Monopsony Power, Spatial Equilibrium, and Minimum Wages

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Abstract

What role does labor market competitiveness play in determining the spatial distribution of economic activity? We develop a model of monopsony power in spatial equilibrium. Workers and firms are free to locate in any labor market. The degree of market power a firm enjoys depends on the number of competing firms in its location. We show the model can rationalize concentrations of economic activity and the city-size wage premium through an endogenous labor market competitiveness channel. Using administrative data from Germany, we calibrate the model to match reduced-form evidence on labor market size and labor market competitiveness. We find endogenous labor market competitiveness can explain approximately one-third of the city-size wage premium and 15% of all agglomeration. We use the model to study the spatial and welfare implications of the 2015 German national minimum wage law, and compare its effects to alternative spatially-targeted policies proposed at the time.

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