**STUDY MATERIAL 1 Module -16 ECONOMICS GENERAL GE -1 SEMESTER –I 2019-20**

**Demand for Labour:**

The demand for labour is a derived demand. It is derived from demand for the commodities it helps to produce. The greater the consumers’ demand for the product, the greater the producers’ demand for the labour required in making it. Hence an expected increase in the demand for a commodity will increase the demand for the type of labour that produces this commodity.

The elasticity of demand for labour depends, therefore, on the elasticity of demand for its output. Demand for labour will generally be inelastic if their wages form only a small proportion of the total wages. The demand, on the other hand, will be elastic if the demand for the commodity it produces is elastic or if cheaper substitutes are available.

The demand for labour also depends on the prices of the co-operating factors. Suppose the machines are costly, as is the case in India, obviously more labour will be employed. The demand for labour will increase. Another factor that influences the demand for labour is the technical progress. In some cases, labour and machinery are used in a definite ratio. For instance, the introduction of automatic looms reduces the demand for labour.

After considering all relevant factors, e.g., demand for the products, technical conditions, and the prices of the co-operating factors, the wages are governed by one fundamental factor, viz., marginal productivity. Just as there is a demand price of commodities, so there is a demand price for labour.

The demand for labour, under typical circumstances of a modern community, comes from the employer who employs labour and other factors of production for making profits out of his business. The demand price of labour, therefore, is the wage that an employer is willing to pay for that particular kind of labour.

Suppose an entrepreneur employs workers one by one. After a point, the law of diminishing marginal returns will come into operation. Every additional worker employed will add to the total net production at a decreasing rate. The employer will naturally stop employing additional workers at the point at which the cost of employing a worker just equals the addition made by him to the value of the total net product.

Thus, the wages that he will pay to such a worker (the marginal unit of labour) will be equal to the value of this additional product or marginal productivity. But since all the workers may be assumed to be of the same grade, what is paid to the marginal worker will be paid to all the workers employed. This is all about the demand side of labour. Now let us consider the supply side.

### Supply of Labour:

By the supply of labour, we mean the various numbers of workers of a given type of labour which would offer themselves for employment at various wage rates.

**The supply of labour may be considered from two view-points?**

(a) Supply of labour to the industry and

(b) Supply of labour to the entire economy.

For an industry, the supply of labour is elastic. Hence, if a given industry wants more labour, it can attract it from other industries by offering a higher wage. It can also work the existing labour force over-time. This in effect will mean an increase in supply. The supply of labour for the industry is subject to the law of supply, i.e., low wage, small supply and high wage, large supply. Hence, the supply curve of labour for an industry rises upwards from left to right.

The supply of labour for the entire economy depends on economic, social and political factors or institutional factors, e.g., attitude of women towards work, working age, school and college leaving age and possibilities of part-time employment for students, size and composition of the population and sex distribution, attitude to marriage, the size of the family, birth control, standard of medical facilities and sanitation, etc.

The supply of labour may be decreased by workers refusing to work for a time. This happens when labour is organised into trade unions. The workers may not accept wages offered by the employer if such wages do not ensure the maintenance of a standard of living to which they are accustomed.

But, as we shall see, it is only when higher wages are justified by higher marginal productivity that high wages will be paid. Thus, workers with low marginal productivity cannot demand high wages merely on the basis of their standard of living. On the whole, we might say that, the number of potential workers being given, the supply of labour may be defined as the schedule of units of labour at the prevailing rates of wages.

**This depends on two factors:**

(a) The number of workers who are willing and able to work at different wages;

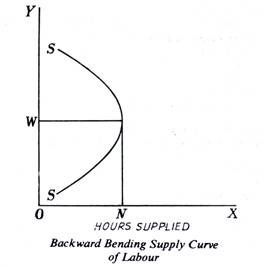
(b) The number of working hours that each Worker is willing and able to put in at different wages.

In case the workers have no staying power and the only alternative to work is starvation, the supply of labour in general will be perfectly inelastic. This means that wages can he driven down. Over a short period, reduction in wages may not cause any reduction in the supply of labour. For any industry over a long period, the supply curve will slope upwards from left to right. In other words, supply will be somewhat elastic in the long run.

#### Backward Sloping Supply Curve of Labour:

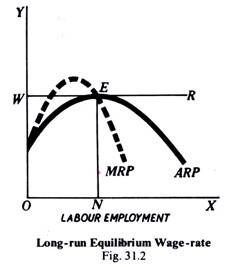
While labour’s supply curve sloping upwards from left to right is the general rule, an exceptional case of labour’s supply curve may also be indicated (see Fig. 31.1) When the workers’ standard of living is low, they may be able to satisfy their wants with a small income and when they have made that much, they may prefer leisure to work. That is why it happens that, sometimes, increase in wages leads to a contraction of the supply of labour. This is represented by a backward-sloping supply curve as under.

