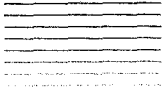


# Contents



<i>Reference Tables</i>	i
<i>Preface</i>	xx
<i>Acknowledgments</i>	xxiv

## 1 Introduction 1

The Labor Market	1
Labor Economics: Some Basic Concepts	2
Positive Economics	3
The Models and Predictions of Positive Economics	4
<b>EXAMPLE 1.1 Positive Economics: What Does It Mean to “Understand” Behavior?</b>	5
Normative Economics	7
<b>EXAMPLE 1.2 Do We Need “Nudges” to Make the Right Decisions for Ourselves?</b>	9
Normative Economics and Government Policy	11
Efficiency Versus Equity	12
Plan of the Text	13
Review Questions	14
Problems	15
Selected Readings	16
<b>APPENDIX 1A</b>	17
<b>Statistical Testing of Labor Market Hypotheses</b>	17
A Univariate Test	17
Multiple Regression Analysis	20
The Problem of Omitted Variables	21
Notes	24

## 2 Overview of the Labor Market 26

The Labor Market: Definitions, Facts, and Trends	27
The Labor Force and Unemployment	28
<b>EXAMPLE 2.1 The Unemployment Consequences of the Sudden COVID-19 Lockdown in March 2020</b>	30
Industries and Occupations: Adapting to Change	31
The Earnings of Labor	32
<b>EXAMPLE 2.2 Real Wages Across Countries and Time: Big Macs per Hour Worked</b>	35
How the Labor Market Works	37
The Demand for Labor	38
The Supply of Labor	42
The Determination of the Wage	44

**EXAMPLE 2.3** *The Black Death and the Wages of Labor* 47

**EXAMPLE 2.4** *Prosecuting Workers Who Leave Their Employers* 49

Applications of the Theory 50

Who Is Underpaid and Who Is Overpaid? 50

Unemployment and Responses to Technological Change Across  
Countries 53

**EMPIRICAL STUDY 2.1** *PAY LEVELS AND THE SUPPLY OF MILITARY  
OFFICERS: OBTAINING SAMPLE VARIATION FROM CROSS-  
SECTION DATA* 54

Review Questions 55

Problems 57

Notes 58

Selected Readings 61

### 3 The Demand for Labor

62

Profit Maximization 62

Marginal Income From an Additional Unit of Input 64

**EXAMPLE 3.1** *The Marginal Revenue Product of College Football  
Stars* 64

Marginal Expense of an Added Input 65

The Short-Run Demand for Labor When Both Product and Labor Markets Are  
Competitive 66

A Critical Assumption: Declining  $MP_L$  66

From Profit Maximization to Labor Demand 67

The Demand for Labor in Competitive Markets When Other Inputs Vary 72

Labor Demand in the Long Run 72

**EXAMPLE 3.2** *Coal Mining Wages and Capital Substitution* 74

More Than Two Inputs 75

Labor Demand When the Product Market Is Not Competitive 76

Maximizing Monopoly Profits 77

Do Monopolies Pay Higher Wages? 77

Policy Application: The Labor Market Effects of Employer Payroll Taxes and  
Wage Subsidies 78

Who Bears the Burden of a Payroll Tax? 78

Employment Subsidies as a Device to Help Unemployed People 81

**EMPIRICAL STUDY 3.1** *DO WOMEN PAY FOR EMPLOYER-FUNDED  
MATERNITY BENEFITS? USING CROSS-SECTION DATA OVER TIME  
TO ANALYZE "DIFFERENCES IN DIFFERENCES"* 82

