Fostering More Competitive Labor Markets through Transparent Wages

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Introduction

Over the past several years, weakened labor market competition has been gaining attention as a source of stagnant wages, lower employment, and rising inequality.[2] In 2016, for example, the Obama administration made improving labor market competition a key objective—calling on states to reform their rules around non-competes and establishing antitrust guidance and a reporting hotline for human resource professionals.

In broad terms, the policy focus on lack of competition—and the presence of monopsony power by employers—can be separated into two categories. The first is characterized by monopsony power arising from increased industry concentration, which would traditionally fall under the purview of antitrust regulators. A second focus is on employer practices that create monopsony-like conditions or inhibit competition, such as non-compete agreements, reclassification of workers to avoid paying overtime, mandatory arbitration, and tacit collusion.[3] A related concern is horizontal shareholding—effective monopolies created when an institution controls large shares of competing companies—has generally received less attention, but preliminary evidence has linked this phenomenon to lower employment.[4]

Wage transparency has received relatively little attention as part of a policy strategy to combat limited competition. This is not to say it's been ignored: advocates for more equal pay have long argued for eliminating prior discussion of wage history to arrest the continued impacts of gender-based discrimination. Indeed, from an Obama-era executive order prohibiting contractors from discouraging wage discussions to the proposed Paycheck Fairness Act, policymakers have made wage transparency a key part of making women's pay more equal.

As I argue in this brief, wage transparency has a broader role in the growing arsenal of strategies to make the labor market more competitive—including but not limited to gender-based discrimination. This brief first lays out the theory behind why limited wage information can inhibit labor market competition, discusses the prevalence of wage information in the labor market, and concludes with a series of proposed reforms to help make wages more transparent.

The underappreciated role of transparency in labor market competition

A competitive labor market is typically characterized by a few key conditions.[5] Firms are price takers, meaning that they have no power to set prices. Workers can freely and instantly move from one firm to another if they receive less than the market-set price. And the wage determined by the market is equal to a worker's marginal product of labor, or the additional revenue added by their labor. This creates the desirable situation whereby workers are on a "knife's edge": if employers pay anything below the market wage, all workers immediately leave; if employers pay anything above the market wage, they pay unnecessarily high compensation and as a result forego potential profits.

[2] See Council of Economic Advisors (2016) for a summary of the link between competition and these outcomes.
[3] See Krueger (2017) for an accessible review of anti-competition practices by employers.
[4] See Elhague (2016) for a discussion of horizontal shareholding.
[5] See Bhaskar, Manning, and To (2002) for an overview of competitive labor market theory.

Economic theory has focused on the breakdown of a competitive labor market when assumptions about sufficient employer competition and worker mobility are not satisfied. For example, if a firm has market power and can set prices—that is, workers do not have sufficient alternatives—then that firm will set wages at the level that maximizes its profit, depressing wages and, subsequently, the amount of work in the economy. (Tacit collusion is a strategy for obtaining market power by limiting plausible alternatives.) And if workers cannot freely and easily move from one job to another, due to non-competes or other labor market “frictions,” employers can set wages at least somewhat below the market wage and still fulfill their desired payroll.

But the theory of a competitive labor market also depends on workers knowing whether they are on the “knife’s edge” in the first place. This assumption has received surprisingly little emphasis in the discussion around competitive labor markets, which implicitly considers workers and firms to have the same level of information. As discussed below, many workers do not. Just as restrictions such as non-competes might prohibit a worker from switching jobs, lack of transparency about market wages might stifle the motivation to move to a better-paying position.

An additional consideration is that in many labor markets, lack of competition stems from limited transparency as well as asymmetric information. That is, due to their ability to purchase or commission surveys of employee compensation (known as “benchmarking surveys” or “salary surveys”), employers often have precise knowledge of the distribution of wages in a given market—dwarfing the information available to workers through public data sources, anecdotes, or biased self-reported data on the internet.

The result is that some labor markets suffer from asymmetric information. Information asymmetry in economics is usually characterized by one party having access to some information which is difficult to observe—such as the likelihood that a borrower will repay a loan or the work effort supplied by an employee. Study after study in economics has shown that having an informational advantage provides the better-informed party with a superior outcome. To name a few examples, Sadler and Sanders (2016) show that asymmetric information between NBA team owners and players improved the owners’ bargaining position during lockout negotiations, Aboody and Lev (2000) explore how insider knowledge of research budgets can lead to large stock gains, and Sufi (2007) reveals how asymmetric firm-specific knowledge leads lenders to change how they structure corporate loans.

