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Monopsony Makes Firms not only Small but also Unproductive:
Why East Germany has not Converged

(with Christian Bayer, Heiko Stüber, and Felix Wellschmied)

Abstract:

When employers face a trade-off between growing large and paying low wages – that is, when they have monopsony power – some productive employers will decide to acquire fewer customers, forgo sales, and remain small. These decisions have adverse consequences for aggregate labor productivity. Using high-quality administrative data from Germany, we document that East German plants (compared to West German ones) face a steeper size-wage curve, invest less into marketing, and remain smaller. A model with labor market monopsony, product market power, and customer acquisition matching these features of the data produces 10 percent lower aggregate labor productivity in East Germany.