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### Horizontal Collusion and Parallel Wage-Setting in Labor Markets

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Horizontal Collusion and Parallel Wage-Setting in Labor Markets  
Jonathan Masur & Eric A. Posner<sup>1</sup>

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Abstract

Horizontal collusion among employers to suppress wages has received almost no attention in the academic literature, in contrast with its more familiar cousin, product market collusion. The similar economic analysis of labor and product markets might suggest that antitrust should regulate labor and product markets in the same way. But product markets and labor markets do not operate identically: people behave differently as employees and as consumers. Unlike consumers who can switch products relatively easily, employees face significant frictions in changing jobs. Other labor market frictions are created by the pay equity norm and downward nominal wage rigidity. These factors and related factors stabilize collusive arrangements and facilitate tacit coordination in labor markets. Antitrust law should therefore more aggressively regulate labor market collusion, including tacit coordination, than product market collusion.

Introduction

In the last few years, academics and policymakers have turned their attention to the role of antitrust law in countering labor monopsony. This work was stimulated by a series of papers written by labor economists that document the high level of concentration in many labor markets and offer evidence that labor market concentration is (as theory would predict) negatively correlated with wages.<sup>2</sup> Other work has found that employers frequently use anticompetitive terms in contracts affecting labor markets, including covenants not to compete and no-poaching agreements.<sup>3</sup> Yet antitrust claims against employers for labor market abuses are exceedingly rare. Law professors and economists have begun to explore why this is the case, and what (if anything) can (or should) be done about it.<sup>4</sup> Policymakers and lawyers in the White House, Congress, the Federal Trade Commission, the Department of Justice, and state attorney general

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<sup>2</sup> José Azar et. al, *Labor Market Concentration*, 1 J. HUMAN RESOURCES 1218 (2020); Efraim Benmelech et al., *Strong Employers and Weak Employees: How Does Employer Concentration Affect Wages?*, J. HUMAN RESOURCES 0119 (2018); Kevin Rinz, *Labor Market Concentration, Earnings, and Inequality*, 56 J. HUMAN RESOURCES 0219 (2021); Elana Prager & Matt Schmitt, *Employer Consolidation and Wages: Evidence from Hospitals*, 111 AM. ECON. REV. 397 (2021); others.

<sup>3</sup> Michael Lipsitz & Evan Starr, *Low-wage workers and the enforceability of noncompete agreements*, MANAGEMENT SCIENCE (2021); and the recent survey by others.

<sup>4</sup> Suresh Naidu et al., *Antitrust Remedies for Labor Market Power*, 132 HARV. L. REV. 536 (2018); Herbert J. Hovenkamp & Ioana Marinescu, *Anticompetitive Mergers in Labor Markets*, 94 IND. L. J. 1031 (2019); Ioana Marinescu & Eric Posner, *Why has Antitrust Law Failed Workers?*, 105 CORNELL L. REV. 1343 (2019); Eric A. Posner, *How Antitrust Failed Workers* (2021).

offices have been considering reforms to antitrust law or new ways to enforce it. Both the FTC and the DOJ have announced and begun to execute new enforcement priorities oriented to anticompetitive labor market abuses.<sup>5</sup>

The academic literature has focused so far on mergers, with some attention to no-poaching agreements, but has not addressed major forms of collusion that are the bread and butter of antitrust law. We try to fill this gap by bringing the literature on (horizontal) collusion and oligopoly in product markets to bear on the special features of labor markets. We argue that while the rules of antitrust law are symmetrical in the sense they apply to all markets, special features of the labor market suggest that collusive wage agreements—both explicit and tacit—are likely to be more durable and cause greater harm than collusive agreements to fix prices. Accordingly, collusive wage-setting agreements deserve more aggressive scrutiny from courts and antitrust regulators than similar price-setting agreements, and far greater scrutiny than they are currently receiving.

In making this argument, we begin with the premise that the status quo approach to coordination in product markets is correct. Under the status quo, firms are permitted to tacitly coordinate prices and other product features. Firms are prohibited from explicitly colluding to fix prices, quantities, or other aspects of production and distribution. But even for explicit collusion, courts have set a high pleading standard for plaintiffs. In order to survive a motion to dismiss and reach discovery, a plaintiff (usually) must demonstrate some evidence of both parallel pricing (or other suspicious behavioral patterns consistent with cooperation) and indicia of an explicit agreement. The court's skepticism appears to reflect the assumption that cartels are inherently unstable. Cartels are believed to be hard to form and even harder to sustain. Accordingly, the conventional wisdom is that plaintiffs should be forced to meet a high burden in order to get discovery in collusion cases. We are, in fact, not sure whether the conventional wisdom is correct but we have nothing to add to this debate, and prefer to begin with a premise that is widely accepted.

We then argue that even if the conventional wisdom is correct, the courts should not be similarly reluctant to hold employers liable. Courts should both relax the pleading standard for allegations of collusive wage-setting (no-poaching, and so on) and treat parallel wage-setting and related forms of tacit coordination as illegal. The reason is that labor markets are different from product markets in several key respects. Employees face higher switching costs than consumers do, in part because employers exercise greater control over workers than do sellers over consumer. Labor markets are also characterized by pay equity norms and downward nominal wage rigidity, neither of which have a parallel in product markets. These and related factors facilitate collusion in labor markets but not in product markets.

## I. Tacit and Explicit Collusion in Labor Markets

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<sup>5</sup> U.S. Dep't of Justice & Federal Trade Commission, Antitrust Guidance for Human Resource Professionals 4 (2016), <https://www.justice.gov/atr/file/903511/download>; Press Release, Office of Pub. Affairs, U.S. Dep't of Justice, Justice Department and Federal Trade Commission Release Guidance for Human Resource Professionals on How Antitrust Law Applies to Employee Hiring and Compensation (Oct. 20, 2016), <http://www.justice.gov/opa/pr/justice-department-and-federal-trade-commission-release-guidance-human-resource-professionals>.

The logic of collusion applies when a small number of firms enjoy market power in labor markets—also known as oligopsony or labor oligopsony. Instead of holding prices above the competitive rate, employers pay wages below the competitive rate and maintain those wages by threatening to match or exceed any wage raises by another employer. The threat suppresses wages by eliminating any advantage to a firm from raising wages. If one firm raises wages in an attempt to acquire a competitive advantage in the market for employees, the advantage disappears once its competitors match the higher rates. An equilibrium with below-market wages is possible even in the absence of communication or agreement as long as each of the two firms can observe or learn the wages paid by the other, and adjust its own wage schedule in response to any deviation (tacit collusion). Such an equilibrium is likely easier to reach and sustain if the firms communicate and agree so that they can jointly adjust to external shocks (explicit collusion).<sup>6</sup>

While we will focus on collusive wage-setting, collusion takes many different forms in labor markets as it does in product markets.<sup>7</sup> In product markets, sellers can collude over quantity or output; similarly, employers can agree to limit the number of people they employ. In product markets, sellers can allocate markets by, for example, agreeing not to poach each other's customers, or dividing up the geographic areas in which they operate. In labor markets, employers can agree not to poach each other's employees or agree to hire workers from particular areas. As we will see, no-poaching agreements appear to be more common in labor markets than in product markets, while quantity limits seem to be more common in product markets than in labor markets. Price- and wage-setting agreements exist in both types of market.