Review Questions 83

Problems 85

Notes 87

Selected Readings 88

**APPENDIX 3A** *Graphical Derivation of a Firm's  
Labor Demand Curve* 89

The Production Function 89

Demand for Labor in the Short Run 90

Demand for Labor in the Long Run 92

Conditions for Cost Minimization 92

The Substitution Effect 94

The Scale Effect 94

Notes 96

<b>4</b>	<b>Labor Demand Elasticities</b>	<b>97</b>
	The Own-Wage Elasticity of Demand	97
	The Hicks–Marshall Laws of Derived Demand	99
	Estimates of Own-Wage Labor Demand Elasticities	102
	Applying the Laws of Derived Demand: Inferential Analysis	104
	<b>EXAMPLE 4.1 Why Are Union Wages So Different in Two Parts of the Trucking Industry?</b>	105
	The Cross-Wage Elasticity of Demand	106
	Can the Laws of Derived Demand Be Applied to Cross-Elasticities?	107
	Estimates Relating to Cross-Elasticities	109
	Policy Application: Effects of Minimum-Wage Laws	110
	History and Description	110
	Employment Effects: Theoretical Analysis	110
	Employment Effects: Empirical Estimates	115
	<b>EXAMPLE 4.2 The Employment Effects of the First U.S. Federal Minimum Wage</b>	115
	Does the Minimum Wage Fight Poverty?	116
	“Living Wage” Laws	117
	Applying Concepts of Labor Demand Elasticity to the Issue of Technological Change	118
	<b>EXAMPLE 4.3 Do Robots and Online Hiring Platforms Create or Destroy Jobs?</b>	120
	<b>EMPIRICAL STUDY 4.1 ESTIMATING THE LABOR DEMAND CURVE: TIME SERIES DATA AND COPING WITH “SIMULTANEITY”</b>	124
	Review Questions	126
	Problems	128
	Notes	130
	Selected Readings	135
<b>5</b>	<b>Frictions in the Labor Market</b>	<b>136</b>
	Frictions on the Employee Side of the Market	137
	The Law of One Price	137
	Monopsonistic Labor Markets: A Definition	139
	Profit Maximization Under Monopsonistic Conditions	140
	<b>EXAMPLE 5.1 Monopsony Power in Labor Markets: The Case of Antitrust in the High-Tech Industry</b>	144
	How Do Monopsonistic Firms Respond to Shifts in the Supply Curve?	145
	Monopsonistic Conditions and the Employment Response to Minimum-Wage Legislation	148
	Job-Search Costs and Other Labor Market Outcomes	149
	Monopsonistic Conditions and the Relevance of the Competitive Model	151
	Frictions on the Employer Side of the Market	152
	Categories of Quasi-fixed Costs	152
	<b>EXAMPLE 5.2 Does Employment-Protection Legislation Protect Workers?</b>	153
	The Employment/Hours Trade-Off	156
	<b>EXAMPLE 5.3 “Renting” Workers as a Way of Coping With Hiring Costs</b>	157
	Training Investments	159
	The Training Decision of Employers	159

<b>EXAMPLE 7.1 Obesity and the Household Production Model</b>	231
Joint Labor Supply Decisions in the Household	233
Specialization of Function	234
Do Both Partners Work for Pay?	235
The Joint Decision and Interdependent Productivity at Home	236
Labor Supply in Recessions: The "Discouraged" Versus the "Added" Worker	236
<b>EXAMPLE 7.2 Child Labor in Poor Countries</b>	238
Life Cycle Aspects of Labor Supply	240
The Substitution Effect and When to Work Over a Lifetime	240
<b>EXAMPLE 7.3 How Does Labor Supply Respond to Housing Subsidies?</b>	241
The Choice of Retirement Age	242
<b>EXAMPLE 7.4 Inducing Earlier Retirement in the 1930s</b>	246
Policy Application: Childcare and Labor Supply	247
Childcare Subsidies	247
Child Support Assurance	250
<b>EMPIRICAL STUDY 7.1 THE EFFECTS OF WAGE INCREASES ON LABOR SUPPLY (AND SLEEP): TIME-USE DIARY DATA AND SAMPLE SELECTION BIAS</b>	252
Review Questions	254
Problems	256
Notes	258
Selected Readings	263
<b>8 Compensating Wage Differentials and Labor Markets</b>	<b>264</b>
Job Matching: The Role of Worker Preferences and Information	264
Individual Choice and Its Outcomes	265
Assumptions and Predictions	267
Empirical Tests for Compensating Wage Differentials	269
<b>EXAMPLE 8.1 Working on the Railroad: Making a Bad Job Good</b>	270
Hedonic Wage Theory and the Risk of Injury	271
Employee Considerations	271
Employer Considerations	273
The Matching of Employers and Employees	274
<b>EXAMPLE 8.2 Parenthood, Occupational Choice, and Risk</b>	276
<b>EXAMPLE 8.3 Indentured Servitude and Compensating Differentials</b>	278
Normative Analysis: Occupational Safety and Health Regulation	279
Hedonic Wage Theory and Employee Benefits	284
Employee Preferences	284
Employer Preferences	285
The Joint Determination of Wages and Benefits	287
Policy <b>EXAMPLE</b> : Employer-Provided Healthcare Benefits	289
<b>EMPIRICAL STUDY 8.1 HOW RISKY ARE ESTIMATES OF COMPENSATING WAGE DIFFERENTIALS FOR RISK? THE "ERRORS IN VARIABLES" PROBLEM</b>	290
Review Questions	292
Problems	293
Notes	295
Selected Readings	300

