

## **Econ 222: Labor Economics**

### **Context and Motivation**

The way labor is allocated and rewarded in the market has profound implications for the welfare of single or multiple households (from child laborers to retirees) at the micro level and economic performance, including growth, at the macro level. Assumptions (or beliefs) about the role of labor in the economy have shaped all economic schools of thought from Adam Smith's labor theory of value to Marx's exploitation of laborers, and from the centrality of the "money illusion" hypothesis in Keynesian economics to the neoclassical theory's assumption that labor supply is positively sloped. Our theoretical understanding of how labor affects and is affected by markets and institutions remains incomplete while recent improvements in econometric techniques and the vast increases in the availability of data (surveys) still produce ambiguous, if not contradictory, empirical results. Part of the continuing search for the truth relates to the continuous change of the truth itself as economies evolve at local and also regional and global levels. Labor economics is one of the most recent fields in economics - said to have started with Albert Rees canonical textbook *The Economics of Work and Pay* in 1973. ECON 222 aims to cover the key developments since.

Most developments relate to the growth of neoclassical economics around the paradigm of competitive markets, which is flanked by many and fundamental criticisms or is enriched with analyses of asymmetric information, imperfect markets, trade union behavior, well-intended or rent seeking government policies, different institutional factors or simply heterogeneous workers who differ in ability, motivation, race, ethnicity, religion or gender.

These developments have by now culminated into a voluminous body of literature, and Labor Economics is no longer considered the Cinderella of the economics profession. In fact, it lies at the very heart of modern economics because much of the revival of growth economics (particularly relevant for the study of globalization) builds on the human capital theory and focuses on the operation of labor markets in the course of development. This puts Kuznets' hypothesis (1955) of rising wage/income inequality during the early stages of development back on the table and eclipses the business-cycle focus that had dominated the field for decades.

### **Objective**

The objective of the course is to provide, first, the basic concepts of Labor Economics and, second, examine theoretically (under different behavioral, market and institutional assumptions) and empirically (through testing and quantifying) how labor is allocated and rewarded today and would grow over time. More precisely, the course aims to help students understand:

- (a) the modeling labor market decisions by households and firms;
- (b) the comparative static properties and dynamics of perfectly competitive and imperfect product and labor markets;
- (c) the macro dimensions of the economy –from a labor market perspective;
- (d) the nuances involved in the empirical testing of the relevant theories; and
- (e) the policy implications of the empirical findings

### **Prerequisites**

Students are expected to have passed intermediate microeconomics (ECON 217) and be familiar with intermediate macroeconomics (ECON 227), econometrics (ECON 214) and basic principles of mathematics.

### **Expectations**

At the end of the course the students should be:

- familiar with the terminology and basic facts related to the labor market;
- able to understand alternative theories which aim at explaining stylized facts familiar with key features of labor markets in OECD and Arab countries.
- in a position to evaluate the results of empirical work
- assess the policy implications of various labor policies.

The general desirability of government intervention of various forms into the labor market is a key issue students should be able to tackle by the end of the course.

### **Course Assessment**

There will be a mid-term examination as well as an end of term final examination. The final examination will cover all the material taught during the semester.

The final grades of students will be calculated over the two exams with weights 20-70 with the remainder allocated to consistent course attendance and participation in the class. The final exam will carry a weight of 90 percent in case of justified failure of a student to sit the mid-term exam.

### **Textbooks**

The lectures will cover material which can be found in George Borjas *Labor Economics* and David Sapsford and Zafiris Tzannatos *The Economics of the Labour Market* (see reading list below). The two textbooks are of similar length (about 500 pages) and, with a few exceptions, provide comparable coverage of the theory though both have some notable omissions (e.g. neither covers issues of pensions, child labor or the implications of globalization for the labor market). The former textbook focuses on the American labor market while the latter draws more examples from the British/European experiences. An additional difference is that Sapsford and Tzannatos (ST) uses a more algebraic approach while George Borjas (GB) relies more on diagrammatic expositions.