Explicit collusion has long been illegal under antitrust law, though as we noted the barriers are high to plaintiffs seeking redress. On the other hand, tacit coordination in price-setting—that is, parallel pricing—is legal, though there has been an extensive debate over the practice. As we will draw on that literature's insights, we briefly describe it here.

The literature began with an article by Donald Turner, published in 1962.<sup>8</sup> Turner observed that in an oligopoly, firms have an incentive to price “interdependently,” meaning that firms do better if they set prices above the competitive level and can do so as long as they adopt a strategy of charging the same price and not undercutting each other. This meant that firms could charge a supracompetitive price without entering a formal (oral or written) agreement, or verbally communicating at all.

Imagine a duopoly in which each firm sets a price above the market rate and adopts a policy of maintaining that price as long as the competitor matches the price. If one firm cuts the price, the other firm will match or exceed the price cut, resulting in a decline in profits for both firms. To avoid this adverse outcome, each firm may avoid price cuts in the first place. Under

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<sup>6</sup> See Margaret C. Levenstein & Valerie Y. Suslow, *Breaking Up Is Hard to Do: Determinants of Cartel Duration*, 54 J. L. & ECON. 455 (2011).

<sup>7</sup> For a survey of the literature on collusion in product markets, see John Asker & Volker Nocke, *Collusion, Mergers, and Related Antitrust Issues*, (Nat'l Bureau of Econ. Research, Working Paper 29175, 2021).

<sup>8</sup> Donald F. Turner, *The Definition of Agreement Under the Sherman Act: Conscious Parallelism and Refusals To Deal*, 75 HARV. L. REV. 655 (1962).

general conditions, an equilibrium exists in which both firms maintain the supracompetitive price. This equilibrium can exist in the absence of any formal agreement or any communication whatsoever as long as the two firms can observe each other's prices, adjust their own prices rapidly, and care sufficiently about future profits.<sup>9</sup>

But while this might seem to suggest that antitrust law should penalize what is now usually called "tacit coordination" or "parallel pricing," Turner argued that this would be unwise. When firms set prices, they unavoidably are aware of the prices set by competitors, and it is hard to imagine how firms could ignore their competitors' behavior. In theory, courts could penalize any firm in an oligopoly that set the same prices as other firms, but this approach would also penalize innocent firms that set identical prices because they incurred identical costs. A better approach would be a requirement that firms set prices by independently adding a markup to their costs, but such a remedy would be little different from price regulation, which courts (and, indeed, as time would show, regulators) are not well-positioned to accomplish.

Turner's view was challenged in a 1969 article by Richard Posner,<sup>10</sup> whose view was further developed by Louis Kaplow in a book published in 2013.<sup>11</sup> On their view, there is no reason in antitrust theory or policy to distinguish between an oligopoly that maintains supracompetitive prices through communication and agreement, and an oligopoly that maintains supracompetitive prices through parallel behavior. Both types of behavior are equally bad, and indeed it is not even clear that there is any difference between them. Parallel behavior, in which one firm might initiate price changes and a second firm imitates them, is a kind of agreement, where communication takes place through actions rather than words. The distinction between tacit coordination and nonverbal agreement is exceedingly elusive; in simple game-theoretic models of repeated interaction, an equilibrium in which the firms charge above supracompetitive prices can be characterized in either way. Both authors argued that courts should therefore impose sanctions on tacit coordination by oligopolists.<sup>12</sup>

The courts have sided with Turner, but the debate was important because it sharpened the law's understanding of the dangers of collusion in oligopolistic market and helped justify legal precautions against market concentration, for example, through merger policy. The debate and its impact on the law also focused attention on the sustainability of (explicit) collusion, which can be traced back to an article written by George Stigler in 1964, and was greatly refined by the game theory literature of the 1970s and 1980s.<sup>13</sup> As is by now familiar, collusion becomes more likely when, among other things, a smaller rather than larger number of firms compete in the market, the commodity is homogenous, and competitors can easily observe one another's pricing and related actions. Stigler also observed that a cartel might fix prices for small customers while competing over large customers. We will discuss some of the other findings of this literature below. For law, these factors have become important for plaintiffs alleging explicit collusion who seek to avoid a motion to dismiss under the *Twombly* standard. Courts require a showing of

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<sup>9</sup> See Louis Kaplow, *Competition Policy and Price Fixing* Ch. 7 (2013), for a review of the literature.

<sup>10</sup> Richard A. Posner, *Oligopoly and the Antitrust Laws: A Suggested Approach*, 21 STAN. L. REV. 1562 (1969).

<sup>11</sup> Louis Kaplow, *Competition Policy and Price Fixing* (2013).

<sup>12</sup> Posner, however, later repudiated his position in a review of Kaplow's book. Richard A. Posner, *Review of Kaplow, Competition Policy and Price Fixing*, 79 ANTITRUST L.J. 761 (2013).

<sup>13</sup> George J. Stigler, *A Theory of Oligopoly*, 72 J. POL. ECON. 44 (1964).

parallelism “plus” allegations of an agreement or other factors suggestive of or conducive to an agreement.<sup>14</sup>

At a high level of abstraction, labor markets are similar to product and other types of markets. The laws of supply and demand hold sway in all markets. But at the lower level of generality at which antitrust law operates, the markets are quite different. Labor markets are characterized by a high degree of friction: interactions are dense, continuous, usually lengthy, complex, and characterized by a high degree of investment by the employee in firm-specific human capital. Bargaining power is almost always asymmetric: exit is more costly for the employee than for the employer. Product markets are far simpler. Transactions are usually discrete and simple; buyers and sellers might interact only once; and no one invests in the relationship. Except when markets are concentrated, bargaining power is symmetric. There are, of course, more complex product markets where relationships are formed (leases, credit cards, bank accounts, insurance policies, software licensing agreements, and so on). And there are markets in which sellers provide labor in relatively discrete bursts (and where they are therefore classified as independent contractors rather than employees). But the differences between product markets and labor markets are large and systematic enough as to have resulted in separate branches of economics (labor economics and industrial organization) and a separate legal system for labor markets (labor and employment law).

As we turn to antitrust, we ask whether the distinctive features of labor markets call for a different kind of antitrust law. Below, we focus on five such features: (1) employees face higher switching costs than consumers do, in part because employers exercise greater control over workers than do sellers over consumers; (2) labor markets are characterized by a pay equity norm that has no parallel in product markets; (3) labor markets are characterized by downward nominal wage rigidity, which also has no parallel in product markets; (4) there are no large sellers of labor, the way there can be large suppliers of products or services; and (5) consumer prices are often more transparent than wages.

To anticipate, most of these features facilitate labor market collusion, so that labor market collusion is easier to initiate and sustain than is product market collusion. Because it is harder for an employer to lure away the employee of a competitor than for a seller to lure away the customer of a competitor, employers will be able to sustain collusion more effectively than sellers can. This also means that collusion will be more attractive to employers than it is to sellers—it is less likely that elaborate arrangements will go down in flames. The pay equity norm and downward nominal wage rigidity increase the risk of cheating in labor markets. The absence of larger labor sellers also eliminates a temptation to cheat that prevails in product markets. And while transparency tends to facilitate collusion, many labor markets exhibit transparent wages, and transparency is increasing thanks to the evolution of internet-based labor-matching platforms. A final point, to which we will return, is that employers appear to compete more vigorously at the entry level (when applicants are more interchangeable) than later on (when employees have grown attached to a particular firm). This too has implications for antitrust enforcement in labor markets.

