



**College of Commerce
Division of Economic and Financial Studies
Economics Department**

Unit Outline

ECON240 Labour Market Economics

Semester Two 2006

STAFF AND ADMINISTRATIVE DETAILS

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LECTURE TIMES

WEDNESDAY: 3pm to 5pm in E5A131

TUTORIALS

Five one hour tutorials are scheduled. The tutorial times and locations are:

WEDNESDAY: 1PM in C5A313

WEDNESDAY: 5PM in W6B338

ASSESSMENT

Assessment will be based on the following **THREE** activities.

STUDENTS MUST SATISFACTORILY COMPLETE ALL THREE ASSESSMENT ACTIVITIES TO BE ELIGIBLE TO PASS THIS UNIT.

ACTIVITY 1:

MULTIPLE CHOICE EXAM (15%)

The Exam will be held on **OCTOBER 12** during the normal lecture time.

ACTIVITY 2:

ESSAY (15%)

One essay, not exceeding 1500 words in length should be submitted no later than **6.00pm** on **Wednesday October 19**. Essays are to be placed in the Econ240 box in ERIC. A photocopy of your essay should be retained. A list of student identification numbers for all students from whom an essay has been received will be posted on the ECON240 web site within 24 hours of the submission date. You must check this list immediately. If your number is not on the list, but you have submitted an essay, contact Michael Dobbie immediately. If you do not follow this procedure then you cannot claim at the end of the year that your essay was submitted but not returned to you. The essay topic will be advised in a separate handout.

ACTIVITY 3:

FINAL EXAMINATION (70%)

An end of unit two hour written examination to be taken during the end of year examination period. The examination will cover material drawn from all parts of the unit's subject matter.

NOTE

There are no supplementary exams held for the within semester multiple choice test. A supplementary exam will only be granted for the end of year examination under exceptional circumstances.

LECTURE/TUTORIAL/ ASSESSMENT SCHEDULE

Lecture No.	Date	Lecturer	Tutorial Number	Assessment Dates
1	August 2	Michael Dobbie		
2	August 9	Michael Dobbie		
3	August 16	Michael Dobbie	Tut1	
4	August 23	Michael Dobbie		
5	August 30	Michael Dobbie	Tut2	
6	September 6	Michael Dobbie		
7	September 13	Michael Dobbie		
	September 20	RECESS		
	September 27	RECESS		
8	October 4	Stephane Mahuteau	Tut3	
9	October 11	Multiple choice exam Stephane Mahuteau		Multiple choice exam held during class time. 15%
10	October 18	Stephane Mahuteau		Essay Due 6.00p.m. 15%
11	October 25	Stephane Mahuteau	Tut4	
12	November 1	Stephane Mahuteau		
13	November 8	Stephane Mahuteau	Tut5	

UNIT OUTLINE

The focus of this unit is upon the use of economic theory to analyse and evaluate the operation of labour markets. The various, often competing, explanations that have been proposed to explain labour market phenomena are stressed when appropriate. Topics covered include; short and long run labour supply and demand, personnel economics, the theory of compensating differentials, the employment relationship, the impact of employment protection legislation and minimum wage laws, trade unions and unemployment.

LECTURE PROGRAM AND READING GUIDE

RECOMMENDED TEXT

Kaufman, Bruce & Hotchkiss, Julie (2003) (6th ed) *The Economics of Labor Markets*, Mason (OH): South-Western (Thomson Learning).

The Co-op bookstore has this book and it is recommended that students purchase a copy.

The following books are referred to in the readings accompanying the lecture and tutorial program. Also many of the following are alternative labour market textbooks which students may wish to consult for assistance in understanding the lecture material.

ADDITIONAL REFERENCES

ACIRRT (1999) *Australia at Work: Just Managing?* Prentice Hall, Australia.

Norris, K., Kelly, R. and Giles, M. (2000) (6th ed) *The Economics of Australian Labour Markets*. Pearson, Australia.

Whitfield, K. & Ross, R. (1996)(2nd ed), *The Australian Labour Market*. Harper Educational, Australia.

Ehrenberg, R.G. & Smith, R.S. (1997)(6th ed). *Modern Labor Economics Theory and Policy*. HarperCollins College Publishers, New York.

