

**Labor Economics II**  
**Spring 2006**

**Instructor:**

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**Class Schedule:**

Tuesday and Thursday, 2-4, Room 539, 110 Fifth Avenue  
Class meets from January 17-March 9

**Office Hours:**

Tuesday 4:30-6, or by appointment.

**Course Objectives:**

The objective of the course is to acquaint students with modern topics, modeling strategies, econometric methods, and empirical work in the field of labor economics. We will cover topics in the analysis of labor market dynamics [(unemployed) search and informational models of turnover], models of the employment relationship in the presence of moral hazard, labor supply in both static and dynamic contexts, alternative models of wage determination, and bargaining models of household behavior. For each of the topics covered we will begin by presenting some of the relevant theoretical models that have been developed. We will then turn our attention to issues of model specification and estimation given the type of data typically available to labor economists. We intend to spend roughly equal amounts of time on theoretical and empirical issues.

**Prerequisites:**

One year of microeconomic theory and Econometrics II or its equivalent.

**Requirements and Grading:**

1. There will be a final exam for the course, which will be given on March 14. The exam will be in class, and will cover the required material on the reading list as well as lecture material.
2. Students are expected to complete a short research paper, in which they pursue some topic covered in class or other labor market issues (subject to the approval of the instructor). The paper may consist of an empirical and/or theoretical analysis, but should contain some original aspects. You are to complete a two-page research proposal no later than February 23, and you have until the end of the semester to complete the paper. If you have difficulty developing a topic, speak to me and we'll work on it together.
3. Each student will be asked to give a report on one or two of the assigned readings during the class meetings (the readings will be selected by the student subject to my approval). The reports will consist of a summarization of the basic argument of the paper(s), the model, and the econometric methodology and empirical results (where appropriate).

The course paper and final exam each have a weight of .45 in the determination of the final grade, with the in-class report and class participation accounting for the rest.

## Readings:

The items on the reading list marked with an asterisk (\*) are required readings. You should be able to find almost everything on-line. If you have difficulties locating something, let me know.

## Topics:

| <i>Week</i>                                       | <i>R.L. #</i> | <i>Topic</i>  |
|---|---------------|---|
| <b>Labor Market Dynamics</b>                      |               |   |
| 1   | 1.A           | <i>Course Introduction; Describing Labor Market Dynamics</i>    |
| 2   | 1.B           | <i>Unemployed Search Theory</i>                                 |
| 3   | 1.C           | <i>Econometrics of Unemployed Search</i>                        |
| 4   | 1.D           | <i>Matching, Bargaining, and Search</i>                         |
| 5   | 1.E           | <i>Job Mobility</i>   |
| <b>Labor Supply and Household Economics</b>       |               |   |
| 6   | 2.A           | <i>Static Labor Supply</i>                                      |
| 7   | 2.B           | <i>Life-Cycle Labor Supply</i>                                  |
| 8   | 2.C           | <i>Household Bargaining and Labor Supply</i>                    |
| 9   | 2.D           | <i>Bargaining Models of Household Formation and Dissolution</i> |
| <b>Asymmetric Information in the Labor Market</b> |               |   |
| 10  | 3.A           | <i>Signalling Models</i>  |
| 11  | 3.B           | <i>Principal-Agent Problems in the Labor Market</i>             |
| 12  | 3.C           | <i>Econometric Models of Moral Hazard</i>                       |
| <b>Human Capital Investment Decisions</b>         |               |   |
| 13  | 4.A           | <i>Human Capital Investment Decisions</i>                       |
| 14  | 4.B           | <i>Equilibrium Models of Human Capital Investment</i>           |

## Reading List

**Note: Selections with (\*) are required**

### 1.A. Describing Labor Market Dynamics

1. \*Burdett, K. and D. Mortensen. "Labor Supply under Uncertainty." In *Research in Labor Economics, Vol. 2* (Ehrenberg, ed.). Greenwich:CN: JAI Press, 1979.
2. \*Flinn, C. Chapter 3 of *Minimum Wages and Labor Market Outcomes: Theory and Evidence*. Downloadable from course home page.
3. \*Flinn, C. and J. Heckman. "Are Unemployment and Out of the Labor Force Behaviorally Distinct Labor Force States?" *Jour. of Labor Economics* 1 (1983): 28-42
4. Flinn, C. and J. Heckman. "Models for the Analysis of Labor Force Dynamics" in *Advances in Econometrics, vol. 1* (Basmann and Rhodes, eds.). Greenwich, CN: JAI Press, 1982.
5. Flinn, C. "Econometric Analysis of CPS-Type Unemployment Data." *J. of Human Resources (1986)*21: 456-484.
6. Toikka, R. "A Markovian Model of Labor Market Decisions by Workers." *A.E.R.* 66 (1976): 821-834.
7. \*Ross, S. *Applied Probability Models with Optimization Applications*. San Francisco: Holden-Day, 1970. Available as a Dover paperback. Highly recommended as background material.