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<sup>14</sup> John E. Lopka, *Solving the Oligopoly Problem: Turner's Try*, 41 ANTITRUST BULL. 843 (1996).

These features hardly exhaust the differences between labor markets and product markets. But they are empirically well-established and fairly general across different labor markets, so they provide a starting point for thinking about the application of antitrust law to employer collusion.

#### A. High switching costs

Models of oligopoly typically assume that consumers will buy from whichever seller offers a lower price—that is, “switching costs” are low, which means the price elasticity of demand is high. Most sellers interact with customers only on occasion, at the time of the sale, as a result of which they can compete only by offering better prices, better quality, or superior advertising. While information costs, brand loyalty, and other frictions keep switching costs above zero, the evidence does indicate that in many product markets those costs remain low enough to disregard for purposes of law and policy.<sup>15</sup> This has important implications for antitrust. If two firms agree to fix prices, then each firm has an incentive to cheat by cutting prices because it will be able to lure away its competitor’s customers. The additional sales made by the firm that cuts prices will compensate for the loss of revenue per sale. Symmetrical incentives to cheat may therefore undercut the arrangement, even deterring the firms from colluding in the first place. Parallel pricing and other forms of tacit coordination may be difficult to sustain for the same reason. So while experience teaches that collusion and parallel prices remain common despite these incentives, courts and scholars are often skeptical about the likelihood that parallel pricing will arise or the duration over which it can persist.<sup>16</sup>

In labor markets, by contrast, switching costs are high. In one striking example, researchers found that for the Amazon Mechanical Turk labor market, which at first glance appears quite thick, the elasticities for recruitment were 0.05-0.11 and for retention were 0.1-0.5.<sup>17</sup> The authors attribute this to the differentiated nature of tasks, which may have appealed to different workers to different degrees, and search costs. This is notable given that Amazon Mechanical Turk is built for ease of search among jobs. A growing literature on more conventional labor markets has also found quite low elasticities, ranging from 2.5 to 5.8.<sup>18</sup>

There are at least five reasons why workers are less likely to switch jobs for higher wages. First, search costs are high. Because employment relationships are more complex than products, workers must devote significant time to find alternative jobs while at the same time being constrained by their time commitment to their existing jobs.

Second, job differentiation is often high. Similar-seeming occupations actually differ because employers are located in different places (affecting commuting times), specialize in different types of work, employ different workforces (affecting interpersonal relationships), and

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<sup>15</sup> Anna Sokolova & Todd Sorensen, *Monopsony in labor markets: A meta-analysis*, 74 ILR REV. 27, 51 (2021).

<sup>16</sup> Robert Bork, *The Antitrust Paradox* (1978). For judicial example, see *In re Text Messaging Antitrust Litig.*, 782 F.3d 867, 879 (7<sup>th</sup> Cir. 2015); *Williamson Oil Co. v. Philip Morris USA*, 346 F.3d 1287, 1300-01 (11<sup>th</sup> Cir. 2003); *Theatre Enters. v. Paramount Film Distrib. Corp.*, 346 U.S. 537, 540-41 (1954).

<sup>17</sup> Arindrajit Dube et al., *Monopsony in Online Labor Markets*, 2 AM. ECON. REV.: INSIGHTS 33 (2020).

<sup>18</sup> See Ihsaan Bassier et al., *Monopsony in Movers: The Elasticity of Labor Supply to Firm Wage Policies* (Nat’l Bureau of Econ. Research, Working Paper 27755, 2020); José Azar et al., *Estimating labor market power* (unpublished manuscript 2019); Sokolova & Sorensen, *supra*.

cater to their workers by offering conditions and amenities that are specific to the often-idiosyncratic preferences of the incumbent workforce.

Third, employers exercise daily control of their workers, usually over a long period of time. As a result, employers obtain significant information about workers' preferences, backgrounds, and productivity. Workers also compose a captive audience, defenseless against the employers' elaborate campaigns to instill loyalty to the company and solidarity with other workers. A firm's information advantage over competitors is much greater for workers than for customers. Employees spend eight hours a day with the employer and zero hours with competitors, while customers may spend a few minutes or hours a year with a typical seller and may also buy from competing sellers in the same period.

Fourth, because employers are more likely to let go of poor workers than good workers, an adverse selection problem may hamper efforts by workers to find new jobs with competitors, who will fear that the incumbent employer let them leave because it knows those workers have low ability.<sup>19</sup> The captive audience advantage further enables an employer to shape workers' preferences far more than a seller can use advertising campaigns to shape the preferences of customers.

Finally, workers typically invest time and effort to learn the idiosyncratic or firm-specific characteristics of their employer. As a result, while their employer will value them more than other workers, competing employers will not be willing to pay them as much the incumbent employer. That means that the worker loses a credible threat to quit if the employer pays below marginal revenue product. More broadly, switching from one job to another can be cumbersome, risky, and fraught, and many people switch jobs only a few times over the course of their life.<sup>20</sup>

In the oligopoly literature, sellers can "capture" buyers by instilling brand loyalty through advertising campaigns or investments in quality. In the simplest model, the result is that the sellers compete (or collude) over only the non-captive buyers.<sup>21</sup> In more complex models, they must manipulate price and quality offerings so as to maximize profits from loyal buyers while also attracting (or not attracting, where collusion occurs) the non-captive buyers.<sup>22</sup> One could think of employers' incentives in a similar way. But because it is cheaper for an employer to instill loyalty in workers because of its natural advantages, fewer workers will be non-captive.

Because switching costs are higher in labor markets than in product markets, both explicit collusion and tacit coordination are more likely to succeed in labor markets. Firms compete by poaching each other's consumers and workers. Because switching costs are low for consumers, a firm can lure them from a competitor by offering a slightly lower price or slightly improved quality. Advertising campaigns will be effective because consumers who learn about the advantages of a competitive brand can easily switch to it. This prospect of easily increasing market share will offer a constant temptation to cheat on collusive agreements or parallel

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<sup>19</sup> Daron Acemoglu & JS Pischke, *Why do firms train? Theory and evidence*, 113 Q. J. ECON 79 (1998).

<sup>20</sup> Raven Molloy, Christopher Smith, and Abigail K. Wozniak. *Changing stability in us employment relationships: A tale of two tails*. No. w26694. National Bureau of Economic Research, 2020.

<sup>21</sup> Barry Nalebuff, *Exclusionary Bundling*, 50 THE ANTITRUST BULLETIN 321 (2005).

<sup>22</sup> *Id.*



behavior. This makes collusive agreements less likely to arise in the first place and less likely to persist when they do arise.

By contrast, a firm that seeks to poach workers from a competitor will be required to overcome the high switching costs of the competitors' workforce. Large rather than small wage increases will be required. Advertising will be pointless when switching costs are high. Indeed, while employers frequently compete vigorously for college or professional school graduates, as illustrated by job fairs, recruitment campaigns, and cushy summer internships, they much more rarely compete for already employed workers. With the incentive to poach lower for labor markets, the risk that one's counterparty will cheat on explicit agreements or tacit coordination diminishes relative to the product market case. Accordingly, these horizontal arrangements should be more stable in labor markets than in product markets.

