

EUROPEAN HUMAN RESOURCES

MIDTERM EXAM – APRIL 1, 2009

QUESTION 1

Suppose to observe a dual labor market with a formal and informal sector.

- a) After the introduction of a minimum wage, the wage in the informal sector increases. What could explain this effect? What would happen to total employment and earnings inequality in such an economy?
- b) Discuss the available empirical findings on the minimum wage and the informal sector.
- c) The introduction of a minimum wage in a monopsony always increases the total surplus. True or false? Motivate your answer in a graph.

QUESTION 2

From the firm's point of view, turnover costs introduce a wedge between the value of the match with insiders and the value of the match with outsiders.

- a) Show if (and why) this situation can result in involuntary unemployment.
- b) Show why (and under what conditions) this situation can lead to asymmetric responses of unemployment to productivity shocks.
- c) Turnover costs also explain the political rent of insiders. True or false? Discuss the basic assumptions of the political economy models of insiders versus outsiders.

QUESTION 3

Payroll taxes and welfare benefits affect labor supply both at the extensive and intensive margin.

- a) Discuss the empirical literature on these topics.
- b) Describe the characteristics and the relative merits of the Negative Income Tax versus In-Work Benefits.
- c) The Earned Income Tax Credit increases labor supply at the extensive margin but decreases it at the intensive margin. True or false? Discuss the theoretical and empirical findings on the subject.