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Wages, employment, labour turnover and the accessibility of local labour markets

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Abstract

In this paper, we extend a dynamic efficiency wage model to the case of multiple local labour markets that interact through migration. Firms are concerned about turnover costs. The quitting behaviour of workers is a function of local labour market conditions, non-wage income and the costs and benefits of migration to other local labour markets. A synthetic micro sample of 20,302 observations from the 1986, 1991 and 1996 New Zealand Censuses of Population and Dwellings provides evidence supporting the theory. Across subgroups, the wages of workers with relatively inelastic local labour supply and/or lower geographical mobility are relatively more responsive to changes in the local employment rate. The evidence is consistent with the notion that local employers engage in monopsonistic competition with respect to the employment of such workers.

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1. Introduction

During the 1990s some empirical phenomena in the labour market were documented that appeared to contradict the standard competitive model. An often-cited example is

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Card and Krueger's (1994) case study of the impact of a minimum wage increase, where, contrary to competitive theory, they found that an increase in the minimum wage increased employment in fast food outlets in New Jersey, United States. Another interesting case is the research of Blanchflower and Oswald (1990), who, using American and British data, found evidence for an inverse relationship between the level of pay of individuals and the prevailing local unemployment rate, which they labelled the 'wage curve'. Subsequently, they and many others have reported additional evidence for this relationship.¹

A common thread running through such findings could be the presence of an upward-sloping supply curve facing the individual employer in a local labour market, rather than the perfectly elastic one of the competitive model. It is therefore no surprise that monopsony has gained a rather more prominent position in the theory of labour demand (see, e.g., Boal and Ransom, 1997; Manning, 2003). Nevertheless, outright monopsony seems a rather extreme market form, given that most firms face some competition in recruitment and barriers to entry into specific markets have been reduced rather than increased in recent decades. Thus, rather than assuming a single buyer of labour, Bhaskar and To (1999) formulated a theory of monopsonistic competition in which there is free entry, but with the establishment of new firms constrained by lump-sum start-up costs. Each employer then has some market power in the labour market, even though the firm employs only a small fraction of the work force. This wage setting power results from horizontal job differentiation, which is a form of worker heterogeneity that leads to workers preferring certain jobs on the basis of non-wage characteristics. Monopsonistic competition may be responsible for the responses to unemployment or institutional shocks in local labour markets being quantitatively small.

One of the main reasons for horizontal job differentiation is the geography of local labour markets. Varying costs of job search and commuting create heterogeneity, even among otherwise identical workers, simply due to differing residential locations. If commuting costs are rather important, Bhaskar and To (1999, p. 195) find that employment will increase following a modest increase in the minimum wage.

The present paper develops this theme further by focussing on frictions in the labour market at a greater spatial scale than commuting, namely wage outcomes across well-defined local labour markets, linked through migration. Again heterogeneity of workers is introduced, but reservation wages now vary across workers because the lump-sum costs of migration between localities will depend on the location of their current job. The geography of labour markets then influences the relationship between local wages and employment. In addition, using a simple search model, Sato (2000) shows that as long as there are productivity differentials across local labour markets, those with higher productivity have higher equilibrium wages and lower unemployment rates. Even with low mobility costs, spatial real wage differentials can then persist in equilibrium because

¹ Blanchflower and Oswald (1994) reported estimated wage curves for 12 countries: United States, United Kingdom, Canada, South Korea, Austria, Italy, Netherlands, Switzerland, Norway, Ireland, Australia and West Germany. See also, for example, Janssens and Konings (1998) on Belgium, Pannenberg and Schwartze (1998) on East Germany, Papps (2001) on New Zealand, Pekkarinen (2001) on Finland and Montuenga et al. (2003) for a comparison of wage curves from France, Italy, Portugal, Spain and the United Kingdom.

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