Labor Market Power & The Distorting Effects of International Trade

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What does the study do?
- Question: How do trade shocks shape and interact with labor market distortions that create market power in labor markets and prevent an efficient allocation of labor?
- Builds a simple partial equilibrium framework to answer this question.

Why is this interesting?
- Gains/losses from trade in terms of allocative efficiency:
  - welfare gains change with imperfect labor markets
  - over/underestimation of trade gains
- Rent sharing between firms and employees:
  - who loses and who gains from trade?

How to calculate labor market distortions

Production: $Q_{it}(\cdot) = Q_{it}(G_{it}, M_{it}, K_{it}, \omega_{it})$

Observed wages are: $V_{iht}^t = (V_{iht}^t + \delta_{iht}^t)$

Intermediate input markets: $V_{iht}^t = MRPM_{it}$

Distortions: $f_i(S_{it}) = \delta_{iht}^t = \frac{V_{iht}^t L_{it}}{K_{it}} - \frac{a_{it}^t \mu_i M_{it}}{K_{it}}$

$\delta_{iht}^t \rightarrow$ Distributional aspects

$\delta_{iht}^t < 0$: Labor market power for firms

$\delta_{iht}^t > 0$: Labor market power for workforce

$|\alpha_{it}^t| \rightarrow$ Firm contribution to inefficiency

Sources of Labor Market Power
- Hiring/firing costs
- Information frictions
- Firm concentration
- Trade unions

Mechanism
- (Incomplete) pass-through
- Firm adjustments

Labor Market Power & Trade

Labor market distortions and trade shocks

Firms where employees possess labor market power in t = 1
Firms with labor market power in t = 1

Findings
- Most of the time, export demand and import competition shocks fortify existing distortions.
- Firms with labor market power do not raise labor expenditures after export profit gains (profit relative to labor share inefficiently increases).
- Export effects four times more important than import effects.
- Implies losses in terms of allocative efficiency from trade.
- Diminishes trade gains compared to a standard model with competitive labor markets.

More research? Go here:

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