in brief...

Monopsony in labour markets: what it is, why it matters

Many firms are able to exploit the fact that it is hard for workers to move from one employer to another, keeping wages lower than they would be in a competitive market. As **Alan Manning** explains, labour markets are becoming less dynamic and one consequence is to increase this 'monopsony power' of employers.

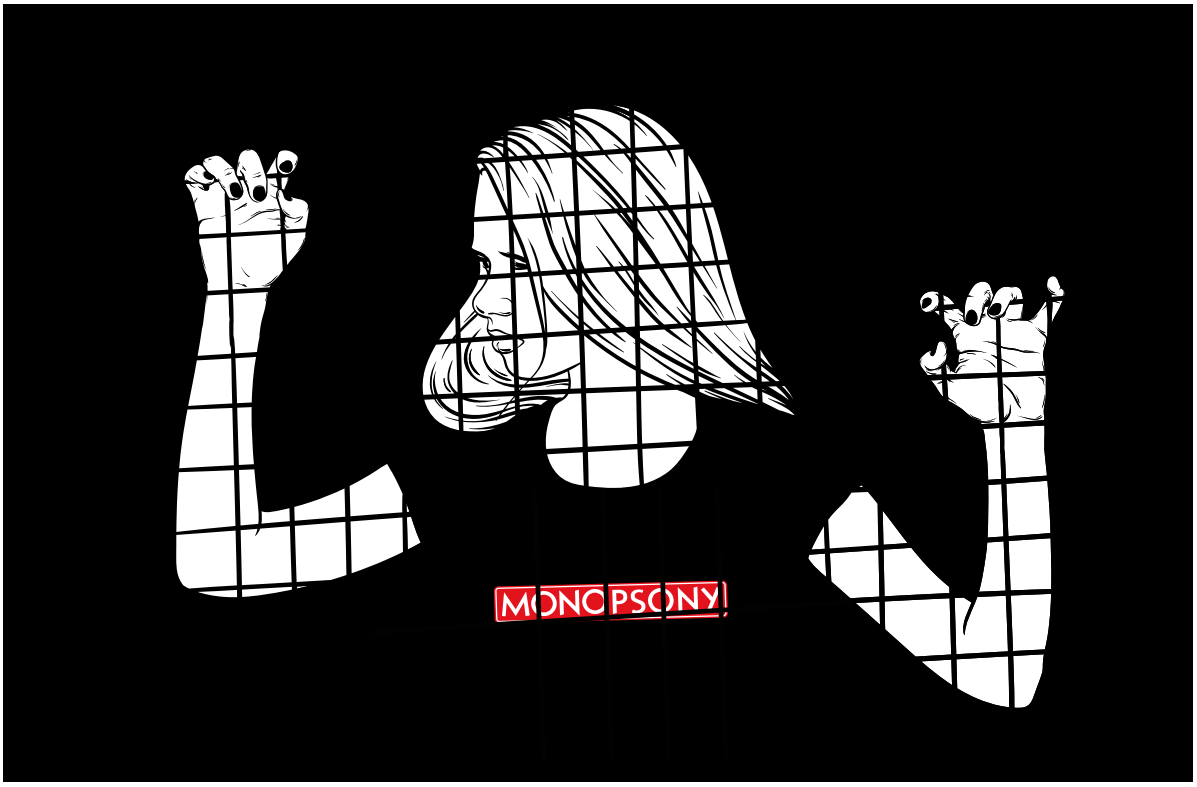
You have almost certainly heard of monopoly, but are less likely to have heard of monopsony. The literal definition of monopoly is a situation where there is only one seller of a product, although the term is used more loosely to refer to the case where there are a few sellers and not much competition between them. Such firms have what is called 'market power': some ability to set their own prices.

The consequence of monopoly is that prices are higher than they would be in a competitive market. Monopsony refers to the same idea but for employers; the consequence is that wages are lower than they would be in a competitive market.

In the labour market, employers have monopsony power because it is hard to change jobs. An employer that pays lower than average wages may find it harder to recruit and retain workers but is still able to hire some.

