FAIR COMPETITION IN LABOR MARKETS REQUIRES A POLICY MAKER'S THUMB ON THE WORKER SIDE OF THE SCALE

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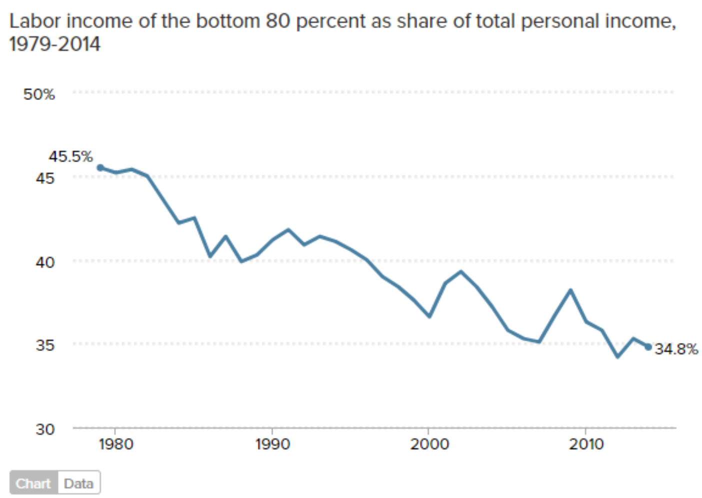
By Josh Bivens and Heidi Shierholz. June 4th, 2018.

Introduction

Since 1979, the bottom 80 percent of the American workforce has seen their pay shrink radically as a share of total income. **Figure A** below shows total labor compensation for the bottom 80 percent as a share of all market-based income in the American economy. In 1979, this share was 45.5 percent, but as of 2015 it had shrunk to just 34.8 percent. The amount of money this loss represents is staggering; had the 1979 share held constant, the bottom 80 percent of the American workforce would have had roughly $1.2 trillion in additional labor income in 2015, or about $12,000 per household.

Figure A:



Note: Labor income for the bottom 80 percent includes cash wages, employer-provided benefits, and employer-side payroll taxes, as well as labor's imputed share of unemployment and corporate taxes.
Source: Author's analysis of data from the Congressional Budget Office (2018).

What happened in the American economy that drove this collapse in pay for the bottom 80 percent? We suggest that a good metaphor is a tug-of-war, where the bottom 80 percent of workers is on one side and corporate managers and capital owners (shorthand these two groups simply as *employers*) are on the other.[1] What matters for the final distributional outcome of this tug-of-war, of course, is

[1] Yes, in the real world distributional conflicts are more complicated than a contest between two parties, but tug-of-war can be multipolar as well, as highlighted in "International Tug of War: Simulating Polarity and Alignment" (Wells 2013).

simply the *relative* strength of each side, and on these grounds the graph makes it obvious that the bottom 80 percent has lost enormous ground to their employers. But this raises three key questions.

- First, did the force brought to bear by employers in this distributional tug-of-war get stronger, or did the force exerted by typical workers somehow erode? While the final outcome of bargaining just hinges on *relative* strength, making policy decisions aimed at giving typical workers a fair shot at achieving wage gains requires a correct and precise diagnosis of what has changed in recent decades.
- Second, what role has *policy* played in granting additional advantages to one side? Did policymakers hand employers spiked cleats to give them extra purchase in the distributional tug-of-war (say by allowing industry concentration to march forward unchecked by antitrust action), or did they grease the floor under workers (say by ineffectively stopping the spread of non-compete agreements)?
- Third, a new and exciting economics literature on *market concentration* has sometimes been characterized by economic observers as providing the dominant explanation for adverse wage trends in recent decades. If this were true, allowing for greater competition to break up market concentration could be a silver bullet for getting typical workers' wages growing again. So, is it possible to achieve a competitively "fair" contest between workers and employers that will lead to more equitable distributional outcomes simply by trying to tame employer power? Or, are capitalist labor markets just intrinsically tilted against workers, and can the distributional contest never be truly "fair" without policymakers willing to weigh in on the side of workers?

