Wages

CONCEPT OF WAGES

Labor is one of the four factors of production. In economics, the term labor refers to both physical and mental work. Wage is the remuneration paid for labor. Payment of wages can be done in different modes such as time wages, piece wages, task wages,cash wages, kind wages and service wages.

- Time wages are the wages which are paid onthe basis on number of hours worked.
- Piece wages are the wages which are paid depending on the quantity of output produced.
- Task wages are the wages which consideraccomplishment of a task for payment of wages.
- Cash wages are the wages which are paid inmoney form.
- Kind wages are the wages which are paid inthe form of commodities.
- Service wages are the wages which are paidthrough a return service for the service rendered.

DISTINCTION BETWEEN REAL WAGES AND NOMINAL WAGES

Real Wages

Organizations provide various facilities toworkers apart from paying salaries. The additional facilities suchas transportation facilities, medical facilities, accommodation,and other allowances paid in addition to the salary constitute thereal wages of workers. According to Prof. Thomas, "real wages orreal earnings refer to the purchasing power of the worker'sremuneration i.e., the amount of necessaries, comforts andluxuries which the worker can command in return for hisservices." If the money earned by a worker is Rs. 10,000 permonth, his/her nominal wage is Rs. 10,000 but the real wage refersto the purchasing power of the money earned i.e., how much theworker can purchase with Rs. 10,000.

Real wages serve as indicators with regard to the prosperity level ofworkers. If the purchasing power of money is high, real wages areconsidered to be high. Adam Smith, a renowned economist, statedthat the laborer is rich or poor, is well or ill-rewarded inproportion to the real, not the nominal, wages of his labor.

Nominal Wages

Accordingto Prof. Thomas, "nominal wages or nominal earnings refer to the amountof the wages as measured in terms of money." Nominal wages are alsoknown as money wages and refers to the payment to a worker for the servicerendered in terms of money. For instance, if an amount of Rs.10,000 iscredited to a worker's bank account as a salary for a month that amountis referred as the nominal wage of the worker.

THEORIESOF WAGE:

The prominent among the theoriesof wages are: the standard of living theory of wages, the bargaining theory of wages, and the modern theory of wages.

Standard of Living Theory of Wages

The standard of living theory was given by Torrens in 1815. According to the theory, the traditional standard of living of laborers determines the wagelevel. The standard of living theory of wages is a modified version of thesubsistence theory of wages. The subsistence theory of wages states that the wages shouldbe fixed at the minimum wage level needed for the physical existence ofthe workers. The standard of living theory is an extension of the subsistence theory and is assumed to be referring to the long run.According to the standard of living theory, the wages will be influencedby the necessities and comforts to which a worker has been habituated.That is, beyond subsistence, workers want many goods, which may not betheir basic needs for survival. So the wage conforms to the standard ofliving including the comforts to which the workers have got used.

Malthus also provided an explanation of the standard of living theory of wages.According to him, the standard of living is not fixed or constant. Ifthere is change in the wage rate, the standard of living also changes.When there is rise in wages, there is an improvement in the standard ofliving of workers. Workers try to maintain the new level of raised wagesso as to maintain the improved standard of living. And in the long run,the improved standard of living forms the basis for determination of wagesfor workers.

The standard of living theory takes into consideration the productivity ofworkers in determining wages, unlike the subsistence theory, which spokeonly of the subsistence wages. Moreover, the standard of living theory ofwages is an optimistic theory as it believes that there is scope for risein wage level through increases in the productivity of workers. Thistheory is an improvement on the subsistence theory. However, the theory isnot free from certain limitations and flaws which are stated below:

Limitations

The standard of living theory of wages is criticized by some economists on thefollowing grounds:

•Itis a one-sided theory as the demand side of labor is ignored and onlythe supply side of labor is considered in determining the wages.
•Theassumption of long run is also criticized. According to Keynes, "inthe long-run we are all dead." Thus the standard of living theory ofwages is criticized for not being practical.
•Thetheory is also criticized for its vague concept of standard of living.As there is no exact method for measuring the standard of living, theworkers' habits have to be known first in order to fix the wages,which is impractical. Thus it does not have any practical application.
•Anothersignificant drawback is the ignorance of the concept of differentialwages. Different wages for the workers with a same standard of livingis not explained in the theory.
•Economistsalso opined that the theory does not provide a clear explanation as towhether wages determines the standard of living or the standard ofliving determines the wages.

However,it can be concluded that the standard of living theory of wages is an improvement on the subsistence theory of wages.

