Adverse Selection, Training, and Monopsony Power

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Abstract :
Even in otherwise competitive labor markets, employers derive monopsony rents from privately observing their employees' performance. We establish that firms (workers) can strategically invest in training to expand (curb) the ensuing adverse selection problem. By supplying training that complements general ability, or substitutes for firm-specific skills, firms indirectly commit to retaining employees more often. This exacerbates the lemons' problem faced by rival firms in the labor market, and, so, lowers equilibrium wages. With adverse selection, the extent of training affects the division of surplus between firms and workers, which results in over-investments in training.