Elliott, R. (1991), *Labor Economics: A Comparative Text*. McGraw Hill, London.

Lazear, E. (1998) *Personnel Economics for Managers*. Wiley, New York.

McConnell, C., Brue, S.L. & Macpherson, D. (1999) *Contemporary Labor Economics*. McGraw Hill, New York.

These references and all the others listed as lecture and tutorial readings are available either in the Reserve section of the library and or ERIC. **Additional references may be recommended in lectures. These will be placed in ERIC.**

LECTURE 1: INTRODUCTION TO THE STUDY OF LABOUR MARKETS

Topics covered include; the nature of labour economics, the role of economic, institutional and sociological factors in the labour market, an overview of key labour market outcomes in Australia.

Readings:

Kaufman & Hotchkiss Ch.1- Essential

Norris, Kelly & Giles Ch 1

Whitfield & Ross Ch 1

Jacoby, S. M. (1990) "The New Institutionalism: What Can it learn from the Old?", *Industrial Relations*, 29(2), 316-340.

ACIRRT (1999) Ch 1 & 2

EPAC(1996) "The Changing Australian Labour Market: An Overview" in, *The Changing Australian Labour Market*, Commission Paper no. 11 AGPS, Canberra.

Garvey, G. T. (1994) "Why labour is not different?" *Agenda*, 1(1), pp 5-12

Boyer, G. R. & Smith, R. S. (2001) "The Development of the Neoclassical Tradition in Labor Economics" *Industrial and Labor Relations Review*, 54(2), 199-223.

Australian Bureau of Statistics (ABS) (2005) *2005 Labour Statistics in Brief Australia*.

Catalogue. no. 6104.0

ABS (2005) *Year Book Australia 2005*. Catalogue no. 1301.0

Norris, K. & Mclean, B. (2000) "How Long do Jobs Last in Australia", *Australian Bulletin of Labour*, 26(2), 97-106.

Rebitzer, J. B. (1993) "Radical Political Economy and the Economics of Labour Markets, *Journal of Economic Literature*, vol.XXXI(Sept.), 1394-1434.

Kerr, C. & Staudohar, P.D (eds) (1994) *Labor Economics and Industrial Relations: Markets and Institutions*. Cambridge M.A.: Harvard University Press. A good account of institutionalist thought.

O'Hara, P. A. (ed) (1999) *Encyclopedia of Political Economy* (2 Volumes). London: Routledge. This is a very readable encyclopedia that students should consult for good SHORT introductions to key labour market concepts – for example "labour markets and market power", "labour and labour power" and "institutions" . [Located in the Reference section, level 2, HB61.E554].

Hodgson, G. M., Samuels, W. J., & Tool, M. R. (eds) (1994) *Elgar Companion to Institutional and Evolutionary Economics* (2 Volumes). Brookfield VT: Edward Elgar. This is also a good dictionary of economic terms from an institutional perspective. [HB99.5.E45]

Kasper, W. & Streit, M. E. (1998) *Institutional Economics*. Cheltenham (UK): Edward Elgar.

Kaufman, B.E. (1988) "The Postwar View of Labour Markets and Wage Determination" in Kaufman, B. E. (ed) *How Labour Markets Work: Reflections on Theory and Practice by John Dunlop, Clark Kerr, Richard Lester, and Lloyd Reynolds*. Massachusetts : Lexington Books.

**LECTURES 2 & 3:
LABOUR SUPPLY IN THE SHORT-RUN.**

Topics covered include; the neoclassical theory of labour supply, applications and criticisms of the theory and a look at the evidence on the Australian labour supply.

Readings:

K & H Ch.2 & 3

Norris, Kelly & Giles Ch 2

**LECTURE 4:
HUMAN CAPITAL THEORY AND THE QUALITATIVE DIMENSION OF LABOUR
SUPPLY**

This topic looks at the human capital account of investment in education and on-the -job training. It also explores the education/earnings relationship from both an empirical and theoretical perspective.

Readings:

K & H Ch.7

Norris, Kelly & Giles Ch 4

Lewis, P., Daly, A. & Fleming, D. (2004) "Why Study Economics? The Private of Return to an Economics Degree", *Economic Papers*, 23(3), 234-243.

