

CONTEMPORARY
LABOR
ECONOMICS

THIRD EDITION



Campbell R. McConnell

Stanley L. Brue

CONTEMPORARY LABOR ECONOMICS

THIRD EDITION

Campbell R. McConnell

Professor of Economics, Emeritus
University of Nebraska, Lincoln

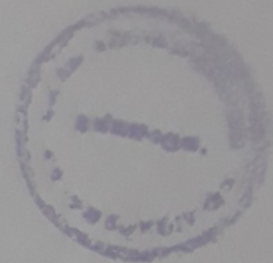
Stanley L. Brue

Professor of Economics
Pacific Lutheran University

McGraw-Hill, Inc.

New York St. Louis San Francisco Auckland Bogotá
Caracas Lisbon London Madrid Mexico Milan
Montreal New Delhi Paris San Juan Singapore
Sydney Tokyo Toronto

CONTENTS



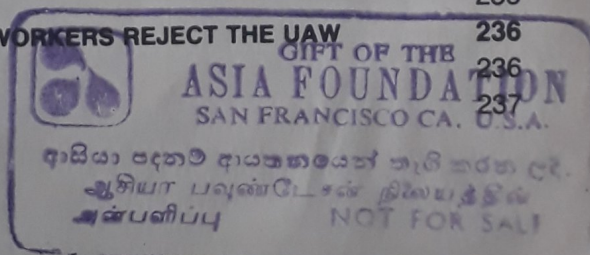
PREFACE	xxiii
1 Labor Economics: Introduction and Overview	1
LABOR ECONOMICS AS A DISCIPLINE	1
Socioeconomic Issues	2
Quantitative Importance	2
Unique Characteristics	2
WORLD OF WORK 1-1: SEWING MACHINES MEAN LIBERATION IN BANGLADESH	3
THE "OLD" AND THE "NEW"	4
ECONOMIC PERSPECTIVE	4
Relative Scarcity	5
Purposeful Behavior	5
Adaptability	5
OVERVIEW	6
PAYOFFS	10
Personal Perspective	11
Social Perspective	11
2 The Theory of Individual Labor Supply	14
THE WORK-LEISURE DECISION: BASIC MODEL	15
Indifference Curves	15
Budget Constraint	19
Utility Maximization	21
Wage Rate Changes: Income and Substitution Effects	23
Graphic Portrayal of Income and Substitution Effects	26
Rationale for Backward-Bending Supply Curve	28
Empirical Evidence	29
Elasticity versus Changes in Labor Supply	30
WORLD OF WORK 2-1: SLEEP TIME LINKED TO EARNINGS	30
APPLYING AND EXTENDING THE MODEL	31
Nonparticipants and the Reservation Wage	31

Standard Workday: Overemployment and Underemployment	35
WORLD OF WORK 2-2: MOONLIGHTING IS ON THE RISE	37
Premium Pay versus Straight Time	37
Income Maintenance Programs	39
WORLD OF WORK 2-3: SOCIAL SECURITY, INCENTIVES, AND THE EARNINGS TEST	44
 3 Population, Participation Rates, and Hours of Work	 50
THE POPULATION BASE	51
BECKER'S MODEL: THE ALLOCATION OF TIME	52
Two Fundamental Changes	52
Commodity Characteristics	53
Household Choices	53
Income and Substitution Effects Revisited	55
PARTICIPATION RATES: DEFINED AND MEASURED	56
SECULAR TREND OF PARTICIPATION RATES	57
Declining Participation Rates of Older Males	57
Rising Female Participation Rates	60
WORLD OF WORK 3-1: DO JOB OPPORTUNITIES DECLINE WITH AGE?	60
WORLD OF WORK 3-2: ECONOMICS AND FERTILITY	65
Relative Importance	66
Racial Differences	66
WORLD OF WORK 3-3: THE CHANGING AMERICAN FAMILY	69
CYCLICAL CHANGES IN PARTICIPATION RATES	70
Added-Worker Effect	70
Discouraged-Worker Effect	70
Procyclical Labor Force Changes	70
HOURS OF WORK: TWO TRENDS	72
Workweek Decline, 1900-1940	72
Post-World War II: Workweek Stability	73
LOOKING AHEAD: SLOWER LABOR FORCE GROWTH	76
Declining Labor Force Growth	76
Implications	76
 4 Labor Quality: Investing in Human Capital	 82
INVESTMENT IN HUMAN CAPITAL: CONCEPT AND DATA	83
THE HUMAN CAPITAL MODEL	84
Discounting and Net Present Value	86
Internal Rate of Return	89
Generalizations and Implications	90
WORLD OF WORK 4-1: HIGHER EDUCATION: MAKING THE RIGHT CHOICES	95

