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For Students of 1 Master, HRM
Course: Wages and incentives systems

LECTURE 1: WAGES THEORIES (PART 2)

Bargaining Theories

Theories of Wages

Bargaining Theory

- Bargaining theory has received attention not only in economics but also in social psychology, sociology, political science, applied mathematics, and industrial relations. John Davidson propounded this theory.
- The bargaining theory of wages holds that wages, hours, and working conditions are determined by the relative bargaining strength of the parties to the agreement.

Bargaining Theory

- Smith hinted at such a theory when he noted that employers had greater bargaining strength than employees.
- Employers were in a better position to unify their opposition to employee demands, and employers were also able to withstand the loss of income for a longer period than could the employees.
- This idea was developed to a considerable extent by John Davidson, who proposed in The Bargain Theory of Wages (1898) that the determination of wages is an extremely complicated process involving numerous influences that interact to establish the relative bargaining strength of the parties.

Bargaining Theory

- This theory argues that no one factor or single combination of factors determines wages and that no one rate of pay necessarily prevails.
- Instead, there is a range of rates, any of which may exist simultaneously.

The Range of Wage According to to Bargaining Theory

- The upper limit of the range represents the rate beyond which the employer refuses to hire certain workers.
- The lower limit of the range defines the rate below which the workers will not offer their services to the employer.
- Neither the upper nor the lower limit is fixed, and either may move upward or downward. The rate or rates within the range are determined by relative bargaining power.

Factors effect on the Upper limit of Wage Rate According to Bargaining Theory

- the productivity of the workers,
- the competitive situation,
- the size of the investment,
- the employer's estimate of future business conditions.

…etc

Factors effect on the Lower limit of Wage Rate According to Bargaining Theory

- Minimum wage legislation,
- the workers' standard of living,
- their appraisal of the employment situation,
- their knowledge of rates paid to others.

Importance of Bargaining Theory

- The bargaining theory is very attractive to labor organizations, for, contrary to the subsistence and wages-fund theories, it provides a very cogent reason for the existence of unions: simply put, the bargaining strength of a union is much greater than that of individuals.

Bargaining Theory Criticism

- It should be observed, however, that historically laborers were capable of improving their situations without the help of labor organizations. This indicates that factors other than the relative bargaining strength of the parties must have been at work.
- Although the bargaining theory can explain wage rates in short-run situations (such as the existence of certain wage differentials), over the long run it has failed to explain the changes that are observed in the average levels of wages.

Investment Theory of Wages

Investment Theory of Wages

- This theory has developed by Gilelman for the replacement of marginal productivity theory.
- Whereas marginal productivity theory focuses on the output of labor, investment theory concentrates on labor inputs, another side of the same coin.
- The theory proposes that the productivity of an individual employee is a function of his personal attributes with which his labor is combined. Workers attributes include values, personality, and physical abilities.

Investment Theory of Wages

- In a sense, however, these attributes are reflected in education, training, and experience. Highly motivated, emotionally mature and energetic individuals are essentially investments in productivity. The larger the investments possessed by workers, the wider the geographic scope of the labor market in which he has a potential to participate. So he is highly mobile. Wages are related to mobility potential.

Investment Theory of Wages Analysis

- ➢➢ It focuses both on the supply of and the demand for labor. It emphasizes worker's investment in productivity
- ➢➢ Its emphasis is on short-run
- ➢➢ It emphasizes the micro aspect
- ➢➢ It tries to answer wage structure as well as the wage level
- ➢➢ wages are assumed to be a return on investment.

Investment Theory of Wages Criticisme

- Logically one would assume that the larger the investment, the higher the wage. However, in practice, this will not be true always, employees seek a number of other satisfaction from job, income being only one of them.
- Further, the wage decisions are influenced by the organization's policy in regard to job design, employment and lay-off as these factors affect profitability of the organization and its ability to pay.

Behavioral theories

Behavioral theories

- Many behavioral scientists - notably industrial psychologists and sociologists like Marsh and Simon, Robert Dubin, Eliot Jacques have presented their views of wages and salaries, on the basis of research studies and action programmes conducted by them. Briefly such theories are:

The Employee's Acceptance of a Wage Level

- This type of thinking takes into consideration the factors, which may induce an employee to stay on with a company. The size and prestige of the company, the power of the union, the wages and benefits that the employee receives in proportion to the contribution made by him - all have their impact.

The Internal Wage Structure

- Social norms, traditions, customs prevalent in the organization and psychological pressures on the management, the prestige attached to certain jobs in terms of social status, the need to maintain internal consistency in wages at the higher levels, the ratio of the maximum and minimum wage differentials, and the norms of span of control, and demand for specialized labor all affect the internal wage structure of an organization.

Human-capital theory

- A particular application of marginalist analysis (a refinement of marginal-productivity theory) became known as human-capital theory. It has since become a dominant means of understanding how wages are determined.
- It holds that earnings in the labor market depend upon the employees’ information and skills.

Human-capital theory development

- The idea that workers embody information and skills that contribute to the production process goes back at least to Adam Smith. It builds on the recognition that families make a major contribution to the acquisition of skills.

Human-capital theory Shape

- The theory of human capital was shaped largely by Gary S. Becker, an American student of Schultz who treated human capital as the outcome of an investment process. Because the acquisition of productive knowledge is costly (e.g., students pay direct costs and forego opportunities to earn wages),
- Becker concluded that rational actors will make such investments only if the expected stream of future benefits exceeds the short-term costs associated with acquiring the skills.

General and Firm-Specific Human Capital

- Becker introduced the important distinction between “general” human capital (which is valued by all potential employers) and “firm-specific” human capital (which involves skills and knowledge that have productive value in only one particular company). Formal education produces general human capital, while on-the-job training usually produces both types.

General and Firm-Specific Human Capital

- In all cases, employers are loathe to provide general skills, because employees can use them in other firms. Conversely, employees are less inclined to invest in firm-specific human capital without substantial job security or reimbursement. These issues lie at the heart of many contemporary analyses of employment relations.

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Thank you for your attention