

Economics Seminar for Ph.D. program in
Industrial Relations and Human Resources
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This seminar is an introduction to economic theory on the origins of the firm and the employment relationship, and to theory and evidence on the types and levels of pay received by workers. The key questions are:

1. Why are there firms?
2. Why are firms organized the way they are?
3. How are workers paid?
4. How much are workers paid?

The readings attempt to give an overview of some classic answers, debates, and research on these four questions. As will be seen, these questions are closely-connected: for example, methods of pay depend on, and influence, how firms are organized. These questions are central to major issues in labor economics that will be covered (e.g., the tenure-pay relationship, education and earnings, discrimination), but this is not a survey course in labor economics and there is little material on some labor economics topics (e.g., unemployment). It is unlikely that we will get to cover all of the topics listed; together we'll select which ones we want to tackle.

Most economic theory is developed in the language of calculus and constrained maximization, and it is very important to understand the logic. Calculus is not a prerequisite for this course, and these readings were selected in part because they summarize the arguments and conclusion in relatively non-technical fashion (for the most part), with references to the more technical literature. While a facility with this kind of math is not required, it is very useful if students have had a basic labor economics course, using Ehrenberg and Smith (Modern Labor Economics) or a similar text.

Class participation is essential! One part of this is that students will be responsible for leading the discussion on the articles assigned each week. Every week, different students will present basic summaries and discuss the assigned articles. While the format may vary depending on the article, one way to structure the presentation is as follows:

1. What's the "big idea"? What's the main question the author is addressing, and what is his/her main conclusion?
2. What are the key assumptions and arguments the author uses in arriving at the conclusion?
3. Construct your own example to illustrate the author's argument.
4. Are you convinced? Does the argument describe reality well? Why might the conclusion be wrong, misleading, or even irrelevant? How do events from your own experience confirm or contradict the conclusion?
5. Are there other ways that would better address the key question? What other methods might be tried?
6. Are there other implications that the author doesn't explore?
7. Additional question(s) or issues provided by me, to relate ideas to current problems.

Participation in the presentations and discussions will count for 30% of the course grade. The remainder of the grade will be based on an exam (30%) and a paper (40%). The paper should be 15-20 pages, on a topic of your choosing related to the ideas in this course. They may take any of several formats: a critical literature review; an empirical study (we can discuss data); new theoretical breakthroughs (I must be mentioned in your Nobel Prize acceptance speech); application of existing theories to new settings or problems; or any other format we agree upon.

Overview of topics

I. Why are there firms?

- What determines the boundaries of a firm?
- Why not organize the economy as one big firm?

II. Why are firms organized the way they are?

- Are the current forms the most efficient, or are there better alternatives?

III. How are workers paid?

- When are incentive systems used, and what are their effects?
- When may compensation be deferred?

IV. How much are workers paid?

- A. How does pay vary with working conditions and other job characteristics?
- B. How to explain the higher pay in large firms and certain industries?
- C. How do education and training affect earnings and productivity? Do the higher earnings from a college degree actually reflect skills that have been gained?
- D. How may pay levels affect worker quality and effort?
- E. How are wages affected by the profitability of a firm or industry, by considerations of "fairness", or by conflicting interests between current employees and potential employees?
- F. Does discrimination play a role in the lower pay received by women, African-Americans, and people with disabilities? Will market competition drive out discrimination, or is government policy needed (and if so, what kind)?
- G. How does the minimum wage affect earnings and employment?
- H. How do unions affect wage levels?
- I. What explains the great increase in income inequality since 1980? How can demand for low-skill workers be increased?
- J. How do international trade and immigration affect labor markets?

I. ORGANIZATION OF THE ECONOMY

Why are there firms? What determines the boundaries of a firm? Why not organize the economy as one big firm?

* Required article

*Adam Smith The Wealth of Nations, excerpted in Putterman and Kroszner (eds.), The Economic Nature of the Firm (New York: Cambridge University Press, 1996), pp. 35-45.