Empirical Data	92
Private versus Social Perspective	96
HUMAN CAPITAL INVESTMENT AND THE DISTRIBUTION OF EARNINGS	97
Diminishing Rates of Return	97
Demand, Supply, and Equilibrium	99
Differences in Human Capital Investment	100
WORLD OF WORK 4-2: THE LABOR MARKET PROSPECTS OF HIGH SCHOOL DROPOUTS	102
Capital Market Imperfections	103
ON-THE-JOB TRAINING	105
Costs and Benefits	105
General and Specific Training	105
Distributing Training Costs	106
Worker Retention	108
CRITICISMS OF HUMAN CAPITAL THEORY	108
Investment or Consumption?	109
Nonwage Benefits	109
The Ability Problem	109
The Screening Hypothesis	111
Recapitulation	112
WORLD OF WORK 4-3: THE MARXIAN VIEW OF HUMAN CAPITAL THEORY	113
5 The Demand for Labor	118
DERIVED DEMAND FOR LABOR	119
A FIRM'S SHORT-RUN PRODUCTION FUNCTION	119
Total, Marginal, and Average Product	119
Stages of Production	121
Law of Diminishing Marginal Returns	122
Zone of Production	122
SHORT-RUN DEMAND FOR LABOR: THE PERFECTLY COMPETITIVE SELLER	124
SHORT-RUN DEMAND FOR LABOR: THE IMPERFECTLY COMPETITIVE SELLER	126
THE LONG-RUN DEMAND FOR LABOR	129
Output Effect	129
Substitution Effect	130
The Combined Effects	130
Other Factors	131
THE MARKET DEMAND FOR LABOR	132
ELASTICITY OF LABOR DEMAND	134
WORLD OF WORK 5-1: COMPARATIVE ADVANTAGE AND THE DEMAND FOR LABOR	134
The Elasticity Coefficient	135

The Total Wage Bill Rules	135
Determinants of Elasticity	137
Estimates of Wage Elasticity	139
Significance of Wage Elasticity	140
DETERMINANTS OF DEMAND FOR LABOR	141
PRODUCT DEMAND	141
WORLD OF WORK 5-2: FAST-FOOD FIRMS WOO HOUSEWIVES AND SEMIRETIRED WORKERS	141
PRODUCTIVITY	141
NUMBER OF EMPLOYERS	142
PRICES OF OTHER RESOURCES	142
WORLD OF WORK 5-3: END OF THE LINE FOR RAILROAD CABOOSES?	143
THE INDETERMINANCY PROBLEM	144
Efficiency Wages	145
Shock Effect	145
APPENDIX: ISOQUANT-ISOCOST ANALYSIS OF THE LONG-RUN DEMAND FOR LABOR	148
Isoquant Curves	148
Isocost Curves	150
Least-Cost Combination of Capital and Labor	151
Deriving the Long-Run Labor Demand Curve	151
 6 Wage Determination and the Allocation of Labor	 155
THEORY OF A PERFECTLY COMPETITIVE LABOR MARKET	155
The Labor Market	156
The Hiring Decision by an Individual Firm	161
Allocative Efficiency	162
WAGE AND EMPLOYMENT DETERMINATION: MONOPOLY IN THE PRODUCT MARKET	164
MONOPSONY	166
UNIONS AND WAGE DETERMINATION	170
Increasing the Demand for Labor	170
WORLD OF WORK 6-1: PAY AND PERFORMANCE IN PROFESSIONAL BASEBALL	171
WORLD OF WORK 6-2: INFLUENCING THE DEMAND FOR LABOR: UNIONS AND MUNICIPAL EXPENDITURES	173
Restricting the Supply of Labor	175
Bargaining for an Above-Equilibrium Wage	177
BILATERAL MONOPOLY	180
WAGE DETERMINATION: DELAYED SUPPLY RESPONSES	182
Cobweb Model	182
Evidence and Controversy	185

