Economic theories of pay and reward

Introduction

The issue of pay and reward can be said to be the most important part of work for individuals in the work place as they expect a reward or compensation for the efforts they put in. hence, employers and organizations have established regular reward packages to insure that workers are paid and remain loyal to their jobs.

Pay however, has been influenced by many factors, and scholars have propounded theories to explain the reasons why wages vary, rise and fall in occupations. There exist the economic theory that stipulates the demand and supply factor to the variation of wages. Here, the demand for labour is a resultant effect of the services labour can produce, and the supply indicates the willingness of any individual to provide labour that will be priced at a certain range. Here, the supply of labour be it low or high, creates a level of demand, that is, the higher the supply of labour, the lower the demand and vice versa, and wages are determined by this degree of demand and supply as it is a price for labour in the free market. Other theories however have emerged with attempts to further explain variations in wages and undermine the reality and application of the economic theory to the real world as the concept of demand and supply of labour and how it affects wage rates may not take into account other psychological and social factors that can also affect wages.

According to the psychologist, individuals do not only work for money, but for other factors that can be intrinsic motivators to them, such as the need for achievement and commitment e. t. c, hence to the pshchologist, the view that individuals are simple rational maximizing agents supplying their labour for the sole purpose of wages, is inadequate (Thorpe and Homan, 2000). On the other hand, the sociologist, argue that variations in wages can occur due to social factors in the labour market, rather than only the market forces of demand and supply.

In the cause of this essay, more light shall be thrown on the economic theories of pay and a critique of these theories shall be highlighted, which also includes Wootton social theory of wages. Also, I shall look at the reasons for inequality in pay as it relates to gender.

The economic theories of wages.

Wages and salaries have become a matter of grave importance to the individual and the public at large. Therefore, the economist postulates that the world is one of pure acquisition and competition, and that humans are motivated and respond to the single motive to make money and acquire the things money can buy. Here, the employer attempts to buy or purchase labour for the cheapest possible rate and workers on the other hand, intend to sell their labour for the best possible price, hence the subject of the demand and supply of labour (Wootton, 1955)

According to the economist, wages are a price of labour and in a free market is determined like all other prices by supply and demand. Here the supply and demand of human labour is equated to the supply and demand of a commodity. The demand side to labour, is indicative of the demand for the goods and services labour can produce, and is also the employers ability to buy labour at the best possible price. The supply side, indicates the individuals ability and willingness to respond to this demand for labour at a certain price. Here, wages serve as an attraction for labour, and it is the reason for the supply and demand of labour (Wootton, 1955)

The economist also adapts itself to explain wages and salary in occupations, where wages act as a signal to allocate labour resources efficiently among competing alternative employments. Here, the reduction or increases of wages indicates the shortage or surplus of workers as wages go up or down to maintain equilibrium in the labour market. Here, if wages are high, workers move to those occupations and due to the excess supply of labour, wages fall, but when there is little supply of that particular needed labour, wages rise to attract people to those professions. Example, where engineers are highly needed, wages rise, but also, if engineers sell their labour too high, they will remain unsold, just like in the commodity market, when goods are prized too high, they will not be sold. Therefore to the economist, when wages rise or fall to a certain point, the economic factors in the labour market (demand and supply) will find a way to bring it back to a state of equilibrium (Thorpe and Homan, 2000)

The economist also stipulate, that wages hinge on the marginal productivity of a worker. This is to say that wage rates are equal to the marginal product of the labour force available in the particular market involved. Just like the marginal product of a commodity is the extra output produced by one more unit of an input, so is it with firms, for instance, the extra output when a firm's labour is increased by one more unit, determines its wages.

Here also, the marginal net product of any worker is the difference made in the total output of an industry when the employees labour is withdrawn. The output can be qualified by the physical output of product created by a worker. This is also the economic value (That is the value of an employee derived from his ability to generate income).

Therefore, the wage rates being equal to the marginal product of a worker, stipulates that a worker gets wages that are equal to the efforts put into the labour process, in other words, in a fully competitive market, people tend to get out of the production process just about what they put in. here, the demand and wages for labour will be dependent on the marginal productivity of the employee, that is what the employee can put into the labour process, hence employers who seek to maximize profits will thus demand for labour at the value of when the increment of output equals the value of the additional labour cost (Bowles et al., 2005; Wootton, 1955).

