Monopsony in Motion

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The role of firms in wage inequality:

Policy lessons from a large-scale cross-country study

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We know that wages and productivity are really important

- Most people depend on earnings as their source of income

- And, over long-run, productivity growth is the main source of earnings growth

We also know that many countries have a problem with wages, productivity and inequality

- 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
- We need to be coming up with solutions to these problems

The wage-productivity-inequality nexus is where we expect some of the biggest market failures

- We know that markets cannot be relied upon to deliver a level of inequality that is fair or sustains the necessary political legitimacy
- We know that there are incentives for firms to try to obtain market power
- We know that innovation is critical to productivity growth and that markets are unlikely to deliver an efficient level as knowledge is a public good
- We know we need public policies to address these market failures

The report is right to say that need a focus on firms to understand wage determination

- Too often we have assumed 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
- Firms have the greatest say in wage determination and we need to focus on their incentives

Firms do not set wages in a vacuum

- There may be institutional restrictions e.g. minimum wages or collective bargaining
- There is competition for workers with other firms
- But competition is limited because labour mobility is limited – there are frictions in the labour market
- A wage cut of 1c would not cause all existing workers to quit immediately as perfect competition implies
- Implies that firms have some monopsony power - a very old idea (invented by Joan Robinson in 1933)
- Monopsony is common sense but has not had many buyers until recently
- Very happy to see this report taking it more seriously

This talk loosely based on ideas expressed in a couple of papers

- “The Measure of Monopsony” (with Monica Langella)
- https://academic.oup.com/jeea/advance-article/doi/10.1093/jeea/jvab039/6368338

- “Monopsony in Labor Markets: A Review”
- https://journals.sagepub.com/doi/abs/10.1177/0019793920922499

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?
- Report makes important contributions to all of these

Consequences for wages, productivity of frictions in labour markets

- Impedes allocation of workers to most productive uses
- Also gives employers some monopsony power so wages are a mark-down on marginal revenue product
- This mark-down may be larger in some labour markets e.g.:
  - In more concentrated markets
  - For women rather than men

But may also be impacts on productivity within firms

- If W=MRPL have little option but to do what your boss tells you to do as anything with a lower MRPL will get you fired
- But If MRPL>W then can slack off (within limits) and still be profitable for the employer
- Implies productivity will be lower if employers have more market powe
- Some evidence consistent with this in work by Decio Coviello, Erika Deserranno, Nicola Persico

More generally:

- We perhaps think too much of productivity as exogenous and wages as reacting to it
- They are both jointly determined
- In perfect competition wages are determined by skills and productivity and productivity adjusts to wages through changing size of employers and diminishing returns to labour

Transmission of productivity to wages

- Report shows there is a transmission
- Average magnitude in line with previous studies
- Extent depends on collective bargaining, product and labour market competition, job mobility
- I have never been quite sure about how to interpret regressions like these – is high pass-through an indication of low worker power or high?

My interpretation of pass-through

- I think the ambiguity in interpretation comes from treating productivity as exogenous
- If we think of equation logWage=logMRPL- logMarkdown
- Then would expect pass-through of 1 independent of extent of competition
- One interpretation of pass-through<1 is that the markdown is larger in more productive firms
- This has the implication that:
  - Incentives for workers to find more productivity firms is weaker
  - But perhaps incentive to become a more productive firm is stronger

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

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
- Voluntary higher Living Wage may be a good approach for employers who can afford to pay more

Counter-vailing power

- Bolstering trade unions or worker voice in firms
- Good there is a revival of research on this – including in this report
- But should this be top-down or bottom-up?
- Individuals less likely now than in past to see trade unions as the solution to their problems?

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’ https://harvardlawreview.org/2018/12/antitrust-remedies-for-labor-market-power/
- Good that report recommends paying more attention to this e.g. in merger policy
- Increasing important role of temporary help agencies deserves a closer look?
- But old-fashioned collusion, implicit or explicit, may be more widespread than we think

Enforcing Labour Market Competition Policy

- 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“
- This is not just then; this is also now e.g. high-tech no cold-calling case involving Apple, Google, Intel, Adobe, Lucasfilm, Pixar, Intuit
- Need to be alert to the possibility this may be going on

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 e.g. in UK The High Court found it was reasonable for a hairdressing salon to prevent a former employee from working within half a mile of its premises (this would rule out 50% of commutes)
- We would not dream of allowing such a restriction for people who change the supermarket where they buy their groceries
- Perhaps we need to look at many common features of employment contracts with an eye to the consequences for competition e.g. are notice periods like switching costs?
- Employers are actively trying to appropriate human capital of workers in many areas: Non-competes are one example

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 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
- 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

A lot of work in this report but (as always) lots more to do..Some ideas

- Regional/Spatial Dimension of Inequality
- More heterogeneity across labour market groups e.g. minorities
- Understanding the role of other firms

Regional/Spatial Dimension

- In many countries growing concern about regional inequalities
- E.g. between ex-industrial areas and service-based cities
- Part of firm contribution to wage inequality probably has a spatial aspect to it
- Report mentions that rural labour markets likely to be less competitive - http://jhr.uwpress.org/content/early/2020/11/04/jhr.monopsony.0119-9960R1.abstract
- How to interpret:
  - Are high wages reflecting high prices?
  - Is high productivity reflecting high prices (because of high wages)?

Minorities

- Report provides evidence that labour market is less competitive for women than men
- And that this contributes to the gender pay gap
- But we know from audit/correspondence studies that irrelevant information on CVs (e.g. names) affect employer decisions
- Every country has found evidence of this but it does not receive attention it deserves
- The more frictions there are in labour markets the worse the consequence of this discrimination is going to be

The Role of Other Firms

- Report starts by saying how often think of wages as determined by individual characteristics e.g. age, gender, ethnicity, skills
- And that the role of firms also needs to be centre-stage
- One group that is missing is ‘other firms’
- A huge determinant of what one firm pays is what other firms pay
- But this is rarely modelled at all – an exception is Spillover effects from voluntary employer minimum wages (Ellora Derononcourt, Clemens Noelke, David Weil, and Bledi Taska).
- Perhaps this transmission mechanism matters more if we are worried about a wage spiral.

Conclusion

- This is a fantastic report
- It covers a huge amount of ground
- But there is always a lot more to be done
- I look forward to it!