Alternative Pay Schemes and Labor Efficiency	190
ECONOMICS OF FRINGE BENEFITS	191
Fringe Benefits: Facts	191
THEORY OF OPTIMAL FRINGE BENEFITS	192
Worker's Indifference Map	193
Employer's Isoprofit Curve	195
Wage-Fringe Optimum	196
CAUSES OF FRINGE BENEFIT GROWTH	197
THE PRINCIPAL-AGENT PROBLEM	200
PAY FOR PERFORMANCE	200
Piece Rates	201
Commissions and Royalties	201
Raises and Promotions	202
WORLD OF WORK 7-1: WHY IS THERE ACADEMIC TENURE?	202
Bonuses	204
Profit Sharing	206
Tournament Pay	207
EFFICIENCY WAGE PAYMENTS	208
Wage-Productivity Dependency	209
Implication: Nonclearing Labor Markets	211
WORLD OF WORK 7-2: THE FORD MOTOR COMPANY'S \$5 PER DAY WAGE	211
Criticisms	213
DEFERRED PAYMENT SCHEMES	213
Seniority Pay	213
Role of Pensions	215
Deferred Contracts: Some Final Points	216
LABOR MARKET EFFICIENCY REVISITED	216
8 Labor Unions and Collective Bargaining	221
WHY UNIONS?	222
LABOR UNIONISM: FACTS AND FIGURES	222
Who Belongs to Unions?	222
Structure of Organized Labor	226
UNIONISM'S DECLINE	230
Structural Changes	231
Managerial-Opposition Hypothesis	233
The Substitution Hypothesis	234
WORLD OF WORK 8-1: UNIONISM'S DECLINE: UNIQUE TO THE UNITED STATES?	235
Other Factors	235
WORLD OF WORK 8-2: NISSAN WORKERS REJECT THE UAW	236
Relative Importance	236
Union Responses	237



ARE UNIONS MAXIMIZERS?	238
Economic Models	238
Political Models	240
Synopsis	241
COLLECTIVE BARGAINING: A COMPLEX TRANSACTION	242
Delivering Labor Services	242
Long-Term Relationship	242
Negotiations	243
A MODEL OF THE BARGAINING PROCESS	243
The Model	244
Implications	245
 9 The Economic Impact of Unions	 255
THE UNION WAGE ADVANTAGE	255
Preliminary Complications	256
Measuring the Wage Advantage	257
Empirical Evidence	262
Total Compensation: Wages Plus Fringe Benefits	265
WORLD OF WORK 9-1: TWO-TIER WAGE SYSTEMS	266
EFFICIENCY AND PRODUCTIVITY	267
Negative View	268
Positive View	274
Mixed Empirical Evidence	276
WORLD OF WORK 9-2: THE EFFECTS OF TEACHER UNIONS ON	278
PRODUCTIVITY	278
FIRM PROFITABILITY	280
DISTRIBUTION OF EARNINGS	280
Increasing Inequality	281
Promoting Equality	283
Increased Equality?	283
OTHER ISSUES: INFLATION, UNEMPLOYMENT, AND INCOME SHARES	283
Inflation	283
Unions and Unemployment	283
Labor's Share	284
 10 Government and the Labor Market: Employment, Expenditures, and Taxation	 288
PUBLIC-SECTOR EMPLOYMENT AND WAGES	288
Government Employment: Extent and Growth	289
Public- versus Private-Sector Pay	290
WORLD OF WORK 10-1: THE TEN MOST UNUSUAL FEDERAL JOBS	291
WORLD OF WORK 10-2: PUBLIC-SECTOR UNIONS: ARE THEY	293
UNIQUE?	293
THE MILITARY SECTOR: THE DRAFT VERSUS THE VOLUNTARY ARMY	293