Further still, another economic theory that tries to explain the rationale behind wages in the labour market have come up with the supply side approach to wage problems. This is embedded in the human capital theory. Wages have previously been determined by the extent to which a worker puts in effort, depicting the marginal productivity theory or the level of demand in the labour market, But here, it is observed that the quality and not the quantity of labour input has marked effects on productivity, hence, wages. The human capital theory therefore emerged as a phenomenon that highlights and explains the variations of wages in relation to the fact that more educated workers are more valuable to employers than less educated workers (Rueda and Pontusson 2000). Here, wages vary resulting from a reflection of the degree of investments people put in themselves through trainings and education, e. t. c. In this case, these investments in human capital tend to attract workers to employers who will pay higher wages to acquire it (Thorpe and Homan, 2000).

Although these theories have had substantial effects on the explanation and approaches to wage problems, they have been criticized as most times, it is not clear how these theories may be applicable to real world situations.

Critisism of the economic theories and suggestions by wootton.

Irrespective of the fact that the economic theories of wages have gained recognition, it has presently come under questioning and criticism. The marginal productivity theory has been considered to be unrealistic because employers may not be able to calculate labour in terms of marginal revenue. How will an employer know how much input a particular worker puts in, in relation to the overall output?

Again, the economic theory has been criticized for its inability to concretely explain the imperfections in the labour market or its occurrences in real world settings. In organizations, wages can be altered above the market rate in other to enhance organizational performance or retain important employees. Here workers are motivated to work harder and turn over may also be reduced when wages are high, as the firm may loose cure workers that are important and have substantial experience from the company, hence wages don't just vary due to supply and demand, but also by the discretion and determination of employers in a company. Hence, these social forces, external factors or noise in the labour market, also act as determinant of wages (Thorpe and Homan 2000).

Another major critique of the economic theory of pay is Barbra wootton, she viewed rewards and pay from the social perspective and criticized the economic theories of pay and delves into the more realistic explanation of wages as it applies to the real world setting. She therefore, has rejected the narrow abstraction of mainstream economics as an approach to the wage problems that really exist such as conflicts in the labour market, discrimination, or working conditions, e. t. c. Here, she reached out for the social foundation to wages because she could not explain why prices went up, when quality supplied went down and vice versa. For Wootton, wage determination was a special case of human behavior and could be investigated by watching and asking people what they do instead of a special case to be deduced from the general theory of value (Dimand and Hardeen, 2003).

Wootton suggests that as social forces determine wage rates and not the principle of demand and supply, there should be a link between abstract theory and its concrete application to the real world, hence, she proposes that wages are fixed by the individuals in the society as they plan for wages for reasons of ethicality. She envisages that for wages to be determined, individuals should understand the social situations and trends that exist, properly analyze the markets to know the problems that can occur and strategically plan to fight these problems.

In woottons analysis of the ministry of labour data on earnings (Dimand and Hardeen, 2003), she realized that the data she found was insufficient to prove or disprove any general theory of wages, however, she still challenges the traditional theories of wages as she stipulates that institutional arrangements and psychological motivations affect wages. Here, classifications of jobs and hierarchy are based on social factors and not economic considerations (Brown, 1955).

As the economic theory creates no distinction of wages and seem to portray an unrealistic world of equality in all occupations, and that employment can be obstructed only by difficulties of mobility and entry, wootton criticizes it and posits that there are differences in wages and this wage differentials mattered greatly to workers, and that they therefore try to rationally resist lowering wages by negotiations or threats of strike. These are corresponding rational behaviors that influence wages. She therefore connots that trade unions act as a force for the regulation of wages. Here, employees may be able to influence the increase of wages through collective bargaining as their trade unions try to obtain a markup of their present wage rates, thereby attracting even more members to them.