The Types of Training	160
<b>EXAMPLE 5.4 General Training and Training Contracts</b>	161
Training and Post-Training Wage Increases	162
Employer Training Investments and Recessionary Layoffs	164
Hiring Investments	165
The Use of Credentials	165
Internal Labor Markets	165
How Can the Employer Recoup Its Hiring Investments?	166
<b>EMPIRICAL STUDY 5.1 WHAT EXPLAINS WAGE DIFFERENCES FOR WORKERS WHO APPEAR SIMILAR? USING PANEL DATA TO DEAL WITH UNOBSERVED HETEROGENEITY</b>	167
Review Questions	168
Problems	170
Notes	173
Selected Readings	178
<b>6 Supply of Labor to the Economy: The Decision to Work</b>	<b>179</b>
Trends in Labor Force Participation and Hours of Work	179
Labor Force Participation Rates	179
Hours of Work	182
<b>EXAMPLE 6.1 Gig Work and the Choice of Working Hours</b>	183
A Theory of the Decision to Work	184
Some Basic Concepts	184
Analysis of the Labor/Leisure Choice	188
<b>EXAMPLE 6.2 The Labor Supply of New York City Taxi Drivers</b>	188
<b>EXAMPLE 6.3 Do Large Inheritances Induce Labor Force Withdrawal?</b>	195
Empirical Findings on the Income and Substitution Effects	202
<b>EXAMPLE 6.4 Daily Labor Supply at the Ballpark</b>	202
<b>EXAMPLE 6.5 Labor Supply Effects of Income Tax Cuts</b>	204
Policy Applications	205
Budget Constraints With "Spikes"	205
<b>EXAMPLE 6.6 Staying Around One's Kentucky Home: Workers' Compensation Benefits and the Return to Work</b>	207
Programs With Net Wage Rates of Zero	208
Subsidy Programs With Positive Net Wage Rates	211
<b>EXAMPLE 6.7 Wartime Food Requisitions and Agricultural Work Incentives</b>	214
<b>EMPIRICAL STUDY 6.1 ESTIMATING THE INCOME EFFECT AMONG LOTTERY WINNERS: THE SEARCH FOR "EXOGENEITY"</b>	215
Review Questions	217
Problems	219
Notes	220
Selected Readings	226
<b>7 Labor Supply Household Production, the Family, and the Life Cycle</b>	<b>227</b>
A Labor Supply Model That Incorporates Household Production	227
The Basic Model for an Individual: Similarities With the Labor-Leisure Model	228
The Basic Model for an Individual: Some New Implications	230