The Economics of Military Conscription	295
The Voluntary, Market-Based Approach	296
NONPAYROLL SPENDING BY GOVERNMENT: IMPACT ON LABOR	297
Government Purchases of Private-Sector Output	297
WORLD OF WORK 10-3: THE EFFECT OF RETENTION BONUSES ON REENLISTMENT IN THE U.S. ARMY	298
Transfer Payments and Subsidies	298
LABOR MARKET EFFECTS OF PUBLICLY PROVIDED GOODS AND SERVICES	300
Effects on Demand	300
Effects on Supply	301
INCOME TAXATION AND THE LABOR MARKET	302
The Income Tax: Impact on Wages and Employment	303
The Income Tax and Individual Labor Supply	305
THE INCIDENCE OF THE PAYROLL TAX	308
Traditional Analysis	308
Empirical Studies	310

11 Government and the Labor Market: Legislation and Regulation 313

LABOR LAW	313
Labor Law and Union Membership	314
Labor Law and Bargaining Power	317
MINIMUM-WAGE LAW	318
Facts and Controversy	319
The Competitive Model	320
The Shock Effect	323
Monopsony	324
Other Considerations	326
Empirical Evidence	326
Final Remarks	328
OCCUPATIONAL HEALTH AND SAFETY REGULATION	329
Profit-Maximizing Level of Job Safety	330
Society's Optimal Level of Job Safety	332
The Occupational Safety and Health Act of 1970	333
GOVERNMENT AS A RENT PROVIDER	335
WORLD OF WORK 11-1: THE EFFECT OF WORKERS' COMPENSATION ON JOB SAFETY	336
Occupational Licensure	337
WORLD OF WORK 11-2: INTERIOR DESIGNERS SEEK LICENSING	340
Tariffs, Quotas, and Domestic Content Rules	340

12 Labor Market Discrimination 345

DISCRIMINATION AND ITS DIMENSIONS	346
-----------------------------------	-----

Types of Discrimination	346
Indicators of Discrimination: Indirect Evidence	347
WORLD OF WORK 12-1: RACISM IN PROFESSIONAL BASKETBALL?	351
THEORIES OF LABOR MARKET DISCRIMINATION	352
Taste-for-Discrimination Model	352
Market Power: The Monopsony Model	356
Theory of Statistical Discrimination	360
The Crowding Model: Occupational Segregation	362
CAUSE AND EFFECT: NONDISCRIMINATORY FACTORS	366
Rational Choice	366
Discrimination as a Cause	368
WORLD OF WORK 12-2: WOMEN IN MANAGEMENT: A "MOMMY TRACK"?	369
A Complex Intermingling	370
Evidence	370
Controversy	371
ANTIDISCRIMINATION POLICIES AND ISSUES	372
Equal Pay Act of 1963	372
Civil Rights Act of 1964	373
Executive Orders and Federal Contracts	373
Comparable Worth Controversy	374
Controversy and Conflict	377
WORLD OF WORK 12-3: ETHNICITY AND EARNINGS	378
Empirical Evidence	379
13 The Wage Structure	385
PERFECT COMPETITION: HOMOGENEOUS WORKERS AND JOBS	385
THE WAGE STRUCTURE: OBSERVED DIFFERENTIALS	387
WORLD OF WORK 13-1: HOURLY PAY AROUND THE WORLD	389
WAGE DIFFERENTIALS: HETEROGENEOUS JOBS	390
Compensating Differentials	390
Differing Skill Requirements	394
Differences Based on Efficiency Wage Payments	396
Other Job or Employer Heterogeneities	397
WAGE DIFFERENTIALS: HETEROGENEOUS WORKERS	398
Differing Human Capital: Noncompeting Groups	398
Differing Individual Preferences	399
THE HEDONIC THEORY OF WAGES	400
WORLD OF WORK 13-2: WAGE DIFFERENTIALS: MARRIED VERSUS SINGLE MALES	401
The Worker's Indifference Map	402
The Employer's Normal Profit Isoprofit Curves	403
Matching Workers with Jobs	404
Labor Market Implications	405
WORLD OF WORK 13-3: PLACING A VALUE ON HUMAN LIFE	406