BargainingTheory of Wages

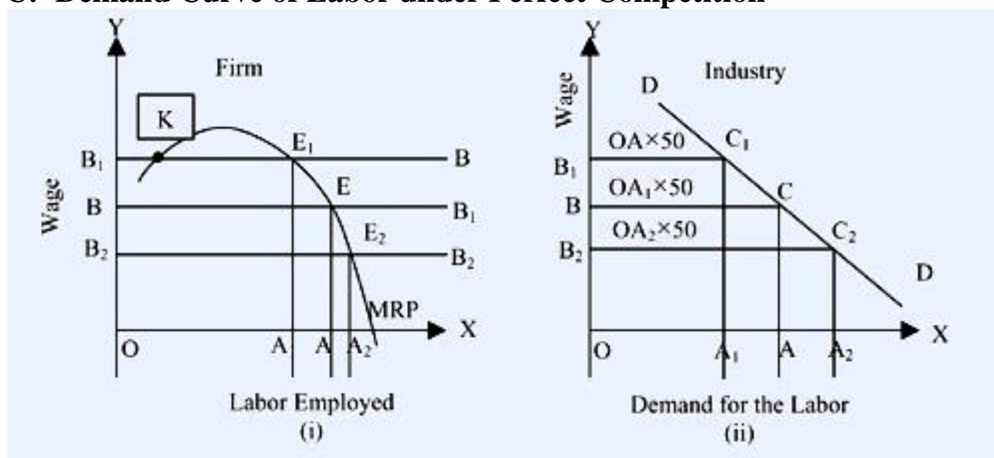
Davidson,Thomton and Maurice came up with the bargaining theory of wages.According to this theory, wages are determined based on thebargaining between the producers and workers. If workers have morebargaining power, the wages will be high, and conversely, if thebargaining power of workers is weak they will get low wages. Themaximum limit or ceiling of wages is considered by producers whenthey make a decision about the number of people to employ. If thewages are beyond the maximum level, the producer may even shutdown the firm. On the other hand, workers may not be willing towork for a wage below a minimum level of wages. Hence, the wagelevel will fall somewhere between the minimum and maximum limits.Thus, the equilibrium level of wages is dependent on thebargaining power of employers and employees.
Thebargaining theory of wages is applicable even under imperfectcompetition conditions. The role of trade unions has beenmentioned in the theory. The theory also explains the concept ofdifferential wages. However, modern economists opine that thebargaining theory of wages is incomplete as it is known that theworkers are economically weak in comparison to the producers andtherefore the bargaining power of workers is weak. The wagedetermination process in this theory is not justified both onmoral and on economic grounds.

ModernTheory of Wages :
Moderneconomists worked on overcoming the drawbacks of the other theories ofwages and wanted to develop a complete theory of wages. The theory ofwages is a special form of the general theory of value. The moderneconomists believed that the determination of wages is based on theinteraction of the forces of supply and demand of labor. The point wherethe demand for and supply of labor is equal determines the wages in anindustry. According to the modern economists, the demand and supply oflabor is slightly different from the demand and supply of goods. Anexplanation about the forces of demand and supply of labor is given below:

Demand for labor :
Factorsof production have a derived demand. Labor being one among the factors ofproduction also has a derived demand. The demand for labor depends on theproductivity of workers. A worker is employed by a producer only becausehe/she can produce something. And the demand for labor depends on thedemand for the goods produced. If there is high demand for the goodsproduced, the demand for labor goes up and if the demand for goods fallsthe demand for labor also comes down. The demand for labor also depends onthe prices of other factors of production i.e., land, capital, andentrepreneurship. When the prices of other factors of production go up,they will be substituted by labor. So the demand for labor increases.Hence, the demand for labor is based on the prices of other factors ofproduction and also the degree of substitutability of those factors ofproduction with labor. Apart from these factors, demand for labor is alsoaffected by the technical factors. If capital-intensive techniques areused in the production process, the demand for labor is minimal as largepart of work is done by machines.
Apart from these factors, the marginal revenue productivity (MRP) is one of the main factors influencing the demand for labor. MRP is the difference in the total income to the producer when one more unit of labor is employed. The law of diminishing productivity operates on

workers and it is profitable to producers to employ workers only up to the level where their wages and marginal productivity are equal. Beyond that level, the marginal productivity of workers goes on diminishing. Hence, there is an inverse relationship between wage rate and the demand for workers. Therefore, the demand curve for labor has a downward slope from left to right. It is explained in Figure C. Apart from thesxe factors, the marginal revenue productivity (MRP) is one of the main factorsinfluencing the demand for labor. MRP is the difference in the total income to the producer when one more unit of labor is employed. The law of diminishing productivity operates on workers and it is profitable to producers to employ workers only up to the level where their wages and marginal productivity are equal. Beyond that level, the marginal productivity of workers goes on diminishing. Hence, there is an inverse relationship between wage rate and the demand for workers. Therefore, the demand curve for labor has a downward slope from left to right. It is explained in Figure C.

