

**Does Product Market Competition
Increase Wage Inequality?**

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Increasing product market competition can have a direct impact on the employment relationship and wage inequality. I develop a simple model in which an increase in product market competition induces higher returns to skill: as competition rises, profits are more sensitive to cost reductions so that the relative marginal product of a high to a low skill worker is higher. This implies that relative wages increase with competition. I then estimate empirically whether skills are more highly rewarded (in relative terms) in highly competitive industries using an individual panel of workers (1982-1999) with complete work histories. I use three different measures of product market competition and identify the impact of competition on returns to observed skill out of its “within” variation, controlling for individual fixed effects. I show results for concentration ratios and for two exogenous measures of competition provided by two quasi-natural experiments. I finally estimate quantile regressions that indicate that increased competition also raised returns to unobserved skills. The hypothesis is confirmed in all the specifications and can explain a substantial part of the increase in inequality.

Keywords: Wage Structure; Returns to Skill; Product Market Competition.

JEL Classification: J31, J33, L22, D21