### **Web sites**

Students can self-assess their progress by visiting George Borjas' study questions at <http://www.mhhe.com/economics/borjas/questframe.mhtml> or the exams page of C. McConnell, S. L. Brue and D. Macpherson at <http://www.contemporarylabor.com/>

## **Course Outline**

### **A BIRD'S EYE VIEW OF LABOR ECONOMICS**

ST Chapter 1, Introduction

GB Chapter 1, Introduction

### **LABOR SUPPLY (1)**

ST Chapter 2, Labour Supply: The Basic Model

GB Chapter 2, Labor Supply

### **LABOR SUPPLY (2)**

ST Chapter 3: Labour Supply: Extensions

GB Chapter 3: Topics in Labor Supply

### **HUMAN CAPITAL**

ST Chapter 4: Human Capital

GB Chapter 7: Human Capital

### **LABOR DEMAND (1)**

ST Chapter 5: Labour Demand

GB Chapter 4: Labor Demand

### **LABOR DEMAND (2)**

ST Chapter 6: Labor Demand: Extensions

### **SUPPLY AND DEMAND: THE LABOR MARKET**

ST Chapter 7: Wage and Employment Determination

GB Chapter 5: Labor Market Equilibrium

### **WAGE DIFFERENCES AND THE DISTRIBUTION OF PAY**

ST Chapter 8: Distribution of Pay

GB Chapters 6: Compensating Wage Differentials; Chapter 8: The Wage Structure

### **DISCRIMINATION**

ST Chapter 9: Discrimination in the Labour Market

GB Chapter 10: Labor Market Discrimination

### **TRADE UNIONS**

ST Chapter 10: Trade Unions; Chapter 11: Collective Bargaining

GB Chapter 11

### **SEARCH, MOBILITY AND EFFICIENCY WAGES**

ST Chapter 12

GB Chapter 9: Labor Mobility; Chapter 2: Contracts and Incentives

### **INFLATION**

ST Chapter 13: Inflation

### **UNEMPLOYMENT**

ST Chapter 14: Unemployment

GB Chapter 13: Unemployment

## **Reading List/Additional References**

There are many textbooks as well as collections papers of (a) classical contributions to the field and (b) expository/synthesis articles on individual topics. In addition, there are some useful surveys on specific issues. Finally, there are some overviews of the global labor market as well as a few surveys of the MENA region (Middle East and North Africa).

### **Textbooks**

- G. Borjas, *Labor Economics*, 2<sup>nd</sup> edition, McGraw-Hill, 2000.  
 R. Ehrenberg and R. Smith, *Modern Labor Economics*, 7<sup>th</sup> edition, Addison Wesley, 2000.  
 R. Elliott, *Labor Economics: A Comparative Text*, McGraw-Hill, 1991.  
 D. Hamermesh and A. Rees, *The Economics of Work and Pay*, 5<sup>th</sup> edition, Harper and Row, 1999.  
 C. McConnell et al., *Contemporary Labor Economics*, 6<sup>th</sup> ed., McGraw-Hill, 2003.  
 D. Sapsford and Z. Tzannatos, *The Economics of the Labour Market*, Macmillan, 1993.

### **Edited Volumes**

- O. C. Ashenfelter and D. Card, *Handbook of Labor Economics*, North Holland, 1999  
 D. Sapsford and Z. Tzannatos, *Current Issues in Labor Economics*, Macmillan, 1990.

### **General/Global**

#### ILO (International Labour Office), Geneva<sup>1</sup>

- World Labour Report* (regular publication with topical coverage e.g. 1997/8 examined industrial relations; 1998/9 training; 1999-2000: Income Security and Social Protection etc).  
*International Labour Review* (journal).  
*Yearbook of Labour Statistics* (annual).  
*Key Indicators of the Labour Market*, 3<sup>rd</sup> edition, 2003.

#### OECD (Organization for Economic Cooperation and Development), Paris<sup>2</sup>

- Employment Outlook, Towards More and Better Jobs*, 2003.  
 See also OECD statistics on labor force, unemployment, earnings, hours of work etc.

#### IBRD (International Bank for Reconstruction and Development) (the World Bank)<sup>3</sup>

- A. Dar and Z. Tzannatos, *Active Labor Market Policies*, Social Protection DP 9901.  
*World Development Indicators* (annual), 2003.  
*World Development Report 1995: Workers in an Integrating World*.  
 D. Mazumdar, *Microeconomic Issues of Labor Markets in Developing Countries: Analysis and Policy Implications*. Economic Development Institute, 1989.

<sup>1</sup> See [www.ilo.org](http://www.ilo.org) or, in Arabic, <http://www.ilo.org/public/arabic/region/arpro/beirut/index.htm>

<sup>2</sup> See [www.oecd.org](http://www.oecd.org)

<sup>3</sup> See [worldbank.org](http://worldbank.org)

## **Regional (MENA – Middle East and North Africa)**

ERF (Economic Research Forum for MENA, Iran and Turkey), Cairo<sup>4</sup>  
*Economic Trends* (annual).

H. Handoussa and Z. Tzannatos, *Employment Creation and Social Protection in the Middle East and North Africa*, 2002.

ESCWA (UN Economic and Social Commission for Western Asia), Beirut<sup>5</sup>  
*Responding to Globalization: Skills Formation and Unemployment Reduction Policies*, 2003.

