



Labour market oligopsonistic competition: The effect of worker immobility on wages

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ABSTRACT

We suggest that firms in a local labour market may be able to exploit worker mobility costs and offer immobile workers wages that are lower than their marginal product. If so, the ability of employers to exploit worker immobility in setting wages would decline in the competitiveness of the local labour market. We test this intuition using a measure of individual mobility costs and measures of local labour market competition. Our findings suggest that worker immobility causes substantial wage variation across workers in small, weakly competitive markets, and in occupations where wages are individually bargained.

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1. Introduction

Workers face important monetary and psychic costs of moving across locations. Since migration is costly, worker moving decisions depend on whether the observed wage disparity between the destination and the origin suffices to cover the costs of moving. So, the presence of mobility costs may explain why workers choose to stay in low-wage local markets, instead of migrating to markets that offer higher wages. Although researchers in many disciplines – economics, sociology, psychology – concur that worker migration decisions are multi-dimensional and are greatly affected by individual mobility costs, rarely have they asked whether such costs influence the wage setting behavior of employers.

In this paper, we examine if employers in a local labour market exploit worker mobility costs in their wage setting behavior. Specifically, we suggest that firms in a distinct local labour market (i.e. a metropolitan area) have an incentive to offer workers with positive mobility costs wages that are lower than their marginal product. Such exploitation is possible since workers with positive mobility costs may be willing to accept lower wages to stay in their current market rather than move to another location and pay the associated mobility costs.

If employers have wage bargaining power on account of worker mobility costs, that power would decline in the intensity of the local labour market competition. For example, in a monopsonistic market, the firm faces no local competition, so the local monopsonist is in position to exploit immobile workers and offer them lower wages. In a market with a large number of employers, on the other hand, labour market competition would drive wages for immobile workers to their marginal product and no exploitation of worker immobility would be possible. In addition, wage discrimination based on worker immobility would be less feasible against workers in unionized occupations, where wages are collectively bargained. Overall, we expect workers with positive mobility costs to have lower wages, especially in less competitive metropolitan areas, and in occupations with weak union presence.

A number of empirical exercises are produced to test this idea. We construct a measure of worker mobility costs using worker characteristics that capture individual immobility and measures of local labour market competition at the metropolitan area level based on occupation. These measures are used to estimate the effect of worker immobility and local competition on wages. Empirical results show that wage discrimination based on worker immobility causes substantial wage variation across equally productive workers in small, weakly competitive metropolitan areas. Our results also show that immobile workers earn substantially lower wages in less competitive markets than what they would earn in large, competitive markets, where firms have limited wage setting power. Finally, the negative effect of worker immobility on wages is lower for workers in highly unionized occupations, where wages are collectively bargained.

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2. Background

Under perfect competition, wage disparities across workers are explained by differences in their accumulated human capital and innate ability (Schultz, 1961; Mincer, 1974; Becker, 1993). Empirically, researchers have used variation in worker productive characteristics, such as education and labour market experience, to explain wage differences, most notably across gender and racial groups. Altonji and Blank (1999) provide an extensive review of this literature.

Wage disparities are also explained in a hedonic environment, through compensating differences. According to the hedonic wages theory, if jobs provide different levels of attributes, high-amenity jobs will offer lower wages (Rosen, 1986). There is substantial empirical work suggesting that wages differ across employers due to heterogeneity in working conditions (Dorsey and Walzer, 1983; McNabb 1989; Dorman and Hagstrom, 1998), and location amenities (Roback, 1982; Blomquist et al., 1988).

Both lines of work assume that the labour market is perfectly competitive, and have been successful in explaining portions of the observed wage disparities across workers, within and across locations. There is evidence, however, that labour supply to one employer is not always infinitely elastic, as the competitive model requires, and employers may have an active role in wage setting. Card and Krueger (1994) conclude that an increase in the minimum wage does not reduce employment, a finding that is inconsistent with the competitive model. Krueger and Summers (1987, pp. 18–47) note the persistence in wage differences across observably identical workers between industries and conclude that market failures may be a reason for that persistence.² Furthermore, a positive relationship between wages and firm size is found in numerous papers in the literature; Brown and Medoff (1989) conclude that this relationship persists even after accounting for differences in worker quality and working conditions.

Models of classic monopsony (Bronfenbrenner, 1956) could explain some of this curious empirical evidence. In a monopsonistic market, for example, a carefully selected minimum wage leads to an increase in employment levels. A monopsony model can also explain wage variation that is not accounted for by differences in worker productivity. If a monopsonist observed non-productive worker characteristics which could be used to sort workers into different labour supply elasticity groups, the monopsonist would offer lower wages to workers who are less responsive to marginal wage changes (classic monopsonistic wage discrimination).

