

CAMPBELL R. McCONNELL • STANLEY L. BRUE

**CONTEMPORARY
L A B O R
E C O N O M I C S**

S E C O N D E D I T I O N



C O N T E M P O R L A B O R E C O N O M I C S

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*To Holly and Ben
and
Terri and Craig*

BACKGROUND AND PURPOSE

There can be no doubt that the winds of change have permeated the field of labor economics. Labor economics has increasingly become an area for the application of micro and macro theory. To make room for such analytical applications, economists are making less and less use of the extensive historical, legal, and institutional materials which dominated the field two or three decades ago. Labor economics has become less and less an area tangential to the core of analytical economics and increasingly a major component of that core.

It is the fundamental purpose of the present volume to capture the content and the attendant excitement of these changes. To put it bluntly, we strive for a logically organized and clearly presented statement of the “new” labor economics. This is not to say that such traditional topics as labor law, the structure of unions, and collective bargaining have been entirely crowded out. These subjects remain, but in a context which explains their impact upon the functioning of labor markets.

The level of analysis is tailored for the undergraduate student who has completed a reasonably rigorous sequence on macro and micro principles. The book is designed for a one-semester or one-quarter course, although appropriate supplementation can make it usable as the focal point of a two-semester course.

ORGANIZATION AND CONTENT

It is informative to summarize briefly the subject matter and organization of *Contemporary Labor Economics*. The specific changes which are incorporated in this second edition are detailed later in the Preface.

The subject matter generally proceeds from micro to macro topics. Figure 1-1 and the “Overview” section of Chapter 1 outline the organizational framework in some detail. Hence, our synopsis at this point will be brief.

Chapters 2 to 6 are designed to provide students with a no-nonsense, bare-bones understanding of how orthodox or neoclassical economists conceive of labor markets. Specifically, Chapters 2 to 4 explore the supply side and Chapter 5 the demand side of labor markets. Chapter 6 combines supply and demand to delineate a variety of labor market models, emphasizing the efficiency aspects of each.

Chapters 7 to 11 introduce institutions which influence the functioning of individual labor markets. Hence, Chapters 7 and 8 add unions and collective bargaining to the discussion and stress the effects of unions upon wages, efficiency, the distribution of earnings, and profits. Chapters 9 and 10 embody a systematic and comprehensive analysis of the direct and indirect impacts of government upon labor markets. Chapter 11 is devoted to the institution of discrimination and the many ways it affects the functioning of labor markets.

In Chapters 12 to 14 we concentrate primarily upon labor market outcomes. Chapter 12 explores the general character of the wage structure which labor markets yield. Similarly, the personal distribution of earnings is examined in Chapter 13. In Chapter 14 we examine the geographic movement of labor resulting from the system of incentives inherent in labor markets and assess how that movement relates to efficiency over time.

While it is accurate to say that our approach is "orthodox," "neoclassical," or "mainstream," we feel that it is important for students to be aware of alternative conceptions of labor markets. Hence, in Chapter 15 we summarize the "old" institutionalism of the immediate post-World War II period, outline the "new" institutionalism of internal labor market theory, and explore the theory of dual or segmented labor markets.

Chapters 16 to 19 are mainly, but not exclusively, macro. The issue of labor productivity is accorded extensive treatment in Chapter 16. Chapter 17 embodies a discussion of several theories of labor's share of the national income. The next two chapters are devoted to the core macro topics of unemployment and inflation. Chapter 18 features a simplified job search model. In Chapter 19 we have resisted a generalized discussion of inflation in order to concentrate upon the relationship between wage determination and the price level.

Chapters 20 and 21 are designed to provide an international perspective on labor. Chapter 20 summarizes the labor sector in the U.S.S.R., and Chapter 21 considers the potential role of labor in the growth process of the less-developed countries. We feel that these two chapters enhance the students' appreciation of labor markets and labor issues in the United States.

Finally, Chapter 22 serves as a unique springboard for students desiring to supplement and extend their newly acquired knowledge of labor economics. The chapter should also prove useful to students doing term papers or projects in this or related courses. By delineating sources of labor-related data, listing and discussing the major journals and nontechnical publications in the field, and citing closely related books, it should help the interested student to avoid obsolescence of his or her human capital investment in labor economics.

This book is purposely designed to provide ample room for topic selection in the one-semester course. For example, an instructor whose course is concerned exclusively with the microeconomics of labor may choose to assign only Chapters 1 through 15. In contrast, the instructor who chooses to cover both the basic micro and macro topics might select Chapters 1 through 12 and 16 through 19. Similarly, if one is interested in inculcating an international perspective in students, the inclusion of Chapters 20 and 21 will meet that objective. The decision to assign Chapter 22 is likely to depend upon the amount of written work assigned.

