Monopsony

Alan Manning

a.manning@lse.ac.uk

@alanmanning4

Centre for Economic Performance

London School of Economics

XXIV European Conference of the fRDB, Chioggia

Monopsony, wages and working conditions

December 12th 2022

What is Monopsony?

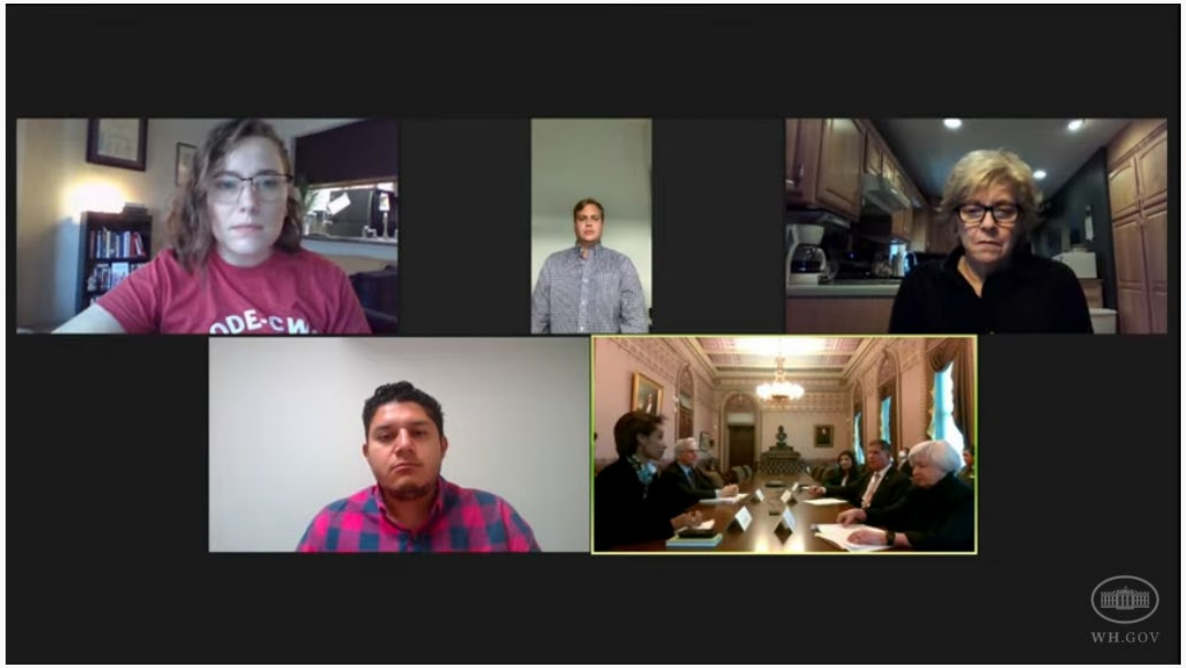
- Literally it refers to the case where there is a single buyer (not necessarily of labour)

- But term is used more generally to refer to the situation where employers have some market power over their workers

- Though the ability to exercise monopsony power may be limited by laws/regulations/institutions

The History of Monopsony

- Monopsony is an old idea – Introduced by Joan Robinson in 1933
- But, for many years, few economists paid much attention to it
- Recently, there has been a resurgence of interest in it e.g. Biden administration issued report on labour market competition in March 2022



Roundtable on the State of Labor Market Competition in the U.S. Economy

Why the recent interest?

- From the 1980s on it was common to argue that we need to de-regulate labour markets
- Key to this was the idea that an unfettered labour market was a very competitive labour market
- So that market competition alone was sufficiently strong to protect workers' interests

But outcomes have been disappointing in many countries

- Sluggish overall productivity growth
- Decoupling of labour cost growth from productivity growth – falling labour share
- Decoupling of labour cost growth from median wage growth – rising inequality
- This means that the current system is not working well for many people so its unsurprising if they are looking for alternatives
- And part of the problem may be that the labour market is not as competitive as many believed

Why do employers have market power over their workers?