*Ronald Coase, "The Nature of the Firm," excerpted in Putterman/Kroszner (1996), pp. 89-105.

*Friedrich Hayek, "The Use of Knowledge in Society," excerpted in Putterman/Kroszner (1996), pp. 66-71.

*Oliver Williamson, "The Limits of Firms: Incentive and Bureaucratic Features," excerpted in Putterman/Kroszner (1996), pp. 146-161.

Joseph Stiglitz, "Symposium on Organizations and Economics," Journal of Economic Perspectives, Spring 1991, pp. 15-24.

*Herbert Simon, "Organizations and Markets," Journal of Economic Perspectives, Spring 1991, pp. 25-44.

*Paul Milgrom and John Roberts, Economics, Organization, and Management (Englewood Cliffs, NJ: Prentice Hall, 1992), pp. 19-43. (Can skip "mathematical examples".)

Bengt Holmstrom and John Roberts, "The Boundaries of the Firm Revisited," Journal of Economic Perspectives, Fall 1998, pp. 73-94.

II. INTERNAL ORGANIZATION OF FIRMS

Why are firms organized the way they are? Are the current forms of organization and ownership efficient, or are there better alternatives?

A. Adverse selection and moral hazard

*Milgrom and Roberts, pp. 127-140, 149-151, 166-170, 179-190.

B. Ownership and decision-making

*Armen Alchian and Harold Demsetz, "Production, Information Costs, and Economic Organization," excerpted in Putterman/Kroszner (1996), pp. 193-216.

*Louis Putterman, "On Some Recent Explanations of Why Capital Hires Labor," excerpted in Putterman, The Economic Nature of the Firm (1986 edition), pp. 312-317.

Oliver Hart, "An Economist's Perspective on the Theory of the Firm," excerpted in Putterman/Kroszner (1996), pp. 354-360.

*Milgrom and Roberts, pp. 288-306, 313-321.

Louis Putterman, "Ownership and the Nature of the Firm," excerpted in Putterman/Kroszner, The Economic Nature of the Firm (1996), pp. 361-369.

*Douglas Kruse and Joseph Blasi, "Employee Ownership, Employee Attitudes, and Firm Performance," Handbook of Human Resource Management (Greenwich, CN: JAI Press, 1997).

John Bonin, Derek Jones, and Louis Putterman, "Theoretical and Empirical Studies of Producer Cooperatives: Will Ever the Twain Meet?" Journal-of-Economic-Literature, 31(3), September 1993, pages 1290-320.

Gregory Dow, Governing the Firm: Workers' Control in Theory and Practice. Cambridge, UK: Cambridge University Press, 2003.

Patrick Bolton and David Scharfstein, "Corporate Finance, the Theory of the Firm, and Organizations," Journal of Economic Perspectives, Fall 1998, pp. 95-114.

C. Human resource policies and internal labor markets

*Milgrom and Roberts, Chapters 10-11.

*Oliver Williamson, Michael Wachter, and Jeffrey Harris, "Understanding the Employment Relation: The Analysis of Idiosyncratic Exchange," excerpted in Putterman/Kroszner (1996), pp. 233-253.

*Richard Freeman, "Individual Mobility and Union Voice in the Labor Market," excerpted in Putterman (1986), pp. 165-169.

*Harvey Leibenstein, "Allocative Efficiency and X-efficiency," excerpted in Putterman (1986), pp. 165-169.

Harvey Leibenstein, "The Prisoners' Dilemma in the Invisible Hand: An Analysis of Intrafirm Productivity," excerpted in Putterman/Kroszner (1996), pp. 267-275.

*David Levine and Laura D'Andrea Tyson, "Participation, Productivity, and the Firm's Environment," in Alan Blinder, ed., Paying for Productivity: A Look at the Evidence (Washington, D.C.: The Brookings Institution, 1990).

