# Monopsony in the low wage labour market: how much is there and what should we do about it?

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#### Overview

- Ultimately we want to assess the importance of monopsony in the UK labour market, especially in low-wage labour markets
- But no well-established methodology for how that should be done: this is an area which remains in its infancy
- This presentation will focus on what I see as the issues:
  - How we can measure monopsony power
  - How we can estimate consequences for wages
  - What we can do about it in terms of policy
- Have not done any empirical work as yet

# 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?
- To understand monopsony power, we need to be able to measure it
- Will provide overview much of it based on my Marshall lecture to EEA Conference 'The Measure of Monopsony'

2 Main Ideas for the Source of Monopsony Power (both identified by Joan Robinson)

- Frictions (e.g. Burdett and Mortensen, IER, 1998)
  - It takes time and money for workers to change jobs
  - These tend to be dynamic models
- Idiosyncracy (e.g. Card, Cardoso, Heining, Kline JOLE 2018)
  - Workers care about many non-wage aspects of jobs and no two jobs are perfect substitutes
  - These tend to be static models
- Both probably have some element of truth

# Empirical Measures of Monopsony Derived from Theories

- Idiosyncracy
  - Wage elasticity of labour supply curve facing the firm (e.g. Kroft, Luo, Mogstad, Setzler, 2020; Caldwell and Oehlsen, 2020)
  - Wage elasticity of applications to the firm (e.g. dal Bo and Finan, QJE 2013; Azar, Berry and Marinescu, 2019)
- Frictions:
  - Wage elasticity of separations/recruits with respect to the wage (e.g. Sokolova and Sorensen, ILRR, 2020)
  - Share of hires/quits from/to non-employment (e.g. Hirsch, Jahn, Manning, Oberfichtner, 2020)
- Ideas from measures of market power in IO:
  - Concentration ratios for vacancies/employment (e.g. Marinescu +co-authors; Abel, Tenreyro and Thwaites)

# Refresher on the basics...simple static model of monopsony

- Profits are given by:  $\Pi = F(N) wN(w)$
- First-order condition can be written as:

$$\frac{(F'-w)}{w} = \frac{1}{\varepsilon_{Nw}} = \frac{1}{\mu}$$

- Could try to estimate LHS gap between marginal revenue product and wage but:
  - Hard to distinguish between mark-ups from product market power and mark-downs from labour market power
  - Hard to estimate marginal revenue product as opposed to average revenue product
- Will focus here on attempts to measure the RHS
- Higher value of  $\mathcal{E}_{NW}$  (more elastic labour supply to firm) means less monopsony power but would like to verify the link to wages

#### Introducing Dynamics

- This is a completely static model models based on idiosyncracy have something like this form
- Not obvious how it translates to a dynamic model which is needed to incorporate frictions
- In my Marshall lecture I sketched one way of doing this can summarize ideas relatively simply

#### Simple dynamic model

• Dynamic labour supply curve to firm can be written as:

$$N_{t} = \left[1 - q\left(w\right)\right]N_{t-1} + R\left(w\right)$$

- Where q(w) is quit rate (q'<0) and R(w) is flow of recruits (R'>0)
- Static model a special case where q=1
- In steady-state N(w) = R(w)/q(w) so that  $\mathcal{E}_{Nw} = \mathcal{E}_{Rw} \mathcal{E}_{qw}$
- Will assume that quit and recruits depend only on current wage
  - May be that current wage influences expectation of future wages (this is fine)
  - May ask whether wages would also depend on the state variable  $N_{t-1}$  (this is more complicated think of workers only observing the current wage)

#### Steady-State Wages

$$\frac{(p-w)}{w} = \frac{\left[1-\beta(1-q)\right]}{q} \frac{1}{\left(\varepsilon_{Rw}-\varepsilon_{qw}\right)} = \frac{1}{\mu}$$

- Employers have more monopsony power than standard formula implies
- But labour supply or quit/recruitment elasticities remain crucial

### Still a Lot of Loose Ends:

- What are the empirical issues in estimating these elasticities?
  - Elasticities seem higher (2) if better controls for individual ability and address measurement error in the wage e.g. Bassier, Dube, Naidu
  - Can we get better research designs e.g. Kroft, Luo, Mogstad, Setzler
- What are the factors affecting quit/recruitment elasticities?
  - Intuitively more job offers means closer substitutes so higher elasticity so role for concentration ratios/tightness/local factors?
  - How do elasticities vary within and across labour markets e.g. gender, ethnicity, skill; or by 'quality' of employer within a labour market; or over business cycle/trend?
  - Role of moves to other jobs/non-employment
  - Role of dismissals in separations
  - Role of hiring intensity

### Example 1: Log Separations and Residualized Wage: UK



# Example 2: The Declining Sensitivity of Separations to Wages: UK



And also need to find how monopsony affects outcomes we care about such as wages

- Could use formula to infer consequence of elasticity for wages
- But more convincing if provide evidence for impact on wages rather than simply rely on theory
- Could be indirect e.g. link from x to elasticity and elasticity to wages
- Or more direct link from x to wages

# What can be done about monopsony power?

- Direct regulation of wages
  - Minimum wage is classic, useful, policy but can only affect wages at bottom of labour market – lots of research on this
  - Not clear how one would do this further up the distribution
- Establish counter-vailing power to the monopsony power of employers
  - E.g. trade unions or worker voice in firms little recent research on this
- More active competition policy
  - Laws often treat labour and product markets symmetrically but practice is not
- Regulation of labour contracts

Pre-COVID UK had reduced low pay to historically low levels through NMW, NLW, without seeming to harm employment

FIGURE 1: Low pay was in decline before the coronavirus crisis

Proportion of all employees below selected low pay thresholds: GB, 1968-2019



### 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)
- I worry about 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
- But a worry this is not really the case especially when 'professionals' meet amateurs:
  - we often assume people differ in their ability e.g. to explain wage inequality
  - but (except in behavioural economics exploitative contracts) assume everyone is 100% fantastic at maximizing their utility
  - For a discipline that prides itself on logical consistency in its thinking this seems a bit embarrassing to me

#### Looking Forward

- Hope to move to empirical work on UK, guided by these ideas
- Hope that will shed light on some aspects of the wider issue of the puzzling behavior of wages in the UK in recent years
- But have not got very far yet