</b>
<b>The Pattern of Employment</b>		<b>173</b>
<b>The Marginal Productivity Theory of Labor Demand</b>		<b>174</b>
The Model		<b>175</b>
The Short-Run Demand Curve for Labor		<b>180</b>
The Market Demand Curve for Labor		<b>184</b>
Criticisms of the Theory of Labor Demand		<b>185</b>
<i><b>In the News</b></i>	<i>Rise in Benefit Costs Leads to Job Growth Slowdown</i>	<b>186</b>

<b>The Elasticity of Demand for Labor</b>	<b>191</b>
Special Relationships	193
Estimates of the Elasticity of Labor Demand	195
<b>The Relationship between Product Demand and Labor Demand</b>	<b>197</b>
The Demand for Labor over the Business Cycle	197
<i>In the News</i> <i>Worries about Middle Class Jobs and Upward Economic Mobility</i>	200
Consumer Expenditure Patterns and the Demand for Labor	204
POLICY APPLICATION 4-1 <b>Wage Subsidy Programs</b>	205
POLICY APPLICATION 4-2 <b>Globalization and the Demand for Labor</b>	209
EMPIRICAL EVIDENCE 4-1 <b>The Motivation behind Union Wage Concessions</b>	214
<b>Summary</b>	216
<b>Review Questions</b>	216
APPENDIX 4A <b>The Short-Run Equilibrium Level of Employment</b>	218

---

## CHAPTER 5    The Demand for Labor in the Long Run 219

<b>The Pattern of Capital/Labor Substitution</b>	<b>219</b>
<b>The Theory of Labor Demand in the Long Run</b>	<b>221</b>
The Technology of Production: Isoquants	221
Factor Prices: Isocost Lines	224
The Equilibrium Level of Employment	226
A Change in the Wage Rate	228
The Long-Run Demand Curve for Labor	230
<b>The Determinants of the Elasticity of Labor Demand</b>	<b>232</b>
Demand for the Final Product	232
The Share of Labor in Total Cost	233
Substitutability of Other Factor Inputs	234
The Elasticity of Supply of Other Factor Inputs	236
<b>Technological Change and Labor Demand</b>	<b>236</b>
The Displacement of Labor by Technological Change	237
Technological Change and Product Demand	239
The Combined Effect	240
<i>In the News</i> <i>How American Manufacturers Survive the Low-Wage Global Challenge</i>	242

<b>Productivity Growth and the Demand for Labor</b>	<b>245</b>
POLICY APPLICATION 5-1 <b>Employment Forecasting</b>	<b>246</b>
POLICY APPLICATION 5-2 <b>Displaced Workers</b>	<b>250</b>
EMPIRICAL EVIDENCE 5-1 <b>Productivity Growth and Employment                                           in Agriculture and Telephone                                           Communication</b>	<b>252</b>
<b>Summary</b>	<b>255</b>
<b>Review Questions</b>	<b>255</b>
<b>APPENDIX 5A   The Long-Run Equilibrium Level                                           of Employment</b>	<b>257</b>

---

## **CHAPTER 6**   The Determination                                           of Wages 260

<b>The Pattern of Wages</b>	<b>260</b>
<b>Wage Determination in Competitive Markets</b>	<b>263</b>
The Law of One Wage	263
The Law of One Wage Put to the Test: Secretaries	265
Market Imperfections	267
A More Realistic Model	272
<b>Wage Determination in a Monopsony Market</b>	<b>274</b>
The Marginal Cost of Labor Schedule	277
The Equilibrium Level of Wages and Employment	278
<b>The Process of Market Adjustment</b>	<b>278</b>
Excess Demand	280
Excess Supply	280
<b>Market Adjustment and the Minimum Wage</b>	<b>281</b>
History of the Minimum Wage	281
Purpose of the Minimum Wage	282
The Minimum Wage in a Perfectly Competitive Market	283
<b><i>In the News   A Living Wage</i></b>	<b>286</b>
The Minimum Wage in a Monopsony Market	287
The Minimum Wage and Efficiency Wage Theory	289
Research Findings	290
<b>The Firm's Internal Wage Structure</b>	<b>295</b>
<b>Segmentation and Dual Labor Market Theory</b>	<b>300</b>
Primary and Secondary Jobs	301
Limited Mobility	301
<b><i>In the News   Are Firms Developing Two-Tier Workforces?</i></b>	<b>302</b>
Implications and Evidence	303