## B. Pay equity norm

Models of oligopoly assume that consumers rationally buy goods and services so as to maximize their utility. Except in unusual circumstances, their purchasing decisions are not affected by the prices paid by other consumers. While common experience tells us that people are sometimes annoyed when they learn that they paid a seller more for a product than other buyers did, this phenomenon does not appear to affect consumer behavior in a significant way. This means that sellers are mostly free to engage in price discrimination—they can charge higher prices to consumers with higher willingness to pay as long as they can prevent arbitrage among consumers or other intermediaries who buy at the low prices and resell at higher prices.

By contrast, in labor markets, the pay equity norm prevails. Employees become angry if they learn that colleagues are paid more for the same work than they are. In a well-known study, economists exploited involving a change in state law that resulted in disclosure of salaries in the University of California system. They randomly informed employees of the website that disclosed the salaries, and then learned via a survey that employees whose salary was below the median reported lower job satisfaction while those above the median were not bothered.<sup>23</sup>

A pay equity norm makes it costly for employers to cheat on horizontal arrangements. Suppose a seller in a collusive agreement tries to increase market share without losing money on inframarginal customers by offering secret discounts to new customers. It is possible that other sellers will notice, causing the cartel to collapse.<sup>24</sup> But the seller is unlikely to be punished by its incumbent customers, who might be annoyed if they find out but will rationally keep buying. On the other hand, if an employer offers wage premiums to new hires, it takes the risk that existing workers will become angry and quit or demand higher pay. Employers can sometimes evade the pay equity norm by offering bonuses to new hires, but this is not always possible, and a one-time bonus may be less alluring than a higher salary that will predictably advance with annual cost-of-living increases. Accordingly, the incentives for employers to cheat on horizontal arrangements are lower than they are for sellers.

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<sup>23</sup> David Card et. al, *Inequality at Work: The Effect of Peer Salaries on Job Satisfaction*, 102 AM. ECON. REV. 2981 (2012).

<sup>24</sup> Kenneth S. Corts, *Third-Degree Price Discrimination in Oligopoly: All-Out Competition and Strategic Commitment*, 29 RAND J. ECON. 306 (1998).

There are, however, possible offsetting effects in both markets. If one seller threatens to steal customers by offering discounts, other sellers can respond by offering discounts to just those same customers. Employers, by contrast, are constrained from offering higher salaries only to employees who threaten to leave. If the pay equity norm is to be respected, the employer who raises salaries for some marginal employees will be required to raise salaries for inframarginal employees as well, at great cost. The pay equity norm thus makes it costlier for employers to poach workers than it is for sellers to poach customers, but also costlier for employers to defend against the poaching of their own workers than it is for sellers to defend against the poaching of their customers.

It might seem these effects would offset, or that the pay equity norm would have an ambiguous effect on the stability of horizontal collusion. But we think that this is not correct. The main difference is one of stakes, and hence risk. A seller can try to poach a rival's customers by offering small discounts; if the rival retaliates, the seller can quickly retreat, reestablishing the equilibrium, with only minor harm to each side. An employer can try to poach a rival's workers only with large bonuses; if the rival retaliates, the two parties can reestablish an equilibrium but only after paying out large amounts of money. And as we will see below, there are reasons to believe that other features of the labor market will further widen the gap between the risk of worker-poaching and the risk of customer-poaching.<sup>25</sup>

### C. Downward nominal wage rigidity

In product markets, sellers can normally raise or lower prices as market conditions dictate, enabling them to respond rapidly not only to changes in costs and in demand but to the pricing decisions of their competitors. In labor markets, employers can always raise wages but cannot easily lower them. Employees tend to psychologically anchor on their current wage and strongly object to any reduction in that nominal wage, irrespective of broader market conditions. This is known as downward nominal wage rigidity, and it is a feature of many labor markets. In periods of low inflation, this means that employers cannot lower real wages either; in periods of high inflation, employers can allow inflation to erode wages, but this is a clumsy way to reduce real wages. While price rigidity also exists in some product markets, wage rigidity is a far more common and significant.<sup>26</sup>

Downward nominal wage rigidity should strengthen the incentives of employers to collude, relative to those of sellers of products. If an employer cheats by raising wages, then it's hard to lower them again if the competitor retaliates by matching the wage increase, or if economic conditions change and high wages are no longer sustainable. The cost and risk of defecting from a collusive agreement is high.

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<sup>25</sup> Separately, if the pay equity norm interferes with discriminatory wage-setting, then monopsony in labor markets is more socially costly than monopoly in product markets, all else equal, where price discrimination is common, and reduces the social cost of monopoly.

<sup>26</sup> On wage rigidity, *see, e.g.*, David E. Lebow et al., *Downward Nominal Wage Rigidity: Evidence from the Employment Cost Index*, 3 *ADVANCES IN MACROECONOMICS* (2003). Prices are also sometimes "sticky," but not as sticky as wages; *see* Daniel Hosken & David Reiffen, *Patterns of retail price variation*, 35 *RAND J. ECON.* 128 (2004) (temporary price discounts are common).

In combination, the pay equity norm and downward nominal wage rigidity make it especially costly and risky for an employer to defect by raising wages. If the employer wishes to poach a competitor's workers, it must raise wages for all of its own workers along with the new employees. Then, irrespective of whether or not it succeeds in its efforts to poach, it must maintain higher wages for all employees, new and old. For such an employer, even success may be worse than the status quo. In product markets, by comparison, a seller can target discounts at a limited number of customers. Regardless of whether it succeeds in poaching those customers, it retains the option of raising prices at a later date, particularly if it can restore some type of collusive agreement. Accordingly, pay equity and downward nominal wage rigidity make collusive agreements in labor markets more stable than those in product markets.

We can see the difference by using a standard example of the effect of monopsony. Suppose that a firm has 50 employees and pays each of them \$100,000. It would like to hire ten of its competitors' employees in order to expand its operations. To do so, it will need to offer these employees \$110,000 to attract them away from their current employers. But if it pays these new employees \$110,000, it will also have to raise the wages of its current employees to \$110,000. And once it has raised wages, it cannot lower them again. This means that the total cost of hiring the ten additional employees is \$1.6 million per year—\$1.1 million for the new employees themselves, and \$500,000 in additional salary for its existing employees—or the equivalent of \$160,000 for each new employee. Unless these new employees are highly productive, this is a losing proposition for the firm, even if its competitors don't attempt to retaliate.

Now this is a familiar result from the economic model of monopsony (or technically, oligopsony), which in fact assumes that the employer pays workers of identical productivity the same wage. In the mirror-image model of oligopoly, the same assumptions are made: the seller who lowers prices to obtain new customers must lower them for incumbent customers as well. But we think the model is more accurate for labor than for products. The identical wage/price assumption is based on a common intuition as well as empirical evidence that sellers roughly charge the same to everyone (putting aside volume discounts and the like) and that employers roughly pay the same wage to everyone of equal productivity. But the assumption in the product market case is based on the practicalities of distinguishing between customers who have private information about their willingness-to-pay. In fact, sellers can price discriminate albeit only crudely. By contrast, the equity norm prevails only in labor market and appears to be quite powerful. That means that employers can wage discriminate much less effectively than sellers can price discriminate, and this difference accounts for the greater stability of labor market collusion than product market collusion, or so we conjecture.

