

It's Not Just Monopoly and Monopsony

How Market Power Has Affected American Wages

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Introduction and key findings

- Economists have started to identify concentration in both labor and product markets as a potential threat to living standards and wages of typical American families.
- Concentration in product markets (a limited number of sellers) is generally labeled monopoly power while concentration in labor markets (a limited number of employers—or buyers of labor) is generally labeled as monopsony power.
- This focus on market power in the form of market concentration represents a welcome and overdue shift.
- For too long, many researchers tried to explain troubling trends in American workers' wages with textbook models of perfectly competitive labor markets.
- Specifically, this long research effort claimed that rising wage inequality and slow wage growth for typical workers was the result of economic influences (such as new technologies) that “shift” demand and supply curves for labor in a competitive model.

Labor market concentration is negatively correlated with wages, but the scope of its downward pressure on wages is limited.

- New research shows that labor market concentration is negatively correlated with wages. However, the effect of labor market concentration is comparatively modest when scaled against what we consider the most significant wage trend in recent decades: the growing gap between typical (median) workers' pay and productivity.
- The new literature on market concentration has not yet provided concrete empirical estimates of a key labor market trend of recent decades—rising compensation inequality. This should be a priority for this research agenda in the future.
- The new concentration literature does allow us to estimate the effect of market concentration on the share of overall income claimed by labor compensation. These estimates suggest that concentration has not risen enough, nor is its effect on labor's share of income strong enough, to account by itself for an economically important share of the divergence between economywide productivity and the typical worker's pay in recent decades.

- The new research on labor market concentration implies that this concentration reduced wage growth by roughly 0.03 percent annually between 1979 and 2014, a decline that would explain about 3.5 percent of the total divergence between the median worker's pay and economywide productivity over the same period.
- One important study shows that the “average” labor market is “highly concentrated.” But differences between measures of concentration of the average labor market and the labor market experienced by the average worker have important implications for how to assess the impact of labor market concentration on long-term wage trends. In other words, many labor markets suffer from high degrees of concentration, but most people work in labor markets with only low-to-moderate degrees of concentration.

- Nonetheless, labor market concentration is a particular challenge for rural areas and small cities and towns. This is an important finding for those looking to provide economic help to residents of those areas.
- Research on labor market concentration within manufacturing shows a modest increase in labor market concentration between 1979 and 2009.

Product market concentration has increased for some sectors—but at varied rates—and the scope of its downward pressure on wages is also limited.

- Product market concentration rose steadily across six sectors from 1982 to 2012 (manufacturing, retail, wholesale, services, finance, and utilities and transportation), but the magnitude of this rise has varied substantially and it is unclear how much product market concentration has affected labor market trends.
- The new literature on product market concentration indicates that it may have reduced overall wages by roughly 0.08 percent annually from 1979 to 2015, or less than 10 percent of the total divergence between a typical worker's pay and productivity over that period.

The focus on market power as a key driver behind American wage trends should focus as well on developments that have weakened workers' power.

- Explaining the expanding pay–productivity gap and increasing inequality in America requires labor market models that allow for employer market power, but the conception of power must go beyond measurable market concentration. Instead, this analysis of power must focus on what has happened to the countervailing power American workers were once able to wield but which now seems radically reduced.
- Correspondingly, a policy response to rising employer power over wages must go well beyond antitrust reform to focus on every possible margin along which policy could strengthen workers' leverage and bargaining power.

**A quick economic background for the
new literature on market
concentration**

The need to explain the productivity– pay divergence

- **Table 1** presents our 2015 findings.
- It shows that the gap between net productivity (economywide productivity net of depreciation) and real median hourly compensation grew 0.8 percent per year between 1973 and 2014 and grew a larger 1.1 percent per year when just looking at the 2000 to 2014 period.
- It further shows that growing compensation inequality is responsible for the large majority (82.5 percent) of the growth of the productivity–pay gap over the entire period, 1973–2014, whereas the erosion of labor share of income explains about one-sixth of the gap (16.3 percent per year).

Table 1: Trends in net productivity

Median compensation gap and explanatory factors, 1973–2014

	1973– 1979	1979–1995	1995– 2000	2000– 2007	2007– 2014	2000– 2014	1973–2014
A. Net productivity–median compensation gap, no price divergence (annual growth)							
	0.35%	0.84%	0.42%	1.17%	0.98%	1.08%	0.80%
B. Explanatory factors impact (annual growth)							
<i>Inequality of compensation</i>	0.48%	0.69%	1.04%	0.66%	0.49%	0.58%	0.66%
<i>Loss in labor's share of income</i>	-0.13%	0.14%	-0.61%	0.51%	0.48%	0.50%	0.13%
C. Relative contribution to net productivity gap (percent of gap)							
<i>Inequality of compensation</i>	137.1%	82.1%	247.6%	56.4%	50.0%	53.7%	82.5%
<i>Loss in labor's share of income</i>	-37.1%	16.7%	-145.2%	43.6%	49.0%	46.3%	16.3%

Note: The gap excludes the influence of diverging consumer and producer prices.