D. Organizational structures and economic development

*Joseph Stiglitz, "Democratic Development as the Fruits of Labor," Keynote Address, Industrial Relations Research Association, Boston January 2000.

E. Debate on employer-employee relationship

Stephen Marglin, "What Do Bosses Do?" excerpted in Putterman (1986), pp. 269-278.

Samuel Bowles and Herbert Gintis, "The Revenge of Homo Economicus: Contested Exchange and the Revival of Political Economy," Journal of Economic Perspectives, Winter 1993, pp. 83-102.

Oliver Williamson, "Contested Exchange versus the Governance of Contractual Relations," Journal of Economic Perspectives, Winter 1993, pp. 103-108.

Joseph Stiglitz, "Post Walrasian and Post Marxian Economics," Journal of Economic Perspectives, Winter 1993, pp. 109-114.

Louis Putterman, "On Some Recent Explanations of Why Capital Hires Labor," excerpted in Putterman (1986), pp. 312-328.

III. METHODS OF PAY

How are employees paid? When are incentive systems used, and what are their effects? When may compensation be deferred?

Review Ehrenberg and Smith, Chapter 11.

*Edward Lazear, "Labor Economics and the Psychology of Organizations," Journal of

Economic Perspectives, Spring 1991, pp. 89-110.

Robert Gibbons, "Incentives in Organizations," Journal of Economic Perspectives, Fall 1998, pp. 115-132.

Joseph Stiglitz, "The Design of Labor Contracts: The Economics of Incentives and Risk Sharing," in Haig Nalbantian, ed., Incentives, Cooperation, and Risk Sharing (Totowa, N.J.: Rowman and Littlefield, 1987), pp. 47-68.

*Milgrom and Roberts, Chapter 12.

Haig Nalbantian, "Incentive Compensation in Perspective," in Haig Nalbantian, ed., Incentives, Cooperation, and Risk Sharing (Totowa, N.J.: Rowman and Littlefield, 1987), pp. 3-46.

*Martin Weitzman and Douglas Kruse, "Profit Sharing and Productivity," excerpted in Putterman and Kroszner (1996).

*Douglas Kruse, Profit Sharing: Does It Make A Difference? (Kalamazoo, MI: W.E. Upjohn Institute for Employment Research, 1993), Chapters 1, 3.

*Richard Freeman, Douglas Kruse, and Joseph Blasi, "Monitoring Colleagues at Work: Profit Sharing, Employee Ownership, Broad-based Stock Options, and Workplace Performance in the United States," presented at 2004 Association for Comparative Economic Systems conference.

*Andrew Weiss, "Incentives and Worker Behavior," in Haig Nalbantian, ed., Incentives, Cooperation, and Risk Sharing (Totowa, N.J.: Rowman and Littlefield, 1987), pp. 137-150.

James Sesil, Maya Kroumova, Joseph Blasi, and Douglas Kruse, "Broad-based Employee Stock Options in High-Technology Firms: Company Performance Effects," British Journal of Industrial Relations, Vol. 40, No. 2, June 2002, pp. 273-294.

Eric Seiler, "Piece Rates vs. Time Rates," Review of Economics and Statistics, 1984.

Robert Hutchens, "Seniority, Wages, and Productivity: A Turbulent Decade," Journal of Economic Perspectives, Fall 1989, pp. 49-64.

IV. LEVELS OF PAY

Review Ehrenberg and Smith, Chapter 3.

*Erica Groshen, "Five Reasons Why Wages Vary Among Employers," Industrial Relations, Fall 1991, Vol. 30, No. 3.

A. Compensating Differences

How does pay vary with working conditions and other job characteristics?

Review Ehrenberg and Smith, Modern Labor Economics, Chapter 8.

Charles Brown, "Equalizing Differences in Labor Markets," Journal of Political Economy, Vol. 85, 1980.