Dockery, A. M & Norris, K. (1996) "The 'Rewards' from Apprenticeship Training in Australia", *Australian Bulletin of Labour*, 22(2), 109-125.

Dockery, A.M., Norris, K. & Stromback, T (1998) "The Social Return to Apprenticeship Training", *Australian Economic Review*, 31(1), 37-46.

OECD (1998), *Human Capital Investment: An International Comparison*. Paris: OECD.

Mincer, J. (1994) "Human Capital: A Review", in Kerr, C. & Staudohar, P.D (eds) *Labor Economics and Industrial Relations: Markets and Institutions*. Cambridge M.A.: Harvard University Press.

Bowles, S. & Gintis, H. (2002) "Schooling in Capitalist America Revisited", *Sociology of Education*, 75 (Jan.), 1-18.

**LECTURES 5 & 6:
LABOUR DEMAND: SHORT RUN & LONG RUN**

This topic presents and critically evaluates the neoclassical theory of labour demand in the short-run and long-run. The empirical evidence on the demand for labour in Australia is examined.

Readings:

K & H Ch.4 & 5

Norris, Kelly and Giles Ch 3

LECTURE 7:

THE DETERMINATION OF WAGES. UNEMPLOYMENT:

This lecture begins by showing how supply and demand come together to determine wages in the market for labour. The lectures then focuses on unemployment. Topics covered in this part of the lectures include; macroeconomic versus microeconomic views on unemployment, the meaning and measurement of unemployment, the meaning and extent of hidden unemployment, the 'risk index' approach to unemployment. Throughout the lecture the Australian experience will be examined with reference to cross-sectional and time series data evidence.

Readings:

K & H Ch 6 pp265-277, 282-285

K & H Ch.13

Norris, Kelly and Giles Ch. 9

Borland, J. & Kennedy, S. (1998) 'Dimensions, Structure and History of Australian Unemployment', paper presented to the Conference on Unemployment and the Australian Labour Market, June 1998.

Le A, T. and Miller, P. (2000), 'Australia's Unemployment Problem', *Economic Record*, 76(232), pp 74-104.

Le A, T. and Miller, P. (2001), 'Is a Risk Index Approach to Unemployment Possible?', *Economic Record*, 77(236), pp 51-70 (not essential reading).

NOTE that during the first hour of LECTURE 9 (OCTOBER 11) there will be a multiple choice exam. The exam covers all material dealt with in the unit up to and including week 7

LECTURES 8 & 9:

Setting the level of the wages: Compensating vs. Non-Compensating wages

- The basic theory of compensating differentials
- Are the wages really compensating? Some stylised facts of the labour market
- Introduction to Search models in Labour Economics

Readings:

Albaek K., Arai M., Asplund R., Barth E., Madsen E.S., (1998), "Measuring wage effects of plant size", *Labour Economics*, vol 5 n°4, pp 425-448.

Brown C., Medoff J., (1989), "The employer size-wage effect", *Journal of Political Economy*, vol.97, n°5, pp.1027-1059.

Davis S.J., Haltiwanger J., (1996), "Employer size and the wage structure in the US manufacturing", *Annales d'Economie et de Statistiques*, n°41/42, pp 323-367.

Dickens W.T., Katz L.F., (1987), "Inter-industry wage differences and industry characteristics", in Lang K., Leonard J.S. (ed.), *Unemployment and the structure of labor markets*, Oxford, Basil blackwell.

Gibbons R., Katz L., (1992), "Does unmeasured ability explain inter-industry wage differentials?", *Review of Economic Studies*, 59, pp 515-535.

- Goux D., Maurin E., (1999), "Persistence of inter-industry wage differentials: A reexamination using matched worker-firm panel data", *Journal of Labor Economics*, vol 17 n°3, pp 492-533.
- Krueger A.B., Summers L.H., (1987), "Reflections on the Inter-Industry Wage Structure", in K. Lang & J.S. Leonard (eds) *Unemployment & the Structure of Labor Markets*, Basil Blackwell, New York, USA.
- Murphy K.M., Topel R.H., (1987), "Unemployment, Risk, and Earnings: Testing for Equalizing Wage Differences in the Labor Market", in K. Lang & J.S. Leonard (eds.), *Unemployment & the Structure of Labor Markets*, Basil Blackwell, New York, USA.
- Thaler R., (1989), "Inter-industry wage differentials", *Journal of Economic Perspectives*, n°3, pp 181-193.

