Ec 317
Labour Economics
2002-2003

Lectures: Prof. Steve Pischke, R425, Tel: 7955-6509, e-mail: s.pischke@lse.ac.uk

Classes: Maarten Goos, R4 Zone 9, Tel: 7852-3520, e-mail: m.goos@lse.ac.uk

Course Web Page: http://econ.lse.ac.uk/courses/ec317/

Time and Location: Lectures: Friday 9:30-11:00, S221
Classes: TBA

There will be 30 hours of lectures and 15 hours of classes.

Office Hours: Steve Pischke Tuesday 15:00-17:00
Maarten Goos TBA

Course Description: This course is an introduction to the economic analysis of behavior and institutions in the labor market. The purpose of this course is threefold. We will learn how microeconomic models are applied to labor market phenomena, such as labor supply and participation, labor demand by firms, and wage determination under different institutional settings. Labor economics is a very empirical field. The second goal is therefore to examine how to distinguish alternative theories empirically and how key parameters of the models are obtained from the data. This will involve students doing some of their own data analysis. Thirdly, we will explore how the models can be applied to evaluate labor market policies, such as the minimum wage, reform of the welfare system, or restricting immigration. The goal of this course is to enable students to think independently about labor market issues, drawing on the models and tools developed during the course.

Either one of these two textbooks is a good complement for the course. I asked the bookstore to order copies of the book by Borjas. Additional reading are provided below on the course outline.

**Classes and Examinations.** There will be (approximately) weekly problem sets, which will be discussed in classes. Some of the problems will involve hands-on data analysis of particular labour market issues. The data will be provided and you will get a lot of guidance what to do. But you will have to go to the computer yourself and use some of the knowledge from your econometrics course to learn first hand how labour economists go about learning empirical facts.

The exam will consist of both problems and essay questions drawing on the material from lectures, problems, and classes.
Course Outline and Annotated Reading List

• denotes required reading [Reference numbers to the library’s offprint collection are in square parentheses].

This course outline will guide you through the topics we will cover during the year. It lists the required readings as well as some optional material. In many cases these optional readings will give you an idea where I have obtained the material for the lectures. The lectures will typically give a simplified account of the articles. If you are interested in further study of a certain topic, the listed sources should serve as a good starting point. I have also added some sources that I just found interesting reading, they may interest you as well. You are encouraged to let me know what you liked and what you didn’t like.

The following books are good references sources, and there are a few references to them below.


**Introduction to the Labor Market**

• Ehrenberg and Smith, chapter 2, Borjas, chapter 1

- Goldin, Claudia “Labor Markets in the Twentieth Century,” manuscript.

  *This is a survey of what has happened in the U.S. labor market during the past 100 years. It presents a lot of basic facts which will help you putting current events into perspective, and will give you an overview of what it is we are studying.*
Labor Supply

The Static Labor Supply Model

- Ehrenberg and Smith, chapter 6, 163-190; Borjas, chapter 2, 17-55

Extensions: Commuting Cost, Overtime, Moonlighting and Self-Employment

- Ehrenberg and Smith, Appendix 6A

  *A discussion of the money and time costs of working.*

Policy Application: Will Welfare Reform Work?

- Ehrenberg and Smith, chapter 6, 190-200; Borjas, chapter 2, 55-65

  *This paper describes the problems with standard welfare systems and discusses suggestions about possible reforms.*


    *Yelowitz analyzes how extensions of the Medicaid program, medical care for the poor, has changed incentives to participate in welfare versus work for pay during the late 1980s. Health care reform may actually be useful to get mother’s off welfare.*

Labor Supply and the Family: Who Stays Home?

- Ehrenberg and Smith, chapter 7, 203-216, 223-228; Borjas, chapter 3, 87-94
  - Killingsworth, 29-38
Life-Cycle Labor Supply and Retirement

- Ehrenberg and Smith, chapter 7, 216-222; Borjas, chapter 3, 69-87


*We look at a particular change in the Social Security law in the late 1970s that has led to a decrease in retirement benefits for specific age cohorts. This was the first time in U.S. Social Security history that benefits were cut. We don’t find evidence that this increased the incentive of older men to work more: the trend to earlier retirement continues.*

Labor Demand

Competitive Labor Demand of the Firm and the Industry

- Ehrenberg and Smith, chapter 3, 56-71, 79-85; Appendix 3A; chapter 4, 96-110; Borjas, chapter 4, 103-136

The Bigger, the Worse: Monopsony

- Ehrenberg and Smith, chapter 3, 73-79; Borjas, chapter 5, 185-193

Policy Application: Minimum Wages – Good or Bad?

- Ehrenberg and Smith, chapter 4, 110-118; Borjas, chapter 4, 138-149


*Brown discusses the traditional research on the minimum wage and concludes that it doesn’t hurt employment much but also does not add much to the income of low wage workers. Easy to read summary.*


*A book that is challenging the conventional wisdom on minimum wage — and makes us wonder how much wisdom labor economists have about low wage labor markets.*
  Summarizes research on the impact of minimum wages in various European countries.

Policy Application: Is Immigration Bad for the Rest of us?
- Ehrenberg and Smith, chapter 10, 321-331; Borjas, chapter 5, 159-182

  More than 100,000 Cubans refugees arrived in Miami during the summer of 1980. While many of them settled permanently in the city, the Cuban’s had surprisingly little impact on the earnings of low skilled native workers.

