MACHAKOS UNIVERSITY

University Examinations for 2016/2017

SCHOOL OF BUSINESS AND ECONOMICS

DEPARTMENT OF ECONOMICS

THIRD YEAR SECOND SEMESTER EXAMINATION FOR DEGREE IN

BACHELOR OF ECONOMICS AND FINANCE

EAE 304: LABOUR ECONOMICS

DATE: 6/6/2017 **TIME: 2:00 – 4:00 PM**

INSTRUCTIONS:

Answer question ONE and any other two questions

QUESTION ONE (COMPULSORY) (30 MARKS)

i. Assume an individual has a utility function of this form

$$U(c,l) = 3 + C^{\frac{1}{2}} l^{\frac{1}{2}}$$

The individual has an endowment of V in non-labor income and T = 16 hours to either work (h) or use for leisure (l).How much utility does the individual receive if she consumes c = 4and works h = 0 hours? (3 marks)

ii. A union representing 400 workers faces a labor demand curve given by
w = 500 – L
Where L is the number of workers employed, and w is the weekly wage, measured in dollars. What wage rate should the union set in order to maximize the total wage income of all of its members? (3 marks)

iii. Our regression model is

$$lnW_i = \alpha_0 + \alpha_1 S_i + \mu_i$$

Where $ln W_i$is individual i log wage, $S_i$is years of schooling, $\alpha_0$and $\alpha_1$are population parameters.

We estimate the regression model using OLS. Here are the parameter estimates (standard errors in parenthesis)

α_0= 2.5 (0.4)

α_1 = 0.1(0.05)

a) What is the "return" to schooling (as a percent) (3 marks)

b) Construct the 95 percent confidence interval for α_1 . (Assume the critical value for this confidence interval is 2). (4 marks)

c) Can we reject the hypothesis at the 95 percent confidence level that α_1 is 0.25? Explain your answer. (4 marks)

iv. In words, explain the difference between real and nominal wages. (5 marks)

v. What are efficiency wages? Why would a firm pay efficiency wages? (8 marks)

QUESTION TWO (20 MARKS)

i) Using a signaling model of human capital investments, explain why college educated worker and a non-college educated worker receive different wages (10 marks)

ii) a) What is labour market friction. (2 marks)

b) Discuss four labour market frictions which explain why construction workers in Kenya earn lower wages than construction workers in the United States of America. (8 marks)

QUESTION THREE (20 MARKS)

i) Explain five separate government policies which would reducethe level of inequality in an economy. (10 marks)

ii) What is the "skill premium"? Explain two separate reasons why the"skill premium" might increase over time. (10 marks)

QUESTION FOUR (20 MARKS)

i) Efficiency wages may increase unemployment when Employment Protection Legislation is introduced. Explain. (10 marks)

ii) Describe how firms and workers 'marry' each other in the labor market when there are many types of jobs offering various levels of risk to the worker. What does the slope of the hedonic wage function measure? (10 marks)

QUESTION FIVE (20 MARKS)

i) What is a trade union? (2 marks)

ii) Discuss main functions of a trade union. (8 marks)

iii) Discuss five problems faced by trade unions in Less Developed Countries? (10 marks)