For some time this particular individual is prepared to work long hours as the wage goes up (wage is represented on OY—axis in Fig. 31.1). But beyond OW wage, he will reduce rather than increase his working hours.

**[](http://cdn.economicsdiscussion.net/wp-content/uploads/2014/07/clip_image00222.jpg)**

### Interaction of Demand and Supply:

We have now analysed the demand side as well as the supply side of labour. We shall now see how their interaction determines the wage level. This is shown in Fig. 31.2

**[](http://cdn.economicsdiscussion.net/wp-content/uploads/2014/07/clip_image0054.jpg)**

In this diagram, we have shown the wage determination of a particular type of labour for an industry. The curve SS represents supply of labour to the industry. DD is the demand curve for labour of that industry. Demand and supply curves intersect at E. Therefore, the wage rate OW (= NE) will be established. The equilibrium wage rate will change if the demand and/or supply conditions change.

Under competitive conditions, wage rate in the long run will be equal to both the marginal revenue product and the average revenue product. If the wage rate is less than the average revenue product, the firms would be earning supernormal profits. As a result, new firms will enter the industry and the demand for labour will increase which will push up the wage rate so as to be equal to average revenue product.

On the other hand, if the wage rate is above the average revenue product, the firms will be suffering losses. As a result, some firms will leave the industry and demand for labour will decrease which will force the wage-rate down. Fig. 31.2 shows the long-run equilibrium of the firms under perfect competition. This diagram shows that long-run equilibrium wage rate is OW. At wage rate OW, the firm is employing ON number of labour. This OW rate is equal to marginal revenue product (MRP) and average revenue product (ARP) at point E. The point E is the equilibrium position of the firm in the long run.

We have so far concerned ourselves with the problem of how wages in general are determined. But is there any general rate of wages?

If labour had been like any other commodity, it would also have been sold in the market at the same rate. But as you know, labour is peculiar in certain respects. Labourers differ in efficiency. They are less mobile than goods. Their supply cannot be increased to order and it is a most painful process to reduce I hem. If a day is lost, its labour is lost with it. For these and other reasons, a uniform rate of earnings for workers is not possible. There is thus no prevailing rate of wages similar to the prevailing rate of interest or prevailing price of a good.

All over the world, labour is spat up into a very large number of groups and sub-groups, each with a different level of wages. Even within the same group, the differences are ever so many. Consequently there cannot possibly be a general rate of wages. All that can be done is to and out an average rate which can be discovered by dividing the total amount paid to a given group of workers by the total number of workers in it. The fact is that the wages differ from occupation to occupation. Wages are relative.

### Meaning and Definition of Rent:

#### Meaning:

The term ‘rent’ literally means a certain amount of money paid for the hire of some consumers durable such as room, air conditioner, house or building etc.

But in economics the term is used in different sense, it refers to the whole or a part of the earning of some factors of production land as well as other factors.

In other words we can say that **“rent”** is the payment for the productive use of land. But modern economists have given it a broader connotation by defining it as the surplus earned by a factor over and above the minimum earnings necessary to induce it to continue its work.

#### Definition:

1. According to Ricardo – “Rent is that portion of the produce of the earth which is paid to the landlord for the use of original and indestructible powers of the soil.”

2. Carver has said – **“Rent is the price paid for the use of land.”**

3. According to Prof. Marshall – “The income derived from the ownership of land and other free gifts of nature is commodity called “Rent” in economics.

4. Mrs. Joan Robinson has said – “The essence of the conception of “Rent” is the conception of a surplus earned by a particular part of a factor of production over and above the minimum earnings necessary to induce it to do its work.”

5. According to Boulding – “Economic Rent may be defined as any payment to a factor of production in an industry in equilibrium which is in excess of the minimum amount necessary to keep that factor in its present occupation.”

On the basis of the definitions written above it can be said that land contains original and indestructible powers and for that the landlord receives some remuneration which is called Rent. But modern economists are of this opinion that rent is not confined to land and other free gifts of nature alone but to all factors of production, when they are in inelastic supply. When any factor is in less than perfectly elastic supply, it yields a surplus amount of that surplus the Rent is paid.

### Types or Forms of Rent:

**Rents are of following types:**

1. Gross Rent.

2. Contract Rent.

3. Economic Rent.

4. Scarcity Rent.

5. Quasi Rent.

#### (1) Gross Rent:

In ordinary language rent refers to the compensation paid for the use of some body’s belongings for a period of time, i.e., rent paid by tenant to landlord or to the owner of the house.

**Under this besides the net or economic rent following are also included:**

**1. Interest on Capital:**

To improve the fertility of land the landlord spends money over the land. The capital which the landlord invests, he charges some money as interest. Thus, rent includes a part of interest of capital.

**2. Reward for Management:**

Landlord invests money over the management of the land and in its care. The expense incurred is also included in the Gross Rent.

**3. Reward for Risk:**

Landlord takes risk by investing money on land and over its management, therefore the expenditure and the risk amount is included in Gross Rent.