It is true that the incentive of an employer to retaliate is also reduced because an employer who retaliates by matching the wage increase will have trouble lowering wages again when the first employer returns to cooperation. But, as before, the crucial distinction between labor markets and product markets is that the stakes of cheating are higher in the former. The combination of high switching costs, pay equity, and downward marginal wage rigidity means that employers who cheat on a cartel agreement and poach workers face the risk of incurring a large and persistent loss—much more so than sellers in the product market. Overall, downward nominal wage rigidity and pay equity are likely to increase the cost of defection, and hence to

strengthen the stability of horizontal arrangements, relative to a seller cartel, where the parties enjoy more flexibility to adjust their behavior in response to the actions of others.

#### D. Magnitude and Duration of Contracts

In an oligopoly, sellers who seek to increase market share by reducing prices take the risk that competitors will match their price discount. A seller can minimize this risk by seeking out large buyers and persuading any buyer (large or small) to enter a long-term contract. Large buyers are attractive because they enable the seller to obtain a substantially larger market share with few transactions. Long-term contracts prevent competitors from luring back customers by matching the seller who initially cheats. Thus, oligopolies become less stable when large buyers exist and long-term contracts are possible.<sup>27</sup>

In labor markets, there is no such thing as a large worker. The magnitude of the input supplied by a worker varies little—with an upper bound of how many hours can be squeezed into a week (and that is only forty hours for regular workers, plus overtime which requires a higher wage). Thus, as a general pattern, the large-buyer source of instability will prevail far more frequently in product oligopolies than in labor oligopolies.

Long-term contracts are less common in labor markets than in product markets. Contracts in labor markets are typically at will, probably because courts very rarely are willing to deny workers the freedom to leave a job, and employers are rarely willing to allow a jury to second-guess their decisions to fire workers. But in practice, employees often remain in the same jobs for long periods of time because of the high switching costs we described earlier. Employers have also discovered that they can use noncompetes to prevent workers from moving to competitors, in this way duplicating the anticompetitive effect of long-term contracts without having to commit to a long employment relationship.<sup>28</sup> Even when noncompetes are not enforceable, the in terrorem effect of a lawsuit may be sufficient. On average, workers stay in a job for around four years—and tenure for a substantial fraction of the workforce exceeds ten years—a period much longer than nearly all product market contracts.<sup>29</sup>

#### E. Pay Secrecy

In oligopoly theory, it is commonly believed that price secrecy undermines collusion and tacit coordination.<sup>30</sup> If prices are not public information, then members of a cartel can easily cheat by cutting prices below the agreed rate. Even if prices are public, sellers can often offer customers secret discounts, disguised as volume discounts and the like. But sellers can penetrate the cloud of secrecy by asking customers to report price discounts offered by rivals and agreeing

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<sup>27</sup> Stigler, *supra* note 13.

<sup>28</sup> Evan Starr, J.J. Prescott & Norman D Bishara, Noncompetes in the U.S. Labor Force, *Journal of Law and Economics* (2020).

<sup>29</sup> Steven F. Hipple & Emy Sok, *Tenure of American Workers*, U.S. Bureau of Labor Statistics Spotlight on Statistics (2013), available at: [https://ecommons.cornell.edu/bitstream/handle/1813/79427/BLS\\_Tenure\\_of\\_American\\_Workers.pdf?sequence=1&isAllowed=y](https://ecommons.cornell.edu/bitstream/handle/1813/79427/BLS_Tenure_of_American_Workers.pdf?sequence=1&isAllowed=y).

<sup>30</sup> Stigler, *supra* note 13; Edward Green & Robert H. Porter, *Noncooperative Collusion under Imperfect Price Information*, *ECONOMETRICA: J. OF THE ECONOMETRIC SOCIETY* 87 (1984).

to match them—often with formal Most-Favored-Nation commitments. And for a huge range of products sold to the general public—as opposed to business-to-business transactions, which are more likely to be confidential—it is not practical to conceal price information. As a general proposition, oligopoly is more likely to be sustained when prices are public than when they are secret. That is why agreements among competitors to share price information may result in liability under the antitrust laws.

While comparisons are difficult, it appears that wage information is more confidential than pricing. As long as sellers seek new customers, they must publicize their prices. By contrast, while employers also must publicize wages to attract workers, they can often maintain confidentiality with respect to raises, bonuses, and other forms of compensation for incumbent employees. Employers often impose a policy of prohibiting workers from discussing their compensation. And a powerful salary taboo prevails among employees even when employers do not prohibit the sharing of wage information.<sup>31</sup> In recent years, however, platforms like Glassdoor have enabled workers (and employers) to publicize wage information, so the era of wage confidentiality may soon come to an end. Pay transparency laws in a number of states also require employers to reveal salary ranges to their employees and job applicants.<sup>32</sup>

To the extent that wage information is more likely to be confidential than price information, this distinction between labor and product markets cuts in the direction of a greater risk of sustainable product oligopoly than labor market oligopsony. However, in many labor markets, wages are public information. (For some examples, see Part II.) Ironically, pay transparency laws and new hiring platforms like Glassdoor may result in lower rather than higher wages because the increase in transparency facilitates collusion among employers.<sup>33</sup>

#### F. A Note on Ex Ante Contracting

A persistent question that arises in discussion of labor market cartelization is whether employees can protect themselves from anticompetitive harm through ex ante negotiation of their contracts. This question arises because of yet another unique feature of labor markets. Labor markets tend to be bifurcated into an ex ante stage when workers first apply for a job in the industry they have chosen, and an ex post stage when workers are employed and must consider whether to leave employment for another position. In the first stage, workers will typically operate in relatively competitive markets. If they are unskilled, they can choose among many different employers. If they are skilled, their choices will be more limited, but they still may have

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<sup>31</sup> Zoe B. Cullen & Ricardo Perez-Truglia, *Salary Taboo: Privacy Norms and the Diffusion of Information*, (Nat'l Bureau of Econ. Research, Working Paper 25145, 2018).

<sup>32</sup> F. Christopher Chrisbans & Christopher T. Patrick, *The Emerging Trend in State Pay Transparency Laws*, 6 NAT'L LAW REV. (Aug. 11, 2021) at <https://www.natlawreview.com/article/emerging-trend-state-pay-transparency-laws>.

<sup>33</sup> Interestingly, pay transparency may also suppress wages by enabling employers to credibly refuse to raise wages; for theory and evidence, see Zoe B. Cullen & Bobak Pakzad-Hurson, *Equilibrium effects of pay transparency*. No. w28903. National Bureau of Economic Research, 2021. If so, this is effect is independent of that of employer collusion, though there could be interactions. For example, an employer could refuse a demand for a raise by telling employees that not only will it have to raise compensation for other employees, as Cullen argues, it will also have higher labor costs than competitors, which could drive it out of business. An employer could also use the fact that it is paying the same wages as competitors as an argument to its own workers that they are unlikely to land a higher-paying job elsewhere and have no credible claim to a raise.

substantial choice. In the second stage, the switching cost problem first arises, and that is when the worker typically faces a monopsonized market. The question then arises, why can't a worker demand from her first employer contractual protections from the switching costs in the second stage? These protections could include mandatory wage increases; freedom to take time off from work to look for other jobs; limits on (or the absence of) noncompetes; and so on.

