

c) so, this is economics in general. What is labor economics?

! Labor Economics is the study of the market for one particular commodity in the economy - labor services.

- i) equilibrium price is the wage that workers receive.
- ii) equilibrium quantity is the amount of work that people do (hours, weeks, effort, skill) in the economy.

NOTE: What has been said so far seems incredibly obvious, but there are those who would take issue with it. They would argue that:

“Labor is not a commodity. A person’s labor is not just something they sell in return for income. Rather, a person’s job, occupation, career are an important aspect of identity, self-esteem, prestige, “who you are”. (Compare this to kinship in primitive societies)

How to respond to this?

All these things are probably true, but they do not negate the fact that labor is something that is bought and sold in a modern capitalist economy, and whose price is set by supply and demand. (for instance, shortage of skilled software engineers today | € wages (example of COBOL programmers and the Y2K issue). In 1970's oil crisis a shortage of petrochemical engineers | € wages; a surplus of educated people caused a decline in the returns to college)

You might wish it wasn't; that it should be otherwise in a better society; but in our society labor is a commodity that is traded in markets.

2) How do we study economics of labor?

i) Construct models of behavior, using the same tools that economists use to study other goods. These tools are found in standard **microeconomic theory**: budget constraints, indifference curves, cost curves, isoquants, supply and demand curves. etc. Occasionally, we will also use some calculus. **{you should know all the above tools from intermediate microeconomics; will assume you know}**

ii) Test models of behavior, using simple **descriptive statistics** and **regression analysis**. If the model doesn't fit, it is revised or rejected. **Some of you will know regression from econometrics (which I strongly recommend)** for others I'll try to provide an intuitive sense.

3) Why study economics of labor?

If labor is just another commodity and can be analyzed just like any other commodity, then why do we need a special course/subfield of economics (with lots of researchers, etc.)?

We don't have a special subfield of economics for other commodities:
 - banana economics; haircut economics; GM stock...
 (Exception: finance)

Why for labor?

a) main reason is importance of market for labor:

! for virtually all households in the economy, sale of their labor services to firms constitutes by far their major source of income. \hat{p} the price of this good that they sell (i.e. wage/salary) is the main determinant of

their economic well-being.

! thus, to understand the distribution of income in society—who earns what and why—we need to understand Labor markets, how equilibrium wages are determined...

b) secondary reason is that although labor is a commodity, like every commodity, it has a number of special features/peculiarities that must be taken into account in a more in-depth analysis. Each of these has important implications for how labor markets work, for equilibrium prices and quantities.

! A list of the labor's distinctive characteristics, and their implication for labor markets is given in the accompanying table. As we go through the course, covering the three main areas of supply, demand and wage structure in turn, we shall study the effects of most of these distinctions.

What Distinguishes Labor from other Goods and Services?

Aspect of Labor	Explanations & Examples	Consequences	Where covered in course
1. Labor is a factor of production , not a final product.	Unlike most goods which households buy, labor is one of the few goods they sell.	-income effects work in different ways for labor than other goods; "perverse" responses like "backward-bending" labor supply are more likely -the demand for labor is a derived demand, from the demand firms face for their products	-Section II (Labor Supply) -Section III (Labor Demand)
2. Like capital, labor is a flow of services attached to a stock of "equipment" .	The "stock" in this case is the worker and the skills he/she possesses. The "flow" is the right to use it for a period of time.	-the stock must be produced and maintained: education, training are needed. -in most cases, delivery of the "flow" requires physical presence: quality of the work environment matters	-Section IV.2 (Human Capital) -Section IV.1 (Compensating Differentials)
3. Unlike capital, the "stock" cannot be bought and sold.	-Slavery is prohibited -For various reasons, people can't sell "shares" in themselves, for example to finance education	-borrowing constraints may matter for human capital investment (education) -human capital investment is riskier than physical capital investment because it is nondiversifiable	-Section IV.2 (Human Capital)
4. Labor is a very heterogeneous commodity	-Workers are differentiated by type of skill, amount of skill, demographic characteristics.	-a wide variety of prices and market conditions for different labor services can coexist. This gives rise to a distribution of earnings .	-All of Section IV.

5. The quality of labor services being supplied is often hard to measure .	<ul style="list-style-type: none"> -workers may simply “shirk” -poor management decisions may not be apparent for years 	-compensation and incentive systems need to be designed appropriately	-Not covered (take “Personnel Economics”).
6. Sometimes the demanders <i>and/or</i> suppliers of labor have considerable monopoly power .	<ul style="list-style-type: none"> -employers’ associations, company towns, other monopsonists -unions -search costs, relationship-specific skills and bilateral monopoly. 	-use monopoly/monopsony and search theory to study these markets	-monopsony covered under minimum wages (Section III.2).
7. Labor markets are highly regulated ; the exchange of labor is both highly taxed and subsidized	<ul style="list-style-type: none"> -income and payroll taxes -income support programs -workplace safety legislation -immigration policy -industrial relations legislation -affirmative action, comparable worth 	-government policy has important effects on labor markets	-throughout the course