Our short answers to these questions are:

- The biggest *change* in relative power between typical workers and their employers in recent decades has been a collapse of workers' power. There is some evidence of increasing absolute employer power (say through increased market concentration), but our view is that the bigger changes remain the collapse of workers' power.
- This collapse of worker power has been overwhelmingly driven by conscious policy decisions that have intentionally undercut institutions and standards that previously bolstered the economic leverage and bargaining power of typical workers; it was not driven simply by apolitical market forces.[2]
- Many of the policy changes that have undercut workers' power, however, cannot be characterized as simply being "uncompetitive" *per se*. In competitive markets in textbooks, both employers and employees lack power. But in real-world labor markets, employers rarely lack for power, and our strong view is that policymakers should care more about labor markets that are *balanced* between the power wielded by employers and workers than labor markets that are *competitive* in the sense defined by economics textbooks.

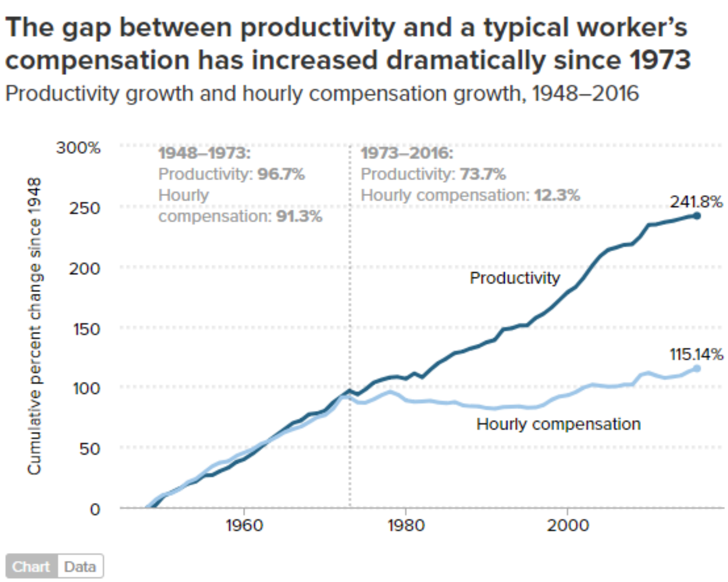
In the rest of this brief, we will expand on these answers and we will also explore how the new economic literature on the effect of market concentration fits in. We think this new literature is rigorous and eye-opening, and largely reinforces the answers to our questions above, rather than overturning them.

[2] An obvious corollary is that no new institutions or standards that provided such leverage and bargaining power were stood up to replace those that were lost.

CLAIM ONE: The biggest change in relative power between typical workers and their employers has been a collapse in workers' power.

The collapse over the last four decades in the share of national income going to the labor earnings of the bottom 80 percent, described above, has been accompanied by rising inequality and near-stagnant pay for most workers. This dynamic is arguably best represented by the divergence between the growth of compensation for the typical U.S. worker and the growth in economy-wide productivity. **Figure B** shows this divergence. In the 1950s and 1960s, hourly compensation grew at roughly the same rate as productivity. But from 1973 and 2016, productivity grew six times as fast as compensation for typical workers, with the vast majority of this gap driven by rising inequality. The gap since the 1970s between economy-wide productivity growth and growth in the typical worker's pay is the footprint of an economy in which the benefits of growth are largely being captured by those at the top of the income distribution, leaving most workers behind.

Figure B



Note: Data are for compensation (wages and benefits) of production/nonsupervisory workers in the private sector and net productivity of the total economy. "Net productivity" is the growth of output of goods and services less depreciation per hour worked.