### 1.B. Unemployed Search Theory

1. \*Burdett and Mortensen (from 1.A), continued.
2. \*Flinn (from 1.A), continued.
3. Mortensen, D. "Job Search and Labor Market Analysis." Chapter 15 in *Handbook of Labor Economics, Volume 2* (Ashenfelter and Layard, eds), Amsterdam: North-Holland, 1986..
4. Danforth, J. "On the Role of Consumption and Decreasing Absolute Risk Aversion in the Theory of Job Search." In *Studies in the Economics of Search* (Lippman and McCall, eds). Amsterdam: North-Holland, 1979.
5. Rendon, S. "Job Search and Asset Accumulation under Borrowing Constraints." Forthcoming, *International Economic Review*, 2006.
6. \*Rothschild, M. "Searching for the Lowest Price when the Distribution of Prices is Unknown." *J. Pol. Econ.* 82 (1974): 689-711.
7. \*Salop, S. "Systematic Job Search and Unemployment." *Rev. Econ. Studies* 40 (1973): 191-201.

### 1.C. Econometrics of Unemployed Search

1. \*Flinn, C. and J. Heckman. "New Methods for Analyzing Structural Models of Labor Force Dynamics." *J. Econometrics* 18 (1982): 115-168.
2. \*Wolpin, K. "Estimating a Structural Search Model: The Transition from School to Work." *Econometrica* 55 (1987): 801-818
3. Wolpin, K. *Empirical Methods for the Study of Labor Force Dynamics*. Harwood Academic Publishers, 1995. Chs. 2,3.
4. \*Van den Berg, G. "Nonstationarity in Job Search Theory." *Rev. Econ. Studies* 57 (1990), pp. 255-277.
5. Lancaster, T. and A. Chesher. "An Econometric Analysis of Reservation Wages." *Econometrica* 51 (1983), pp. 1661-1676.

### 1.D. Matching, Bargaining, and Search

1. \*Dey, M. and C. Flinn. "An Equilibrium Model of Health Insurance Provision and Wage Determination." *Econometrica*, (March 2005): 571-627.
2. \*Flinn, C. "Minimum Wage Effects on Labor Market Outcomes under Search, Bargaining, and Endogenous Contact Rates" Forthcoming, *Econometrica*. Downloadable from <http://www.nyu.edu/econ/user/flinn/papers/mw-cjf.pdf>.
3. \*Cahuc, P., F. Postel-Vinay, and J-M Robin. "Wage Bargaining with On-the-Job Search: A Structural Econometric Model." Downloadable from <http://eurequa.univ-paris1.fr/membres/robin/robin.htm>.

### 1.E. Job Mobility

1. \*Jovanovic, B. "Job Matching and the Theory of Turnover." *J. Pol. Econ.* 87 (1979): 972-990.
2. Jovanovic, B. "Matching, Turnover, and Unemployment." *J. Pol. Econ.* 92 (1984): 108-122.
3. Flinn, C. "On-the-Job Search with Information Obsolescence." C.V. Starr Center Report 96-07, February 1996.
4. \*Flinn, C. "Labour Market Structure and Inequality: A Comparison of Italy and the U.S." *Review of Economic Studies* 69 (August 2002): 611-645.
5. Lippman, S. and J. McCall. "The Economics of Belated Information." *Int. Econ. Rev.* 22 (1981): 135-146.
6. Mortensen, D. "Specific Capital and Labor Turnover." *Bell J. Econ.* 9 (1978): 572-586.
7. Salop, S. "Wage Differentials in a Dynamic Theory of the Firm." *J. Econ. Theory* 6 (1973): 321-344.
8. \*Flinn, C. "Wage and Job Mobility of Young Workers." *J. Pol. Econ.* 94 (1986): S88-S110.

9. \*Miller, R. "Job Matching and Occupational Choice." *J. Pol. Econ.* 92 (1984): 1086-1120.
10. McCall, B. "A Dynamic Model of Occupational Choice." *Journal of Econ. Dyn. and Control* 15 (1994): 387-408.
11. \*Van der Klaauw, Wilbert. "On the Use of Expectations Data in Estimating Structural Dynamic Models: An Analysis of Career Choices." Mimeo, UNC (2000). Downloadable at <http://www.unc.edu/~vanderkl/expect.pdf>.