	<i>APPENDIX 8A Compensating Wage Differentials and Layoffs</i>	300
	Unconstrained Choice of Work Hours	301
	Constrained Hours of Work	302
	The Effects of Uncertain Layoffs	302
	The Observed Wage–Layoff Relationship	304
	Notes	304
<b>9</b>	<b>Investments in Human Capital Education and Training</b>	<b>306</b>
	<i>EXAMPLE 9.1 War and Human Capital</i>	306
	Human Capital Investments: The Basic Model	308
	The Concept of Present Value	308
	Modeling the Human Capital Investment Decision	310
	The Demand for a College Education	311
	Weighing the Costs and Benefits of College	311
	Predictions of the Theory	313
	<i>EXAMPLE 9.2 Can Language Affect Investment Behavior?</i>	315
	<i>EXAMPLE 9.3 Did the G.I. Bill Increase Educational Attainment for Returning World War II Veterans?</i>	316
	<i>EXAMPLE 9.4 When Investments in Human Capital Are Less Risky Than Investments in Physical Assets</i>	318
	Market Responses to Changes in College Attendance	319
	Education, Earnings, and Post-Schooling Investments in Human Capital	319
	Average Earnings and Educational Level	320
	On-the-Job Training and the Concavity of Age–Earnings Profiles	321
	The Fanning Out of Age–Earnings Profiles	322
	Women and the Acquisition of Human Capital	323
	Is Education a Good Investment?	326
	Is Education a Good Investment for Individuals?	326
	<i>EXAMPLE 9.5 Valuing a Human Asset: The Case of the Divorcing Doctor</i>	327
	Is Education a Good Social Investment?	329
	<i>EXAMPLE 9.6 The Socially Optimal Level of Educational Investment</i>	334
	Is Public Sector Training a Good Social Investment?	336
	<i>EMPIRICAL STUDY 9.1 ESTIMATING THE RETURNS TO EDUCATION BY USING A SAMPLE OF TWINS: COPING WITH THE PROBLEM OF UNOBSERVED DIFFERENCES IN ABILITY</i>	337
	Review Questions	339
	Problems	340
	Notes	341
	Selected Readings	352
	<i>APPENDIX 9A A “Cobweb” Model of Labor Market Adjustment</i>	353
	An Example of “Cobweb” Adjustments	353
	Adaptive Expectations	355
	Rational Expectations	355
	Notes	356
<b>10</b>	<b>Worker Mobility: Migration, Immigration, and Turnover</b>	<b>357</b>
	The Determinants of Worker Mobility	358
	Geographic Mobility	359
	The Direction of Migratory Flows	359

**EXAMPLE 10.1 The Great Migration: U.S. Southern Black People  
Move North** 360

Personal Characteristics of Migrants 360

The Role of Distance 361

The Earnings Distribution in Sending Countries and International  
Migration 362

**EXAMPLE 10.2 Migration and One's Time Horizon** 362

The Returns to International and Domestic Migration 363

Policy Application: Restricting Immigration 366

U.S. Immigration History 366

Naive Views of Immigration 369

An Analysis of the Gainers and Losers 371

Do the Overall Gains From Immigration Exceed the Losses? 375

**EXAMPLE 10.3 Illegal Immigrants, Personal Discount Rates, and  
Crime** 377

**EXAMPLE 10.4 Immigrants and Labor Mobility in the United  
States** 379

Employee Turnover 380

Age Effects 380

Wage Effects 380

Effects of Employer Size 380

Cyclical Effects 381

Employer Location 381

Is More Mobility Better? 382

**EMPIRICAL STUDY 10.1 DO POLITICAL REFUGEES INVEST MORE IN  
HUMAN CAPITAL THAN ECONOMIC IMMIGRANTS DO? THE USE OF  
SYNTHETIC COHORTS** 383