Source: EPI analysis of Bureau of Labor Statistics and Bureau of Economic Analysis data

A recent empirical literature has attracted much attention for its hypothesis that growing market concentration has boosted the power of employers and suppressed wage growth. This literature has examined concentration in both product markets (monopoly power) and labor markets (one form of monopsony power). While this examination of market concentration is exciting and welcome, a close look at the empirical findings would argue that market concentration by itself is unlikely to be able to explain larger trends in American labor markets – like the growing gap between economy-wide productivity and pay for typical workers.[3]

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[3] See Bivens, Mishel and Schmitt (2018). We should note that the finding that concentration alone cannot explain large wage trends in recent decades is not a criticism of this literature – the papers themselves generally make no such claim and the authors tend to emphasize a broad portfolio of shifts in market power

Evaluating the role of market concentration in this growing pay–productivity gap since the 1970s can largely be informed by assessing how growing concentration affects the two channels through which increased productivity can bypass the pay of typical workers: (1) the erosion of labor's share of income, i.e. a decline in the percent of the total income in the economy that is received by workers in wages and benefits and an increase in the percent that is received by owners of capital, and (2) increasing inequality in compensation, i.e. a decline in the percent of labor's share of income that is received by low- and moderate-wage workers and an increase in the percent that is received by workers at the top of the pay distribution.

An increase in monopoly power means that firms can raise the prices that consumers pay, increasing corporate profits. This results in a shift in national income towards owners of capital and away from workers, i.e. an erosion of labor's share of income, not increasing inequality of compensation. An increase in *monopsony* power means that firms can set wages lower than they would be able to in a more competitive labor market, also resulting in a shift in national income away from workers. In other words, if increasing concentration were a key driver of the increase in the productivity-pay gap since the 1970s, we would expect to see a substantial erosion of labor's share of income.

A caveat to this analysis is that it assumes that labor market concentration affects all workers equally and hence it does not increase compensation inequality. But if, for example, labor market concentration is more pronounced in economic sectors that disproportionately employ less-credentialed workers, then concentration could in theory contribute to rising compensation inequality. An empirical examination of the effect of labor market concentration on compensation inequality is hence a prime candidate for further research.

This caveat notwithstanding, it certainly seems fair to use the shift from labor to capital incomes as a proxy for the scope of concentration's impact on the labor market. A decomposition of these two components of the productivity-pay gap (the erosion of labor's share of income and increasing inequality of compensation) shows that typical workers lost substantial ground through both channels since the 1970s -- but that rising inequality of compensation made up the vast majority of the gap. In particular, between 1973 and 2014, rising inequality of compensation made up 83.5 percent of the growth of the productivity-pay gap, whereas the erosion of labor's share of income explains about one-sixth of the gap (16.5 percent).[4] Importantly, if rising product and labor market concentration were primary drivers of the rise in inequality over these four decades, it seems that the erosion of labor share should have played a much larger role in the growth of the productivity-pay gap.

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that have affected wages. However, commentary and analysis of these papers often do make these claims, both implicitly and explicitly.

[4] https://www.epi.org/publication/its-not-just-monopoly-and-monopsony-how-market-power-has-affected-american-wages/. It is however worth noting that the erosion of labor's share of income became more important after 2000, though it still explains less than half of the productivity pay gap over this period. Declining labor share explains 46.3 percent of the gap from 2000 to 2014 compared with 53.7 percent explained by rising compensation inequality.

Bivens, Mishel and Schmitt (2018) examined some of the recent research on labor market concentration and found that the results of this research imply that increased 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 increase in the productivity-pay gap over the same period, and that recent research 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 productivity pay gap over that period. This suggests that while it is clear from compensation trends since the 1970s that employers do wield more *relative* power vis-à-vis their workers, this rise in the relative market power of employers might owe less to growing market concentration by itself.

