Labor Markets and Minimum Wage: Crash Course Economics #28

Crash Course: Economics
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=====Introduction (00:00)=====

Adriene: Welcome to Crash Course Economics, I'm Adriene Hill,

Jacob: and I'm Jacob Clifford, and today we're going to talk about labor markets, a pretty important topic.

A: Unless you're independently wealthy, or fine with living in your parents basement, you probably need to get a job. But how do you even get a job? And what kind of job should you get? In a lot of ways, it comes down to supplying a skill that someone else demands.

(Crash Course Economics Intro)

=====Supply and Demand(00:29)=====

A: This is Cristiano Ronaldo. He makes about $20 million a year playing soccer. Or football, depending on where you live. Pretty much everybody would agree no one needs that kind of money, but does he deserve it? How do his employer, the Real Madrid Football Club, justify this huge salary?

Admittedly, the market for professional athletes is complex, but on some level, it's supply and demand. The supply of people that have the skills to be world class soccer players is low. And the demand for world class soccer players is incredibly high. Ronaldo might be willing to play for only $10 million a year, it's a lot of money. He might even play for $5 million. And if he really, truly loved the beautiful game, he might do it for free. So why is he getting $20 million?

This goes back to that really high demand. Having a superstar on your team generates millions in tickets and merchandise sales. It might help you win some of the many cups up for grabs in international football. So Real Madrid thought Ronaldo, and his double scissor move, were worth $20 million, and Ronaldo agreed, so they have a contract.

=====Thought Bubble(01:33)=====

A: These same ideas explain how wages are determined in nearly every labor market. Let's go to the Thought Bubble.

J: Usually when Stan goes to the mall he's the buyer. He demands sunglasses and giant pretzels and the businesses supply them. But if he wants a job at the mall's pretzel shop, the roles are reversed. Since he supplies labor, he's now the seller and the pretzel shop owner becomes the buyer. A buyer of labor. Now, that's when wage negotiation ensues.

Stan could insist on a wage of $25 an hour for his pretzel skills, but the owner would point out that they could easily hire other people for much less. The owner could offer Stan a wage of only $1 per hour, but Stan would point out that he could easily get paid more at the Fro-Yo shop. In the end, they agree on a wage that makes each of them better off. The owner gets some help around the store and Stan earns money so he can buy even cooler sunglasses. Economists call this voluntary exchange. The supply of labor depends on the number of people that are qualified to do the job. So, Stan would love to get paid more, but since warming up pretzels doesn't require extensive skills, the supply of capable workers is high and consequently the wage is relatively low.

But that doesn't mean Stan is going to work for peanuts. The wage offered has to cover his opportunity cost, the value of his lost free time and the money he could be making doing something else. The demand for labor depends on the demand for the product a business sells. Economists call this derived demand. If pretzel demand is booming, then the store owners are gonna want more pretzel makers. If other stores also need more employees, demand for workers will increase and drive up wages.

Thanks Thought Bubble!

=====Wage Discrimination(02:53)=====

J: Supply and demand explains why wages are different for different professions. Engineers are high in demand because they produce the products that many consumers want and their supply is limited because the training for these jobs are pretty difficult.

Social workers and historians, aren't paid as much, even though their work is important, because demand is relatively low and supply is relatively high. It's not rocket science.

A: Supply and demand explain a lot but there are several reasons why ages in a labor market don't end up at a competitive equilibrium. Sometimes workers get paid less not because they have different skill levels, but because of their race, ethnic origin, sex, age, or other characteristics. This is called wage discrimination.

Wages might also be unfairly low when a labor market is a monopsony, when there is only one company hiring and workers are relatively immobile. When you're the only employer, workers have to take what you offer, or they're out of luck.

Take the NCAA, the organization that regulates college athletics in the U.S. Many economists point out that high profile college athletes are generating millions of dollars for their schools, but they're forced to accept a very low "wage" of a scholarship with free tuition. Now sure, baseball and hockey player can skip straight to the pros, but the NFL prohibits drafting football players until three years after high school. And NBA teams can't draft basketball players until they're 19.

=====Efficiency Wages(04:13)=====

There are some situations where wages might actually be higher than the market equilibrium. For example, some employers might voluntarily offer higher than normal wages to increase workers productivity and retention. Economists call this efficiency wages. Henry Ford doubled the wages of the assembly line workers in 1914 to keep them from seeking jobs elsewhere. And this still goes on today. You may not be completely happy with you job, but if it offers way more than what everyone else is paying, you're less likely to quit.

