

Problem Set 7: Sample Problems to Accompany Chapter 9
Economics 152
Prof: Philip Babcock

1. You are in period $T-1$. (In other words, after this period, there is only 1 more period until you retire). The chance of getting caught shirking if you shirk this period is $.2$. If you get caught shirking, you will be fired at the end of this period. Your job pays $80K/\text{period}$. Your next best alternative pays $60K/\text{period}$. It's worth $3K$ to you to be able to goof off for a period. Calculate your expected gains for shirking and for not shirking. Which do you choose? (Show your work).
2. If a firm always pays you your $VMPT$ at every point in time, are you more inclined to shirk when you're older (more years on the job) than when you're younger? Explain.
3. Some firms pay workers wages that rise with seniority. This helps reduce shirking. According to Lazear, what specific (new) problem does it create?
4. A beautiful golf course near your place of business abruptly closes down. (It gets turned into a parking lot.) Would you expect this to raise or lower the probability that your more senior workers would choose to shirk? Explain. (Assume no one was able to sneak away to play golf during business hours.)