This question rarely arises in product market antitrust cases, though it is not unknown. In *Eastman Kodak Co. v. Image Technical Servs.*, customers who bought Kodak copiers complained that Kodak exerted monopoly power over them in the aftermarket of service and parts by driving aftermarket competitors out of business.<sup>34</sup> Kodak argued that because the “beforemarket” of copiers was competitive, the customers could have, should have, and probably did, demand adequate contractual protection—and implicitly bought Kodak copiers that included in their price the risk (or actuality) of Kodak’s aftermarket hijinks. The Supreme Court rejected this argument, based on the commonsense notion that customers—even sophisticated business customers—could not necessarily anticipate the risk of Kodak’s behavior. That would be a factual question to be decided at trial.

This point is even stronger in the case of labor markets, where most workers are unsophisticated and do not benefit from the advice of legal counsel. But even if workers were perfectly rational and far-seeing, they would be helpless to stop firms from exercising labor market power in the second stage. There are two reasons for this. First, information about the productivity of workers is classically “nonverifiable.”<sup>35</sup> Because employers cannot determine at the time of hiring which employees will be more or less productive, they almost never voluntarily incorporate “for cause” provisions in contracts, presumably because second-guessing by a judge or jury would be intolerable. Second, it can often be in the mutual interest of a particular worker and employer for them to agree on an anticompetitive contract—just as in the case of sellers who may conspire with favored customers. By agreeing to a noncompete, for example, the worker helps the employer by increasing the cost to a rival entering the labor market. The employer can, in theory, compensate that worker for entering the noncompete even though workers as a whole are harmed by suppressing market entrance and thus competition for their labor. This is a kind of divide-and-conquer strategy where workers collectively would benefit by refusing to agree to anticompetitive relationships and employers exploit a collective action problem (where there is no union) in order to achieve its goals.

#### G. Summary and Implications

Most of the factors we have considered—switching costs, equity norms, downward nominal wage rigidity, and magnitude and duration of contracts—imply that collusion and tacit coordination will be more stable in labor markets than in product markets. Only secrecy considerations point in the other direction, but the secrecy of wages is eroding, as noted above. The differences are not only directional; they appear in most cases to be significant, as shown by comparisons of elasticities in product markets and labor markets. High switching costs for counterparties facilitate collusion, and switching costs are higher in labor markets than in product markets.

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<sup>34</sup> *Eastman Kodak Co. v. Image Technical Servs., Inc.*, 504 U.S. 451 (1992).

<sup>35</sup> See Oliver Hart & John Moore, *Foundations of incomplete contracts*, 66 REV. ECON. STUD. 115 (1999).

We draw two general conclusions from these points. First, because collusion is more likely to be common in labor markets than in product markets, courts should be more receptive to collusion claims in labor markets than in product markets. Today, the opposite is the case: courts are skeptical about labor market claims and labor-side antitrust cases are rare.<sup>36</sup> Courts might begin by recognizing that the *Twombly* standard is too strict for labor market cases. The near-absence of discovery and trials has meant a dearth of information about how labor market collusion works. *Twombly*'s concern about excessive litigation is clearly not present.

Second, because tacit coordination is likely to be more stable in labor markets than in product markets, and therefore wages are more likely to be suppressed than prices inflated over the long term, tacit coordination in labor markets is a more urgent problem that calls for policy and legal reforms. At a minimum, the assumption in the literature that tacit coordination should be tolerated because the cure is worse than the disease should be reconsidered for labor-side antitrust. The disease is worse than in product markets, so even a debatable cure may be justified.

## II. A Brief Look at Some Evidence

We have so far provided some reasons for believing that labor market collusion (both tacit and explicit) should be both worse and more common than product market collusion. If labor market cartels are more stable than product market cartels, then they should also be more lucrative, and therefore more common. The fact that, until recently, the government never criminally prosecuted labor market cartels is an independent reason for expecting that they flourish. But is there any evidence for these conjectures?

Adam Smith famously claimed that

We rarely hear, it has been said, of the combinations of masters [employers], though frequently of those of workmen. But whoever imagines, upon this account, that masters rarely combine, is as ignorant of the world as of the subject. Masters are always and everywhere in a sort of tacit, but constant and uniform combination, not to raise the wages of labour above their actual rate. To violate this combination is everywhere a most unpopular action, and a sort of reproach to a master among his neighbours and equals. We seldom, indeed, hear of this combination, because it is the usual, and one may say, the natural state of things, which nobody ever hears of. Masters, too, sometimes enter into particular combinations to sink the wages of labour even below this rate. These are always conducted with the utmost silence and secrecy, till the moment of execution, and when the workmen yield, as they sometimes do, without resistance, though severely felt by them, they are never heard of by other people.<sup>37</sup>

Smith did not provide any evidence, but even if he was right that labor market collusion was ubiquitous in the eighteenth century, labor markets are different today.

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<sup>36</sup> Posner, *How Antitrust Failed Workers*, *supra* note 4.

<sup>37</sup> Adam Smith, *Wealth of Nations* 35 (4d ed., 1786).

Commentators who have looked for evidence of *product* market conspiracies (that is, explicit collusion, not tacit collusion) have frequently observed that research in this area is hampered by the simple fact that conspirators do not disclose their conspiracies but keep them secret.<sup>38</sup> Thus, the handful of studies on conspiracies are able to examine only those conspiracies brought to light by government enforcement, presumably only a fraction of them. This problem is even more difficult for labor market conspiracies. Since the government began enforcement in 2020, when it indicted labor market conspirators for the first time ever, we have an inadequate track record, to say the least. The best we can say is that the four indictments over the last year<sup>39</sup>—along with promises of more to come—suggest that labor market conspiracies do exist. We can add to this small group the no-poach conspiracy of the Silicon Valley tech companies, which settled a civil suit with the Justice Department in 2010.<sup>40</sup> A lawsuit against Tyson, Perdue, and other meatpackers alleges that these companies fixed the wages of employees.<sup>41</sup> And dozens of large retail franchise, including McDonald’s, included no-poach clauses in their franchise agreements, which has a collusive flavor, and has led to litigation.<sup>42</sup> A few other cases round out the group.<sup>43</sup>

There is also the closely related question of whether tacit coordination takes place in labor markets. In product markets, where prices are usually public, we can at least observe whether sellers of identical goods charge identical prices. They frequently do, consistent with the law of one price. But identical pricing proves nothing. In a competitive market, sellers are forced to charge the same price even though they cannot tacitly collude. Evidence of parallel pricing comes from studies of markets where prices change in lockstep and independently of cost. Where a firm undercuts a price leader, and then the price leader lowers its prices even farther, one can infer that tacit collusion has taken place.<sup>44</sup>

Studies of parallel wage-setting are rare, in part because wages are often confidential, and in part because labor economists have not been concerned with this topic. But two recent unpublished papers shed some light on this practice, and so we discuss them here.

#### A. Law Firm Associates (and Other Professionals)

As most readers of *The University of Chicago Law Review* are likely aware, the market for associates at large law firms is highly structured. During the summer after their first year, law students interview with large law firms for summer positions, which they then hold during the

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<sup>38</sup> Levenstein & Suslow, *supra* note 6.

<sup>39</sup> Valerie Bauman, Siri Bulusu & Erin Mulvaney, Labor Cases Turn Criminal as DOJ Defines New Antitrust Approach (2022), <https://news.bloomberglaw.com/daily-labor-report/labor-cases-turn-criminal-as-doj-defines-new-antitrust-approach> (last visited Jan 12, 2022).