In the labor market context, information asymmetry can also refer to differential knowledge of prices—in this case wages, which are the prices assigned to different forms of labor. Prior studies of instances when prices became more transparent lead to idiosyncratic results. For example, a requirement in Denmark that concrete suppliers make their contracts public corresponded with a 15–20 percent rise in prices (Albaek, Mollgaard, and Overgaard 1997), while another study found that increase price transparency of life insurance contracts, owing to easier comparison due to increase internet penetration, significantly reduced the price of insurance contracts (Brown and Goolsbee 2002). A review by the Congressional Research Service found that “Most research suggests that when better price information is available prices for goods sold to consumers fall” (Austin and Gravelle 2008).

A handful of high-quality studies measure the impact of wage transparency specifically. One study of a 2010 California mandate that public manager salaries be made public found that disclosure lowered public salaries, especially those above $200,000, and steeply raised resignations—findings attributed to populist backlash against high public salaries (Mas 2017). Another study examined a Depression-era mandate regarding disclosure of executive salaries, finding that executive salaries generally ratcheted *up* as a result of such disclosure: lower-paid CEOs within an industry saw their wages increase once they could see how well other CEOs were paid (Mas 2016). Pay disclosure can also impact more than just wage levels: an experimental study found that workers with relatively low pay reported diminished satisfaction and higher rates of job seeking after learning about their pay relative to others (Card *et al.* 2012).

The recent focus on lack of competition in the workforce has led some to call for "a new theory of the labor market." Such a call may be warranted, or at least perfect competition should be regarded more as a special, aspirational circumstance rather than the baseline case. Importantly, too, labor economists and policymakers alike should consider the potentially negative implications of a market in which the distribution of wages is more transparent for employers than for workers.

The transparency landscape

In the United States, wage transparency is uneven and sporadic. The public sector is often characterized by fully transparent wages, with some wages being published on public websites. For example, all salaries of Congressional staffers are published online (mined by the company *Legistorm*), as are those of many executive branch employees. Salaries paid to state and local government employees are often available as well.

Wages are less transparent in the private sector, but there are exceptions. Unionized workers likely have access to, or are represented by an entity with, substantial data on compensation. A handful of private companies, such as the software firm *Buffer*, publish their salaries. Websites like *Glassdoor* and *PayScale* can provide self-reported data on wages and compensation, although the data might not constitute a reliable and representative sample of workers. Workers in minimum wage jobs know the wages of their counterparts are bound by the statutory minimum. On the opposite end of the spectrum, public companies must disclose the compensation paid to their CEO, CFO, and three other highest-paid executives; non-profits filing form 990 must report the compensation of their five most highly paid workers. Public sources of data, such as the Bureau of Labor Statistics and some trade associations, publish broad wage measures—such as mean wage by occupation—but these often lack sufficient precision (in terms of specific jobs and locations) to assist workers in wage negotiations. Beyond public-sector workers and select private-sector cases, the extent to which workers precisely know the distribution of wages in a given market is largely unknown—although there is little evidence to suggest that most workers know the distribution of compensation within a given market.

One of the major barriers to better knowledge of worker compensation are policies and environments that discourage workers from talking about their pay. The right to discuss pay is partially protected by the National Labor Relations Act of 1935, which states that workers are allowed to engage in "concerted activities for the purpose of collective bargaining or other mutual aid or protection" (29 U.S.C. § 157), and Title VII of the Civil Rights Act of 1964. Yet the protection is not absolute. Supervisors, independent contractors, agricultural workers, and public sector workers are among those not covered by the law. More importantly, employers who violate the law are typically subject only to minor fines and penalties.

While workers likely do not have fully information on wage levels, employers can know this information with precision. Employers often have ready access to fulsome data on compensation through salary surveys, also referred to as compensation surveys, which typically provide the distribution of recently-paid compensation to workers in a very specific labor market. For example, these surveys might provide the level and composition of compensation for a specific job at the 25th, 50th, and 75th percentiles. The use of compensation surveys are widespread, with PayScale (2017) recently estimating that over half of North American companies utilize the service.

These surveys are rightly justified on the grounds that hiring firms want to offer competitive salaries. Just as public information is generally insufficient for workers to understand a market, employers often require a salary survey to help identify the market wage. Indeed, the need for better information is why so many consulting firms provide this service, and why so many firms are willing to pay for the privilege.

But the widespread use of salary surveys creates a stark asymmetry between the knowledge available to employers versus employees. And in wage negotiations or in determining relative bargaining power, being less-informed can only hurt one's position. Just as buyers of a new home seek "comparables" from recently purchased properties to help in negotiations, workers would benefit from market data on wages.

