

Optimal Redistribution Policy with Labor Market Monopsony*

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Abstract

We study the optimal redistribution policy in the presence of imperfect competition in the labor market. Firms have monopsonistic wage-setting power due to the workers' idiosyncratic preferences for non-wage characteristics of firms—such as amenities. Firms have a role in wage inequality through the firm's productivity pass-through to wage and compensating differentials. A redistribution policy across workers can improve consumption inequality and increase the effective amount of amenities at the cost of distorting the allocation of workers across firms. These trade-offs can be optimally balanced by designing a redistribution policy that subsidizes firm's productivity and (indirectly) taxes amenity for more productive firms. Optimal allocation can be implemented by a firm regulation in the goods market, but its effectiveness depends on the sources of inequality.

Keywords: Imperfect Labor Market, Monopsony, Redistribution Policy, Firm Regulation

JEL Classification: D61, H21, H24, H25, J22, J31, J42

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