Dynamic Labor Demand
- Ehrenberg and Smith, chapter 5, 131-149; Borjas, chapter 4, 149-155

Wage Determination

The Economics of Schooling: The Human Capital Model
- Ehrenberg and Smith, chapter 9, 265-276; Borjas, chapter 7, 226-237

- Mincer, Jacob Schooling, Experience, and Earnings. New York: Columbia University Press, 1974, especially chapters 3, 4, and 5 
  This is a labor economics classic. Mincer was the first to systematically analyze the relationship between earnings, schooling, and age. He probably discovered one of the most stable empirical relationships in labor economics. Browse for historical interest at your leisure.

The Signalling Model: Why Do LSE Students Have to Work so Hard?
- Ehrenberg and Smith, chapter 9, 291-295; Borjas, chapter 7, 249-255
The Returns to Schooling: Does All the Toil and Trouble Pay Off?

- Ehrenberg and Smith, chapter 9, 286-290, 296-297; Borjas, chapter 7, 237-248


If ability confounds our estimates of the returns to schooling we want to look for something that induces students to stay in school longer but something should have no relation to intelligence. Compulsory schooling laws do just that. Given that students are born in different months of the year, some can drop out earlier than others. Angrist and Krueger finds that forcing a student to go to classes another quarter raises earnings by 3 percent. So shouldn’t you go to class? The part with the pictures is easy to read, skip the rest.

Earnings Growth Over the Life Cycle: On-the-Job-Training

- Ehrenberg and Smith, chapter 5, 150-157; chapter 9, 276-286; Borjas, chapter 7, 255-268


That’s what he won the Nobel Prize for! Becker was the first to provide a systematic framework for thinking about training investments.


The problem with Becker’s story is that it doesn’t seem to fit the actual facts about the financing of training. We try to fix that.

Efficiency Wages and Labor Contracts: The Economics of Working and Shirking

- Ehrenberg and Smith, chapter 11; Borjas, chapter 12, 432-439, 447-461
Lazear is one of the pioneers of applying economics to the personnel problems of a firm. Here he argues his case: that managers can learn a lot from some simple economic models.

Tournaments and Races: How Much Should Bill Gates Make?

- Ehrenberg and Smith, chapter 11, 366-368; Borjas, chapter 12, 440-447

Summing Up What We Know About Wages


We have a multitude of theories about how firms set wages. Still, we know relatively little about the relevance of the various theories. Blinder, a former member of the Federal Reserve Board, and a student of his went out and asked large employers what they do. The focus is on the question why wages don’t fall in recessions. An interesting break from standard empirical methodology in economics.

The Distribution of Earnings

Compensating Differentials: Someone Has to Do the Dirty Work

- Ehrenberg and Smith, chapter 8; Borjas, chapter 6

- Smith, Adam, The Wealth of Nations, 1776, chapter 10, part 1, [P6170a/b]

The classic treatment on why wages differ. Smith actually discusses a variety of models, among them what is now called human capital and efficiency wages. He presents these in the language of compensating differentials (and of the 18th century, which makes the reading, let’s say, a little different).
Gender and Race: Do Women and Blacks Produce Less?

- Ehrenberg and Smith, chapter 12; Borjas, chapter 10

*Chapter 4 of the book is required reading, but the rest of the book is quite interesting as well. It is relatively easy reading. Goldin gives a nice account of the changing role of women in the labor market, especially chapters 2 and 3 might be of interest.*

The Changing Wage Structure: Why Are the Poor Getting Poorer?

- Ehrenberg and Smith, chapter 14; Borjas, chapter 8

  - *Journal of Economic Perspectives*, Spring 1997, Symposium on Wage Inequality

    *Four authors discuss the recent trends in wage inequality in the US and possible explanations based on a) changes in the relative demand for more skilled workers due to technology or trade, b) changes in the supply of different skill groups, and c) changes in economic institutions which impact wage dispersion.***


    *A good summary of the recent literature on earnings inequality. Starting point to find what we know about inequality trends in other countries. Also summarizes some of the things we know about the reasons for rising wage dispersion.*


    *Using data that go back to World War II, Goldin and Margo document that there is not just a recent trends in rising earnings inequality. Rather, this trend has a counterpart in closing differentials during the 1950s. Maybe*
the puzzle is not rising wage inequality in the 1980s, but rather the wage compression at mid-century?


While rising wage inequality in the U.S. has been well documented the causes have been much more elusive. Krueger puts forward a possible explanation based on the differential wage impact of technological change: Has the PC benefitted the well educated at the cost of less skilled workers?

Getting Organised: Labor Unions

Why Workers Want Unions

- Ehrenberg and Smith, chapter 13, 423-429, 437-443; Borjas, chapter 11, 388-400

Wage and Employment Determination in Unionized Labor Markets

- Ehrenberg and Smith, chapter 13, 429-436; Borjas, chapter 11, 400-411

Bargaining and Strikes

- Ehrenberg and Smith, chapter 13, 442-449; Borjas, chapter 11, 411-417

What Do Unions Really Do?

- Ehrenberg and Smith, chapter 13, 452-463; Borjas, chapter 11, 417-425


The voice theory of unions is an important alternative to traditional economic explanations based solely on the role of unions in bargaining over wages and benefits. The authors present evidence for their approach in a popular book.