WAGE DIFFERENTIALS: LABOR MARKET IMPERFECTIONS	406
Imperfect Labor Market Information	407
Immobilities	409
14 The Personal Distribution of Earnings	414
DESCRIBING THE DISTRIBUTION OF EARNINGS	414
Frequency Distribution	415
Lorenz Curve	416
Gini Coefficient	417
Cautions	418
WORLD OF WORK 14-1: COMPARING POOR WITH NONPOOR WORKERS	419
EXPLAINING THE DISTRIBUTION OF EARNINGS	420
Human Capital Theory	420
A Modified Human Capital Model: A Multifactor Approach	422
Schematic Summary	427
MOBILITY WITHIN THE EARNINGS DISTRIBUTION	428
Life-Cycle Mobility	428
"Churning" within the Distribution	429
WORLD OF WORK 14-2: GOVERNMENT EMPLOYMENT AND THE EARNINGS DISTRIBUTION	430
RISING EARNINGS INEQUALITY	430
Trends in Quintile Shares	431
Causes of Growing Earnings Inequality	431
Conclusions and Future Prospects	434
15 Mobility, Migration, and Efficiency	438
TYPES OF LABOR MOBILITY	439
MIGRATION AS AN INVESTMENT IN HUMAN CAPITAL	440
WORLD OF WORK 15-1: LONG-TERM JOBS IN THE U.S. ECONOMY	441
THE DETERMINANTS OF MIGRATION: A CLOSER LOOK	442
Age	442
Family Factors	443
Education	444
Distance	445
Unemployment Rates	446
Other Factors	447
THE CONSEQUENCES OF MIGRATION	448
Personal Gains	448
Wage Narrowing and Efficiency Gains	450
External Effects	452
CAPITAL AND PRODUCT FLOWS	456
Capital Flows	456
Product Flows	458



U.S. IMMIGRATION POLICY AND ISSUES	458
History and Scope	458
WORLD OF WORK 15-2: THE MEXICAN MAQUILADORAS	459
Effects of Illegal Immigration	460
Immigration Reform and Control Act of 1986	463
 16 Critiques of Orthodox Wage Theory	 468
INSTITUTIONAL ECONOMICS AND WAGE DETERMINATION	469
Conscious Human Decisions	470
Unions as Political Institutions	470
Inappropriateness of Maximizing Assumption	470
Equitable Comparisons	471
INTERNAL LABOR MARKETS	472
Characteristics of Internal Labor Markets	473
Reasons for Internal Labor Markets	474
The Role of Unions	476
Labor Allocation and the Wage Structure	476
The Efficiency Issue	478
DUAL LABOR MARKET THEORY: SEGMENTATION	480
Primary and Secondary Labor Markets	480
Mutually Supportive Characteristics	481
WORLD OF WORK 16-1: THE CONTINGENT ECONOMY: TEMPORARY AND PART-TIME WORKERS	481
Job-Worker Feedbacks	482
Sources of Dualism	483
Barriers to Mobility	486
WORLD OF WORK 16-2: FRINGE BENEFITS AND LABOR MARKET SEGMENTATION	487
Comparing Orthodoxy and Dualism	487
Criticisms of Dualism	490
A Summing Up	493
 17 Labor Productivity: Wages, Prices, and Employment	 497
THE PRODUCTIVITY CONCEPT	497
Measurement	498
The BLS Index	500
IMPORTANCE OF PRODUCTIVITY INCREASES	501
Productivity and Real Wages	502
Inflation and Productivity	503
LONG-RUN TREND OF LABOR PRODUCTIVITY	505
Average Quality of Labor	506
Quantity of Physical Capital	507
Increased Efficiency	508
CYCLICAL CHANGES IN PRODUCTIVITY	510