Growing concentration is, of course, just one possible manifestation of growing employer power. Other forms are highlighted in the "dynamic monopsony" framework best elucidated by Manning (2003). In this framework, labor market frictions (uncertainty about viable alternatives or spatial mismatches or the need for flexible schedules) give employers some measure of wage-setting power over workers. For example, there may be plenty of fast-food restaurants within a few miles of a given low-wage workers' house, but maybe only one has a direct bus route that makes the commute manageable. Or only one allows for an efficient pairing of commuting and dropping kids off at school. Such frictions accumulate and grant employer-side power in the labor market.

While this dynamic monopsony approach is enormously valuable for understanding why many labor markets (particularly those for low-wage workers) don't behave the way textbook models of competitive labor markets claim they ought to, there has been little evidence so far mobilized to suggest that these frictions granting dynamic monopsony power have *increased* dramatically in recent decades (an increase is what would be required for these factors to explain the increasing productivity-pay gap). It's worth noting that growing attention is being focused on employer practices that create frictions, like noncompete agreements, nonpoaching agreements, and the use of mobility-restricting temporary immigrant work visas. This attention is more-than-warranted and will almost certainly indicate that these practices have indeed increased in recent decades. Yet it seems to us that these developments (however worrisome) are likely dwarfed by clearly-visible degradations in *employee-side* power in the labor market. Further, the degradation in employee-side power may in many cases be the thing that paves the way for employers to be able to adopt such practices.

Likely the most important factor behind the collapse in workers' bargaining power has been the erosion in the share of workers in a union, which fell from 24 percent in 1973 to 10.7 percent in 2017. Research demonstrates that this erosion has had a substantial impact on middle-wage workers, both union and nonunion (Rosenfeld, Denice, and Laird 2016).

Another post-1979 development that has undercut the bargaining position of low and moderate-wage workers is the rise in the average level of unemployment. Between 1949 and 1979 the unemployment rate averaged 5.2 percent, between 1979 and 2017 it averaged 6.3 percent. This is not just a result of the Great Recession – between 1979 and 2007 unemployment averaged 6.1 percent. Research has demonstrated clearly that low- and middle-wage workers' pay is much more responsive to unemployment than highly-paid workers. The post-1979 increase in average unemployment hence has predictably contributed to rising inequality and slow pay growth for the bottom 80 percent.

Finally, economic theory and evidence clearly indicates that growing trade with low-wage countries should boost wage inequality in the United States and lower wages for workers without a 4-year college degree. This type of trade grew significantly since the 1970s. Imports from low-wage countries were equal to 0.7 percent of U.S. GDP in 1973, but 6.3 percent in 2016.

All in all, the direct evidence indicating a substantial decline in workers' power in the labor market is much easier to see in the data than evidence indicating an increase in employers' power. This, of course, does not mean that employer power in labor markets is trivial or should be ignored. Instead, it simply may not have *changed* dramatically in recent decades, but has instead been an ongoing fact of labor markets for decades, only contributing to substantial slowdowns in wage growth when the countervailing power of workers was stripped away.

The view that labor market concentration and other specific sources of employer power have always been present but were tamed in previous decades by countervailing worker power is consistent with the empirical findings by Benmelech, Bergman, and Kim (2018), which finds that the wage-suppressing effect of labor market concentration is lessened when union coverage is strong. So, if labor market concentration has been relatively constant, but the countervailing force imposed by unionization has eroded, this combination could well have led to significant compensation losses.

CLAIM TWO: The collapse of workers' power has been driven by conscious policy choices

The prior section suggests that it has always been the case that American labor markets are riven with forces – concentration and other frictions -- that impede competition and, all else equal, give employers the power to set wages lower than the competitive wage. This section will show that the key difference between the post-1970s period (when the pay of most workers and economy-wide productivity diverged) and previous decades (when pay and productivity grew in tandem) is that in the earlier period, these sources of employer power were more likely to be compensated for by institutions and policies that provided countervailing power to workers. In the recent period, many of these institutions and policies have eroded or been rolled back, with nothing to replace them as sources of countervailing worker power.

