Local Labor Markets and Market Power*

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Abstract

Labor markets in large metropolitan areas are segmented. The literature has referred to these micro-markets as "Local Labor Markets" and has typically used location and industry, or occupation, to delineate them. This is problematic for two reasons: 1) delineations rely on arbitrary administrative boundaries for regions, industries, and occupations, and 2) this implicitly assumes that the structure of the larger market does not change. In this paper, we use the metro expansion in Santiago de Chile to show that transport infrastructure can change what constitutes a local labor market and thus have knock-on effects on labor market power and aggregate outcomes. We build a simple theoretical framework that delivers testable predictions to guide our analysis. We find empirical evidence that after a relevant reduction of commuting costs, workers from previously small markets have higher probabilities of changing local labor market and enjoy higher wages. Lastly, we find that in labor markets affected by the reduction of commuting costs, mean markdowns fall around 10 percentage points.

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