LECTURES 10 & 11:

Asymmetric information in the Labour market or Why should firms pay efficiency wages?

- Adverse selection: Hiring the right people
 - Education as a signal of the worker's quality
 - Defining an optimal separating contract
- Moral hazard: The Principal-Agent problem
 - The standard Principal-Agent model
 - Learning and Monitoring a worker's productivity
- The theory of efficiency wages
 - The shirking model
 - The turnover model
 - Efficiency wages as a mean to attract better employees: The adverse selection model
- The sociological approach of the efficiency wages
 - Rewarding worker's expected cooperation: Akerlof & Yellen's model
 - Fair wage as a cooperation enforcement device: Theory and facts

Readings:

- Akerlof G.A., Yellen J.L., (1990), "The fair wage-effort hypothesis and unemployment", *The Quarterly Journal of Economics*, vol CV, issue 2, pp 255-282, May.
- Blanchflower D., Oswald A., Sanfey P., (1992), "Wages, Profits and Rent Sharing", *NBER Working paper*, n° 4222.
- Bosworth D., Dawkins P., Stromback T., (1996), *The Economics of the Labour Market*, Addison Wesley Longman Limited.
- Bosworth D., Dawkins P., Stromback T., *The Economics of the Labour Market*, (1996), Addison Wesley Longman Limited.
- Ehrenberg R.G., Smith R.S., (1997), *Modern Labor Economics: Theory and Public Policy*, 6th edition, Addison Wesley.
- Fehr E., Gächter S., Kirchler E., Weichbold A. (1998), "When social norms overpower competition: Gift exchange in experimental labor markets", *Journal of Labor Economics*, vol.16, n°2, pp.324-351.
- Fehr E., Gächter S., Kirchsteiger G., (1996), " Reciprocal Fairness and non compensating wage differentials", *Journal of Institutional and Theoretical Economics*, vol 152, pp 608-640.

- Fehr E., Gächter, (1998), "Cooperation and punishment", *Working Paper*, University of Zurich, Switzerland.
- Hart O., (1995), *Firms, Contracts and Financial Structure*, Oxford University Press, Oxford.
- Hart O., Holmstrom B., (1987), "The theory of contracts", in Bewley T.F. (ed). *Advances in economic theory: Fifth World Congress. Econometric Society Monographs series*, no. 12, Cambridge; New York and Melbourne: Cambridge University Press, 1987, pages 71-155.
- Krueger A.B., Summers L.H., (1988), "Efficiency wages and the interindustry wage structure", *Econometrica*, n°56, pp 259-293.
- Macho-Stadler I., Perez-Castrillo J.D., (2001), *An introduction to the economics of information: Incentives and contracts*, Oxford University Press, New York,
- Mahuteau, S., (2003), "Reciprocal fairness and gift exchange practices in the labor contract: Econometric analysis on a French firms survey", Working paper, www.ssrn.com
- Mahuteau, S., (2003), "Does it pay to be fair? Evidences from French firms", Working paper, www.ssrn.com
- Manning A., Thomas J., (1997), "A simple test of the shirking model", *Discussion Paper*, Centre for Economic Performance, n°374, Nov.
- Milgrom P., Roberts J., (1992), *Economics, Organization and Management*, Prentice Hall, Englewood Cliffs, New Jersey.
- Myerson R.B., (1983), "Mechanism design by an informed principal", *Econometrica*, 51, pp. 1767-1797.
- Okuno-Fujiwara M., (1987), "Monitoring Costs, Agency Relationships and Equilibrium Modes of Labor Contracts", *Journal of the Japanese and International Economies*, 1, pp. 147-67
- Pauly M.V., (1968), "The Economics of Moral Hazard: Comment", *The American Economic Review*, vol 58, pp. 531-537.
- Ross S.A., (1973), "The economic Theory of Agency: The principal's problem", *The American Economic Review, Papers and proceedings*, vol 63, pp. 134-9.
- Shapiro C., Stiglitz J., (1984), "Equilibrium Unemployment as a worker discipline device", *The American Economic Review*, 74 (june), pp. 433-44.
- Spence M.A., (1973), "Job Market Signaling", *Quarterly Journal of Economics*, 87, pp. 355-74.
- Weiss A., (1981), "Self Selection in the Labor Market", *The American Economic Review*, 71 (3), pp. 275-84.
- Weiss A., (1990), *Efficiency wages: Models of unemployment, layoffs, and wage dispersion*, Princeton University Press, Princeton.
- Weiss A., (1995), "Human Capital vs. Signalling Explanations of Wages", *Journal of Economic Perspectives*, 9(4), pp. 133-54.