- Frictions – it costs time and money to change jobs
- Idiosyncratic amenities from jobs e.g. a convenient commute or hours
- Employers may actively restrict competition by collusion or other anti-competitive practices
- The bottom line is that an employer who cuts wages by 1c may find it harder to recruit and retain workers but they will not all immediately quit
- The labour supply curve to the employer is not infinitely elastic – the elasticity gives us a measure of how much market power they have
- Monopsony is common sense but has not had many buyers until recently

As we all know, jobs are a big deal
Self-reported most important events over past year

	All	Men	Women
Family	38	33	42
Employment	22	24	20
Nothing	20	22	18
Leisure	19	19	19
Education	13	11	15
Health	12	10	13
Consumption	9	9	8
Housing	8	7	9
Other	7	6	7
Financial	4	4	4

Changing Questions

- Question used to be “do employers have monopsony power over their workers?”
- But now questions are:
    - How much monopsony power?
    - How does it vary?
    - What are the consequences of monopsony power?
    - What should be done about monopsony power?
- Papers today make important contributions to this agenda

Accumulating Evidence that Labour Markets are not Perfectly Competitive

- Both experimental and observational studies find that labour supply to individual employers is not perfectly elastic
- Even among workers where you might think the labour market would be very competitive e.g. Uber drivers who also work for Lyft
- Perhaps consensus settling that labour supply elasticity is about 4- 5 (David Card ‘Who Set Your Wage’) though with variation
- This gives employers some potential market power, but whether they can use depends on how wages are determined

We need to focus on firms to understand wage determination

- Too often economists assume that wages are determined by impersonal market forces
- Or that there is some bargaining between worker and firm which conveys the impression they are equals
- Or ignore the fact that employers have more workers than workers have employers so employers are more ‘practiced’
- Firms have the greatest say in wage determination and we need to focus on their incentives
- And firms’ incentive is to pay workers below the competitive wage (marginal revenue product)

Firms do not set wages in a vacuum

- There may be institutional restrictions e.g. minimum wages or collective bargaining or antitrust laws or restriction on legal employment contracts

- There is competition for workers with other firms

- But competition is limited because labour mobility is limited – because of the frictions and idiosyncracies

Why monopsony matters for economists?

- Wages are lower than the competitive wage (marginal revenue product)
- This is bad for inequality
- Impedes allocation of workers to most productive uses so also lowers efficiency

More specifically..

- Monopsony offers new perspectives on old questions e.g.:
  - The employment effect of the minimum wage (does not have to destroy jobs if there is monopsony)
  - The gender pay gap (women's labour market is less competitive)
  - Ethnic pay penalties
  - The economics of immigration
  - The urban pay gap (cities are more competitive)
- Not just of interest to academics but also to practitioners
- Need to intervene to ensure an appropriate balance of power between workers and employers

What can be done about monopsony power?

- Direct regulation of wages e.g. minimum wages
- Establish counter-vailing power to the monopsony power of employers
- More active competition policy
- Regulation of labour contracts
- Policies to give workers more options

Minimum Wages

- Minimum wage is classic, useful policy
- I have been continually surprised by how high seem to be able to push minimum wage without clear job losses
- UK currently has target for National Living Wage for age 23+ of 2/3rds of median by 2024
- But minimum wage does have limitations
- Can only affect wages at lower-end of labour market
- And may be employer avoidance strategies – bogus self-employment, fewer guaranteed hours, zero hours contracts

Counter-vailing power

- Bolstering trade unions or worker voice in firms
- But this seems hard
- Individuals less likely now than in past to see trade unions as the solution to their problems?
- But in current environment that is perhaps changing e.g. if inflation is low downward nominal wage rigidity is a protection against real wage falls
- But when inflation is high, need to be more pro-active to raise wages