WORLD BANK (Washington DC, USA)  
*Reducing Vulnerability and Increasing Opportunity: Social Protection in the Middle East and North Africa Region*. 2002.  
*MENA's Employment Challenge in the 21<sup>st</sup> Century: From Labor Force Growth to Job Creation*. 2003.

UN/UNDP/UNESCO<sup>6</sup>  
*Human Development and the Acquisition of Advanced Knowledge in Arab Countries Human Development*, Series No. 11, 2003.

## OTHERS

W, Shahin and G. Dibeh (eds.), *Earnings Inequality, Unemployment and Poverty in the Middle East and North Africa*. Greenwood Press, 2000.

E. Doumato and M. Pripstein-Posusney (eds.), *Women and Globalization in the Arab Middle East: Gender, Economy and Society*. Lynne Rienner, 2003.

Z. Tzannatos and I. Kaur, *Welfare State Policies in the MENA* in E. Kapstein and B. Milanovic (eds.) *When Markets Fail: Social Policy and Economic Reform*. Russel Sage, 2002.

## **Journals**

Many labor economics articles are published in mainstream economics journal but there are now an increasing number of specialized labor journal such as:

- Journal Human Resources
- Journal of Labor Economics
- British Journal of Industrial Relations
- Industrial Relations Journal
- International Labour Review (ILO)
- Labor Economics
- Labour
- Industrial and Labor Relations Review

Survey articles on labor economics are frequently published also in  
Journal of Economic Perspectives  
Journal of Economic Surveys  
Journal of Economic Literature (advanced)

---

<sup>4</sup> See [www.erf.org.eg](http://www.erf.org.eg)

<sup>5</sup> See [www.escwa.org.lb](http://www.escwa.org.lb)

<sup>6</sup> See [www.unesco.org](http://www.unesco.org). (or [unesco.lb](http://unesco.lb) for the Beirut office) and similarly for [undp.org](http://undp.org) (or [undp.org.lb](http://undp.org.lb)).

## Supplementary Material

As a general rule, most of the topics covered in the course are treated extensively in separate chapters in Ashenfelter et al. (1986; 1999) or Sapsford and Tzannatos (1990).

Additional material (handouts) will be distributed during the course

The references below start with a seminal publication on the issue followed by topical articles. Students are expected to supplement their textbook reading with some of the material listed below.

### A Bird's Eye View of Labor Economics

A. Rees, *The Role of Fairness in Wage Determination*, Journal of Labor Economics, 1993, Vol. 11, No. 1, Part1, 243-252

Z. Tzannatos, *Labor Policies and Regulatory Regimes*, in C. Frischtak (ed.) *Regulatory Policies and Reform: A Comparative Perspective*. World Bank, Private Sector Development Dept., 1995

### Labor Supply

G. Becker, *A Treatise on the Family*. Harvard University Press, 1981.

M. Killingsworth, *Labor Supply*, Cambridge University Press, 1983.

K. Basu and Z. Tzannatos, *Child Labor*, World Bank Economic Review, Fall, 2003.

### Human Capital

G. Becker, *Human Capital*, National Bureau of Economic Research, 1964.

J. Mincer, *Schooling, Experience and Earnings*, Columbia University Press, 1974.

V. Billeh, *Matching Education to Demand for Labor in the MENA Region*. Chapter 1 in Handoussa and Tzannatos, 2002.

M. Cinar, *Earnings Profiles of Women Workers and Education in the Middle East*, in Shahin and Dibeh (2000).

### Labor Demand

W. Oi, *Labor as a Quasi-Fixed Factor*, Journal of Political Economy, 1962.

D. Hamermesh, *Labor Demand*". Princeton University Press, 1993.

### Supply and Demand, Internal Labor Markets, Segmentation

R. McNabb and P. Ryan, *Segmented Labour Markets*, in Sapsford and Tzannatos, 1990.

S. Nickell, "Unemployment and Labor Market Rigidities: Europe versus North America," *Journal of Economic Perspectives*, 1997, Vol. 11, Number 3, pp. 55-74.

### Wage Differences and the Distribution of Pay

A. Atkinson, *Wealth, Income and Inequality*, 2<sup>nd</sup> edition, Oxford University Press, 1980.

S. Polachek and W. S. Siebert, *The Economics of Earnings*, Cambridge University Press, 1993.

A. Marin and G. Psacharopoulos, *The Reward for Risk*, Journal of Political Economy, 1982.

Discrimination/Gender

- G. Becker, *The Economics of Discrimination*, Chicago University Press, 1957.  
 A. Zabalza and Z. Tzannatos, *Women and Equal Pay*, Cambridge University Press, 1985.  
 H. Sayed and Z. Tzannatos, *Gender Segregation* in N. Stromquist (ed.) *Encyclopedia of Third World Women*. Garland Publishing. 1998.