**4. Economic Rent:**

Economic Rent is a part of Total Rent. This is paid for the use of land. Economic Rent is also called Net Rent.

Therefore, Gross Rent = Interest on Capital + Remuneration for Risk + Expenditure on management + Economic Rent.

#### (2) Contract Rent:

Contract Rent is a commercial rent referring to a periodic payment for the use of something. It is a contractual payment over a stated period of time. It is a gross rent. It being gross rent includes economic rent, or pure rent, plus other elements etc., interest on capital, service charges, profit etc.

**For example:**

The rent of a hotel room is gross rent as it includes Compensation for the use of land or ground, interest on capital invested, wages for management and other services and profit for the risk involved. Thus,

Contract Rent = Gross Rent = Pure Rent + Wages + Service Charges + Depreciation Charges + Profit + Interest.

Contract Rent is just like price, determined by the interaction of demand for the rented goods and their supply. In actual practice, rent is always a contract rent.

#### (3) Economic Rent:

The modern economists consider that the Economic Rent is not only concerns with land alone but it is applicable to all the factors of production.

**According to them:**

“There exists rent element in the earning of the every factor of production and it is identified with surplus income.”

**The definition of economic rent has been given by Prof. (Mrs.) Joan Robinson, Vilfredo, Pareto, Ricardo and Penson as under:**

1. Joan Robinson – “The essence of the conception of rent is the conception of surplus earned by a part of a factor of production over and above the minimum earning necessary to induce it to do work.”

2. According to Ricardo – “Bent is that portion of the produce of the earth which is paid to the landlord for the use of the original and indestructible powers of the soil.”

3. According to Pareto – **“The Economic Rent is the excess payment to a factor over and above the minimum necessary to keep a factor in its present occupation.”**

4. According to Penson – “It means the surplus which remains to the cultivator after he has paid all the expenses of production and has remunerated himself for his own productive efforts. In this sense, it is the excess of the crop over expenses,” Therefore,

Economic Rent = Total Rent – Interest on Capital – Management Expenses – Reward for Risk.

**The modern economists have explained the problem of rent determination with reference to the following situations:**

(i) Specificity of the factors of production,

(ii) Scarcity of the factor of production.

#### (4) Scarcity Rent:

Scarcity rent is that rent which is paid by all lands including the marginal land. The modern concept of rent is scarcity rent. Rent arises when there is scarcity of land due to increase in demand. Rent is based on the scarcity of the availability of land—it is immaterial whether it is of superior or inferior or any other quality. Rent emerges even if they are scarce in relation to demand. To explain this point let us assume that all land is homogeneous and specific in use, but in scarce on account of its rigid supply.

In any period, whether long or short, the supply of land in existence is perfectly inelastic. Thus, the rise in the demand for land, with the growth of population, will intensify its relative scarcity, so the price of land, i.e., rent, tends to rise further and further with the rise in demand.

#### (5) Quasi-Rent:

The term ‘Quasi-Rent’ proposed by Alfred Marshall, refers to a short period phenomenon. He has said that—”all earnings caused by temporary scarcity in the supply is called Quasi-Rent.” It is the earnings of a factor of production like—machinery, equipment etc. whose supply is inelastic in the short-run, but not in the long-run.

**According to Stonier and Hague:**

“The quasi rent of a machine is its total short-period receipts less the total costs of hiring the variable factors used in association with it to produce output, and of keeping the machine in running order in the short-run.” Thus, in the short-run, any returns earned by the use of a machine in excess of the prime costs or variable costs of running it can be regarded as quasi-rent.

**Further, according to Prof. Alfred Marshall:**

**“Quasi-rent of a machine is nothing but its total short-run receipts minus the cost of hiring the variable factors used with it and also of the keeping machine in running order in the short-period.”** Thus, quasi rent is a surplus earned by a machine in the short-period over its running cost. This surplus shows by how much the short-run earnings of a machine exceeds the short-run cost of maintaining it.

We can understand the concept of quasi rent in a better way by taking the example of shipping during World War I. As a result of the war, there was a sudden increase in the demand for shipping, but the supply could not keep pace with it because new ships could not be produced overnight. There was, thus, an acute shortage of shipping.

The shipping freight charges went up. The old and the discarded ships were also brought into use. They also started yielding income. The ships which were already in service were more intensively utilised. Income from these ships greatly increased. In this way, the ships earned a surplus over their normal income.

These surpluses were given the name of quasi rent. This additional income of ships was due to the fact that their supply was fixed in the short-period. In the long-period more ships were constructed, the supply of shipping increased, and as a consequence, shipping charges came down in the long period. The additional income earned by the ships during the initial years of the war now comes to an end. Quasi rent disappeared.

**Features of Quasi Rent:**

**Important features of quasi rent are as follows:**

1. Quasi rent is a surplus-income.

2. It is a differential income which arises in the short-period.

3. It arises on the man-made machinery and equipment.

4. It arises because the supply of man-made capital goods is inelastic in the short-period.

5. It disappears in the long-period.