Figure C: Demand Curve of Labor under Perfect Competition



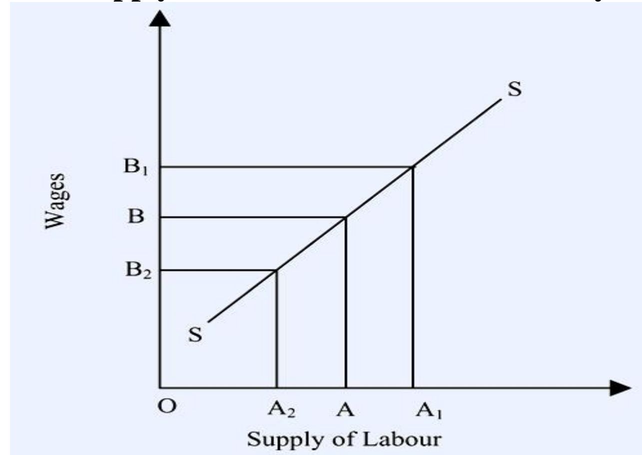
In Figure C, laborers employed are represented on the x-axis and the wages are represented on the y-axis. The demand curve of labor is DD and it has a downward slope. When the wage is OB, the demand for workers is OA. When the wages rise to OB_1, demand for labor falls to OA_1. Hence, the demand for workers is low at higher wages. In the same way, when wages fall to OB_2, demand for labor rises to OA_2. The left part of the figure explains the variations in demand for labor at different levels of wages in a firm. When the wage rate is OB_1, firm will be most profitable by employing OA_1 number of workers. The point K in the figure 8.C(i) is not the point of equilibrium. It shows loss minimization and not profit maximization. In fact, E_1 is the point of equilibrium. And the points E and E_2 also indicate the points of equilibrium of the firm by employing varied numbers of laborers. The demand for labor curve is obtained by joining these points. The demand curve for an industry is obtained by horizontal summation of the demand curves of all the firms in the industry. There is an inverse relationship between wages and the demand for labor as the marginal productivity of workers goes down with increased employment.

Supply of labor

The supply of labor indicates the number of workers ready to work at a particular wage rate. The supply side of workers can be studied under three different headings such as supply of labor to a firm, supply of labor to an industry, and supply of labor to an economy as a whole.

Firm: When there is perfect competition prevailing in the industry with large number of firms operating in a market, price cannot be influenced by an individual firm. In fact, the industry fixes the price. Firms had to adjust their demand for workers only at the existing wage rate. Therefore, the supply curve of labor is represented by a horizontal line and the supply of labor is perfectly elastic for a firm

Figure D: Supply of Labor Curve for an Industry



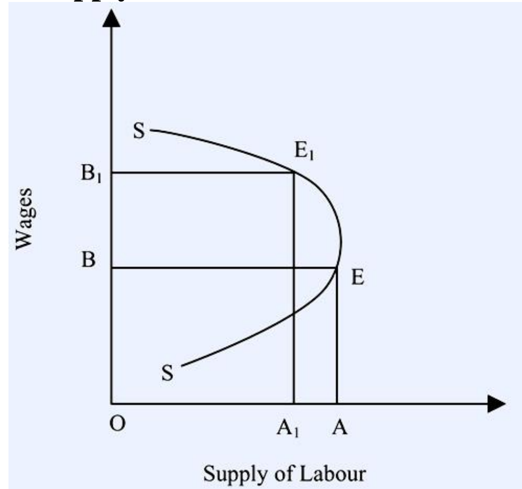
Industry: The supply curve of labor for an industry is upward sloping from left to right. An industry can attract more workers only at higher wages. This is represented in Figure D.

In Figure D, when wages are at OB level, OA workers are ready to work. If wages rise to OB_1, supply of labor increase to OA_1. And if the wages fall to OB_2, supply of labor goes down to OA_2. So, an industry can get workers from another industry only with higher wages.

Supply of labor for an economy*:* Supply of labor for an economy depends on varied factors - social, political, and economic. Supply of labor for an economy as a whole is influenced by the population size, working hours, sex ratio, the society's attitude regarding the employment of women, mobility of labor, efficiency of workers, and the preference of people towards leisure, etc. Usually, when there is an initial increase in wages, workers are willing to take up more work. Hence, there is going to be an increase in the supply of labor up to a point; beyond this point, if wages increase, workers will prefer leisure to work. Put in other words, supply of labor decreases if wages increase beyond a limit as the present increased level of wages will be sufficient for them to maintain the same standard of living. On the other hand, if wages are low, workers tend to work more to maintain the same standard of living. So, it can be inferred that if wages increases, the supply of labor goes up only to a certain limit and then starts diminishing. The supply curve of labor for an economy which is backward sloping is presented in Figure E.

