

CHAPTER 6 - SUPPLY OF LABOR TO THE ECONOMY: THE DECISION TO WORK

Beyond introducing some descriptive material on labor force trends in this century, the primary purpose of Chapter 6 is to present an analysis of an individual's decision concerning whether and for how long to work. The context of this decision is the traditional labor/leisure choice framework and the chapter is carefully constructed to build the concepts necessary for this analysis. The analysis begins with a section that discusses the choice process verbally, building upon what students know concerning product demand. It then moves to a specific analysis of the demand for leisure time (which in this context is the obverse of the supply of labor), and introduces the concepts of income and substitution effects (they are more rigorously dealt with later in the context of a graphic analysis).

Our graphic analysis is intended to accomplish two ends. One is to fix and define more precisely the concepts of income and substitution effects. The second is to equip students with a tool necessary to analyze many policy issues affecting work incentives. A sampling of such policies and their analyses is given in the final section of the chapter (following a section that discusses empirical findings concerning labor supply to the economy).

List of Major Concepts

1. Measures of aggregate labor supply generally focus on labor force participation rates and weekly hours of work; trends in these measures are presented and discussed.
2. The relationship between the demand for leisure, the demand for other goods, and the supply of labor is the focal point for beginning our analysis of labor supply theory.
3. The substitution effect is defined as the change in hours supplied attendant on a change in the wage (price of leisure), holding income constant.
4. The income effect is the change in hours supplied for a given change in income, holding the wage constant.
5. The major forces affecting labor supply are preferences, wages, and income; these forces can be graphically depicted.
6. The five assumptions underlying indifference curves (a graphic depiction of preferences) are discussed.
7. The incorporation of information on wages and income into the drawing of budget constraints is illustrated.
8. Graphical analyses of the income and substitution effects are presented.

9. The concept of "reservation wage" is defined and illustrated graphically.
10. Empirical findings with respect to the labor/leisure choice, from both nonexperimental cross-section data and experimental studies, are presented.
10. Analyses of the budget constraints created by several government income support programs are presented. Analyzed are those with "skikes," those with zero net wage rates (including those with work requirements), and those with positive effective wage rates (as illustrated by an analysis of the Earned Income Tax Credit program).