

Wage determinant



Wage Determinants Introduction Several forces are responsible for the ultimate determination of wages which are defined as the amount of earnings that accrue to a worker per period of time. Under competitive markets, such as that of the U. S, these forces range from behavioral and institutional forces to economic and equity considerations. A multitude of factors come into play under these forces including the skill set of the employee, productivity of the worker per period of time (referred to as the Marginal Product of Labor/ Demand for Labor under perfectly competitive conditions) the amount of budget the employer has at his discretion to devote to wages, the supply of labor, minimum wage laws, labor union bargaining etc. The main emphasis of this paper is on the role of productivity in determining wage rates with respect to competitive markets such as the U. S. Productivity as a Wage Determinant Productivity is defined as the ratio of input to output. However, productivity can denote both ‘ total factor productivity’ and ‘ labor productivity’ (Backman). Labor productivity, traditionally, is seen as the output produced per hour/unit of time (Backman). The 1960’s and 1970’s saw a fall in productivity levels in the U. S (Backman). However, the economy recovered in the 1990’s and 1995 onwards was marked by very high levels of productivity. As far as wage markets are concerned, the more appropriate concept is that of labor productivity as it bears direct relation with the wage rate. As far as the U. S is concerned, the importance of this factor in determining wage levels dates back to 1948 when labor contracts underwent positive change throughout the automobile industry (Lewin and Kaufman). Later, in the 1960’s another proposition came into play that wage rates in an organization should be linked to the productivity of the economy as a whole (Lewin and Kaufman).

This proposition has been heavily debated. Economists arguing ‘ against’ the proposition claim that although, in the long run there is a strong link between wage rates and productivity, in the short-run the relationship is highly inconsistent which means that ‘ other factors’ impact the wage levels (Mortensen). They also contend that linking productivity with wages leads to steadiness in price levels only if enhancement in productivity is taken as a limit to rise in wages (Mortensen). Revisiting the example of the U. S automobile industry mentioned earlier, the advancement in labor contracts was accompanied by rising inflation levels (Lewin and Kaufman). This was attributed to the failure of guideposts that so failed because the increase in wages was not sufficiently met by an increase in productivity of the economy. The soaring price levels ultimately had to be incorporated into the cost structure which was one of the reasons that resulted in failure of the U. S automobile industry. This case demonstrates one of the inherent dilemmas of the positive relationship between productivity and wage rates. In other words, when productivity is not accepted with restrictions (especially if the productivity measure chosen has the capacity to instigate large wage increases) it has the tendency to create inflationary pressures in an economy (Martin F. Hellwig). Thus, the arguments of most economists tilt in favor of not tying rise in productivity to rise in wages. This is largely because of the inability to use economy’s productivity as a limit in the context of wages.

Conclusion To conclude, the link between productivity and wages, although strong, has been heavily debated over the years by economists largely because of the inherent tendency of the volatility in wage rates brought about by changes in productivity if the latter is not accepted as a limit. It must be realized that productivity levels have the tendency to lead to

massive upsurge in price levels, and if no controls are placed, can lead to a wage price spiraling effect. Thus, caution must be exercised by limiting the intensity of relationship between productivity and wage and taking other factors into account. References: Backman, Jules. Wage determination: an analysis of wage criteria. New Jersey: Van Nostrand, 1959. Lewin, David and Bruce E. Kaufman. New research on labor relations and the performance of university HR/IR programs. New York: Elsevier Science, 2001. Martin F. Hellwig, Andreas Irmen. Wage growth, productivity growth, and the evolution of employment. Munich: Centre for Economic Policy Research, 2001. Mortensen, Dale T. Wage Dispersion: Why Are Similar Workers Paid Differently? . Massachusetts : Massachusetts Institute of Technology, 2005.