DISTINGUISHING FEATURES

At the hazard of immodesty, we feel that this volume embodies a number of features which distinguish it from other books in the field.

Content. In the area of subject matter, the emphasis in Chapter 6 and elsewhere upon allocative efficiency is both unique and desirable. The efficiency emphasis makes students realize that *society* has an interest in how labor markets function. The systematic and comprehensive analysis of government's impact upon labor markets found in Chapters 9 and 10 also sets this book apart. Chapter 13 confines its focus almost entirely to the personal distribution of *earnings*, compared to the usual discussion of the distribution of *income* and the poverty problem. Although we recognize that the preferences of instructors vary on this matter, we believe our approach to be more relevant for a textbook on *labor* economics. In our treatment of the critiques of orthodoxy in Chapter 15 we have taken care to treat the "old" institutionalism, internal labor market theory, and labor market segmentation as logical outgrowths of one another, rather than as disparate topics. Indeed, we observe that many competing books give these topics only fleeting mention. The critical topic of labor productivity has been largely ignored or treated in a piecemeal fashion in other books. We have upgraded this topic by according it extensive treatment in Chapter 16. Chapters 18 and 19 on unemployment and wages and inflation embody the modern aggregate supply and demand model now common in principles texts to discuss the contending views of economists concerning search versus cyclical unemployment and wage-push versus demand-pull inflation. And to our knowledge, no other labor text embodies separate analytically oriented chapters on the labor sectors of the U.S.S.R. and the less-developed countries. Finally, Chapter 22 provides a comprehensive discussion of information sources which can be used to widen and deepen the reader's understanding of the field.

Organization and Presentation. We are aware that this book faces intense competition from other texts authored by distinguished labor economists. Our basic strategy for meeting this competition has been to put great stress upon the logical organization of subject matter, not only chapter by chapter but within each chapter. It is our hope that our earlier discussion of "Organization and Content" and a reading of the "Overview" section of Chapter 1 will convince most instructors that we have given a great deal of thought to the sequence of chapters. What the world does *not* need is a new labor text comprised of twenty or so disparate and unrelated chapters. Hence, we have sought to develop the subject matter logically from micro to macro, from simple theory to real-world complications, and from analysis to policy. Similarly, considerable time has been spent in seeking the optimal arrangement of topics within each chapter. Chapter subheadings have been used liberally; our feeling is that the student should always be aware of the directional flow of the subject matter.

Many of the key topics of labor economics will be intellectually challenging for most students. We have tried not to impair student understanding with clumsy or oblique exposition. Our purpose is to communicate effectively with students. To this end we have taken great care that our writing be clear, direct, and uncluttered. It is our goal that the material contained herein be highly accessible to the typical college undergraduate who has limited training in economics.

Pedagogical Features. We have included a variety of pedagogical devices which we feel will make significant contributions to student understanding. First, the introduction of each chapter contains a paragraph or so stating the goals of the chapter and, in many cases, relating it to prior or future chapters. Second, end-of-chapter summaries provide a concise, point by point recapitulation of each chapter. Third, key terms and concepts are highlighted at the end of each chapter. Fourth, ample lists of questions are provided at the end of each chapter. These range from “open-ended” discussion questions to numerical problems which permit students to test their understanding of basic analytical concepts. Fifth, a list of basic references is provided at the end of each chapter for those ambitious students who seek greater breadth and depth of understanding. Sixth, we have utilized the inside covers of the book to present relevant historical statistics which we hope will be valuable to both students and instructors. Furthermore, as indicated previously, the final chapter of the book lists and discusses various avenues by which the interested reader can update statistical materials found in the book and continue the learning process beyond the course. Finally, we have included short minireadings under the heading “Time and a Half” prior to the endmaterial of each chapter. Some are special applications or cases pertinent to the chapter’s subject matter. Others present views which contrast with or dissent from positions presented in a chapter. Others are simply in-depth extensions of subject matter. The “Time and a Half” sections are purposely located after the text material so as not to interrupt the continuity of the presentation.

