

Problem Set #5:

1. Question 1 in chapter 8 of Contemporary Labor Economics by McConnell et al. (course textbook) on page 271.
2. Question 3 in chapter 8 of Contemporary Labor Economics by McConnell et al. (course textbook) on page 271.
3. Question 10 in chapter 8 of Contemporary Labor Economics by McConnell et al. (course textbook) on page 272.
4. After graduating from UTD, you are faced with two job offers. The first is with a start-up company offering an income of \$2000 per week. You know that any offer from a new firm carries with it a certain amount of risk. You calculate the probability of keeping your job to be equal to 75% and consequently, the probability getting laid off to equal 25%. Were you to get laid off, your unemployment benefits would be equal to 60% of your wage. The second job offer is with an established firm, offering a fixed income of \$1600 per week (you may assume there is no chance of getting laid off with the bank).

Suppose your utility function is known, and given to be $U(I) = 5 - \frac{1000}{I - 200}$.

- a. Which job will you prefer, start-up or established firm?
- b. What income would this job yield? Is it higher or lower than the other job? Why?
- c. How much lower would the income for the job taken have to be for you to be indifferent between the two jobs?
- d. Suppose the economy is in a recession and consequently the probability of you losing the job with the start-up firm grows. Would you expect the compensating wage differential to grow as well?