<sup>40</sup> Press release, Department of Justice, Justice Department Requires Six High Tech Companies to Stop Entering into Anticompetitive Employee Solicitation Agreements (September 24, 2010), <https://www.justice.gov/opa/pr/justice-department-requires-six-high-tech-companies-stop-entering-anticompetitive-employee>.

<sup>41</sup> Mike Leonard, Tyson, Pilgrim’s, Hormel to Face Poultry Worker Wage-Fixing Suit [news.bloomberglaw.com](https://news.bloomberglaw.com/antitrust/tyson-pilgrims-hormel-to-face-poultry-worker-wage-fixing-suit) (2021), <https://news.bloomberglaw.com/antitrust/tyson-pilgrims-hormel-to-face-poultry-worker-wage-fixing-suit> (last visited Jan 12, 2022).

<sup>42</sup> Alan B. Krueger & Orley Ashenfelter, *Theory and evidence on employer collusion in the franchise sector*, J. HUMAN RESOURCES 1019 (2021).

<sup>43</sup> See Posner, *How Antitrust Failed Workers* *supra* note 4.

<sup>44</sup> A nice example is *Brooke Group Ltd. v. Brown & Williamson Tobacco Corp.*, 509 U.S. 209 (1993).



summer after their second year in school.<sup>45</sup> Barring unusual circumstances, those students are then offered post-graduate employment with the same firms for which they worked over the summer.<sup>46</sup> Large law firms hire a substantial proportion of their associates through this process.

The other regimented characteristic of the market for law firm associates is the pay scale. Associates are typically paid in lockstep with one another, based on seniority: all first-year associates make the same salary, all second-year associates make the same salary, etc.<sup>47</sup> More remarkably, associates at nearly every major firm in every major legal market across the country are paid identically. An associate at Kirkland & Ellis in Chicago makes the same salary as an associate at Skadden in New York, who makes the same salary as an associate at Vinson & Elkins in Houston, despite the widely divergent costs of living and somewhat divergent billing rates across the three markets.<sup>48</sup> The bonuses paid by the firms are generally identical as well, though there are occasionally slightly larger deviations.<sup>49</sup> In sum, an employee in this market can expect to be paid exactly the same amount no matter which firm in which city she chooses.

In a recent paper, Ryan Boone argues that associate salaries have been set via tacit collusion among firms.<sup>50</sup> For many years, the consistent associate pay scale was set via explicit collusion. Firms openly discussed the fact that they would follow the wages set by the firm of Cravath, Swain & Moore, and the pay scale was referred to as the “Cravath scale.”<sup>51</sup> Wages were typically set at an industry conference held every year. In modern times, no such public collusion is taking place. But the fact of identical wages across the industry remains. Over the past several decades, there have been multiple occasions when—spurred by an outside shock—one or more firms unilaterally raise wages. One such increase occurred in 2000, when the tech boom in Silicon Valley caused one Northern California firm to raise its associates’ pay scale.<sup>52</sup> After only a very short delay, every other major firm across the country matched the pay raise.<sup>53</sup> There was of course no talk of “punishing” the firm that had raised wages. But the effect was that any advantage that firm might have had against its competitors vanished in days.

Notably, despite the fact that law firm associates are paid quite handsomely, their salaries have risen only modestly over the past several decades. The starting salary for first-year associates was \$125,000 in the year 2001. In the year 2021, it is \$205,000.<sup>54</sup> That equates to annual increases of 2.5%, barely above the annual rate of inflation. During this same time period, associates’ billing rates and firms’ profits have risen far more dramatically, reflecting significant increases in productivity and the demand for high-end legal services. Over the past twenty-five

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<sup>45</sup> JDEmployed, *2L OCI: How the On Campus Interview Process Works*, JDEMPLOYED (n.d.) at <http://jdemployed.com/2l-on-campus-interviews>.

<sup>46</sup> *Id.*

<sup>47</sup> Biglaw Investor, *Biglaw Salary Scale*, available at: <https://www.biglawinvestor.com/biglaw-salary-scale/> (last visited Jan. 10, 2022); Ryan Boone, *Tacit Collusion in Labor Markets: The Case of BigLaw* (unpublished manuscript 2021), at 5.

<sup>48</sup> Boone, *supra*, at 8-9.

<sup>49</sup> *See supra* note 45.

<sup>50</sup> Boone, *supra*.

<sup>51</sup> Boone, *supra*, at 5.

<sup>52</sup> Debra Baker, *Go West, Young Lawyer*, 86 A.B.A. J. 34 (2000).

<sup>53</sup> David Leonhardt, *Law Firms’ Pay Soars to Stem Dot-Com Defections*, N.Y. TIMES, (Feb. 2, 2000), <https://www.nytimes.com/2000/02/02/business/law-firms-pay-soars-to-stem-dot-com-defections.html>.

<sup>54</sup> *See supra* note 45.

years, salaries of partners have increased at roughly 1.4 times the rate of associate salaries.<sup>55</sup> All told, there is substantial evidence that law firm associates are paid less than they would be in a fully competitive marketplace that did not have these rigid wage structures.

Remarkably, this system of parallel wage-setting has persisted in the market for law firm associates for decades. Indeed, all of the conditions we described in Part II that facilitate a stable wage equilibrium are present.

*High switching costs.* Switching between law firms can be difficult and time-consuming for associates.<sup>56</sup> Open jobs are not typically advertised transparently and in a centralized manner. The process of obtaining a new job involves an extensive series of interviews.<sup>57</sup> Employees must find time for this search and interview process while simultaneously performing their current time-consuming associate jobs.<sup>58</sup> Perhaps more importantly, working in a large law firm can require a substantial amount of firm-specific knowledge, despite the outward appearance of similarity between firms. Associates work for partners, who decide which types of work they can be trusted to accomplish. The practice of law at such firms is a team endeavor, with associates working in groups or with partners on large, complex cases.<sup>59</sup> Moreover, the goal of many associates is to be promoted to partner after several years.<sup>60</sup> The practice of law does not always involve easily quantifiable metrics—an associate’s quantity of work can be quantified, but her quality of work is much more difficult to measure. A consistent track record of perceived high-quality work at a given firm and a series of close interpersonal relationships are thus considered essential to being made partner.<sup>61</sup> All of this makes the formation of relationships with fellow attorneys a substantial component of success at a large law firm. Associates cannot sacrifice those relationships and move firms without incurring significant costs.

*Pay equity norm.* As we noted above, at essentially all large law firms, associates are paid in lockstep: lawyers at the same level of seniority within a given firm are all paid the same amount of base salary.<sup>62</sup> Bonuses will occasionally diverge depending upon productivity, but

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<sup>55</sup> See Boone, *supra* note, at 9-10.

<sup>56</sup> A. Harrison Barnes, *Firm Hopping*, FIND LAW, (Dec. 20, 2016), <https://careers.findlaw.com/legal-career-options/firm-hopping.html>.

<sup>57</sup> Lateral Link, *How to Prepare for a Lateral Interview as an Associate: Looking to Improve Your Chances of Receiving an Offer?*, available at: <https://laterallink.com/how-to-prepare-for-a-lateral-interview-as-an-associate-looking-to-improve-your-chances-of-receiving-an-offer/> (last visited Jan. 10, 2022).

<sup>58</sup> Law firm associates are typically expected to bill at least 2,000 hours, and in some cases many more. Boone, *supra* note, at 6. The number of billable hours significantly understates the total number of hours worked, because many working hours are not billable.

