

Chapter 13 outline

Why do earnings differ?

We have already answered that question in chapter 12. People make different amounts of money because they have different levels of productivity.

If (given:):

1. identical in preferences, skills, and background
2. all jobs were equally attractive
3. workers were perfectly mobile among jobs

then we would assume that everyone would receive the same wage.

However, we know that:

1. those assumptions are not true (people are not robots)
2. everyone does not receive the same wage

So we need a new theory.

Assuming people are not identical, why do they receive different wages?

1. People have different skills and abilities – Mark McGwire has the ability to hit baseballs very far on a consistent basis. Most people do not have that ability. Because society places a great worth on that ability, he receives a very nice salary. I have the abilities to flip burgers and fry foods. Many people have these abilities. Thus, the salary that I would receive if I were to flip burgers and fry foods would be low because many people (probably even Mark McGwire) can do these things.
2. People have different preferences. Recall the Alaska/Hawaii example from chapter 12. In order to get me to move to Alaska, I would need \$100,000/yr. in Alaska as opposed to \$45,000/yr. in Hawaii. So my preferences play a part in how much I am paid. I am willing to take a substantial monetary pay cut in order to live in Hawaii.
3. Sadly enough, discrimination plays a part in pay determination. For whatever reasons, employers decide to pay certain people less based on their race or gender. To explore this topic further I encourage you to take a labor class.

Earnings differentials due to non-identical jobs

1. Wages differ due to non-pecuniary job characteristics. What are non-pecuniary job characteristics? They are characteristics that are not related to money to help the employee evaluate the job. For example, the high risk rate of fire-fighting would lead people to choose washing cars over fire-fighting if the pay was the same for both.
2. This leads us to compensating wage differentials. Because jobs have different non-pecuniary characteristics, they have different pay scales. Fire-fighters make more per hour (hopefully) than the local car wash person, because of the high degree of risk involved in fire-fighting.

Earnings differentials due to immobility of labor

1. Because it is not easy to move machinery (or labor) in response to an increase in demand, the pay scale in one area of the country could be higher than that in another area. If there was an increase for lawyers in Nebraska the lawyers in Nebraska would receive a higher wage than those not in Nebraska in the short run. Once lawyers moved to Nebraska the wages may settle down to more normal levels, but the decision to move to Nebraska is probably not an easy one for most people to make.
2. Institutional restrictions can also cause earnings differentials. Immobility of labor does not always mean immobility across various parts of the country. It can mean immobility across jobs as well. Because there are certain licensing requirements that must be met for doctors, lawyers, etc., people cannot always shift their human capital resources into those occupations easily. Thus their skill may be a limited supply of those occupations because of the immobility of human capital.

Fringe and mandated benefits

Fringe benefits are those benefits from a job other than normal monetary compensation. They can include, but are not limited to: health-care, child-care, company car, paid vacations, meals, etc. Now I know the question you are all asking: how are fringe benefits any different from non-pecuniary characteristics when considering a job? My answer is: It has to do with who pays for them. Fringe benefits are provided by the company. Non-pecuniary benefits are a result of working for a specific company, which the company does not have to pay for. People must take a look at the total compensation package, including fringe benefits and non-pecuniary benefits

when making a choice on where to be employed. Thus, living in Hawaii is not a fringe benefit because the company does not have to pay for me to live in Hawaii, like it would have to pay for child-care. To distinguish between fringe and non-pecuniary benefits one merely has to think about whether or not the company puts out any money for that particular benefit.

Why do employers include fringe benefits and why do employees accept these benefits?

1. It may be cheaper to purchase some of these fringe benefits as a group. Think about child-care for a minute. Think of the time and money it would cost you to find a suitable child-care center. Now what if your employer had an on-site child-care center provided free of charge. You could then bring the child to work with you, be close to the child in case of emergencies etc., saving you time, money and stress. If many parents have young children, the company could hire 3 or 4 supervisors, provide an on-site center, and then cut your pay some because of the fringe benefit of the child-care center. Individually it may cost the parents more (total economic cost not necessarily just monetary cost) to find child-care centers than it would to have the company provide the service. Thus, a pay cut is taken for the benefit of the center.
2. Fringe benefits may reduce the amount of taxes you pay. Say you decide to take the job without a child-care center and to find your own center. Now you have to pay taxes on the additional income you earn as well as pay for the child-care. Will it be worth it? Maybe, if the earnings are high enough.

Mandated benefits are those benefits that the government forces employers to include in their compensation package. Mandated benefits have both their proponents and their critics, like everything else.

3 point to remember when analyzing mandated benefits

1. A mandated benefit is only one component of the total compensation package.
2. Employees earn and ultimately pay for all components of their compensation packages – including mandated benefits.
3. Fringe benefits are often an inefficient form of employee compensation.

All of these things are nice, but it is important to remember the key ingredient to high earnings.

What is that key ingredient?

High productivity. High productivity does not necessarily mean that you will make a lot of money, but, if your employers understand anything about economics, it should be a crucial factor in determining your pay rate. After all, that is what everyone is striving for isn't it? We want high productivity workers wherever we are, and whoever we are.