

1. The effect on work hours of a change in nonlabor income ( $I$ )
  - Parallel shift of budget constraint
  - *Third and final assumption about preferences: Income and leisure are both “normal goods”.* Given an increase in nonlabor income, a person will choose more leisure (less labor), and more total income.
  - Given enough nonlabor income, an individual may choose not to work
  
2. The effect of a change in the hourly wage ( $w$ )
  - Pivot of budget constraint
  - A wage increase has income and substitution effects that work in opposite directions on work hours:
    - \* *Income effect:* the wage increase allows you (potentially) to have a higher income, which leads to reduced work hours (because leisure is a normal good)
    - \* *Substitution effect:* the wage increase increases the opportunity cost of leisure time, making it more attractive to substitute consumption for leisure (increased work hours)
    - \* Whether a person works more or fewer hours after a wage increase depends on which effect is bigger
  - Income and substitution effects graphically
  - Effects of wage decrease are in the opposite direction
  - The income effect tends to be larger if the person is already working a lot of hours. The substitution effect is more important for workers with few (or zero) hours
  
3. The participation decision and the reservation wage
  - Reservation wage graphically
  - Effect of nonlabor income on reservation wage
  - Application: the changing labor force participation of married women
    - \* Evidence: U.S. and international
    - \* Wage effects (changing demand for women’s labor)
    - \* Other factors: nonlabor income, fertility, changes in attitudes
  
4. Empirical evidence on individual labor supply elasticity
  - In the real world, how sensitive is labor supply to changes in the wage? (What is the elasticity?)
  - Difficulties and biases in measuring the elasticity
  - For adult men, both the income and substitution effects are small, perhaps zero
  - For adult women, both effects are also small, although women may be more sensitive to wages in their participation decision

Homework #2 due Tuesday, October 2: See attached sheet.