LECTURES 12 & 13:

Bargaining and strikes

- Unions and the labor market
 - Union structure and membership: Some figures from Australia
 - What is the Union's objective?
- Models of wage and employment determination
 - The Monopoly Union model
 - The "efficient contract" model

- Unions and the threat of strike: The Hicks' paradox
 - What is the Hick's paradox?
 - Resolving the paradox: asymmetric information models
- Game theoretic models of wage bargaining
 - Sharing a pie between the Union and the employer: introduction to sequential bargaining
 - War of attrition against preemption: who's gonna win?

Readings:

- Binmore K., Rubinstein A., Wolinsky A., (1986), "The Nash Bargaining solution in Economic Modelling", *RAND Journal of economics*, 17 (2), pp. 176-88.
- Booth A.L., (1995), *The economics of the trade union*, Cambridge University Press, New York.
- Card D., Olson C., (1995), "Bargaining power, strike duration and wage outcomes: An analysis of strike in the 1880's", *Journal of Labor Economics* 1, pp 32-61.
- Cramton P., Tracy J., (1992), "Strike and holdout in wage bargaining: Theory and data", *American Economic Review* 81, pp 100-121.
- Dunlop J.T., (1944), *Wage Determination Under Trade Unions*, London; Macmillan.
- Ehrenberg R.G., Smith R.S., (1997), *Modern Labor Economics: Theory and Public Policy*, 6th edition, Addison Wesley.
- Fernandez R., Glazer J., (1991), "Striking for a bargain between two completely informed agents", *American Economic Review* vol 81 n°1, pp 240-252.
- Forsythe R., Kennan J., Sopher B., (1991), "An experimental analysis of strikes in bargaining games with one side private information", *American Economic Review* vol 81 n°1, pp 253-278.
- Haller H., Holden S., (1990), "A letter to the editor on wage bargaining", *Journal of Economic Theory*, vol 52 n°1, pp 232-236.
- Hicks J.R., (1963), *The Theory of Wages*, 2nd edition, London, MacMillan.
- Kennan J. (1986), "The Economics of Strikes", in O. Ashenfelter and R. Layard (eds.), *Handbook of Labor Economics*, vol II, Amsterdam, North-Holland.
- Nickell S., Wadhvani S., (1990), "Insider forces and wage determination", *Economic Journal*, 100, pp. 496-509.
- Ross A.M., (1948), *Trade Union Wage Policy*, Berkeley, University of California Press.
- Roth A.E., Kagel J.H. (eds.), (1995), *Handbook of experimental economics*, Princeton University Press, Princeton, New Jersey.
- Rubinstein A., (1982), "Perfect equilibrium in a bargaining model", *Econometrica* vol 50, pp 97-109.

TUTORIAL PROGRAM

There are no assessment marks allocated to the tutorial program. However 20% of the questions set in the final exam will be drawn directly from questions set and discussed in the tutorials. Tutorial solutions will not be placed in ERIC.

Tutorial 1: (August 16)

Describe the major schools of thought in labour economics. As a guide students should think about the importance different schools of thought assign to market forces, institutional forces and sociological forces and whether they regard labour as a unique commodity or not.

Readings:

Kaufman & Hotchkiss Ch1

Whitfield. & Ross (1996) Ch1, pp 19- 35 and especially pp 30-32 for a simple and brief explanation of the Marxist (radical) perspective.

Garvey, G. (1994) 'Why Labour is Not Different', *Agenda*, Vol 1 No 1, pp5-12.

The following are optional readings; relevant entries in O'Hara and Hodgson et al (from the week 1 reading list). Also see readings by Rebitzer, Jacoby, Boyer & Smith and articles in Kerr & Staudohar from the reading list for Lecture 1.

Tutorial 2: (August 30)

What is the reservation wage?