Workbook and Manual. *Contemporary Labor Economics* is accompanied by a comprehensive *Student Workbook*, which has been prepared by Professor Norris Peterson of Pacific Lutheran University. The *Workbook* contains behavioral objectives and a chapter by chapter glossary in addition to problems, exercises, and multiple-choice questions. The philosophy of the workbook is captured by the Chinese proverb inside its cover: “I hear and I forget, I see and I remember, I *do* and I understand.” It is our belief that the *Student Workbook* will prove to be a valuable aid both to the instructor and to students. Professor Peterson’s considerable expertise is also reflected in the *Instructor’s Manual*, which he has authored. Among other features, it contains chapter outlines and learning objectives, answers to selected end-of-chapter text questions, answers to the problems and multiple-choice questions in the *Workbook* (answers to odd-numbered questions also are contained in the *Workbook* itself), and several sample examinations comprised of essay and multiple-choice questions.

THE SECOND EDITION

By any reasonable standard, the second edition of *Contemporary Labor Economics* embodies a very comprehensive revision. In part this revision reflects new developments in labor theory and policy. It also incorporates the insights and suggestions of some 24 scholars who reviewed the first edition and the revised

manuscript for the second edition. It is useful to highlight the major changes on a chapter by chapter basis.

In Chapter 1 we have shifted the choice-theoretic discussion into the body of the text and added a new "Time and a Half" section which describes a number of prominent labor market trends. Chapter 2 has been extensively reworked. The figure which provides an overview of labor supply decisions has been shifted from Chapter 3 to Chapter 2, the discussion of the nature of indifference curves has been expanded and now emphasizes differences in work-leisure preferences, the reservation wage concept has been introduced, new data on worker satisfaction with their hours of work are now included, and data on the Seattle-Denver income-maintenance experiment are now incorporated in the text. There is also a new "Time and a Half" which presents evidence consistent with a backward-bending labor supply curve.

Major changes in Chapter 3 include rewriting the discussion of aggregate participation rates to highlight the recent updrift, extending and reworking the sections on the participation rates of females and older males, and elaborating the section on hours of work. The presentation and discussion of the discount formula in Chapter 4 have been reconceived for greater clarity. In addition, a short discussion of the possible effects of public policy upon the distribution of human capital and earnings has been added. In Chapter 5 we have improved the presentation of the value of marginal product–marginal revenue product relationship, reworked the long-run labor demand section to sharpen the focus upon output and substitution effects, included a new section on estimates of wage elasticity and their practical significance, rewritten the section on determinants of labor demand to distinguish between substitutes and complements, and appended a new section on the possible indeterminacy of labor demand which makes special reference to efficiency wages and the shock effect. A new "Time and a Half" focuses upon several real-world illustrations of changes in labor demand.

Chapter 6 features a new section on efficiency wage theories and the implications and criticisms thereof. The discussion on quality circles has been restated, and new emphasis is placed upon union control over labor supply as opposed to the "monopolization" of labor supply. The discussion of the union shop has been clarified, and a short discussion of labor-management collusion has been appended to the bilateral monopoly model. Finally, the "Time and a Half" section on professional baseball has been extended to include the team owners' apparently collusive response to free agency. The major changes in Chapter 7 include a short discussion of the rationale for unionization, an elaboration of the discussion of union growth in the public sector, and a rewrite and expansion of the material on the decline of unions. The new "Time and a Half" is a case study of the recent wave of labor unrest in the meatpacking industry.

Chapter 8 has been extensively rewritten to incorporate new research on the economic impact of unions. More specifically, a table has been added to ensure student understanding of the difficulties in measuring the union wage advantage. H. Gregg Lewis's most recent estimates of the union wage advantage

are highlighted, the discussion of why unions might increase fringe benefits is extended, the sections concerning restrictive work rules and the allocative implication of the union wage advantage have both been reconceived for greater clarity, new evidence of the potential impact of unions upon productivity has been incorporated to stress existing disagreement on this issue, and a new section on how unions affect profitability is now included. The new "Time and a Half" section explores the existence and implications of two-tier wage systems.

Chapter 9 now includes an updated and slightly expanded comparison of public and private pay scales and a rewritten discussion of the impact of income taxes upon labor supply. A new "Time and a Half" section focuses upon the possible differences between public- and private-sector unions. In Chapter 10 the discussion of labor law and union membership has been reorganized with new material added on public-sector unionism. The section on labor law and bargaining power has been rewritten and condensed. The minimum-wage section has been extensively overhauled in terms of both organization and content. The new discussion includes recent legislative proposals to increase the minimum wage, a discussion of why unions support the minimum wage, and a consideration of how the minimum wage might decrease the need for the payment of efficiency wages. The reworking of the section on job safety includes a shift from tabular to graphic analysis and the inclusion of recent findings on the effectiveness of OSHA. A new "Time and a Half" section examines recent attempts by interior designers to get state legislatures to set licensing standards for the design of interior spaces.