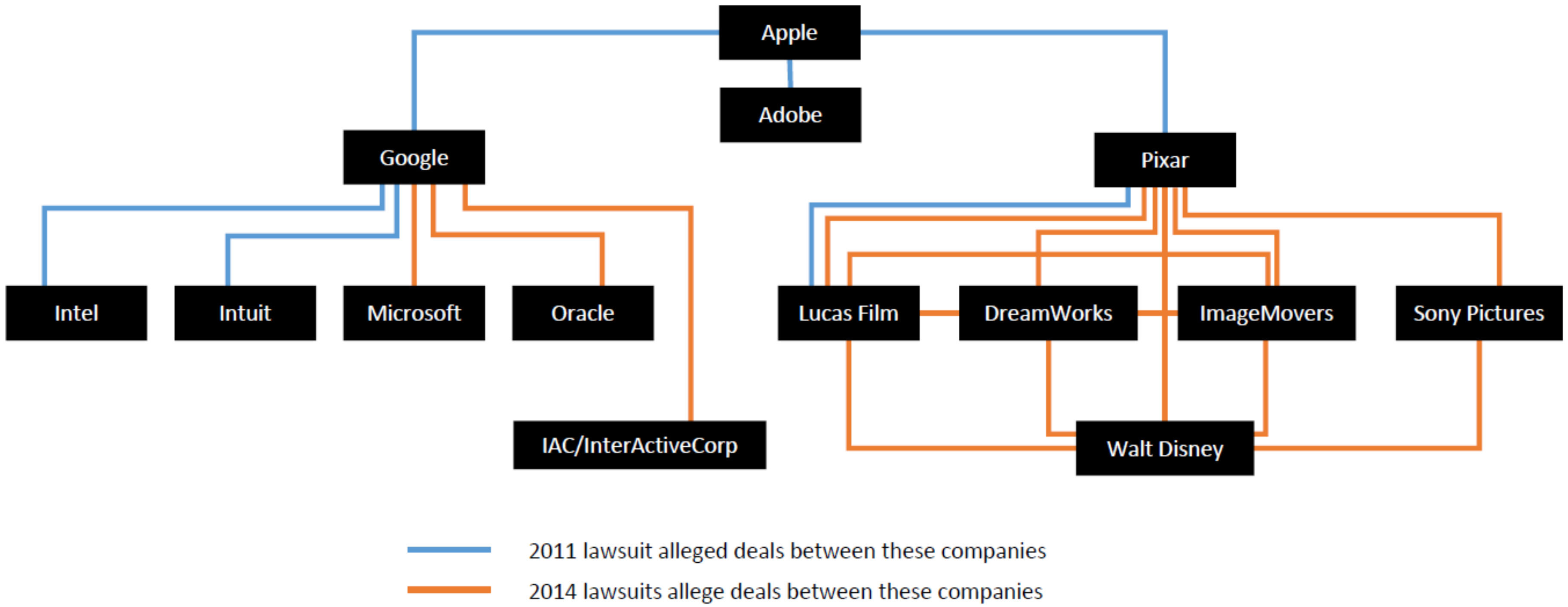
More active competition policy

- Laws often treat labour and product markets symmetrically in principle but practice does not
- Posner, Weyl and Naidu term this the ‘historic imbalance’
- Eric Posner’s book ‘How Antitrust Failed Workers’ is a great summary
- US has committed to examining mergers for labour market not just consumer consequences; some evidence that hospital mergers reduce wages
- Labour markets seem very concentrated
- And old-fashioned collusion, implicit or explicit, may be more widespread than we think

Employer Collusion

- Adam Smith: “are always and everywhere in a sort of tacit, but constant and uniform combination, not to raise the wages of labour above their actual rate. To violate this combination is everywhere a most unpopular action, and a sort of reproach to a master among his neighbors and equals.”
- And… "We rarely hear, it has been said, of the combination of masters; though frequently of those of workmen. But whoever imagines, upon this account, that masters rarely combine, is as ignorant of the world as of the subject“

High-tech no cold-calling case in US



Sources: Lawsuits filed in federal court in San Jose, California;
Bloomberg Graphics.

This is Steve Jobs trying to recruit Palm to the collusive arrangement

- Mr. Jobs proposed an arrangement between Palm and Apple by which neither company would hire the other's employees, including high tech employees.
- Colligan (Palm CEO) to Jobs "Your proposal that we agree that neither company will hire the other's employees, regardless of the individual's desires, is not only wrong, it is likely illegal,“
- Mr. Jobs also suggested that if Palm did not agree to such an arrangement, Palm could face lawsuits alleging infringements of Apple's many patents."

