CHAPTER 5 - QUASI-FIXED LABOR COSTS AND THEIR EFFECTS ON DEMAND

This chapter is designed to analyze the effects of quasi-fixed costs on the demand for labor. We begin the chapter with a descriptive section on the magnitude and growth of nonwage labor costs, because the quasi-fixed costs of labor are generally nonwage in nature. In this section we discuss employee benefits (not all of which are quasi-fixed in nature), and we also introduce the concept of hiring and training costs.

One implication of the existence of both variable and quasi-fixed labor costs is that there arises a trade-off between increasing employment through hiring added workers and increasing employment through hiring workers for longer hours. This trade-off is discussed in the second section of the chapter, and the importance of distinguishing between employment and hours is highlighted in our policy analysis of the overtime pay premium and mandated benefits for part-time workers.

In the third major section we move from a general discussion of quasi-fixed labor costs to an in-depth analysis of one particular kind of quasi-fixed cost: firms' labor investments. An investment is a type of expenditure that occurs primarily in some initial period and then does not recur. While the firm hopes to recoup the investment over a period it expects the worker to be with the firm, the cost of investment becomes a "sunk cost." This section analyzes the implications of these labor investment characteristics for the demand for labor (after first introducing the concept of present value and modeling the labor investment decision by the firm).

The fourth and fifth sections offer detailed analyses of the two principal types of labor investments: training investments and hiring investments. In the section on training investments the student is introduced to the notion of general and specific training, as well as to the implications of training investments for the demand for labor. While Chapter 9 also covers aspects of education and training, it is our belief that this introduction to human capital theory in Chapter 5 is useful. In this chapter, as throughout the text, we introduce particular concepts or tools as they are called for by the larger context of analysis, because by maintaining a clear view of the overall context of analysis, the student is better able to learn the insights that economics has to offer. In this particular case, we deliberately chose to spread the concepts of human capital theory across different chapters--using these concepts as necessary and maintaining the overall substantive organization of the text (built around demand and supply).

For similar reasons, the section on hiring investments includes a discussion of credentials and signaling, as well as an introduction to the concept of internal labor markets. These topics are also discussed elsewhere in the text (notably in Chapters 11 and 12), but we felt that a complete discussion of the effects of quasi-fixed costs on the demand for labor was impossible without a discussion of these concepts. Again, we wanted to maintain the organizational overview in the minds of the students. (We also firmly believe that discussing concepts or phenomena in several contexts and at different points in the book reinforces the learning process.)

List of Major Concepts

1. The distinction between variable and quasi-fixed labor costs is made.

2. The relative growth of wage and non-wage costs is presented.

3. The essential characteristic of an investment is that resources are expended in the current period and returns are received later; the principal types of labor investments that firms undertake relate to training and hiring.

4. There are both explicit and implicit costs of job training.

5. Employee benefits are categorized and the types typically received are listed.

6. The presence of quasi-fixed costs causes an employment/hours trade-off, and the firm must determine its optimum mix of employment and hours per worker.

7. Increased overtime pay premiums that might be required under the Fair Labor Standards Act would tend to reduce the use of overtime, but whether they increase the number of workers employed depends on the size of the reduction in total labor hours demanded.

8. The concept of present value and the need for discounting when economic decisions are made in the context of several time periods are discussed.

9. The multi-period demand for labor, the way this demand is affected by investment costs in the initial period of hire, and the way investment costs alter profit-maximizing conditions with respect to labor are all generalizations of the single-period analysis in Chapter 3.

10. The distinction between general and specific training is defined, and the effects of specific training on the relationship between wages and marginal productivity is analyzed.

11. Training investments are recouped through the creation of a "surplus" (a gap between marginal product and wage) that also cushions the worker from layoffs over the business cycle.

12. The presence of hiring costs induces firms to use credentials and internal labor markets in the recruiting, selection and promotion processes.

13. Like training costs, hiring investments increase the productivity of selected job applicants (by distinguishing among them on the basis of productivity), and they are recouped by paying wages less than productivity.