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


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


C. Human resource policies and internal labor markets

*Milgrom and Roberts, Chapters 10-11.


D. Organizational structures and economic development


E. Debate on employer-employee relationship


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.


*Milgrom and Roberts, Chapter 12.


IV. LEVELS OF PAY

Review Ehrenberg and Smith, Chapter 3.
A. Compensating Differences

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

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


B. Puzzles

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


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


**Training**


**D. Efficiency Wages**

How may pay levels affect worker quality and effort?


**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?


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)?


Women


**African-Americans**


**People with disabilities**


G. Minimum Wage

How does the minimum wage affect worker earnings and employment?


H. Unions

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


I. Inequality

What explains the great increase in income inequality since 1980?


J. International trade and immigration

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