Review Questions 384

Problems 386

Notes 387

Selected Readings 394

**11 Pay and Productivity Wage Determination Within the Firm** 395

**EXAMPLE 11.1 The Wide Range of Possible Productivities: The Case of  
the Factory that Could Not Cut Output** 395

Motivating Workers: An Overview of the Fundamentals 396

The Employment Contract 397

Coping With Information Asymmetries 397

Motivating Workers 400

**EXAMPLE 11.2 Calorie Consumption and Type of Pay** 401

Motivating the Individual in a Group 402

**EXAMPLE 11.3 The Effects of Low Relative Pay on Worker  
Satisfaction** 402

Compensation Plans: Overview and Guide to the Rest of the Chapter 404

Productivity and the Basis of Yearly Pay 404

Employee Preferences 404

Employer Considerations 406

**EXAMPLE 11.4 Poor Group Incentives Doom the Shakers** 407

Productivity and the Level of Pay 411

Why Higher Pay Might Increase Worker Productivity 411

Efficiency Wages 412

<b>EXAMPLE 11.5</b> <i>Did Henry Ford Pay Efficiency Wages?</i>	412
Productivity and the Sequencing of Pay	413
Underpayment Followed by Overpayment	414
Promotion Tournaments	417
<b>EXAMPLE 11.6</b> <i>The "Rat Race" in Law Firms</i>	418
Career Concerns and Productivity	420
Applications of the Theory: Explaining Two Puzzles	421
Why Do Earnings Increase With Job Tenure?	421
Why Do Large Firms Pay More?	423
<b>EMPIRICAL STUDY 11.1</b> <i>ARE WORKERS WILLING TO PAY FOR FAIRNESS? USING LABORATORY EXPERIMENTS TO STUDY ECONOMIC BEHAVIOR</i>	424
Review Questions	426
Problems	427
Notes	428
Selected Readings	438
<b>12 Gender, Race, and Ethnicity in the Labor Market</b>	<b>439</b>
Measured and Unmeasured Sources of Earnings Differences	440
Earnings Differences by Gender	441
<b>EXAMPLE 12.1</b> <i>Bias in the Selection of Musicians by Symphony Orchestras</i>	443
<b>EXAMPLE 12.2</b> <i>Does Gig Work Eliminate the Gender Pay Gap?</i>	450
Earnings Differences Between Black Americans and White Americans	450
<b>EXAMPLE 12.3</b> <i>Race Discrimination Might "Strike" When Few Are Looking: The Case of Umpires in Major League Baseball</i>	454
Earnings Differences by Ethnicity	455
Theories of Market Discrimination	457
Personal-Prejudice Models: Employer Discrimination	457
Personal-Prejudice Models: Customer Discrimination	463
Personal-Prejudice Models: Employee Discrimination	463
<b>EXAMPLE 12.4</b> <i>Fear and Lathing in the Michigan Furniture Industry</i>	464
Statistical Discrimination	465
<b>EXAMPLE 12.5</b> <i>"Ban the Box" and Statistical Discrimination</i>	466
Noncompetitive Models of Discrimination	467
A Final Word on the Theories of Discrimination	471
Federal Programs to End Discrimination	471
Equal Pay Act of 1963	472
Title VII of the Civil Rights Act	472
<b>EXAMPLE 12.6</b> <i>Comparable Worth and the University</i>	474
The Federal Contract Compliance Program	476
Effectiveness of Federal Antidiscrimination Programs	477
<b>EMPIRICAL STUDY 12.1</b> <i>CAN WE CATCH DISCRIMINATORS IN THE ACT? THE USE OF FIELD EXPERIMENTS IN IDENTIFYING LABOR MARKET DISCRIMINATION</i>	478
Review Questions	480
Problems	482
Notes	484
Selected Readings	495



*APPENDIX 12A Estimating Comparable-Worth Earnings Gaps: An Application of Regression Analysis* 497

*APPENDIX 12B Estimating the Gender Pay Gap in a Large International Company* 500

Notes 500

### **13 Unions and the Labor Market** 502

Union Structure and Membership 502

International Comparisons of Unionism 503

The Legal Structure of Unions in the United States 505

Constraints on the Achievement of Union Objectives 508

*EXAMPLE 13.1 A Downward-Sloping Demand Curve for Football Players* 509

The Monopoly-Union Model 510

The Efficient-Contracts Model 512

The Activities and Tools of Collective Bargaining 516

Union Membership: An Analysis of Demand and Supply 516

*EXAMPLE 13.2 The Effects of Deregulation on Trucking and Airlines* 519

Union Actions to Alter the Labor Demand Curve 521

Bargaining and the Threat of Strikes 522

*EXAMPLE 13.3 Permanent Replacement of Strikers* 525

Bargaining in the Public Sector: The Threat of Arbitration 527

The Effects of Unions 530

The Theory of Union Wage Effects 530

Evidence of Union Wage Effects 533

Evidence of Union Total Compensation Effects 535

The Effects of Unions on Employment 535

The Effects of Unions on Productivity and Profits 536

Normative Analyses of Unions 537

*EMPIRICAL STUDY 13.1 WHAT IS THE GAP BETWEEN UNION PAY AND NONUNION PAY? THE IMPORTANCE OF REPLICATION IN PRODUCING CREDIBLE ESTIMATES* 539

