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Monopoly, human capital accumulation and development

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Abstract

Monopoly is an important barrier to development for it restricts the mobility of workers. This gives rise to specificity problem and consequently weakens workers' incentives to invest in human capital. In a two-sector general equilibrium model calibrated to the facts about the labor market, I find that in the long run, GDP can rise by about 2.6 times if these distortions are removed even if the monopoly markup and the degree of specificity are set at modest levels. © 2000 Elsevier Science B.V. All rights reserved.

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1. Introduction

Citing Adam Smith and Alfred Marshall, Parente and Prescott (1997) remind us that classical economists took a very strong position against monopoly and considered it a powerful drag on economic progress. But since the celebrated study of Harberger (1954) and the literature that followed which established that the allocative inefficiency from non-marginal cost pricing may reduce GDP, at most, by a few percentage points, this view has not commanded much prominence in contemporary economics.

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The point of departure in this paper is that monopoly distortions do not fall on product markets alone. Under the premise that many skills are industry-specific, entry barriers in the product market would effectively turn the labor market of the industry into a monopsony in which workers are paid less than their marginal products. This gives rise to a classic holdup problem in human capital investment. The purpose of the paper is to make a quantitative assessment of the resulting distortions in a dynamic general equilibrium model.

That workers suffer large wage declines when they switch industries (Neal, 1995) is very good evidence that human capital is, to a very important extent, industry-specific. While the literature on specific human capital has focused mostly on firm-specific skills, [1] the specificity of skills may lie mostly in industry-specific skills, instead. Undoubtedly, in many professions, skills acquired in one firm are highly valued by firms in the same line of business. The strongest piece of evidence can again be found in Neal. He reports that the return to job tenure accumulated in a worker's previous jobs is about the same magnitude as the return to tenure in the worker's current job, for workers who did not switch industry. This suggests that skills can be transferred across firms in the same line of business largely intact and the specificity of skills is a problem only when workers's mobility across firms in the same industry is restricted.

In this paper, I study a two-sector general equilibrium model in which production in the two sectors differs in human capital intensities. There is a competitive traditional sector in which production is less human-capital-intensive and an industrial sector in which it is more so. Skills in the industrial sector are specific to a particular industry in the sector. When there are entry barriers to the industries in the industrial sector, workers are denied mobility within the industry in which they are skilled, and consequently will only get paid their outside options which are what they may earn in the traditional sector. The assumption, that production in the traditional sector is less human-capital-intensive, implies that under the monopoly industrial organization, wages in the industrial sector rise less rapidly than the marginal product of skills, which would eventually attenuate workers' incentives to invest in human capital.

The model is calibrated to the facts about the US labor market to make a quantitative assessment of the effects of labor specificity. I find that the specificity problem results in a substantial reduction in human capital investment and GDP even when the parameter governing the degree of specificity is set at a modest level compared to what the data in the labor market suggest. There is an income differential of 2.6 times between the economy with a monopolistic industrial sector and a competitive benchmark that is free of any specificity problems.

The big effects that I find are due, in large part, to the assumed human and physical capital complementarity. There is only much to gain from investing in

[1] For example, Topel (1991).

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