## 2.A Static Labor Supply

1. \*Deaton, A. and J. Muellbauer. *Economics and Consumer Behavior*. Cambridge: Cambridge University Press, 1980. Chapters 4.1, 11.1-11.2.
2. \*Heckman, J. "Shadow Prices, Market Wages, and Labor Supply." *Econometrica* 42 (July 1974): 679-694.
3. Hausman, J. "The Effect of Wages, Taxes, and Fixed Costs on Women's Labor Force Participation." *J. of Public Economics* 14 (October 1980): 161-194.
4. \*Aaberge, R., U. Colombino, and S. Strom. "Labour Supply in Italy: An Empirical Analysis of Joint Household Decisions, with Taxes and Quantity Constraints." *J. of Applied Econometrics* 14 (July-August 1999): 403-422.
5. Moffitt, R. "The Estimation of a Joint Wage Hours Labor Supply Model." *J. of Labor Economics* 2 (October 1984): 550-566.

## 2.B Life-Cycle Labor Supply

1. \*Deaton and Muellbauer, Chapters 4.2,5.
2. \*MaCurdy, T. "An Empirical Model of Labour Supply in a Life-Cycle Setting." *JPE* 89 (December 1981): 1059-1085.
3. Heckman, J. and T. MaCurdy. "A Life Cycle Model of Female Labour Supply." *Rev. Econ. Studies* 47 (Jan 1980): 47-74.
4. Browning, M., A. Deaton, and M. Irish. "A Profitable Approach to Labor Supply and Commodity Demands over the Life-Cycle." *Econometrica* 53 (May 1985): 503-543.
5. \*Hotz, V.J., F. Kydland, and G. Sedlacek. "Intertemporal Preferences and Labor Supply." *Econometrica* 56 (March 1988): 335-360.
6. Abowd, J. and D. Card. "On the Covariance Structure of Earnings and Hours Changes." *Econometrica* 57 (March 1989): 411-445.
7. Mabli, J. "Dynamic Household Labor Supply: An Application of Household Search over Wages and Hours." Mimeo, NYU, 2006. Downloadable from [http://homepages.nyu.edu/~jgm243/household\\_search.pdf](http://homepages.nyu.edu/~jgm243/household_search.pdf)

## 2.C Household Bargaining and Labor Supply

1. McElroy, M. and M. Horney. "Nash-bargained Decisions: Towards a Generalization of the Theory of Demand." *International Economic Review* 22 (1981): 333-349.
2. \*Manser, M. and M. Brown. "Marriage and Household Decision-Making: A Bargaining Analysis." *International Economic Review* 21 (1980): 31-44.
3. \*Chiappori, P-A. "Rational Household Labor Supply." *Econometrica* 56 (1988): 63-89.
4. \*McElroy, M. "The Empirical Content of Nash-bargained Household Behavior." *Journal of Human Resources* 25 (1990): 559-583.
5. \*Browning, M, F. Bourguignon, P-A Chiappori, and V. Lechene. "Incomes and Outcomes: A Structural Model of Intra-Household Allocation." *Journal of Political Economy* 102 (1994): 1067-1096.
6. Kooreman, P. and A. Kapteyn. "On the Empirical Implementation of some Game Theoretic Models of Household Labor Supply." *Journal of Human Resources* 25 (1990): 584-598.
7. \*Del Boca, D. and C. Flinn. "Household Time Allocation and Modes of Behavior: A Theory of Sorts. Mimeo, NYU, October 2005. Downloadable from <http://www.econ.nyu.edu/user/flinn/papers/hhsorting4.pdf>

## 2.D Models of Household Formation and Dissolution

1. \*Weiss, Y. and R. Willis. "Children as Collective Goods and Divorce Settlements." *Journal of Labor Economics* 3 (July 1985): 268-292.
2. \*Flinn, C. "Modes of Interaction between Divorced Parents." *International Economic Review* (August 2000): 545-578.
3. \*Del Boca, D. and C. Flinn. "Rationalizing Child Support Decisions." *American Economic Review* 85 (December 1995): 1241-1262.
4. \*Brown, M. and C. Flinn. "Investment in Child Quality over Marital States." Mimeo, U.W.-Madison and NYU, January 2004. Downloadable from course home page.
5. Brien, M., L. Lillard, and S. Stern. "Cohabitation, Marriage, and Divorce in a Model of Match Quality." Mimeo, University of Virginia. Downloadable from <http://www.people.virginia.edu/~sns5r/resint/structstf/bls.html>.
6. Weiss, Y. "The Formation and Dissolution of Families: Why Marry? Who Marries Whom? and What Happens upon Divorce." In Rosenzweig,-Mark-R.; Stark,-Oded, eds. *Handbook of Population and Family Economics, Volume 1A* (Rosenzweig and Stark, eds.). Handbooks in Economics, vol. 14. Amsterdam; New York and Oxford: Elsevier Science, North-Holland, 1997, pages 81-123.