=====Unions(04:42)=====

Unions can also drive up wages. A union is an organization that advances the collective interest of employees and strives to improve working conditions and increase wages. They do this through collective bargaining. Representatives for the workers negotiate with employers and if their demands aren't met, workers go on strike, and stop production altogether.

Although unions were once very strong in the U.S., union membership and their strength has declined since the 1950s. At their height, approximately 1 in 3 American workers were in a labor union. These days it's more like 1 in 9, and the largest unions represent workers in the public sector, like teachers and firefighters.

=====Minimum Wage(05:20)=====

Wages might also no the at equilibrium when there is a minimum wage, basically a price floor that prevents employers from paying workers below a specific amount. Technically, in the U.S., minimum wage affects less than 3% of workers. But the Brookings Institution estimates that an increase in minimum wage likely wouldn't just impact that small slice of the labor market. It would also drive up the wages of people who make just above the minimum wage. According to Brookings, that ripple effect could raise the wages of nearly 30% of the workforce. The debate over whether or not there should be a minimum wage, and how high that minimum wage should be, gets pretty heated pretty fast.

some classical economists argue against nearly all forms of government manipulation in competitive market. They say the minimum wage not only lead to unemployment, but it actually hurts the people it claims to help. Their logic goes something like this: A minimum wage deters employers from hiring unskilled workers, hiring only skilled or semi-skilled workers instead. These economists argue that minimum wage does little or nothing to alleviate poverty, since instead of earning a minimum wage, unskilled workers end up earning no wage at all.

The economists that support minimum wage argue that real life labor markets aren't as competitive or transparent as classical economists suggest. They believe that employers have the upper hand when it comes to negotiating wages and that individual workers lack bargaining power.

I'm not going to tell you what to think but think about it like this; if a grocery store wasn't required to pay $7.25 an hour, and the grocery store was the only place hiring, they could likely squeeze individual employees to accepting lower than market value. In this interpretation, minimum wage isn't interfering with competitive markets, as much as it's correcting market failure.

Remember anti-trust laws that prevent powerful monopolies from charging higher prices? Economists that support minimum wage laws say they prevent employers from using their power to exploit workers. The economists who are entirely opposed to minimum wage laws are losing the policy battle. Most countries around the world have minimum wage laws, and many of those countries without them have de facto minimum wages, set by collective bargaining agreements.

But even among economists who support some sort of minimum wage, there's disagreement over how high that minimum wage should be, and what raising minimum wage might do to the economy. Consider the U.S.: the current federal minimum wage is $7.25 an hour. In 2014, 600 economists, including 7 Nobel Prize winners signed a letter arguing that the minimum wage should be increased to $10.10 an hour. They argued that raising the minimum wage could have a small benefit to the economy workers, with their newly increased wages would spend more. This would increase demand, and perhaps help stimulate employment. But some of those economists balked when it came to the question for raising the minimum wage to $15 an hour. They argue that even if a $15 an hour minimum wage might make sense in an expensive city, like Los Angeles or New York, where the median income is relatively high, it could have a significant negative effect on employment in a city or town where incomes are lower.

If economics was a pure science, we could just test these ideas under controlled circumstances. We could have one state set a significantly higher minimum wage than its neighbor and see what happens. It turns out that happened in 1992, and economists David Card and Alan Krueger studied it. New Jersey raised its minimum wage from $4.25 to $5.05 while Pennsylvania kept theirs at $4.25. The economists surveyed the large fast food chains along the state's shared border and found that workers didn't get fired, in fact, employment in New Jersey actually increased.

But it's far from settled. There have also been studies that indicate raising the minimum wage does increase unemployment. A relatively recent survey of economists, by the University of Chicago found that a small majority think raising the minimum wage to $9 an hour would make it noticeably harder for poor people to get work. But, an this is where it gets interesting, a slim majority also thought the increase would be worthwhile, because the benefits to people who could find jobs at $9 an hour would overweigh the negative effect on overall employment.

=====Conclusion(09:36)=====

J: Very few economists argue a higher minimum wage will end poverty, but some argue that it could reduce poverty. The minimum wage doesn't exist in vacuum. The policies that fight poverty should also focus on providing education and skills.

A: Those skills are what the labor market values. It's those skills that are in short supply and high demand, and will command higher wages. So, while you're waiting for economists to figure all this out, you might want to learn a new skill. Practice you double scissor, and maybe take Ronaldo's job.

J: Thanks for watching Crash Course Economics, which is made with the help of all these awesome people. You can help keep Crash Course free for everyone, forever by supporting the show at Patreon. Patreon is a voluntary subscription service where you can support the show by giving a monthly contribution. Thanks for watching! DFTBA!