In Figure E, X-axis represents the supply of labor and Y-axis represents the wages. The supply curve of labor is SS. It has an upward slope up to the point E and bends towards Y-axis after this point. This implies that the supply of labor increase up to the point E and then starts diminishing even when there is an increase in wages. When the wages rise to OB_1 from OB, as shown in Figure E, supply of labor comes down to OA_1 from OA. The reason stated by modern economists for the decrease in supply beyond a certain wage level is that workers prefer more leisure to work at higher wages.

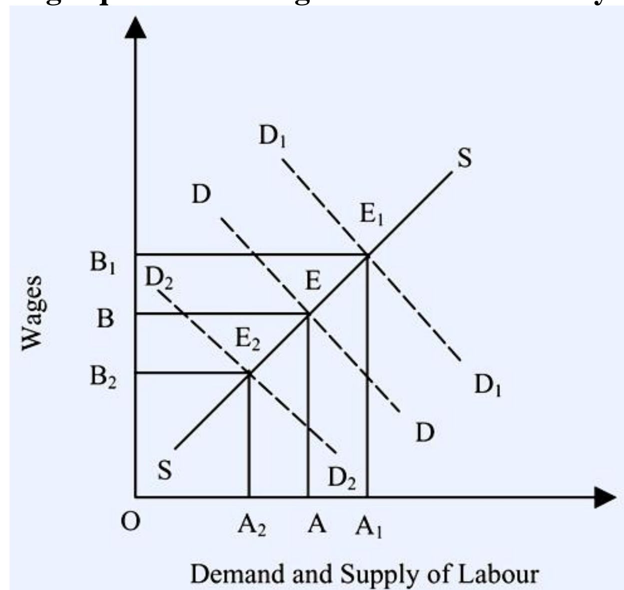
Figure E: Supply Curve of Labor in an Economy



Equilibrium wage level

Modern theorists believed that wage level is determined at the point of intersection of the forces of demand and supply of labor. Let us consider the case of an industry. The supply of labor curve for an industry has an upward slope and the demand curve has a downward slope. Wages are determined at the point of intersection of these two curves. It is represented in Figure F

Figure F: Determining Equilibrium Wage Level in an Industry



In Figure F, supply of labor curve, SS and the demand for labor curve, DD cut each other at point E. At this point, OB is the equilibrium wage rate. If the demand goes up to D_1D_1, the equilibrium point is E_1 and wage rate is at OB_1. On the other hand, when demand falls to D_2D_2, the wage rate goes down to OB_2. Thus,determination of wages is based on the demand for and supply oflabor in an industry.

WAGESAND TRADE UNIONS

Tradeunions are in general an organization of workers formed to serve theinterests of members in relation to wages and working conditions. Tradeunions usually have a limited membership and are comprised of people inthe same trade. Unions are formed with an intention to strengthenbargaining power of workers with the management of an organization.Studies have proved that the wages earned by unionized workers aresignificantly higher than non-unionized workers. The main reasons for wagedifferentials between union and non-union workers are cited by economistsas the increased productivity among unionized workers and the restrictedsupply of labor.

Productivity of Unionized Workers

RichardFreeman and James Medoff of Harvard University co-authored a book titled WhatDo Unions Do? In it they have quoted, ‘unions raise wages of workersby increasing their marginal product.’ This is explained to have beenfacilitated by providing a channel for communication between management and workers, resolving disputes in democratic means, and motivatingworkers. In general, when there is no trade union existing, if a workerhas a dispute with the management of an organization he/she would move outof the organization. But this move results in high costs for the companyand also to the worker as well. The reason for high costs is that thecompany might have invested a lot in training the worker and for theworker the cost is high as it includes shifting to a new place. However,this situation of worker moving out of the organization can be avoided byvoicing the concern of worker to the management of the company. Usually,exercising your voice requires collective action. The collective voice canbe through a trade union further, some economists believed that tradeunions also provide a means through which workers improve their productivity. That is one of the reasons for union workers to have higherwages than non-unionized workers

Limited Supply of Workers

The trade unions have restricted membership. By restricting the supplyof workers, trade unions try to increase the wage rate in an industry. But this affects the wages of workers outside the unionin another industry. If two industries are supposed to requireworkers with the same type of skill sets and there is an existenceof organized union in one of the two industries, then wagedifferential takes place. Due to the formation of union in oneindustry, wages of unionized workers in that industry increases.But the increase in wage rates will lead to decrease in the demandfor labor. So, the unemployed workers in the same industry move onto another industry which is not unionized. This increases thesupply of labor in that industry and the wages come down. Thus,wage differentials are created between unionized and non-unionizedworkers.

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