### 3.A Job-Market Signalling

1. \*Spence, M. "Job Market Signalling." *Q.J.E.* 87 (1973): 355-374.
2. \*Kreps, D. *A Course in Microeconomic Theory*. Princeton: Princeton Univ. Press, 1990. Ch. 17.
3. Greenwald, B. "Adverse Selection in the Labor Market." *Rev. Econ. Studies* 53 (1986): 325-347.
4. \*Berkovitch, E. "A Stigma Theory of Unemployment Duration." In *Advances in the Theory and Measurement of Unemployment* (Y. Weiss and G. Fishelson, eds.), New York: MacMillan, 1990.
5. Waldman, M. "Job Assignments, Signalling, and Efficiency." *Rand J. Econ.* 15 (1984): 255-270.

### 3.B Principal-Agent Problems in the Labor Market

1. \*Kreps, D. *A Course in Microeconomic Theory*, Ch. 16.
2. \*Shapiro, C. and J. Stiglitz. "Equilibrium Unemployment as a Worker Discipline Device." *A.E.R.* 74 (1984): 433-444.
3. \*Foster, J. and H. Wan. "Involuntary Underemployment as a Principal-Agent Equilibrium." *A.E.R.* 74 (1984): 476-484.
4. Malcomson, J. "Work Incentives, Hierarchy, and Internal Labor Markets." *JPE.* 92 (June 1984): 486-507.
5. \*MacLeod, B. and J. Malcomson. "Implicit Contracts, Incentive Compatibility, and Involuntary Unemployment." *Econometrica* 57 (March 1989): 447-480.
6. Albrecht, J. and S. Vroman. "Nash Equilibrium Efficiency Wage Distributions." *International Economic Review* 39 (February 1998): 183-203.

### 3.C. Estimation of Models with Moral Hazard

1. Flinn, C. "Equilibrium Dismissal without Stigma." Chapter 5 in *Labor Demand and Equilibrium Wage Formation* (van Ours, Pfaan, and Ridder, eds.). Amsterdam: North-Holland, 1993, pages 249-275.
2. \*Flinn, C. "Equilibrium Wage and Dismissal Processes." *Journal of Business and Economic Statistics* 15 (April 1997): 221-236.
3. \*Ferrall, C. and B. Shearer. "Incentives and Transactions within the Firm: Estimating an Agency Model Using Payroll Records." *Review of Economic Studies* 66 (1999): 309-338.
4. \*Paarsch, H. and B. Shearer. "The Response of Worker Effort to Piece Rates: Evidence from the British Columbia Tree-Planting Industry." *Journal of Human Resources* 34 (1999): 643-667.

5. \*Shearer, B. "Piece Rates, Fixed Wages, and Incentives: Evidence from a Payroll Experiment." Forthcoming, *Review of Economic Studies*. Downloadable at <http://www.ecn.ulaval.ca/~bshe/wkpapers/CIRPEE03-15.pdf>.

#### **4.A Human Capital Investment Decisions**

1. Ryder, H., F. Stafford, and P. Stephan. "Labor, Leisure and Training over the Life Cycle." *International Economic Review* 17 (October 1976): 651-674.
2. Snow, A. and R. Warren, Jr. "Human Capital Investment and Labor Supply under Uncertainty." *International Economic Review* 31 (February 1990): 195-206.
3. Keane, M. and K. Wolpin. "The Career Decisions of Young Men." *JPE* 105 (June 1997): 473-522.
4. \*Willis, R. and S. Rosen. "Education and Self-Selection" *JPE* 87 (October 1979): S7-S36.
5. \*Imai, S. and M. Keane. "Intertemporal Labor Supply and Human Capital Accumulation." *IER*, April, 2004.
6. \*Eckstein, Z. and K. Wolpin. "Dynamic Labor Force Participation of Married Women and Endogenous Work Experience." *Review of Economic Studies* 56 (1989): 375-390.

#### **4.B. Human Capital Investment, Fertility, and Cohort Size**

1. \*Flinn, C. "Cohort Size and Schooling Choice." *J. of Population Economics* 6 (1993): 31-55.
2. \*Lee, D. "An Estimable Dynamic General Equilibrium Model of Work, Schooling, and Occupational Choice." Forthcoming in the *International Economic Review*. Downloadable at <http://homepages.nyu.edu/~dl64/labor36.pdf>
3. Welch, F. "Effects of Cohort Size on Earnings: The Baby Boom Babies Financial Bust." *J.P.E* 87 (1979): S65-S97.
4. Stapleton, D. and D. Young. "Educational Attainment and Cohort Size." *J. of Labor Economics* 6 (1988): 330-361.
5. \*Hotz, J. and R. Miller. "An Empirical Analysis of Life Cycle Fertility and Female Labor Supply." *Econometrica* 56 (1988): 91-118.
6. Siow, A. "Occupational Choice under Uncertainty." *Econometrica* 52 (1984): 631-645.