Source: Analysis of data in Bivens and Mishel 2015 (Table 1)

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**Assessing the empirical findings of
the new literature on market
concentration**

The effect of concentration in the labor market (monopsony)

**Azar, Marinescu, and Steinbaum 2017:
Measuring labor market concentration
across industries and commuting zones**

**Benmelech, Bergman, and Kim 2018:
Looking at increasing labor market
concentration in manufacturing**

- Benmelech, Bergman, and Kim (2018) actually provide more detailed results that allow us to further assess the wage impact of rising concentration: they estimate a separate wage elasticity of concentration for each subperiod and provide the concentration levels for each subperiod. This enables one to infer the rise in concentration and its resulting effect on wages in each subperiod.
- The relevant data are presented in **Table 2**, with column 1 providing the coefficient on HHI estimated for each subperiod, column 2 providing the HHI for each subperiod, and the last column showing the impact on wages of HHI in each subperiod (the result of multiplying column 1 by column 2). The table shows that labor market concentration reduced wages by 3.1 percent in 1977–1981, by 3.2 percent in 1997–2001, and by 3.6 percent in 2002–2009. The amount that wages were reduced by labor market concentration rose by 0.5 percent over the entire period from 1977–1981 to 2002–2009, but there is no consistent trend in between those years.

Table 2: Impact of labor market concentration on wages, 1977–2009

Period	Coefficient in HHI*	HHI	Wage Impact
1977–1981	0.044	0.698	3.1%
1982–1986	0.038	0.714	2.7%
1992–1996	0.044	0.717	3.2%
1997–2001	0.047	0.719	3.2%
2002–2009	0.033	0.756	3.6%
<i>Change 1977–2009</i>		0.058	0.5%

* Herfindahl-Hirschman Index

Source: Benmelech, Bergman, and Kim 2018 (Figure 1 and Table 5, panel B)

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**Naidu, Posner, and Weyl 2018: Looking at
labor market power, though not
necessarily labor market concentration**

- Naidu, Posner, and Weyl (2018) provide a wide-ranging treatment of how market power—particularly in the labor market—can lead to both inefficiency and inequality.
- They survey a broad literature assessing the potential strength of labor market power and use the estimated parameters to put bounds on how large the efficiency and distributional effects of labor market power might be.
- They find it could be quite large: in one calibration they find that labor market power might reduce overall gross domestic product by almost 13 percent and overall wages by almost 25 percent.

The effect of concentration in the product market (monopoly)

Autor et al. 2017: Finding growing market power lowers labor's share of national income

- Autor et al. (2017) break new ground by using firm-level data to examine the impact of product market concentration on labor's share of income in six different large sectors.
- Autor et al. are largely concerned with the question of whether the lower labor share is a widespread phenomenon across all firms, or is driven by a small number of large “superstar” firms (think Facebook, Apple, Amazon, and Google, among others).
- Use of firm-level data allows the study to test these contrasting theories, as they respectively imply “...heterogeneous vs. homogeneous changes in the labor share across firms in an industry”

Struyven 2018: Finding increases in industry concentration are associated with falling labor shares of income

The still-missing link: How changes in market power unrelated to concentration might explain wage trends

- The new papers on market concentration are useful and creative, and provide important new lenses for various forms of policy evaluation.
- For example, Naidu, Posner, and Weyl (2018) note that the potential wage-suppressing effect of corporate mergers should be a criterion considered by the regulators who approve these mergers.
- Yet, as we note above, the findings from these empirical analyses of market concentration also make clear that growing concentration alone is unlikely to emerge as a plausible primary driver of the adverse labor market trends affecting the vast majority of American workers in recent decades.

What if relative employer power has grown only because workers' power has been hamstrung by policy?

- Given that frictions can reduce workers' ability to find alternative employment, it is no surprise that some employers strive to create such frictions.
- For example, many firms require that new employees sign noncompete agreements as a condition of employment.
- If workers believe that these noncompete agreements are enforceable, then their ability to search for better jobs can be restricted, giving firms some degree of monopsony power.
- Or employers may collude to refrain from poaching one another's employees.
- The baldest real-world example of this type of employer collusion surfacing in recent years was the cartel of Silicon Valley employers that agreed to not hire one another's employees

The underappreciated history of research into bargaining power

- A focus on the changing power of workers in the labor market has a rich pedigree in theoretical work.
- Manning (2003) explicitly notes that models of dynamic monopsony give a lot of scope for labor market policies and institutions such as minimum wages and unions to redistribute income from employers to workers without adversely affecting economywide efficiency or employment.
- Further, dynamic monopsony models combine the existence of frictions in the labor market with an assumption that wage determination is set entirely by employers.
- Broader (but messier) models of labor markets sometimes assume that wages are set through a bargaining process in which both employers and employees have some degree of power and operate in a context where standard labor supply curves are not well defined.

Conclusion