



LECTURE NINE - PART SIX

Other Factors Affecting Wage Differentials

- This brings us full circle to some of the questions raised in the introduction to this lecture:
 1. Why do sports stars earn more than the president of the United States?
 2. Why does a college graduate earn substantially more than a high school dropout?
 3. Why do doctors earn 15 to 20 times more than lifeguards even though both are saving lives?

#1: Compensating Differentials

- One reason has to do with so-called **compensating differentials** that measure the relative attractiveness of jobs as well as the degree of risk.

High School Graduates

- A group of high school graduates may be equally capable of becoming either bank clerks or unskilled construction workers.
- As a rule, the construction laborers will receive higher wages than the bank clerks.



Non-Monetary Aspects

- The construction job involves dirty hands, a sore back, potentially dangerous accidents, and irregular employment.
- The banking job means a white shirt, pleasant air-conditioned surroundings, and little risk of injury or layoff.

Other Things Equal

- It is easy to see why workers would rather pick up a deposit slip than a shovel.
- That's why contractors must pay higher wages than banks pay to compensate for the unattractive non-monetary aspects of construction jobs.

Ability And Economic Rent

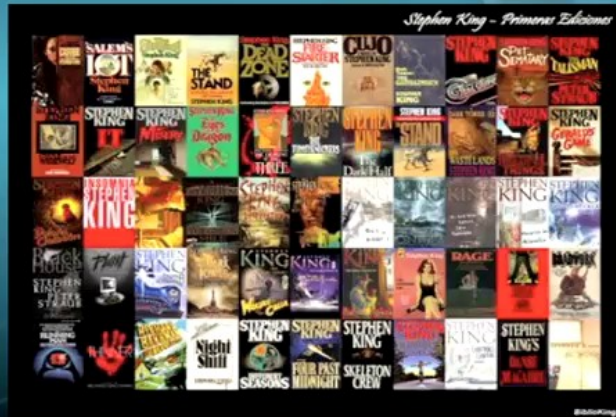
- This idea of compensating differentials might lead you to the conclusion that garbage collectors and soldiers probably make more money than university professors or doctors.
- However, we know this not to be the case.

Many Examples Exist

- We see countless examples of high-paying jobs that are far more pleasant than low-paid work.
- Accordingly, we have to look beyond compensating differentials for additional explanations of wage differentials.

#2: Differences in Mental and Physical Capabilities

- Outside their special fields, they might earn but a small fraction of their high incomes.



Quasi-Rent

- Economists refer to the excess of these wages above those of the next-best available occupation as a **pure economic rent**, or, as we learned in the last lecture, more precisely a quasi-rent.
- In fact, these **quasi-rents** are logically equivalent to the rents earned by a fixed supply of land.

#3: Human Capital

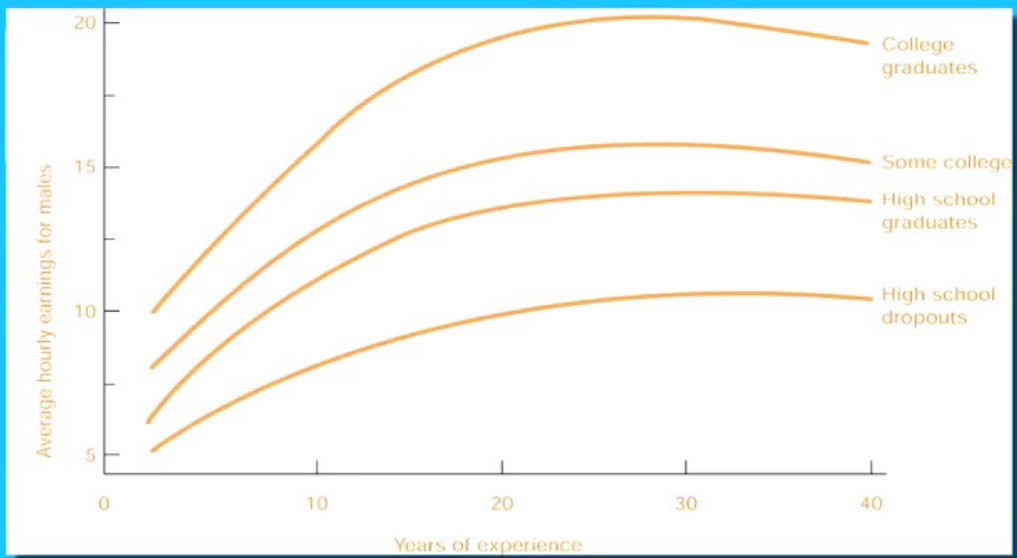
- Still a third explanation of wage differentials has to do with the different amounts that people invest in their own **human capital**.

Key Definition

Human capital refers to the stock of useful and valuable skills and knowledge that are accumulated by people in the process of their education and training.

For Example

- Unlike lifeguards, doctors as well as lawyers, engineers, and professors, invest many years in their formal education and on-the-job-training.
- They spend large sums on tuition and foregone wages, investing a \$100,000 or more in college and graduate-level training.
- At least part of the high salaries of these professionals should be viewed simply as a return on their investment in human capital.



#4: Geographic Immobilities

- A final source of wage differentials takes the form of various **immobilities** such as geographic immobilities.
- For example, workers take root geographically, and they are often reluctant to leave friends, relatives, and associates.

The Costs And Inconveniences

- Nor do they want to sell their homes, force their children to change schools, and incur the costs of adjusting to a new job and a new community.
- Such reluctance or inability of workers to move enables geographic wage differentials for the same occupation to persist.



Institutional Immobilities

- A low-paid non-union carpenter in Colorado may be willing to move to heavily-unionized Chicago to find higher wages.
- But in Chicago, she or he may not be able to get a union card; and with no card, there is no union job.
- In fact, many professions impose similar restraints.

Sociological Immobilities

- Despite legislation to the contrary, both women and blacks frequently receive less pay than white men on the same job.

**EQUAL WORK
DESERVES
EQUAL PAY !**

Non-competing Groups



- We have seen that wage differentials may reflect the attractiveness of certain occupations, differences in the amount of education and training, rewards or "rents", and various immobilities.
- Even taking into account these factors, there may still be substantial wage differentials.
- The reason may be traced to the fact that labor markets are segmented into **non-competing groups**.

Think About It This Way

- Instead of labor being a single factor of production, it is many different, but closely related, factors of production.
- Doctors and mathematicians are not in competing groups because it is difficult and costly for a member of one of these professions to enter the other.
- Just as there are many different kinds of houses, each demanding a different price, so, too, there are many different occupations and skills that compete in only a general way.

Labor Sub Markets

- The point is that once we specialize in a particular occupation, we become part of a particular labor sub-market.
- We are then subject to the supply and demand for that skill and will find that our own labor earnings will rise and fall depending upon events in that occupation and industry.

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THE POWER OF MICROECONOMICS

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END OF LESSON NINE

Coming Up Next!

Lesson Ten:
The Capital Market, Interest, and Profits