Stockholm University

Department of Economics

Course name:	Labour Market Economics
Course code:	EC2102
Type of exam:	Re-exam
Examiner:	Ines Helm and Ann-Sofie Kolm
Number of credits:	7,5 (hp)
Date of exam:	February 23, 2019
Examination time:	9:00-12:00 (3 hours)
Aids:	No aids are allowed.

Write your identification number on each answer sheet (the number stated in the upper right hand corner on your exam cover).

Start each new question on a new answer sheet.

Explain notions/concepts and symbols. If you think that a question is vaguely formulated, specify the conditions used for solving it. Only legible exams will be marked.

The exam consists of 6 questions with 100 points in total. For the grade E 40 points are required, for D 50 points, C 60 points, B 75 points and A 90 points.

Your results will be made available on your Ladok account (www.student.ladok.se) within 15 working days from the date of the examination.

Good luck!

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Q.1) (24 points) Assume a perfectly competitive firm experiences a decrease in the wage rate. Before the decrease in wages the firm decided to produce 50 units of output. Following the decrease in the wage rate it is now optimal for the firm to produce 100 units of output. Discuss both graphically and explain in your own words how the decrease in the wage rate affects labour and capital demand in the *long run*. Focus on all relevant effects. If the effects for one of the input factors are ambiguous (i.e. can be either positive or negative), focus on one scenario in your graph, but explain both verbally and clearly mark all relevant effects in your graph.

Q.2) (14 points)

a) What measure can we use to empirically test the responsiveness of labor demand to changes in the wage rate?
b) Do we know the expected sign of this measure from theory? Why?
c) Is labor demand more responsive to changes in the wage rate in the short or in the long run? Why?

Q.3) (12 points) State whether the following statements are true or false. Shortly explain your answer in 1-2 sentences.

a) In the neoclassical model of leisure-labour choice indifference curves can be upward sloping.
b) In the basic model of individual labor supply, the introduction of a proportional tax rate on labor income will decrease hours worked.
c) The life cycle model of labor supply predicts that (unexpected) transitory increases in the wage rate lead to an increase in hours worked).
d) In a perfectly competitive model, the labor supply elasticity plays no role in determining how much of a payroll tax imposed by the government on the firms is shifted to the worker.

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Q.4) (10 points) Discuss the Efficiency wage model.

a) What are the key features of the model?
b) Explain why the model predicts involuntary unemployment as an equilibrium outcome.

Q.5) (15 points) This question is about human capital accumulation.

a) What do we know about the correlation between educational attainment and various labour market outcomes? Consider the following outcomes in turn: unemployment, labour force participation, and earnings.
b) Explain the concept of 'ability bias'.
c) Discuss schooling as a signalling device.

Q.6) (25 points) This question is about unemployment insurance schemes and active labour market programs.

a) Use any model of the equilibrium rate of unemployment and discuss how a more generous unemployment benefit scheme is likely to affect wages. Explain through which channels these effects work in the model.
b) Discuss the pros and cons with an unemployment benefit design where the generosity of the benefits falls with the unemployment spell compared to one where it does not.
c) Consider the active labour market program of 'wage subsidies' to firms. How would we expect such wage subsidies to affect unemployment from a theoretical point of view? Explain through which channels these effects work.
d) Discuss the displacement effects that are associated with 'wage subsidies' to firms.