The Demand & Supply Theory of Wages

According to the modern theory of wages, wages are the price of services rendered by a labor to the employer.

As products the prices are determined with the help of demand and supply curve. Similarly, the wages (prices of services rendered by labor) is also obtained with the help of demand and supply of labor.

Therefore, for the determination of wage level, it is necessary to study the demand for labor, supply of labor, and the interaction between them.

Demand for Labor:

The demand for labor is dependent on various factors.

Some of these factors are as follows:

i. Demand for a product:

Refers to one of the important determinant of demand for labor. The demand for labor is derived from the demand of the product it produces. In case, the demand for the product increases, the demand for labor would also increase However, this is the expected demand of the product and not the current demand. Therefore, the expected demand of the product determines the demand for labor. Moreover, along with the magnitude of demand, the elasticity of demand for labor is also need to be determined. The elasticity of output helps in determining the elasticity of labor.

The following are the conditions for determining the elasticity of demand of labor:

a. Condition 1:

Labor would be inelastic if their wages contribute only a small amount to the total wages of industry

b. Condition 2:

Labor would be elastic if the product produced by him is elastic

c. Condition 3:

Labor would be elastic if cheaper substitutes of products are available

Elasticity of demand of labor depends on two factors, which are technical aspects of production and elasticity of demand for the product. The longterm demand for labor is more elastic than the short-term demand of labor.