Trade Unions

- G. Lewis, *Union Relative Wage Effects: A Survey*, Chicago University Press, 1986.  
 A. Booth, *The Economics of Trade Unions*, Cambridge University Press, 1995.  
 T. Aidt and Z. Tzannatos, *Trade Unions in a Globalizing World*, World Bank, 2002.

Topics: Search, Implicit Contracts, Profit Sharing, Efficiency Wages

- G. Stigler, *Information in the Labor Market*, *Journal of Political Economy*, 1962.  
 C. Azariadis, *Implicit Contracts and Underemployment Equilibria*, *JPolEconomy*, 1975.  
 M. Weitzman, *The Share Economy*, Harvard University Press, 1984.  
 I. McDonald and R. Solow, *Wage Bargaining and Employment*, *AER.*, 1981.  
 Z. Tzannatos, *Labour Economics* in J. Maloney (ed) *What is New in Economics*, Manchester UP.

Unemployment

- A.W.H. Phillips, *The Relationship Between Unemployment and Money Wages*, *Economica*, 1958.  
 R. Layard, S. Nickell and R. Jackman, , *Unemployment, Macroeconomic Performance and the Labour Market*, Oxford University Press, 1991.

**Useful web sites**

In addition to ILO, OECD, World bank etc web cites, other useful cites for the course include:

Electronic journals e.g. [www.jstor.ac.uk](http://www.jstor.ac.uk) and [www.ingenta.com](http://www.ingenta.com).

Similarly try EconPapers which links you to free downloadable articles from many different journals <http://econpapers.hhs.se/article>.

The Labour Economics Gateway (<http://labour.ceps.lu>): contains useful Information (such as web-links, list of labour economists, homepages of academics, relevant papers etc).

The Center for Economic Performance (London School of Economics) web site offers free downloadable papers at <http://cep.lse.ac.uk>.

The Journal of Economic Surveys (<http://ideas.repec.org/s/bla/jecsur.html>) with free downloadable articles and various links to other (than Blackwell) publishers.

The UK websites (such as [www.statistics.gov.uk](http://www.statistics.gov.uk), [www.dwp.gov.uk](http://www.dwp.gov.uk) and [www.dfes.gov.uk](http://www.dfes.gov.uk)) which include downloadable statistics and policies.

The US websites of the Department of Labor ([www.dol.gov](http://www.dol.gov)) especially the Bureau of International Labor Affairs ([www.dol.gov/ilab](http://www.dol.gov/ilab)).

## **Epilogue**

Three topics relevant to labor economics: pensions, discrimination and inequality.

### **Reuters, August 9, 2003**

The southwestern India state of Kerala, bordering the Arabian Sea, is the first state to set guidelines for the treatment of elephants used for colorful Hindu festivals or to cart timber over its hilly terrain: compulsory retirement age of 65, each animal should have its own mahout and to walk no more than 30 kilometers (19 miles) a day. Kerala has about 800 working elephants, more than any other state, living an average 80 years and earning \$110-\$543 a day, depending on the occasion and the size of the animal. But elephant owners are not happy. "Age should not be the criterion for determining when an elephant should retire," Kerala Elephant Owners' Association chief said. "Its health and physical fitness are more important."

### **International Herald Tribune, September 24, 2003**

Malaysian airlines have grounded airhostesses over the age of 40. The national flag carrier has no intention of discriminating against women, the general manager said. But he added "let's face reality. Customers prefer to be served by young, demure and pretty stewardesses, especially Asian ladies". He added that women over 40 had domestic problems that interfered with their jobs, especially if they were married with children. Now women must retire from flying 15 years earlier than their male counterparts.

### **New York Times, Sept 25, 2003**

The gap between the rich and poor in the US has widened into an even deeper gulf in which the richest 1 percent of Americans (2.8 million) had more after tax income in 200 than did the bottom 40 percent (110million). By contrast in 1979 the wealthiest 1 percent had less than half of the total economic pie of the poorest 40 percent. The share of after tax income enjoyed by the richest 1 percent of households was nearly one trillion dollars (\$950 billion) representing nearly 16 percent of the nation's total \$6.2 trillion and averaging \$862,700 annually after taxes. The wealthiest 1 percent has not had a larger share of income since 1929.