New approaches to encourage transparent wages

In large part due to the increased concern over gender-based pay discrimination, laws to promote widespread wage disclosure are gaining popularity. For instance, an increasing number of states are passing anti-retaliation laws that prohibit employers from punishing workers for discussing pay. The Obama administration took a series of steps to collect wage data more effectively as a strategy for combating gender and race discrimination. Last year, Germany passed a law that empowers workers to request data on the compensation of their peers, and that offers arbitration if the worker believes her compensation to be below her economic value; earlier this year the United Kingdom implemented a new regulation that employers with 250 or more workers publish median and mean pay gaps, among other measures of pay disparity. And in the U.S. Congress, lawmakers have proposed the Paycheck Fairness Act to prohibit employer retaliation against workers who share wage information.

These are all positive and consequential proposals, but they are far from the final word. In a recent Hamilton Project paper (Harris 2018), I laid out a five-pillar strategy to complement existing efforts to make wages more transparent. The unifying theme through these proposals was to address information asymmetry—to provide employers and employees with a similar set of information from which to bargain. This set of proposals is summarized below.

Provide uniform coverage at the state-level for worker discussions on pay

Several states have tried to address the disconnect between the protection provided by the NLRA and workers' reports of mandatory pay secrecy. As of 2018, fifteen states and the District of Columbia have laws that explicitly prohibit employers from retaliating against workers who discuss pay. In 1982 Michigan was the first state to enact a pay secrecy law, prohibiting retaliation against workers for discussing pay and prohibiting employers from requiring workers to waive their right to discuss pay. California passed a similar law in 1985. Since then, twelve additional states have passed wage secrecy laws (Department of Labor [DOL] 2016).[6]

State legislatures that have not yet adopted laws protecting workers from employer retaliation for pay disclosure should do so. Laws should be broadly written along the lines found in Michigan's statute, such that workers are protected from retaliation and employers are prohibited from requiring that workers sign clauses restricting pay disclosure.

These state-level strategies are still being evaluated. If they eventually prove less effective than has been hoped, a potential extension of the proposal would be for states to adopt laws explicitly prohibiting employers from including anti-disclosure clauses in contracts, rather than simply requiring that workers be permitted to decline to sign the clauses without loss of employment. Such an extension would nearly eradicate the practice of employers exerting pressure on workers to withhold wage information but could lead to adverse consequences for industries and occupations with legitimate need for nondisclosure of compensation.

Continue an Obama-era policy to collect additional data through the EEOC

In January 2016 the Equal Employment Opportunity Commission (EEOC) and the Department of Labor announced plans to begin collecting wage data by gender, race, and ethnicity from large employers. The change would have required employers with more than 100 workers to submit aggregated wage and hours data across job categories, pay bands, and demographic characteristics. The EEOC would have collected these data through a revision to the EEO-1 form, an annual filing requirement for a subset of private-sector firms to report employment data by race, gender, and ethnicity; the revised form would collect data on pay, in addition to employment.

In August 2017 the Trump administration effectively halted the move when the Office of Management and Budget (OMB) issued a stay against the implementation of the revised form. To better improve transparency, OMB should lift the stay on the revision to form EEO-1.

Revising the form would have three distinct impacts on wages. First, the revised data-collection process would have provided companies with an opportunity to address gender and racial inequities themselves.[7] Second, the development would also have better enabled the EEOC

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[6] These states include Colorado, Connecticut, Illinois, Louisiana, Maine, Maryland, Minnesota, New Hampshire, New Jersey, New York, Oregon, and Vermont, as well as the District of Columbia.

[7] The oft-cited example is the company Salesforce, which—along with other companies—signed a White House–initiated pledge to address gender pay inequities (White House 2016). Salesforce regularly reviews its compensation structures to identify inequities, and in recent years has twice adjusted its pay levels to account for glaring discrepancies. The aspiration of President Obama's executive order was to induce similar reviews at other companies.

to undertake reviews of companies that exhibited evidence of pay disparities. In particular, the newly collected aggregated data would be a useful first screen for the EEOC to investigate wage disparities. Third, the revised EEO-1 form would have furthered a growing shift in workplace culture toward more transparency about worker pay.

Amend antitrust safe harbor to encourage sharing of compensation surveys

To help clarify the boundaries of legal behavior, in 1993 the Department of Justice (DOJ) and Federal Trade Commission (FTC) jointly issued a statement establishing an antitrust safety zone, or a safe harbor, for exchanges of price and cost information between firms (DOJ and FTC 1993). This statement related specifically to the health-care industry, but the guidance for sharing compensation information is applicable to other industries, as well. In broad strokes, the safe harbor protects companies if they obtain compensation information through a third-party, it is at least three months old, and is based on information from at least five providers.

