Learning Objectives

Upon completion of this unit, students should be able to:

1. Identify examples of resource demand and supply in daily life.
2. Explain resource supply and demand.
3. Define opportunity cost and economic rent.
4. Analyze the factors influencing resource demand.
5. Discuss issues affecting labor supply and utility maximization.
6. Explain the market supply factors that lead to differing wages.

Unit Summary

Unit VI discusses the market for resources, which includes the supply and demand of labor. Firms use resources to produce goods for consumption. The benefit of using a certain input in production must outweigh the cost of the resource. The cost of each resource is determined by supply and demand just as the price of any other good or service.

In order to make the decision to use a certain resource, some analysis must be done to determine if the use of the resource, or an additional unit of a resource, will be profitable. The marginal revenue product of a resource is the change to a firm’s total revenue that results from employing an additional unit of the resource, ceteris paribus (all other things constant). The marginal resource cost is what an additional unit of the resource will cost. A firm maximizes profits when marginal revenue product is equal to marginal resource cost.

One of the most important resources used by firms for production is labor, or the human element of producing goods and services. Many factors are involved in the market for labor, as people derive varying levels of utility from working a certain job for a set number of hours per week. Generally, people have three uses of their time: market work, nonmarket work, and leisure (market work is time sold as labor, and nonmarket work is time spent getting an education or conducting work activities for personal benefits). To maximize utility, a person attempts to equate the marginal utility of the last unit of each of the three activities.

Regarding market work, people supply labor for a specific period of time each pay period based on wages, or the money paid by a firm to an employee for market work. The supply curve below shows an individual’s willingness to supply labor in terms of hours per week at a given wage rate. As wages increase, an employee is willing to supply more labor. The substitution effect of a wage increase defines this reaction according to the subsequent increase in the opportunity cost of giving up an hour of work due to a higher wage.

Key Terms

1. Backward-bending supply curve of labor
2. Binding arbitration
3. Collective bargaining
4. Craft union
5. Derived demand
6. Economic rent
7. Featherbedding
8. Income effect of a wage increase
9. Industrial union
10. Labor union
11. Leisure
12. Marginal resource cost
13. Marginal revenue product
14. Market work
15. Mediator
16. Nonmarket work
17. Resource complements
18. Resource substitutes
19. Right-to-work states
20. Strike
21. Substitution effect of a wage increase
22. Winner-take-all labor markets
However, unlike a standard supply curve, the supply of labor curve eventually bends backwards. In other words, as wages continue to increase, the demand for leisure also increases. The income effect of a wage increase is the term used to define the increased demand for leisure that eventually accompanies a larger paycheck.

Wages are rarely homogenous in an organization. Often, many people doing similar jobs will have extremely diverse salaries. Several factors are involved in determining wages. First, a person's willingness to supply labor is different than other employees' for varying reasons, including alternative sources of income, amenities from the job, or previous work experiences. If an employee inherits a billion dollar savings account, he may not be as picky about his wages. Additionally, if an employee enjoys white water kayaking, and her job is conveniently located next to a rapid flowing river, her supply curve may be lower than another employee who enjoys only family vacations. Second, employers are willing to pay differing wages based on training, education, job hazards, or geographical differences. All of these factors come together to determine individual wages, and cumulative wages produce the supply of labor in an economy.

The remainder of this unit centers on the existence of unions, or groups of workers who organize to improve wages and working conditions. Differing types of unions may include craft unions (a group of employees with similar skills) or industrial unions (employees who work together as part of the same industry). A union's most powerful weapon is its ability to strike, or withhold labor until a negotiation can be made.

When a union demands a higher wage, it is effectively using a price floor in the labor market for the particular industry or firm from which the union was developed. The graph below shows the effect of the requested higher wage. Intuitively, if the wage is increased to the level desired by the union, which is above equilibrium, the quantity of labor demanded must fall. If a union is successful in increasing wages, it may come at the cost of lost employment by some union members.