Pure monopsonies rarely exist in the real economy, so the above explanations are of little relevance. However, researchers have explored whether monopsonistic or oligopsonistic behavior is possible even in markets with a large number of employers.³ For example, if firms differ along dimensions that affect worker utility, then firms with higher levels of the desirable characteristic enjoy an upward sloping labour supply (Boal and Ransom, 1997). Also, Bhaskar and To (1999) show that, in a perfectly competitive market, firm differentiation could explain how an increase in the minimum wage may raise employment levels.

Black and Lowenstein (1991) introduced the possibility that a lone firm in a local labour market (such as a metropolitan area) is in position to exploit worker mobility costs. The authors note that a worker facing mobility costs in a monopsonistic market may accept the wage offer she receives from the monopsonist, or reject the offer, move to another market, and pay the associated mobility costs. As a result, the monopsonist chooses to offer such workers wages that are lower than their marginal product, while it offers workers with zero mobility costs wages that are equal to their marginal product. This prediction

contradicts the perfect market outcome and provides intuition on how wage discrimination based on worker mobility costs may occur.

Ransom (1993) uses a similar intuition to attribute the negative returns to tenure for college professors to low geographic mobility. He suggests that since some colleges are located in geographically isolated towns, they can exploit professors with positive mobility costs by offering them lower wages late in their careers.

2.1. Exploitation of worker immobility in setting wages

The Black and Lowenstein (1991) and Ransom (1993) models describe the market for college professors, in which some employers are geographically isolated. In this section, we extend the intuition of this work to understand more generally under which conditions employers in a local labour market (such as a metropolitan area) may exploit worker mobility costs in their wage setting behavior.

Suppose that firms in a metropolitan area observe worker characteristics signaling whether the worker faces positive costs of moving to another location. Using observed mobility cost signals, firms would be able to sort workers in different mobility cost groups based on perceived immobility. For example, workers may value working in their birthplace and married workers may appreciate living in their spouse's place of birth. So, firms will expect local workers to be less willing to move to another market than non-locals. In addition, firms will expect married local workers whose spouses were born in the same location to be less mobile than unmarried local workers. In contrast, unmarried non-local workers are expected to be highly mobile.

If firms observe such worker characteristics, they will know which workers may be willing to accept lower wages to avoid moving to another market. So, firms will have an incentive to offer workers with positive mobility costs wages that are lower than their marginal product. Wage offers will be even lower for workers in high mobility cost groups. In the above example, wages offered to local workers will be lower than their marginal product and wages for married local workers whose spouses were born in the same location will be lower still.

Since workers with positive mobility costs may accept lower wages to avoid moving, firms would obtain greater profits from hiring them. This means that if there were multiple firms in the local market, they would all compete to hire such workers. So, the higher the number of firms in a local market, the more intense the competition to hire immobile workers will be, leading to higher wages. In other words, the wage setting power firms enjoy due to worker immobility would decline in the intensity of the local labour market competition.

Let us consider a local labour market with only one employer. A worker in such market will accept the offer he receives from the monopsonistic firm or move to another market and pay the associated mobility costs. As a result, in the absence of local competition, the monopsonist is in position to offer immobile workers lower wages. In an oligopsonistic market, where there is more than one employer, all firms would compete for workers who are perceived as having positive mobility costs. Competition would push wages for immobile workers up and would limit, but not eliminate, the ability of local employers to exploit worker immobility in setting wages. As a result, immobile workers in an oligopsonistic market would receive wage offers that are lower than their marginal product but higher than the monopsonistic wage rate.

On the other hand, in a perfectly competitive local labour market (i.e. a market with a large number of firms) firms will not be able to exploit worker mobility costs. The intensity of the local competition to hire immobile workers would push wages for such workers to their marginal product, eliminating wage discrimination based on worker immobility.

In summary, in the presence of worker mobility costs, firms in a local market may exploit workers with positive mobility costs by offering them lower wages. However, the wage setting power employers enjoy would diminish in the competitiveness of the local market; only firms in weakly competitive markets will be able to exploit worker immobility. This scenario has two important implications. First, unexplained wage

² The authors note (p. 42): "Our conclusion that the inter-industry wage structure cannot plausibly be interpreted as a competitive outcome, has significance for both micro and macroeconomic issues".

³ See Bhaskar, Manning, and To (2002), and Boal and Ransom (1997) for literature reviews.

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