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Matching and competition for human capital

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Abstract

A simple model of discretionary worker investment in human capital is developed in which worker productivity is affected by a firm-specific match and employers bid strategically for workers. The labor market returns a share of specific capital productivity to workers without Nash bargaining power and without recourse to long-term contracts, because efficient turnover transforms a worker's former employers into her outside options. When the cost of specific investment falls, wage profiles become less steep and turnover is reduced. Perversely, an increase in the probability of turnover increases the (privately) optimal investment in specific capital. © 2000 Elsevier Science B.V. All rights reserved.

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1. Introduction

Human capital theory emphasizes the distinction between specific skills, productive at only one firm, and general skills, productive at many firms, because of the different incentives for accumulation of the two types of skill. Since more than one firm will bid for a worker with general skills, ''the cost as well as the return from general training would be borne by trainees, not by firms'' (Becker, 1962, p.13). In contrast, the return from specific investment is a quasi-rent, available

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only when the trainee works for the specific firm, so alternative employers cannot be relied upon to bid up wages. As the cost of investment must be borne before the returns are available, the investment decision depends on the expected resolution of a bilateral monopoly. In the absence of credible promises of future compensation, workers exposed to the potential of being 'held-up' by their employers are unwilling to invest in specific capital. Nevertheless, the best evidence suggests that wages do rise with job tenure as well as experience, and that the source of the wage gain is training (Brown, 1989; Topel, 1991). However, training alone does not explain all of the wage growth among workers. Topel and Ward (1992), e.g., find that job changes also account for a substantial fraction of wage growth, and conclude that the labor market systematically sorts workers into firms at which they have better matches.

If the labor market sorts workers into better matches, then a worker's present employer may in the future become her best alternative. Even if employers can extract all of the relationship-specific *surplus*, the ability of workers to change firms means that specific capital may be transformed from surplus at one firm into the worker's rival opportunity at the other, and hence, into wages. This paper develops a simple two-period model of human capital accumulation in the presence of worker–firm matching to explore the potential of efficient turnover for providing workers a share in the return from their specific investments. To focus attention on the role of the spot labor market in inducing specific investments by workers, long-term contracts are assumed to be unavailable. [1] The principal finding is that matching and training explanations of wage growth reinforce each other: when matching is important, workers are sorted across firms and so have an incentive to invest in specific as well as general human capital. [2]

There remain important differences between the effect of general and specific human capital investment in the model. Since workers capture all of the returns from general capital, the socially efficient levels of these skills are accumulated. Not so with specific capital: workers ignore the benefit these skills confer on their employer, so they underinvest relative to the social optimum. Less obvious is the fact that workers also invest in specific skills insufficiently to maximize their own lifetime incomes. This occurs because a worker enters the labor market twice, once before and once after her investment in human capital. The anticipated investment in specific skills increases the expected profit of her employer, and so intensifies wage competition for young, uncommitted workers. Thus, part of the benefit to specific capital is incorporated in the first period wage. At the time the specific investment is actually made, this wage is fixed, and unable to commit ex

[1] Grout (1984) provides a formal model of the hold-up problem in the absence of contracts.

[2] A recent paper by Parent (1996) finds empirical support for the complementarity between matching and human capital investment.

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