Monopsony is not a new idea – it was invented by the economist Joan Robinson in 1933. On paper, the competition laws of many countries (including the UK) could be applied to monopsonists just as much as monopolists. In practice, there was almost no action taken on monopsony; in the United States, many mergers have been blocked because of fears they would increase monopoly power, but none have been blocked because of concerns about increased monopsony power.

The monopsony power of employers has been neglected for too long: we need to do something about it



In the United States, that began to change when it became apparent that some employers were engaging in what seemed to be blatantly anti-competitive practices in the labour market. In one case – eventually settled out of court – household names Apple, Google, Intel, Adobe, Lucasfilm, Pixar and Intuit were accused of having agreements between them to limit the hiring of each other's workers.

Steve Jobs tried at one point to enter a similar arrangement with Palm, only to be told by its chief executive that such an agreement was immoral and likely to be illegal. At this point, Jobs appeared to threaten Palm with litigation over alleged patent infringements. In response to this and other cases, the US Department of Justice issued guidance on human resources practices in 2016. Other countries are yet to take this as seriously.

In product markets, a practical way to limit monopoly power is to increase the ability of customers to change from whom they buy. Similarly, measures to increase the mobility of workers are a powerful way to limit the monopsony power of employers. Yet we do not do this.

Imagine you want to change the supermarket where you buy your groceries; your existing supermarket allows this but only if your new shop is more than half a mile from them. Unthinkable!

Yet many workers sign employment contracts containing 'non-compete' clauses or restrictive covenants that limit their ability to work for rival employers in the future. In the UK, the High Court has ruled it acceptable for a hairdressing salon to prevent its employees from working for other salons within half a mile. Half a mile might not sound like much but 50% of commutes for hairdressers are less than ten minutes so this may be a sizeable reduction in employment opportunities.

Utility regulators in the UK have actively made it easier for consumers to switch supplies of gas, electricity and water in the belief that this promotes competition. Yet your employment contract probably contains a lengthy notice period that makes it harder for you to change employers. These notice periods are so normal that we do not reflect on whether they are anti-competitive.

The monopsony power of employers has long been an unrecognised problem, but it may also be an increasing problem. In my Marshall Lecture to the 2020 European Economic Association annual congress, I presented evidence that the monopsony power of employers has been increasing over time. Contrary to common belief, labour markets are becoming less dynamic and one consequence of this is to increase the monopsony power of employers.

So, what can be done about monopsony? One way is to raise wages directly, for example, through minimum wages. This approach has its place but can only help to address monopsony power at the bottom end of the labour market.

Ways to limit monopsony power include minimum wages, trade unions, competition policy and regulation of employment contracts

Elsewhere, perhaps we need measures to give countervailing power to workers, either through a more supportive environment for trade unions or giving workers a louder voice on boards. Trade unions are often accused of raising wages above competitive levels but if we start from a point where wages are too low, we want wages to be higher.

The competition authorities need to be more alert to the possibility of anti-competitive collusive practices among employers. In *The Wealth of Nations*, Adam Smith wrote that 'We rarely hear… of the combination of masters; though frequently of those of workmen. But whoever imagines, on this account, that masters rarely combine, is as ignorant of the world as of the subject.' It has taken us over 200 years to realise that he had a point.

We also need to think about how to regulate what is and what is not allowed in employment contracts, including non-compete clauses and notice periods, but also zero-hours contracts and fake self-employment among many other issues. The general approach here is too often hampered by the view that if an employer and worker voluntarily sign a contract, the presumption is that both parties benefit from it (otherwise they would not have signed it).

But in labour markets (and some other markets) we often have a situation akin to one where a professional is interacting with an amateur; an employer typically has experience of dealing with many more workers than a worker has experience of employers. Part of being a professional is to be skilled in getting the other party to agree terms favourable to you but not them. The state needs to step in to influence what is allowable and what is not.

The monopsony power of employers needs to be taken seriously. It has been neglected for too long – and we need to do something about it.

Alan Manning is professor of economics at LSE and co-director of CEP's community wellbeing programme. This article is a summary of his Marshall Lecture, 'The Measure of Monopsony', delivered at the European Economic Association's annual congress in August 2020.