Take, for example, the higher average unemployment rate characterizing the post-1979 period. This is not just a sad accident. Instead, macroeconomic policy (particularly monetary policy) has prioritized steady and very low inflation over low unemployment in recent decades. Even by too-conservative standards set by official estimates of the natural rate of unemployment, macroeconomic policy has failed to secure full employment for the large majority of these years. It is no coincidence, in our view, that the only period of strong, across-the-board wage growth since 1979 was during the late 1990s and early 2000s, when unemployment was allowed to fall far below levels that had previously been thought to lead to accelerating inflation.

Similarly, the steady erosion of union coverage is not the natural evolution of a modern economy, as is often claimed. Instead, it is the result of a sustained policy assault on workers' right to effectively organize. Almost half (48 percent) of workers polled said they'd vote to create a union in their workplace tomorrow if they got the chance, indicating that union decline was not driven by workers' preferences (Bivens et al 2017). Instead, a failure of policy to keep the playing field level between workers hoping to organize and employers willing to engage in ever more-aggressive practices to stymie these campaigns has driven this decline (Bronfenbrenner 2009).

For the bottom-end of the labor market, the policy assault on their bargaining position is obvious: the federal minimum wage is now roughly 25 percent lower in inflation-adjusted terms than it was at its height in 1968, even though productivity has nearly doubled and low-wage workers have become far more educated in the intervening years (Cooper 2017). Notably, policymakers have failed to enact sufficient increases in the federal minimum wage despite growing economic evidence that most minimum wage increases since 1990 (at the federal or state level) have not caused measurable employment loss, contrary to predictions of competitive labor market models (Cooper, Mishel, and Zipperer 2018). This finding of no measurable job-loss is consistent with low-wage labor markets that are characterized by monopsony power held by employers. In models of monopsony, legislated wage increases can lead to higher wages and greater, not reduced, employment.

Further, employers have pursued an aggressive host of practices meant to limit workers' bargaining position, and policymakers' have not, for the most part, taken the necessary action to curb these practices through strengthened standards or enforcement. These include practices like requiring workers to sign mandatory forced arbitration agreements with class and collective action waivers as a condition of employment, misclassifying workers as independent contractors, and not providing workers with predictable schedules.

Finally, the rise of globalization that has pressured American workers' wages is often presented as inevitable – simply driven by technology and other countries' decisions to join the global trading system. There is some truth in this and these developments were likely always going to be hard on American workers' wages. But this trade-induced redistribution has been amplified by policy decisions. Trade agreements in recent decades have sought to maximize labor market competition between workers in the U.S. and abroad while simultaneously boosting protections for corporate profits.[5] Further policy actions that amplified the wage-depressing effects of globalization include tolerance of an overvalued dollar which led to trade deficits and manufacturing job-losses. Globalization's pressure on American wages, in short, clearly has deep policy roots that look like intentional assaults on the economic leverage of typical workers.

CLAIM THREE: Lodestar for economic policy should be *balanced*, not necessarily *competitive*, labor markets

The previous sections have highlighted that it is primarily a collapse of workers' power, rather than an increase in employer power, that has so imbalanced the distributional tug-of-war in recent decades and led to the rise in inequality. We have also shown that the fingerprints of intentional policy decisions are all over this collapse in workers' power.

However, many of the key policy changes that undercut workers' power cannot necessarily be characterized as making the labor market less "competitive." The textbook conceptions of competitive labor markets are those where *both* employers and workers lack power. In fact, an implication of a perfectly competitive model of the labor market is that policy interventions that

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[5] These protections included expansions of American intellectual property protections to other countries and new legal fora for multinational corporations to contest regulatory actions that could reduce their profits.

intentionally reduce union power and/or the purchasing power of legislated minimum wages push labor markets *closer* towards the textbook definition of competitive.