B. Puzzles

How to explain the higher pay in large firms, and the pay dispersion among industries?

Charles Brown, Jay Hamilton, and James Medoff, Employers Large and Small (Cambridge, MA: Harvard University Press, 1990).

*Douglas Kruse, "Supervision, Working Conditions, and the Employer Size-Wage Effect," Industrial Relations, Vol. 31, No. 2, Spring 1992, pp. 229-249.

*Richard Thaler, "Anomalies: Inter-Industry Wage Differences," Journal of Economic Perspectives, Spring 1989, pp. 181-194.

C. Education and Training

How do education and training affect earnings and productivity? Do the higher earnings from a college degree actually reflect skills that have been gained?

Review Ehrenberg and Smith, Chapter 9.

Education

Orley Ashenfelter and Alan Krueger, "Estimates of the Economic Return to Schooling from a New Sample of Twins" American Economic Review, December 1994.

Francine Blau, "Symposium on Primary and Secondary Education," Journal of Economic Perspectives, 10(4), Fall 1996, pages 3-8.

Eric Hanushek, "Measuring Investment in Education," Journal of Economic Perspectives, 10(4), Fall 1996, pages 9-30.

David Card and Alan Krueger, "School Resources and School Outcomes: An Overview of the Literature and New Evidence from North and South Carolina," Journal of Economic Perspectives, 10(4), Fall 1996, pp. 31-50.

Milgrom and Roberts, Economics, Organization, and Management, pp. 154-161.

Andrew Weiss, "Human Capital vs. Signalling Explanations of Wages," Journal of Economic Perspectives, Vol. 9, No. 4, Fall 1995.

Training

Ann Bartel, "Productivity Gains from the Implementation of Employee Training Programs," Industrial Relations, October 1994, pp. 411-425.

Lisa Lynch, "Private-Sector Training and the Earnings of Young Workers," American Economic Review, March 1992, pp. 299-312.

-----, "Payoffs to Alternative Training Strategies at Work," in Richard Freeman, ed., Working Under Different Rules (New York: Russell Sage Foundation, 1994), pp. 63-96.

What's Working (and what's not): A Summary of Research on the Economic Impacts of Employment and Training Programs (Washington, D.C.: Office of the Chief Economist, U.S. Dept. of Labor, January 1995).

D. Efficiency Wages

How may pay levels affect worker quality and effort?

Janet Yellen, "Efficiency Wage Models of Unemployment," American Economic Review, Vol. 74, May 1984, pp. 200-205.

Milgrom and Roberts, Economics, Organization, and Management, Chapter 8.

George Akerlof, "Gift Exchange and Efficiency Wage Theory," Quarterly Journal of Economics, Vol. 97, November 1982, pp. 543-569.

E. Rent-Sharing, Fairness, and Insider/Outsider Theories

How may wages be affected by the profitability of the firm or industry, by considerations of "fairness", or by conflicting interests between current employees and potential employees?

Nancy Rose, "Unionization and Regulation: The Division of Rents in the Trucking Industry," Journal of Political Economy, December 1987.

Michael Piore, "Fragments of a 'Sociological Theory of Wages,'" American Economic Review, Vol. 63, No. 2, May 1973, pp. 337-344.

Assar Lindbeck and Dennis Shower, "Wage Setting, Unemployment, and Insider-Outsider Relations," American Economic Review, Vol. 76, No. 2, May 1986, pp. 235-239.

David I. Levine, "Fairness, Markets, and Ability to Pay: Evidence from Compensation Executives," American Economic Review, December 1993, pp. 1241-1259.

Milgrom and Roberts, Economics, Organization, and Management, pp. 269-282.

F. Discrimination

Does discrimination play a role in the lower pay received by women, African-Americans, and people with disabilities? Will market competition drive out discrimination, or is government policy needed (and if so, what kind)?

Review Ronald Ehrenberg and Robert Smith, Modern Labor Economics, Chapter 12.

