Labor Market Power in Sub-Saharan Africa: The Role of Small Firms, Self-Employment, and Migration

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Abstract :
What role does labor market power play in the low levels of output in Sub-Saharan Africa? Unlike developed countries, labor markets in low-income countries are characterized by a large number of small firms, high rates of self-employment and costly migration. I develop a general equilibrium spatial monopsony framework that accounts for each of these features. The model is identified through Tanzania's 2010 sectoral minimum wage law which specified different levels for twenty industries and a national floor for all others. I find that labor market power is concentrated in rural areas where there are fewer firms and workers face higher migration costs. Less competitive wages in rural areas causes a misallocation of workers into self-employment where they are less productive. At the same time, self-employment plays an important role in diminishing labor market power. I consider several policy counterfactuals aimed at reducing the share of labor in self-employment. Eliminating migration frictions increases welfare but reduces output through an increase in the self-employment labor share. Alternatively, increasing the number or productivity of firms in rural areas has a positive effect on both welfare and output. This suggests that governments in low-income countries should target policies of rural development rather than policies that reduce migration frictions.