The recognition that "deviations" from competitive models do not only occur on the worker-side of labor markets is an obvious motivation for the new attention being given to market concentration by many authors. However, as we noted above, the empirical bite of concentration on wages does not seem large enough for this concentration to explain a large portion of the gap between typical workers' pay and economy-wide productivity. Relatedly, there is little evidence indicating that concentration has *increased* significantly enough in recent decades to provide a compelling explanation of wider trends in wages. This makes us pessimistic about relying only on tools that tame employer power as a key strategy for improving outcomes in the labor market.

Our pessimism also stems from a judgement that bargaining between employers and workers takes place on an unlevel playing field even in non-concentrated markets that have not been riven by noncompete agreements or other explicit aids to employer power. Labor markets are generally tilted against individual workers simply because workers only have one job to lose while employers typically have access to plenty of workers. The fact that power is exercised even in labor markets characterized by free entry of employers has often been overlooked or even denied by economists. Alchian and Demsetz (1972) argued, for example, that:

> *"The firm ... has no power of fiat, no authority, no disciplinary action any different in the slightest degree from ordinary market contracting between any two people...Wherein then is the relationship between a grocer and his employee different from that between a grocer and his customer?* (1972, p. 777)

Hart (1989) provides one of the clearest statements of how labor markets *are* different from product markets, and how employers are indeed likely to be able to exercise power over their employees:

> "*… the reason that an employee is likely to be more responsive to what his employer wants than a grocer is that the employer...can deprive the employee of the assets he works with and hire another employee to work with these assets, while the customer can only deprive the grocer of his customer and as long as the customer is small, it is presumably not very difficult for the grocer to find another customer*."

In the end, our reading of the evidence on labor market trends is that employer power is ubiquitous and persists even when there is free entry into markets. This employer power is simply a fact of modern capitalist labor markets. Perhaps the best recent mobilization of evidence in support of the view that labor markets' "natural" state is characterized by significant employer power is provided by Naidu and Yuchtman (2016), who look at American labor markets in the Gilded Age (late 19th and early 20th century). They note:

> *"The American Gilded Age labour market came extraordinarily close to the archetypical labour market taught in Economics 101 (Fishback 1998). One might think that in a world without regulatory red tape, the labour market would simply equate supply and demand, establishing a 'market wage' for a unit of labour, eliminating non-competitive rents, and diminishing the stakes from conflict. One might further assume that in such a world, the institutions resolving such conflict would be irrelevant. However, we provide evidence that despite the lack of regulation, economic frictions in the labour market generated rents, and costly and violent conflicts over these rents were pervasive."*

We interpret these findings as arguing that there is no way to construct a labor market that conforms to competitive ideals found in textbooks. Instead, the prelapsarian state of capitalist labor markets is one where power rules and employers have disproportionate power. The only period that has seen sustained, shared prosperity up and down the wage distribution, the decades following World War II, was one during which politics led to strong policy buttresses for labor's bargaining position. We worry that this point might be obscured by a recent flurry of interest in one facet of employer power - market concentration - that may be ameliorable in some cases with policy action (antitrust, for example). Restricting policymakers' attention only to pushing back against violations of competitive markets that empower employers will not lead to a restoration of healthy and equitable wage growth.

Conclusion

Some economists and policymakers might express unease at the view that the downsides of one market imperfection (either frictions or market concentration granting employers power) should be countered by introducing another marker imperfection (unions or a binding minimum wage). But this unease is unwarranted. The "theory of the second best" clearly argues that once markets depart at all from perfect competition, efficiency may well be increased by further departures. For example, in the case of monopsony power in low-wage labor markets, legislated minimum wage increases move wages closer to efficient levels and increase employment.

All of this certainly does not mean one should ignore potential policy opportunities that could erode employer power (say through more robust antitrust enforcement) or strip away non-competitive constraints on workers using competition to their advantage (say by banning most non-compete agreements). But the larger opportunities are likely those that lead to more labor market *balance* in the power between employers and workers without necessarily moving the labor market closer to some competitive ideal.

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