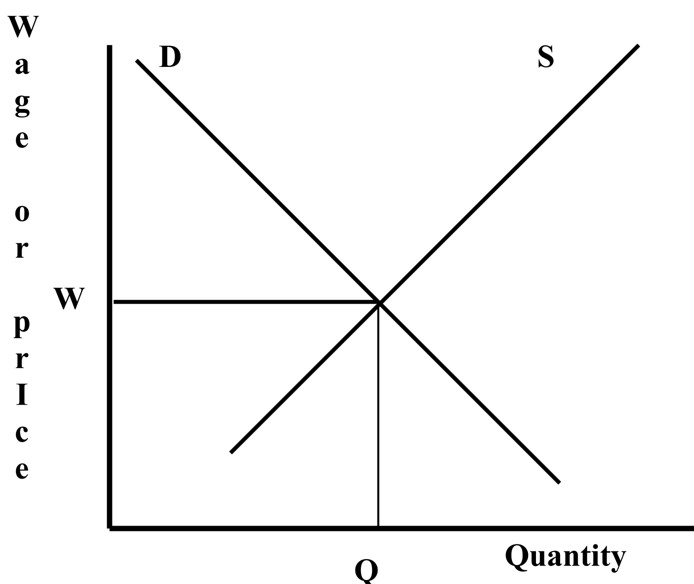
Wage Determination

Wages are in general set by a combination of two factors - the numbers of workers chasing jobs (the supply of workers) and the number of jobs available (the level of demand for those workers). We can show how these demand and supply factors come together on a demand and supply diagram.

The demand line shows how much labour is demanded at each price level (wage rate), and the supply curve how many workers are willing to work at each wage rate

D is the demand line (curve) for labour, S is the supply line (curve). Where they intersect (cut), this gives us the wage rate W, and the quantity demanded / employed Q.



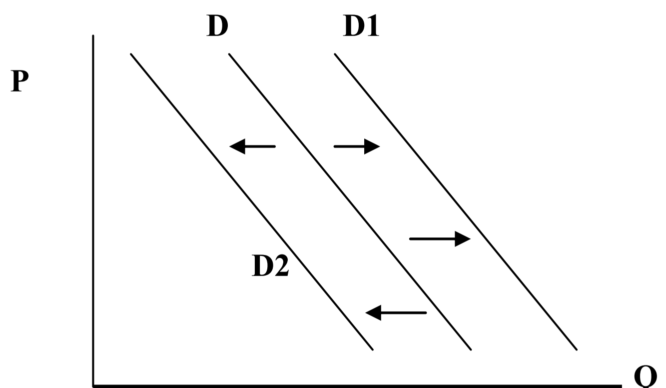
Where the demand and supply lines intersect gives us what is known as the equilibrium wage and level of employment. We can see this shown above—again W and Q.

Shifts in the demand curve

The equilibrium wage is not fixed, it can change. This change can be both in wage and employment levels.

One of the reasons for a change is when the demand curve for labour moves position –it shifts.

A movement from D to D1, (as shown below) shows a shift out in the demand curve. More labour is now being demanded. On the other hand a movement from D to D2 is a shift in, in the demand curve for labour. Less labour is now being demanded.

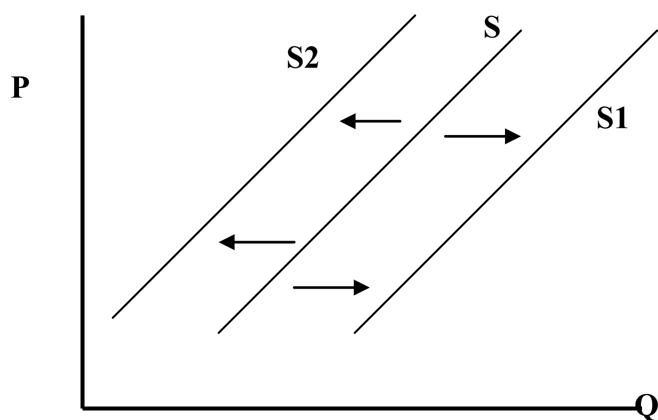


An increase in the demand for labour normally means that there has been an increase in the amount demanded of the good or service that labour produces – more houses being bought, so more bricklayers and plasterers needed, busier shops, more shop assistants required and so on.

A fall in demand for labour, leading to a shift in, in the demand curve, could be caused by a fall in demand for the good that labour produces, or perhaps technology replacing workers.

Shifts in the supply curve

Supply of labour to any particular occupation or profession depends on a number of factors. For example the size of the working population, numbers of women working, how difficult is to gain the qualifications to do the job, and of course wages offered. The supply curve like the demand curve can also change position. Supply of labour can also shift in or out.