Define the labour force participation rate (LFPR). What has been happening to the LFPR of men and women overtime in the U.S. and Australia?

For both the U.S. and Australia what is the pattern of the male LFPR by age and how has it been changing overtime? What is the pattern for women and how has it changed overtime?

What is the behaviour of the LFPR over the business cycle in the U.S. and Australia? What is the discouraged worker effect and the added (or additional) worker effect?

For the above questions also mention any of the factors accounting for changes in the LFPR of men and women.

Readings

Kaufman & Hotchkiss Ch3

ABS (2005) Australian Labour Statistics, July, (cat. no. 6105.0) pp 10-18.

Norris, Kelly & Giles pp 30-37.

Tutorial 3 (October 4)

Readings

K & H Ch 6.

Richard B. Freeman (1996) 'The Minimum Wage as a Redistributive Tool' *The Economic Journal*, 106 (May), 639-649.

Sue Richardson (1998) 'Who Gets Minimum Wages' *The Journal of Industrial Relations*, 40(4), 554-579.

Questions

1. (a) Who are the potential losers from a minimum wage increase?
(b) Under what conditions do minimum wage workers lose from minimum wage increases?
2. What are the main socio-demographic features of low wage workers in Australia? How do they differ from the general workforce?
3. What conditions are necessary for increases in minimum wages to benefit the lowest income households? Are these conditions satisfied in Australia?
4. Would a cut in minimum wages lead to a more equitable distribution of income in Australia?
5. Use your knowledge of economics to provide an assessment of the following proposition. "Cutting the wages of high wage earners can lead to a more equitable distribution of income AND more employment of low wage workers." Does this proposition make economic sense to you?
6. Freeman (1996) identifies four positive attributes of minimum wages as a redistributive tool. What are they?

Tutorial 4: (October 25)

Questions:

1. Why, according to the theory, should the wages compensate both for job and workers' characteristics?
2. Econometric estimations of wage equations tend to highlight an "employer size-wage effect". How can you explain the existence of such a positive relationship between employer size and level of wages? (see Brown and Medoff, *Readings on WebCT*).
3. In the estimations of wage equations, one always finds a significant coefficient associated with the worker's gender. What does that mean?
4. What is "job matching". How can this be used as an explanation of the existence of inter-industry wage differences?
5. What do we call efficiency wages? What is the common rationale of the various models of efficiency wages?
6. Highlight some reasons why employers may pay efficiency wages?
7. According to the shirking model of efficiency wage, monitoring and pay are substitutes for motivating employees. Discuss this statement using the article written by Allgulin and Ellingsen (*Readings on WebCT*).
8. Mathewson (1969, p.127) quotes the following poetry stemming from the Bulletin Board of a machine shop:

*"I am working with the feeling
That the company is stealing
Fifty pennies from my pocket everyday;
But for every single pennie [sic]*

*They will loose ten times as many
By the speed that I'm producing, I dare say.
For it makes one so disgusted
That my speed shall be adjusted
So that nevermore my brow will drip with sweat;
When they're in an awful hurry
Someone else can rush and worry
Till an increase in my wages do I get."*

9. What comments, in terms of employers' wage policies, does this poetry inspire you?
10. Recent studies of the labour market have highlighted that workers are sensitive to some norms of compensation rather than to the level of compensation itself. How can this explain the existence of non-compensating wage differentials among industries or firms? Illustrate your answer with the survey conducted by Rich and Teicher.

Tutorial 5: (November 8)

Questions:

1. According to Vedder and Gallaway (*Readings on WebCT*), what has been the economic impact of unionism in the US? What comments does it inspire you about the nature of the unions' objective function?
2. What is the Hick's paradox?
3. Why does the monopoly union model produce an inefficient equilibrium? Explain with the use of a graph. How can the situation of both the employer and the union be improved from this equilibrium?
4. Using the article written by Bramble (*Readings on WebCT*) picture the main characteristics of Australia's trade unions' officials.
5. Using the article written by Budd and Na (*Readings on WebCT*), explain the US institutional background in terms of employees' representation. Is there likely to be a union membership wage premium in the US? What kind of problem may arise due to the fact that employees can benefit from collective bargaining agreements without even being a member of the union? What conditions the probability for a worker to become member of a union?