Women

Francine Blau, "Trends in the Well-Being of American Women, 1970-1995," Journal of Economic Literature, Vol. 36 (1), March 1998, pp. 112-65.

Erica Groshen, "The Structure of the Female/Male Wage Differential: Is It Who You Are, What You Do, or Where You Work?" Journal of Human Resources, Vol. 26, No. 3, Summer 1991.

Bergmann, Barbara, "Does the Market for Women's Labor Need Fixing?" Journal of Economic Perspectives, Vol. 3, No. 1, Winter 1989, pp. 43-60.

Mark Killingsworth, The Economics of Comparable Worth. Kalamazoo, MI: W.E. Upjohn Institute for Employment Research, 1990.

Joni Hersch, "Male-Female Differences in Hourly Wages: The Role of Human Capital, Working Conditions, and Housework," Industrial and Labor Relations Review; 44(4), July 1991, pages 746-59.

African-Americans

Marianne Bertrand and Sendhil Mullainathan, "Are Emily and Greg more Employable than Lakisha and Jamal? A Field Experiment on Labor Market Discrimination," Working paper 03-22, M.I.T. Department of Economics, May 2003.

Harry Holzer, "Employer Skill Demands and Labor Market Outcomes of Blacks and Women," Industrial & Labor Relations Review, Vol. 52 (1), October 1998, pp. 82-98.

Robert Cherry and William Rodgers III, eds. Prosperity for All? The Economic Boom and African Americans. New York: Russell Sage Foundation, 2000.

Harry Holzer and David Neumark, "What Does Affirmative Action Do?" Industrial and Labor Relations Review, January 2000.

People with disabilities

Marjorie Baldwin and William Johnson, "A Critical Review of Studies of Discrimination Against Workers with Disabilities," School of Health Administration and Policy, November 2002.

Baldwin, Marjorie L. 2000. "Estimating the Potential Benefits of the ADA on the Wages and Employment of Persons with Disabilities." In *Employment, Disability Policy and the Americans with Disabilities Act*, edited by Peter David Blanck, pp. 258-284. Evanston, IL: Northwestern University Press.

Douglas Kruse and Lisa Schur, "Employment of People with Disabilities Following the ADA," Industrial Relations, Vol. 42, No. 1, January 2003, pp. 31-66.

David Stapleton and Richard Burkhauser, eds., Why the Decline in Employment of People with Disabilities: A Policy Puzzle. Kalamazoo, MI: W.E. Upjohn Institute for Employment Research, 2003

Morley Gunderson and Douglas Hyatt, "Do Injured Workers Pay for Reasonable Accommodation?" Industrial and Labor Relations Review, Vol. 50, No. 1, October 1996, pp. 92-104.

Alan Krueger and Douglas Kruse, "Labor Market Effects of Spinal Cord Injury in the Dawn of the Computer Age," NBER Working Paper No. 5302, October 1995.

Peter Blanck, Lisa Schur, Douglas Kruse, Susan Schwochau, and Chen Song, "Calibrating the Impact of the ADA's Employment Provisions," Stanford Law and Policy Review, Vol. 14.2, 2003, pp. 267-290.

G. Minimum Wage

How does the minimum wage affect worker earnings and employment?

Charles Brown, "Minimum Wage Laws: Are They Overrated?" Journal of Economic Perspectives, Summer 1988, pp. 133-145.

David Card and Alan Krueger, Myth and Measurement: The Economics of the Minimum Wage (Princeton, NJ: Princeton University Press, 1995).

Ronald Ehrenberg et al., "Review Symposium: Myth and Measurement", Industrial and Labor Relations Review, Vol. 8, No. 4, July 1995.

H. Unions

How do unions affect wage levels, inequality, and firm productivity?

Richard Freeman and James Medoff, What Do Unions Do? (New York: Basic Books, 1984).