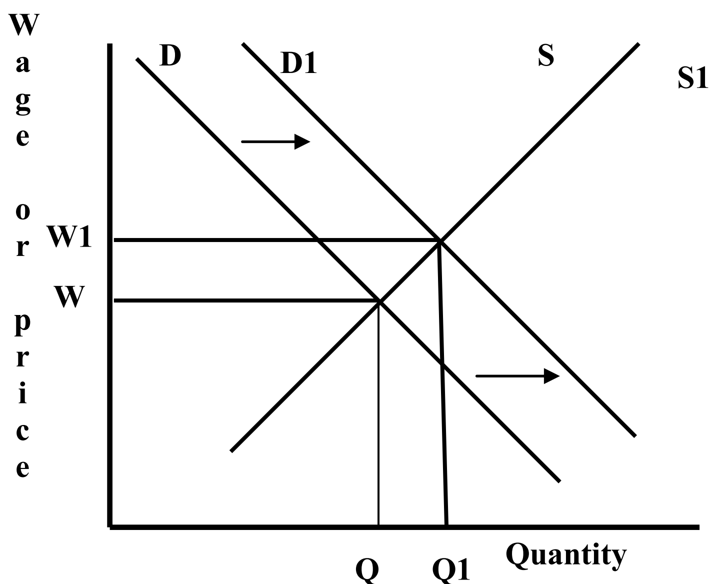
A shift out to the right, S to S1, represents an increase in the supply of labour, perhaps caused by an increase in graduates qualifying to do a job, or an increase in immigration. A reduction in supply, a shift from S to S2, could be caused by a change in career preferences - less young people may want to train for a career in beauty, so the supply curve shifts in. Also emigration (people leaving a country) or large amounts of deaths due to natural disaster or disease e.g. black death or Spanish flu, will shift in supply of labour.

Changes in Equilibrium

A shift in the demand or supply curves, causes changes in equilibrium—so wage levels will change (W—price), and the numbers employed will change (Q—quantity)

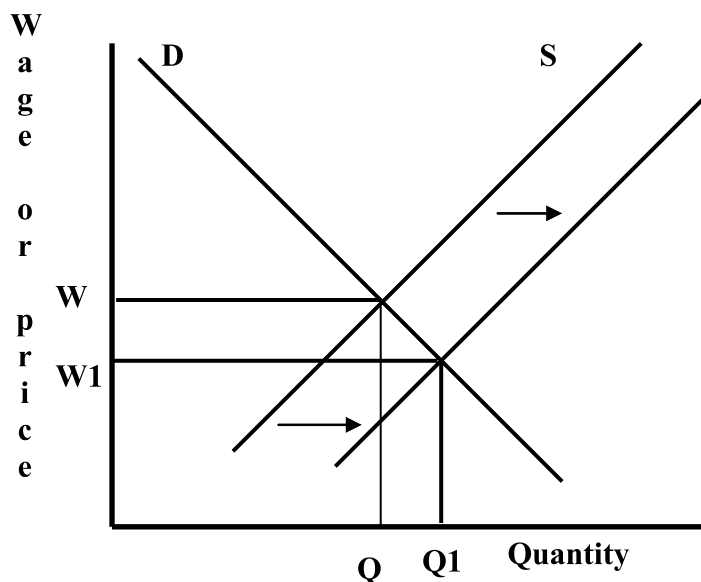
Example 1 An increase in demand for houses.

An increase in demand for houses, increases demand for bricklayers, shifting out the demand curve for bricklayers, from D to D1. This leads to a higher wage W1, and larger number of bricklayers in jobs Q1.



Example 2 An increase in immigration'

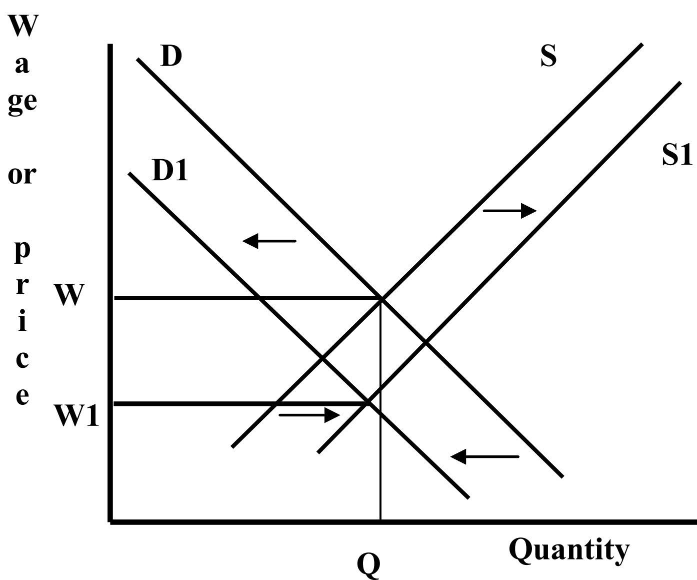
The impact of an increases in the numbers arriving from abroad would be to shift out the supply curve of labour, to S1.. This reduces wages to W1, but is likely to lead to an increase in employment to Q1.



Example 3. The market for newly qualified lawyers

If supply is increasing, say lots of new graduates in law, but demand for new lawyers is low, because of a fall in crime and cut backs in legal aid, then lots of new lawyers are chasing the few available jobs, so wages fall. Supply has shifted out, but demand has shifted in.

Notes



Other factors altering wages paid.

Demand and supply are not the only factors that help decide wage levels. The minimum wage sets the lowest hourly wage that can be legally paid in the UK, and this affects the pay of around 3 million workers.

For individuals, wages will depend on experience, qualifications, and performance. Trade Unions sometimes are able to increase wages for members, above the free market rate. On occasion, industries can become flooded with money, leading to massive increases in wages. This has recently happened in banking and also in premiership football.