Chapter 11 on discrimination also embodies a number of salient changes. The Becker model has been restated for greater clarity, a brief discussion of why occupational crowding occurs has been added, new evidence concerning both the trends in occupational segregation and the "explained" and "unexplained" portions of earnings differentials is presented, a new table has been added to summarize antidiscrimination legislation and policies, and finally, the comparative worth section has been rewritten, expanded, and shifted from the "Time and a Half" section to the text itself. The new "Time and a Half" summarizes recent research on how ethnicity and religion might affect earnings.

Chapter 12 now embodies a new section on efficiency wage explanations of intra- and interindustry wage differentials and a clearer presentation of the material on wage rate distributions. The section on cyclical and secular changes in wage differentials has been deleted. In Chapter 13 we have tightened the sections which describe the distribution of earnings and which compare earnings in the private and public sectors. Chapter 14 on migration includes new research findings, a brief consideration of the *maquiladora* program, and a discussion of selected aspects of the Immigration Reform and Control Act of 1986. The main substantive change in Chapter 15 is that we have tied in monitoring and efficiency wages as a possible explanation of the evolution of dual labor markets.

The inflation-productivity section of Chapter 16 has been recast for greater precision. The section on the long-run trend of labor productivity has been extensively rewritten to incorporate Edward Denison's most recent data. Similarly, more recent data on labor hoarding and the productivity slowdown are also included. Although the topic itself—the implications of labor productivity

for international trade—remains the same, the “Time and a Half” section has been virtually rewritten in its entirety. Chapter 17 has been condensed, largely by omitting the material on cyclical changes in labor’s share. The new “Time and a Half” considers the composition of the wage share.

Chapter 18 has been augmented by the inclusion of a new discussion of the employment-population ratio in the section on employment-related statistics. The basic graphic model (Figure 18-3) used in Chapters 18 and 19 has been recast to include direct analysis of the labor market. This enables us to stress more explicitly the microeconomic foundations of the macro model and to provide an entrée to Chapter 19’s analysis of wages and inflation. Other changes in Chapter 18 include a discussion of “wait” unemployment, union job queues, and efficiency wages in the frictional unemployment section; specific consideration of displaced workers in the section on structural unemployment; and the deletion of the material on public service employment. The new “Time and a Half” section summarizes Martin Weitzman’s much-discussed “share economy” proposal, which is designed to enhance downward wage flexibility. In Chapter 19 the presentation of the links between productivity growth, hourly wages, and unit labor costs has been tightened, and the material pertaining to productivity declines and accelerating inflation has been excised.

Chapter 20 now features more information on labor turnover in the U.S.S.R., a brief discussion of part-time work, and reorganized and rewritten material on Soviet labor productivity. This last change involves the separation of worker attitudes and planning problems as determinants of labor productivity. The discussion of policies to enhance labor productivity has been expanded. Chapter 21 on labor and economic growth in the less-developed countries is entirely new in the second edition. The rationale for this chapter is the increasing internationalization of labor markets. The chapter describes the main characteristics of the labor sectors of the LDCs, presents a simple model of labor force growth and real wages, and critically examines the Arthur Lewis and Michael Todaro models of economic growth. Both the Lewis and Todaro models stress the role of labor in the growth process. The “Time and a Half” section details the unhappy status of child workers in India. Several new bibliographic entries have been added to Chapter 22, which examines information sources in labor economics. The selected list of term paper topics contained in Table 22-1 has also been updated.

Finally, on a more general note, we have upgraded the end-of-chapter questions lists by adding more analytical questions, headings and subheadings have been used more liberally, definitions of key terms have been made more explicit, and recent research findings have been incorporated and cited throughout the text.

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Although the above listing makes it evident that this book is a collective endeavor, the coauthors see no gracious means by which our traditional responsibility for errors of omission or commission can be avoided.

Campbell R. McConnell
Stanley L. Brue

Preface

xxiii

1	LABOR ECONOMICS: INTRODUCTION AND OVERVIEW	1
	Importance of Labor Economics	1
	The "Old" and the "New"	3
	The Choice-Theoretic Approach	3
	<i>Relative Scarcity</i>	4
	<i>Purposeful Behavior</i>	4
	<i>Adaptability</i>	4
	Overview	5
	Payoffs	9
	<i>Personal Perspective</i>	10
	<i>Social Perspective</i>	10
	TIME AND A HALF: Major Labor Market Trends	11
2	THE THEORY OF INDIVIDUAL LABOR SUPPLY	14
	The Work-Leisure Decision: Basic Model	15
	<i>Indifference Curves</i>	15
	<i>Budget Constraint</i>	20
	<i>Utility Maximization</i>	21
	<i>Wage Rate Changes: Income and Substitution Effects</i>	22
	<i>Graphic Portrayal of Income and Substitution Effects</i>	26
	<i>Rationale for Backward-Bending Supply Curve</i>	28
	<i>Empirical Evidence</i>	28
	<i>Elasticity versus Changes in Labor Supply</i>	30