Richard Freeman, "Longitudinal Analysis of the Effects of Trade Unions," Journal of Labor Economics, January 1984.

Richard Freeman and Morris Kleiner, "The Impact of New Unionization on Wages and Working Conditions," Journal of Labor Economics, Vol. 8, No. 1, pp. S8-S25.

David Neumark and William Wachter, "Union Effects on Non-union Wages: Evidence from Panel Data on Industries and Cities," Industrial and Labor Relations Review, Vol. 49, No. 1, October 1995.

Freeman, Richard B; Kleiner, Morris M. "Do Unions Make Enterprises Insolvent?" Industrial & Labor Relations Review, Vol. 52 (4). p 510-27. July 1999.

David Card, "Falling Union Membership and Rising Wage Inequality: What's the Connection?" NBER Working Paper No. 6520, April 1998.

Edward P. Lazear, "Symposium on Public and Private Unionization," Journal of Economic Perspectives. Vol. 2 (2). p 59-62. Spring 1988

Freeman, Richard B. "Contraction and Expansion: The Divergence of Private Sector and Public Sector Unionism in the United States," Journal of Economic Perspectives, Vol. 2 (2). p 63-88. Spring 1988.

Reder, Melvin W. "The Rise and Fall of Unions: The Public Sector and the Private," Journal of Economic Perspectives, Vol. 2 (2). p 89-110. Spring 1988.

I. Inequality

What explains the great increase in income inequality since 1980?

Ronald Ehrenberg and Robert Smith, Modern Labor Economics, Chapter 15.

Richard Freeman and Lawrence Katz, "Rising Wage Inequality: The United States vs. Other Advanced Countries," in Richard Freeman, ed., Working Under Different Rules (New York: Russell Sage Foundation, 1994), pp. 29-62.

Dinardo, John; Lemieux, Thomas. "Diverging Male Wage Inequality in the United States and Canada, 1981-1988: Do Institutions Explain the Difference?" Industrial & Labor Relations Review, Vol. 50 (4). p 629-51. July 1997.

Peter Gottschalk, "Inequality, Income Growth, and Mobility: The Basic Facts," Journal of Economic Perspectives, 11(2), Spring 1997, pp. 21-40.

George Johnson, "Changes in Income Inequality: The Role of Demand Shifts," Journal of Economic Perspectives, 11(2), Spring 1997, pp. 41-54.

Richard Freeman and Peter Gottschalk, eds., Generating Jobs: Increasing the Demand for Low-Skill Workers (New York: Russell Sage Foundation, 1998).

J. International trade and immigration

How does international trade and immigration affect the employment and earnings of U.S. workers?

Richard Freeman, "Are Your Wages Set in Beijing?" Journal of Economic Perspectives, 9(3), Summer 1995, pages 15-32.

J. David Richardson, "Income Inequality and Trade: How to Think, What to Conclude," Journal of Economic Perspectives, 9(3), Summer 1995, pages 33-55.

Adrian Wood, "How Trade Hurt Unskilled Workers," Journal of Economic Perspectives, 9(3), Summer 1995, pages 57-80.

George Borjas, "The Economic Benefits from Immigration," Journal of Economic Perspectives, 9(3), Spring 1995, pages 3-22.

-----, "The Economics of Immigration," Journal of Economic Literature, 32(4), December 1994, pages 1667-1717.

Gary Burtless, "Labor Standards and Global Trade: Workers' Rights," Brookings Review, Fall 2001, pp. 10-13.

David Card, "Is the New Immigration Really So Bad?" Economic Journal, November 2005, pp. F300-F323

George Borjas, "Increasing the Supply of Labor Through Immigration: Measuring the Impact on Native-born Workers," Background, Center for Immigration Studies, Washington, D.C., May 2004.

Roger Lowenstein, "The New Immigration," New York Times, July 9, 2006.

Alan Krueger, "Observations on International Labor Standards and Trade," NBER Working Paper No. 5632, June 1996.