Utilization of Labor	510
WORLD OF WORK 17-1: PRODUCTIVITY: INTERNATIONAL COMPARISONS	511
Utilization of Plant and Equipment	512
Composition of Output	512
Implications	513
PRODUCTIVITY AND EMPLOYMENT	514
Demand Factors Constant	515
Demand Factors Variable	516
Observed Productivity–Employment Relationship	518
THE PRODUCTIVITY SLOWDOWN	520
Possible Causes	520
WORLD OF WORK 17-2: LAGGING PRODUCTIVITY AND WOMEN'S WAGES	522
A Resurgence?	525
18 Labor's Share of the National Income	530
THE STUDY OF FUNCTIONAL SHARES	530
MEASUREMENT AND INTERPRETATION	531
Conceptual Problems	531
Interpreting the Data	533
MARGINAL PRODUCTIVITY THEORY OF LABOR'S SHARE	534
Changes in Absolute Shares	536
Relative Shares: Price and Quantity Changes	537
Generalizing: The Elasticity of Substitution	539
Constant Relative Shares: $E_s = 1$	540
Increasing Labor Share: $E_s < 1$	540
Decreasing Labor Share: $E_s > 1$	540
WORLD OF WORK 18-1: DO UNIONS RAISE LABOR'S SHARE?	541
12 19 Employment and Unemployment	545
EMPLOYMENT AND UNEMPLOYMENT STATISTICS	546
Measurement	546
Historical Record	547
A Critique of the Household Data	548
The Stock-Flow Model	550
Defining Full Employment	551
MACROECONOMIC OUTPUT AND EMPLOYMENT DETERMINATION	552
Aggregate Demand and Supply	552
WORLD OF WORK 19-1: COMPARATIVE UNEMPLOYMENT RATES	553
The Aggregate Labor Market	555
FRICTIONAL UNEMPLOYMENT	555
Search Unemployment	556
Inflation and Search Unemployment	558

Unemployment Compensation and Search Unemployment	560
Other Implications of the Search Model	561
Wait Unemployment	561
STRUCTURAL UNEMPLOYMENT	563
Displaced Workers	563
Additional Observations	564
WORLD OF WORK 19-2: ADVANCED NOTIFICATION OF PLANT CLOSURE OR SIZABLE LAYOFF	565
DEMAND-DEFICIENT UNEMPLOYMENT	565
Graphic Analysis	565
Wage Rigidity	567
THE DISTRIBUTION OF UNEMPLOYMENT	568
WORLD OF WORK 19-3: THE SHARE ECONOMY	569
REDUCING UNEMPLOYMENT: PUBLIC POLICIES	572
Fiscal and Monetary Policy	572
Wage Subsidies	575
 20 Wages and Inflation	 581
INFLATION AND HOURLY WAGES: AN HISTORICAL OVERVIEW	581
WAGE INCREASES AS A CAUSE OF INFLATION	583
The Relationship between Wages, Productivity, and Unit Labor Costs	583
The Wage-Push Model	584
Wage-Push Inflation: Contributing Factors	585
WORLD OF WORK 20-1: WAGE INFLATION AND INTERNATIONAL COMPETITIVENESS	586
WAGE INCREASES AS A SYMPTOM OF INFLATION	591
The Demand-Pull Model	591
Excess Demand and the Short-Run Phillips Curve	593
Adaptive Expectations and the Long-Run Phillips Curve	596
Rational Expectations in Labor Markets	599
WAGES AND INFLATION: EVIDENCE AND CONCLUSIONS	600
INCOMES POLICIES	602
Wage and Price Guideposts	602
WORLD OF WORK 20-2: THE RISE AND FALL (AND RISE?) OF THE COLA	603
Mandatory Wage and Price Controls	604
Incentive-Based Incomes Policies	605
 21 Information Sources in Labor Economics	 609
SOURCES OF LABOR STATISTICS	611
Bibliographies of Statistical Sources	611
General Summary Statistics	612
Labor-Specific Statistical Sources	613

Research Institute Survey Data	614
Updating and Augmenting Tables	615
APPLICATIONS, NEW THEORIES, EMERGING EVIDENCE	615
Indexes and Bibliographies	615
Professional Journals	616
Compendiums of Invited Essays	619
Nontechnical Publications	619
TEXTBOOKS AND RESEARCH SURVEYS	621
Advanced Texts and Surveys	621
Texts in Related Fields	622
 GLOSSARY	 624
INDEXES	
Author Index	645
Subject Index	653