Review Questions 541

Problems 542

Notes 544

Selected Readings 554

*APPENDIX 13A Arbitration and the Bargaining Contract Zone* 555

Notes 558

### **14 Unemployment** 559

A Stock-Flow Model of the Labor Market 561

Duration of Unemployment 562

Paths to Unemployment 562

Rates of Flow Affect Unemployment Levels 563

Frictional Unemployment 566

The Theory of Job Search 567

*EXAMPLE 14.1 How Discerning Should Unemployed People Be in the Search for Work?* 569

Effects of Unemployment Insurance Benefits 571

Structural Unemployment 573

Occupational and Regional Unemployment Rate Differences	574
<i>EXAMPLE 14.2 Structural Unemployment as a Threat to Social Well-Being</i>	575
International Differences in Long-Term Unemployment	576
Whether Efficiency Wages Cause Structural Unemployment	577
Demand-Deficient (Cyclical) Unemployment	579
Downward Wage Rigidity	580
<i>EXAMPLE 14.3 Nominal Wage Cuts for Construction Workers in the Great Recession</i>	581
<i>EXAMPLE 14.4 Recessions and Worker Effort</i>	584
Financing U.S. Unemployment Compensation	584
Seasonal Unemployment	586
<i>EXAMPLE 14.5 Unemployment Insurance and Seasonal Unemployment: A Historical Perspective</i>	587
When Do We Have Full Employment?	588
Defining the Natural Rate of Unemployment	588
Unemployment and Demographic Characteristics	589
What Is the Natural Rate?	590
<b>EMPIRICAL STUDY 14.1 DO RE-EMPLOYMENT BONUSES REDUCE UNEMPLOYMENT? THE RESULTS OF SOCIAL EXPERIMENTS</b>	590
Review Questions	592
Problems	593
Notes	595
Selected Readings	605

## 15 Inequality in Earnings 607

Measuring Inequality	607
Earnings Inequality Since 1980: Some Descriptive Data	610
<i>EXAMPLE 15.1 Differences in Earnings Inequality Across Developed Countries</i>	614
The Increased Returns of Higher Education	615
<i>EXAMPLE 15.2 Changes in the Premium to Education at the Beginning of the Twentieth Century</i>	616
Growth of Earnings Dispersion in Human-Capital Groups	617
The Underlying Causes of Growing Inequality	618
Changes in Supply	618
Changes in Demand: Technological Change	620
<i>EXAMPLE 15.3 Will Machine Learning Increase Earnings Inequality?</i>	621
<i>EXAMPLE 15.4 Are Early Childhood Programs a Vehicle for Reducing Earnings Inequality?</i>	623
Changes in Institutional Forces	626
Is Inequality Inherited?	627
<b>EMPIRICAL STUDY 15.1 DO PARENTS' EARNINGS DETERMINE THE EARNINGS OF THEIR CHILDREN? THE USE OF INTERGENERATIONAL DATA IN STUDYING ECONOMIC MOBILITY</b>	628
Review Questions	630
Problems	631
Notes	633
Selected Readings	638

<b>APPENDIX 15A Lorenz Curves and Gini Coefficients</b>	639
Notes	642
<b>16 The Labor Market Effects of International Trade and Production Sharing</b>	<b>643</b>
Why Does Trade Take Place?	644
Trade Between Individuals and the Principle of Comparative Advantage	644
The Incentives for Trade Across Different Countries	646
<b>EXAMPLE 16.1 The Growth Effects of the Openness to Trade: Japan's Sudden Move to Openness in 1859</b>	650
Effects of Trade on the Demand for Labor	651
Product Demand Shifts	651
Shifts in the Supply of Alternative Factors of Production	653
The Net Effect on Labor Demand	655
<b>EXAMPLE 16.2 Could a Quarter of U.S. Jobs Be Offshored? Might Your Future Job Be Among Them?</b>	656
Will Wages Converge Across Countries?	659
Policy Issues	660
Subsidizing Human-Capital Investments	661
Income Support Programs	662
Subsidized Employment	663
How Narrowly Should We Target Compensation?	663
<b>EMPIRICAL STUDY 16.1 EVALUATING EUROPEAN ACTIVE LABOR MARKET POLICIES: THE USE OF META-ANALYSIS</b>	665
Summary	667
Review Questions	667
Problems	668
Notes	669
Selected Readings	673
 <i>Answers to Odd-Numbered Review Questions and Problems</i>	 675
<i>Index</i>	725