Economics 150
Fall 2001
Handout, 11/6/01

1. Globalization and labor demand elasticity
   - Demand elasticity and bargaining power, rent sharing
   - Incidence of labor standards and taxes
   - Demand elasticity and volatility of wages and employment

2. The market model of pay differences: compensating wage differentials
   - Assumptions:
     (1) Rational choice by workers: each worker seeks best job, all things considered
     (2) Information: workers know what is available
     (3) Mobility: workers are free to move to a preferred job
   - The principle of equal net advantage: Adam Smith on wages
   - Sources of compensating differentials
   - Limits of the competitive model: non-competing groups (e.g. physicians vs. hockey players)
   - Imperfect information / rationality: the cases for and against workplace health and safety regulation

3. Compensating differentials applied to education and training: the human capital model
   - Education as an investment
   - Costs of education: direct and indirect (opportunity) costs
   - Benefits of education: higher earnings, nonpecuniary benefits
   - Optimal investment rule: Invest in one more year of education as long as MB > MC
   - Marginal rate of return on education:
     Costs of one more year of schooling = D + Y (direct expenses + foregone earnings)
     Benefits on an annual basis are ÄY + N (boost to annual earnings + non-wage benefits)
     Then the marginal rate of return to one more year of schooling is approximately

$$r = \frac{\Delta Y + N}{D + Y} \approx \frac{\Delta Y}{Y} \quad \textit{if } N \textit{ and } D \textit{ are relatively small}$$

   - ÄY/Y is the percentage change in earnings due to one more year of schooling. This can be estimated as the slope of an earnings equation, where the natural log of earnings is the dependent variable and years of schooling is a regressor (independent variable).

Reading for next time: Finish reading Sundstrom, *Notes on Labor Economics*, chapter 6; Weiss, "Human Capital vs. Signalling Explanations of Wages" (web site)
Homework #9 due 11/13/01: see attached.
Remember: Topic proposal for final data analysis project due this Thursday. See me for advice.