Applying and Extending the Model	30
<i>Nonparticipants and the Reservation Wage</i>	31
<i>Standard Workday: Overemployment and Underemployment</i>	34
<i>Premium Pay versus Straight Time</i>	36
<i>Income Maintenance Programs</i>	38

TIME AND A HALF: The Backward-Bending Labor Supply Curve: Indirect Evidence	44
--	----

3 **LABOR FORCE PARTICIPATION RATES AND HOURS OF WORK..... 49**

Becker's Model: The Allocation of Time	49
<i>Two Fundamental Changes</i>	50
<i>Income and Substitution Effects Revisited</i>	52

Participation Rates: Defined and Measured	53
Secular Trend of Participation Rates	54

<i>Rising Female Participation Rates</i>	55
<i>Relative Importance</i>	59
<i>Racial Differences</i>	60
<i>Declining Male Participation Rates</i>	61

Cyclical Changes in Participation Rates	65
<i>Added-Worker Effect</i>	65
<i>Discouraged-Worker Effect</i>	66
<i>Procyclical Labor Force Changes</i>	66

Hours of Work: Two Trends	68
<i>Workweek Decline, 1900–1940</i>	68
<i>Post-World War II: Workweek Stability</i>	69

TIME AND A HALF: Economics and Fertility	71
--	----

4	LABOR QUALITY: INVESTING IN HUMAN CAPITAL	77
	Investment in Human Capital: Concept and Data	78
	The Human Capital Model	79
	<i>Discounting and Net Present Value</i>	80
	<i>Internal Rate of Return</i>	84
	<i>Generalizations and Implications</i>	85
	<i>Rate-of-Return Studies</i>	87
	<i>Private versus Social Perspective</i>	88
	Markets for the College-Trained Work Force	90
	Human Capital Investment and the Distribution of Earnings	91
	<i>Diminishing Rates of Return</i>	92
	<i>Demand, Supply, and Equilibrium</i>	93
	<i>Differences in Human Capital Investment</i>	94
	<i>Capital Market Imperfections</i>	97
	On-the-Job Training	99
	<i>General and Specific Training</i>	99
	<i>Distributing Training Costs</i>	99
	<i>Worker Retention</i>	101
	Criticisms of Human Capital Theory	102
	<i>Investment or Consumption?</i>	102
	<i>Nonwage Benefits</i>	103
	<i>The Ability Problem</i>	103
	<i>The Screening Hypothesis</i>	104
	TIME AND A HALF: The Marxian Critique of Human Capital Theory	106
5	THE DEMAND FOR LABOR	112
	Derived Demand for Labor	112
	A Firm's Short-Run Production Function	113
	<i>Total, Marginal, and Average Physical Product</i>	113
	<i>Stages of Production</i>	114

<i>Law of Diminishing Marginal Returns</i>	115
<i>Zone of Production</i>	116
Short-Run Demand for Labor: The Perfectly Competitive Seller	117
Short-Run Demand for Labor: The Imperfectly Competitive Seller	120
The Long-Run Demand for Labor	123
<i>Output Effect</i>	123
<i>Substitution Effect</i>	123
<i>The Combined Effects</i>	124
<i>Other Factors</i>	124
The Market Demand for Labor	125
Elasticity of Labor Demand	127
<i>The Elasticity Coefficient</i>	127
<i>The Total Wage Bill Rules</i>	128
<i>Determinants</i>	129
<i>Estimates of Wage Elasticity</i>	132
Changes in Demand for Labor	133
The Indeterminacy Problem	135
<i>Efficiency Wages</i>	136
<i>Shock Effect</i>	136
TIME AND A HALF: In the News: Changes in Labor Demand	137
Appendix to Chapter 5: Isoquant-Isocost Analysis of the Long-Run Demand for Labor	141
Isoquant Curves	141
Isocost Curves	143
The Cost-Minimizing Combination of Capital and Labor	145
Deriving the Long-Run Labor Demand Curve	145

6 WAGE DETERMINATION AND RESOURCE ALLOCATION 149

The Theory of a Perfectly Competitive Labor Market	149
<i>The Labor Market</i>	150
<i>The Hiring Decision by an Individual Firm</i>	154
<i>Allocative Efficiency</i>	156