Trade unions have been seen to adopt the monopolistic approach towards wage rates as they are responsible for the dissemination and selling of labour, however, they are also aware of the fact that there is a point of equilibrium were the demand and supply of labour will balance out. They may then decide to either sell small units of labour at high prices or a large amount of labour for lower prices and decide on the most profitable cause of action. However, the trade unionist knows that if wages are raised above a certain amount, unemployment will increase no matter how strong the trade union is. However, as trade unions may demand for high wages from employers, they may not demand that all their workers be taking but to ensure wages are optimal, they may threaten to go on strike and to the employer, wages are better paid as the cost of the stoppage of work may be higher. In any case, the economist suggests that, the point of the curve at which the employer and trade unions agree, being the point of intersection, indicates the highest wage trade unions can accept from employers. (Professor hicks, 1932) cited in Wootton 1955 however proposes that the use of negotiations and collective bargaining to regulate wages is in itself self defeating, as the marginal productivity wage distribution will always prevail (Wootton, 1955)

Having examined the economic theories of pay, and it criticisms, we can also note that different occurrences amount to wage gaps not just demand and supply. Here, I will be considering the wage gaps that results from Gender inequality and differences in wages that result from culture.

Variatioins in wages as it relates to gender and culture.

The economic theory, views all individuals in the labour market as one, without any distinctions of gender, in relation to wages. However, considering the supply of labour in the labour market, there have been gaps and differentials in wages of women compared with men. The persistence of the gender pay gap and the resultant disparity between men's and women's income has become an issue of concern. When the individual incomes of men and women and compered, the difference is alarming. The office of national statistics note that although pay gap has become wide over the years, it is narrowing down in 2008 and 2009. It has decreased to 22% from 22. 5% in 2008, however it still exist. The overall disparity has still remained 16. 4%. the consequence of this inequality in that women are more likely to be poorer than men (TUC 2008)

However, as measures are being taking to reduce this inequality, Rubery et al., (2005) noted that significant wage gaps in the European union has brought about policies that will help close up the gender gap as there are underlying factors that result in wage gaps, such as occupational and sectoral segregation, education and training, job classifications and pay systems, e. t. c. however, it has been noted that employers often make rational decisions to employ women at lower wages than men for the same observable level of productivity and despite women’s participation in education and employment patterns, there has been an un-adjustable pay gap between men and women as most times, the female participation in the labour force promotes wage inequality by increasing the relative supply of unskilled labour (Rueda and Pontusson, 2000). Research has also noted that their exist a high level of discrimination in relation to the recruitment and placement of women in the labour force, resulting in wage gap differentials. Women are regularly placed down the occupational hierarchy, irrespective of the fact that they are as qualified as their male counterparts. Hence, investments in women through education and training, does not particularly help close gap differentials or make wages higher for women as envisaged by the human capital theory. Women have been segregated against, as they have been stereotypically looked at to belong to certain occupations that simply pay less, such as teaching, social care, part time jobs and none regular jobs and they are viewed as individuals with less education and less experience than men. This is a resultant effect of increased wage inequality. However, the mainstream theory argues that gender inequality can be reduced if the pay gap is adjusted for the differences in the characteristics of the individual, such as education, training and experience, and not the gender (Rubery et al., 2005).

Similarly, discussions have been put forward to note the existing differentials in wages and pay gaps as it relates to cultures. Here, different cultural factors may impinge on issues of pay and reward preferences, that is the types of pay, systems and criteria for pay. Although most pay systems have largely been framed in terms of developed economies and a full convergence of management practices such as reward could be exported anywhere and have similar outcomes, culture acts as a divergent force as reward practices in particular are highly susceptible to its influence.

Rewards and pay, represent the principal means by which organizations attract, sustain and retain desired workforce behaviors, employers therefore have to consider factors in the environment as employee preferences which rewards attempt to satisfy are notably shaped by unique cultural settings. That is why managers in multinational companies may be faced with the hard question of what reward is useful and preferred by the host country nationals as the challenge goes beyond just the design or structure of reward system to the reward preferences of individuals across borders. Rewards however may not just be limited to financial compensation as different cultures may vary in choices (Chiang and Birth, 2007).

Conclusion.

As pay and reward is a core issue of concern for individuals, employers and the public, theories of pay and reward have erupted as an approach to wage problems. The general economic theories of wages have equated the buying and selling of labour to that of the commodity market, as demand and supply of labour act as a means of wage variations and pay, which is the price of labour. However, social and psychological theories have criticized the economic theories, stipulating that other social factors apart from market factors of demand and supply, act as a force in the regulation of wages. These social factors, such as trade unions, culture, gender, institutions and so on, have therefore thrown more light on the reasons why wages vary. However, economic as well as social factors, have glaring effects on wages and although the economic theory may not give explanations for disparity in pay, they have been helpful in highlighting the determinants of wages.

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