

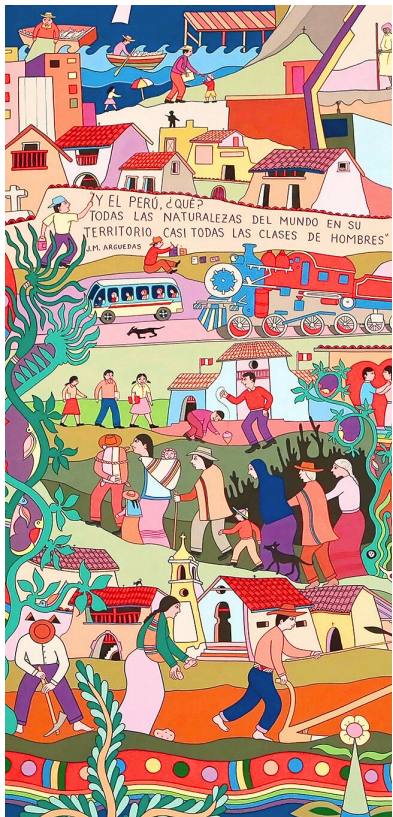
## Labor Market Power, Self-Employment, and Development

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# INDUSTRIAL POLICY EFFECTIVENESS IN BOOSTING WAGES AND WAGE EMPLOYMENT DEPENDS ON HOW SELF-EMPLOYMENT CONSTRAINS LABOR MARKET POWER

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[LINK TO PAPER](#)

## Summary

This paper examines how self-employment interacts with employer market power in local labor markets. Using Peruvian worker- and firm-level data, the authors show that wage-setting power rises with employer concentration, but less so in markets with higher self-employment. A general equilibrium model explains this pattern: self-employment acts as an outside option that raises labor supply elasticity and weakens oligopsony power. As a result, policies that expand wage employment by reducing reliance on self-employment can unintentionally backfire by strengthening employer market power.

## Objective

To understand how self-employment shapes employer market power in local labor markets, and how this interaction affects wages, earnings, and the effectiveness of policies aimed at expanding wage employment.

## Methodology

The authors combine detailed Peruvian data on workers' earnings and firms' employment, and develop a structural general equilibrium model to study how workers choose between wage employment and self-employment in local labor markets. They estimate the model using simulated moments to quantify labor market power and its interaction with employer concentration.

## Results

- Employer wage-setting power is substantial, with workers receiving ~70 cents for each additional dollar they produce.
- Employer concentration amplifies wage-setting power only in low self-employment markets, where higher markdowns leave workers as little as 57 cents p/additional dollar produced.
- Self-employment rises with employer concentration, and acts as outside option disciplining employer wage-setting power.
- Ignoring labor market power can backfire. The effectiveness of industrial policies depends almost entirely on labor market power. Changes in wage markdowns account for 99% of wage effects and 88% of employment effects.

Industrial policy effects explained by market power:

**99%**

of wage effects, and

**88%**

of employment effects