There is currently no aspect of the safe harbor that encourages firms to share data on market wages with workers. The DOJ and the FTC should amend the safe harbor to facilitate information symmetry in the labor market. To better encourage information sharing, the fourth part of the safe harbor should require that compensation surveys be made available to workers. That is, in order to gain regulatory assurance that information sharing does not violate antitrust law, the DOJ and FTC should require that if companies use compensation surveys in any capacity, they must share the information with workers. Appropriate safeguards could be put in place to limit workers' ability to make the information public beyond the firm, including stipulations that employers can limit or prohibit electronic transmission of the documents.

This addition to the safe harbor could have two distinct effects. First, employers could reduce their use of compensation surveys. This result seems unlikely, because human resources departments have come to rely on compensation surveys to benchmark wages, and there is no comparable source of information that would fill this need. Second, firms could begin sharing the results of compensation surveys with workers, providing employees with a better understanding of where their pay falls in the distribution of comparable jobs.

Facilitate reciprocal pay disclosure

A recent push has been made to address gender pay disparities by banning or delaying discussions of pay history. However, a wholesale ban on discussions of wage history presents drawbacks, because there could be several legitimate reasons for employers to know a potential worker's prior wages. Employers might reasonably want to learn about a worker's productivity, and prior wages can be informative. Employers might also want to offer potential hires an attractive wage relative to a worker's wage history. In addition, banning discussions of wage histories does not guarantee that gender and racial biases will fade away.

Ultimately, the goal is for all parties to have complete information, rather than to exacerbate the asymmetry on either side. An alternative approach is to provide workers with a more complete understanding of their wage offer relative to other workers, helping to create a more level playing field with regard to wage negotiations. Under this framework, prospective workers could trade information regarding their most recent wage history in exchange for companies revealing their own information about their wage distribution. Specifically, states should amend their bans on discussions of wage history to require reciprocity: asking prospective workers about their wage history would be permitted, but only if the employer in turn provided an average wage of comparable positions within the company. Under this proposal, firms could choose between either forgoing any discussion of prior pay levels (for both the firm and prospective worker) or fully disclosing pay of comparable employees.

Fund evaluations by the Department of Labor to better understand pay transparency

The DOL has been a leader in creating the infrastructure to evaluate the impacts of key programs within its purview. In 2010 the agency established the Chief Evaluation Office, charged with directly studying and funding evaluations of issues and programs related to labor policy in the United States. In 2017 its studies ranged from the impact of trade adjustment assistance to the efficacy of state workforce training centers.

Funding for the Chief Evaluation Office comes from one of two sources: funds that were directly appropriated for departmental evaluations, and program set-asides. Set-asides are funds allocated, at the discretion of the secretary of labor, to evaluate particular programs; these can amount to up to 0.75 percent of the program's cost. In fiscal year 2016 the DOL had $10 million and $30 million, respectively, for these two funding sources for evaluation.

Congress should allocate $1 million in annual appropriations for the DOL to evaluate the impact of pay transparency on worker compensation. This funding—which would increase the DOL's evaluation budget by 2.5 percent—should constitute an increase in the departmental evaluation budget, rather than a reallocation of existing funding. Potential areas of study could include the impact of state and city bans on discussing pay history, the impact of new public sources of wages (such as Glassdoor) on pay levels, and an investigation of international reforms. A better understanding of the impacts of pay transparency will inform policymakers as they seek to increase competition and ensure that workers receive pay commensurate with their economic value.

Conclusion

In practice, competitive labor markets cannot work without transparency. The theoretical proposition that worker's operate on a "knife's edge," willing to seek new employment if their pay is below the market rate, implicitly assumes that workers know when they are underpaid. However, workers at private-sector firms frequently lack reliable data on market wages, which puts them at a distinct disadvantage relative to often better-informed employers. In wage negotiations, this information asymmetry might put workers at a marked disadvantage.

Fortunately, progress is being made. States are prohibiting employers from discouraging wage discussions. The Obama administration put in place several initiatives to make wages more transparent; initiatives that have been arrested by the current administration but could easily be reinstated. Internationally, both Germany and the U.K. have put in place laws that dramatically change workers' knowledge of wages.

This brief summarizes a five-part framework to continue this momentum, with the end goal of creating a labor market characterized by symmetric information—where all parties have complete information about wages and compensation. Although there is probably no "silver bullet" to right the wage stagnation that has plagued the U.S. labor market for decades, more transparent wages can help raise worker's bargaining power and make labor markets more competitive.

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