Regulating Employment Contracts

- Non-competes that restrict workers future employment after leaving a firm – evidence that these reduce wages even if might be an idle threat for many
- Evidence from sports – Brazilian football, UFC
- Paper today looks at this for Italy
- Employers are actively trying to appropriate human capital of workers in many areas:
  - Non-competes are one example
  - Who owns the ratings of gig workers?

Re-thinking Freedom of Contract?

- Economists make widespread use of the idea that if two parties voluntarily agree a contract, the presumption is that they both gain
- We should worry about this practice
- We often assume people differ in their ability e.g. to explain wage inequality
- But often (except in behavioural economics) assume everyone is 100% fantastic at looking after their own interest (maximizing their utility)
- Of particular concern in markets where amateurs meet professionals – labour markets are like this; “do workers read the small print”

Policies to give workers more options

- Run labour market hot

- Better information about job opportunities
  - Employers seek to restrict information e.g. through NDAs, salary secrecy rules

- So easier to change jobs

Who Owns/Uses Information/Data is increasingly important

- We have an explosion in the amount of data
- And the ability to process it
- This data can be used for good or bad
- We need to make sure it is used for good
- Risk is that it increases power of employers relative to workers
- Who owns data is important e.g. report mentions portability of ratings for gig workers
- But use also matters
- We need to ensure it is as freely available to workers as to employers

Implications for Designing Policy

- Policies that improve one margin can make things worse on others
- Need to find a policy that balances the different margins
- Because the ‘natural’ state of affairs is that firms have too much power, need some intervention on side of workers
- But this does not mean we cant go too far – need an appropriate balance of power
- And some of it may be complicated

Still a lot to do: A selection of open research questions

- How Best to Measure Monopsony Power?
- How Does it Vary Across Segments of the Labour Market And Why?
- How much monopsony power do employers use?
- Where do monopsony profits go?
- Transmission Mechanism of Shocks to Wages
- Other ways in which firms adjust employment

How Best to Measure Monopsony Power?

- Concentration ratios (as in paper today)
  - how best to define these? Vacancies/employment; geography/industry/occupation
  - What is the source of variation in concentration ratios?
- How sensitive are separation rates to wages?
  - A lot of research on this but typically looks at involuntary as well as voluntary separations
- How sensitive is recruitment to wages?
  - I have some recent work on this with Boris Hirsch, Elke Jahn and Michael Oberfichtner

How much monopsony power do employers use?

- A lot of measures of monopsony power really measure potential monopsony power
- We would like evidence that these measures translate into wages
- One paper today looks at this using concentration ratios
- But other measures are less tested; I have some nearly completed work on this with Boris Hirsch, Elke Jahn and Michael Oberfichtner

Where do monopsony profits go?

- Often assumed that they end up in the pockets of employers
- But may simply be frittered away in the form of inefficiency
- Monopsony makes it hard to allocate workers to most productive use
- But may also be wasted in rent-seeking activities of employers
- And productivity may respond to wages rather than the other way round (Decio Coviello, Erika Deserranno, Nicola Persico find minimum wage raises productivity)

Transmission Mechanism of Shocks to Wages

- A growing literature on the pass-through of employer-specific demand shocks to wages
- But it seems possible (probable?) that a bigger influence is the wages paid by competitor firms.
- A few papers (e.g. Caldwell/Daniele, Derononcourt/Noelke/Weil/Taska) but could be more
- Perhaps particularly relevant when we are interested (once again) in the possibility of wage-price spirals

Other ways in which firms adjust employment

- A lot of the monsopony models assume the wage is the only instrument available to firms to adjust wages
- Not clear this can explain all the regularities in labour market e.g. magnitude of wage and employment variation within specific labour markets
- But there are other dimensions employers can use; recruitment intensity, worker quality
- How important are these, and how this affects our way of thinking is unclear

Conclusions

- The relationship between employers and workers is not fundamentally one of equals
- Employers naturally have some market power; we need to take this seriously
- We need to intervene in order to ensure appropriate balance of power between employers and workers
- There are both efficiency and equity grounds for this
- Finding effective forms of intervention is not easy
- But this is a not a reason not to try
- But still a lot of work to be done; I am optimistic because others seems to have so many ideas about what to do