<sup>59</sup> The Practice, *Why Lawyers Work Together*, 1 THE PRACTICE (2015), available at: <https://thepractice.law.harvard.edu/article/lessons-from-practicing-lawyers/#:~:text=Teamwork%20and%20collaboration%20matter&text=Practicing%20law%E2%80%94the%20art%20of,successful%20result%20for%20the%20client.>

<sup>60</sup> Boone, *supra* note, at 6.

<sup>61</sup> Dona DeZube, *Law Partnership*, MONSTER, available at: <https://www.monster.com/career-advice/article/law-partnership> (last visited Jan. 10, 2022).

<sup>62</sup> See *supra* note 45.

there are typically no more than two or three levels of bonuses for employees who meet particular billing quotas.<sup>63</sup>

The pay equity norm explains (or may explain) identical or nearly identical pay *within* law firms, at least if wage information is shared among employees. It cannot explain identical pay across firms. But of main relevance here, the pay equity norm would facilitate tacit collusion. A law firm that might be tempted to engage in wage discrimination—secretly offering higher pay to employees who threaten to leave—faces the risk that word will get out, and other employees will become angry and demoralized. Firms have worked around this problem in two ways. First, they have multiplied the number of pay tiers (for example, counsel, non-equity partner) so that they offer pay that is more closely tied to contribution.<sup>64</sup> Second, they have increasingly offered bonuses to employees who bring in business.<sup>65</sup> The pay equity norm is sustained because pay is still tied to publicly observable indicators of employee quality; at the same time, collusion or parallelism can take place across employers if either all firms adopt these variations or their practical effect is minor.

*Downward nominal wage rigidity.* Like pay equity, downward nominal wage rigidity is an ambiguous indication of collusion because it could be either a cause or an effect of identical or similar wages. But also like pay equity, the causal impact of downward nominal wage rigidity can be detected using indirect evidence. Wages for law firm associates have not declined at any point in the past five decades, including through repeated economic downturns.<sup>66</sup> For instance, during the Great Recession of 2008, large law firms laid off large numbers of associates and substantially reduced new hiring, but did not reduce wages for associates.<sup>67</sup> This type of behavior in the midst of a recessionary downturn is evidence of downward nominal wage rigidity, and the existence of downward nominal wage rigidity helps explain the longevity and robustness of wage parallelism in the market for lawyers.

*Pay secrecy.* Associate pay is highly transparent. When any firm announces that it is raising salaries, that information is typically leaked to online trade publications and made public within a matter of hours, if not minutes.<sup>68</sup> Even information related to year-end bonuses, which can differ slightly more between firms and between associates within firms, typically becomes public knowledge within hours of its announcement.

The relative transparency of associate salaries is facilitated by the fact that associates within each firm are generally paid in lockstep. That means that in order for one firm to keep tabs on another firm's pay scale, it is not necessary to know how much each individual employee

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<sup>63</sup> Staci Zaretsky, *Biglaw Firm Puts Some Extra Oomph Into Bonuses for High Billers – We're Talking Above-Market Money!*, ABOVE THE LAW, (Dec. 8, 2021), <https://abovethelaw.com/2021/12/srz-bonus-2021/#:~:text=1.,2300%2C%202500%20and%202700%20hours>.

<sup>64</sup> Shari Davidson, *Not All Partners Are Created Equal: A Look at Partner Compensation*, JDSUPRA, (May 14, 2021), <https://www.jdsupra.com/legalnews/not-all-partners-are-created-equal-a-7136140/>.

<sup>65</sup> Tracey J. Coates et al., *Law Firm Origination Policies: Climbing the Mountain to Equity*, LAW PRACTICE TODAY, (Jun. 15, 2020), <https://www.lawpracticetoday.org/article/law-firm-origination-policies-climbing-mountain-equity/>.

<sup>66</sup> Boone, *supra* note, at 68.

<sup>67</sup> *Id.*

<sup>68</sup> *Id.*

is paid—thereby eliminating the typical impediment to pay transparency. Instead, each firm must only know the other firms’ generalized pay scale, which quickly becomes public knowledge once it is disseminated throughout the firm.

*Magnitude and duration of contracts.* As with most labor markets, each law firm associate contributes a roughly equivalent amount of labor, an amount that is small compared to the overall output of the firm. There is no analogue to a large buyer. A law firm therefore cannot cheat on the cartel by hiring a single superhuman lawyer who could have a significant impact on market share. Thus, a firm that seeks to achieve larger market share must undergo the complex, costly, and risky maneuver of raiding firms and hiring many lawyers at once, and by offering them pay above the cartel level. This appears to be quite difficult, contributing to the stability of the cartel.

Law firms do not try to bind associates with long-term contracts, and noncompetes are not permitted. As in other cases, the existence or absence of long-term contracts can be seen as evidence of a cartel or else as an exogenous factor that facilitates cartels. For example, one reason that law firms may avoid long-term contracts with associates is that they need to be able to fire employees in order to maintain the cartel where the pay equity norm and downward nominal wage rigidity prevent them from reducing wages in response to a demand shock. From the other angle, law firms may avoid long-term contracts because they would necessarily involve judicial second-guessing of decisions to fire employees, and law firms cannot take the risk that judges may block their firing decisions. If this is the case, long-term contracts are inherently uneconomical, which could mean that law firms cannot realistically cheat on cartels by attracting employers with high wages embodied in long-term contracts that would lock in the gains from cheating.

While the Boone study gives us a great deal of useful detail about the market for law firm associates, there is good reason to believe that similar patterns prevail in other professional markets. For instance, salaries at the Big Four accounting firms are nearly identical across firms, with between-firm deviations of less than 10% at any given level of seniority.<sup>69</sup> Tacit collusion in this industry, if it exists, is facilitated by many of the same dynamics that exist in the market for law firm associates, including lockstep salaries based on levels of seniority.<sup>70</sup> There is even a history of what appears to be explicit collusion within the industry. In 2005, KPMG (one of the Big Four) was under federal investigation for having created an illegal tax shelter.<sup>71</sup> Concerned that KPMG would collapse as Arthur Andersen had several years earlier, the other three large accounting firms instructed their personnel not to poach either KPMG’s clients or its employees.<sup>72</sup> This is a peculiar instance, in that it represents potentially explicit cartelization of both the product and the labor side of the firms’ businesses, but for a competitive purpose—the

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<sup>69</sup> Corporate Finance Institute, *Big Four Accounting Salary – Overview*, available at: <https://corporatefinanceinstitute.com/resources/careers/compensation/big-four-accounting-salary/> (last visited Jan. 10, 2022); Samuel, *Big 4 Accounting Firm Salary*, HOW I GOT THE JOB, (July 15, 2020), <https://howgotjob.com/salary-guide/big-4-accounting-firm-salary/>.

<sup>70</sup> *Id.*

<sup>71</sup> Press release, Department of Justice, KPMG to Pay \$456 Million for Criminal Violations (August 29, 2005), [https://www.justice.gov/archive/opa/pr/2005/August/05\\_ag\\_433.html](https://www.justice.gov/archive/opa/pr/2005/August/05_ag_433.html). [SB: IRS page was no longer available]

<sup>72</sup> Jim Peterson, *Balance Sheet: Bottom Line is Survival*, N.Y. TIMES (Sept. 9, 2005), <https://www.nytimes.com/2005/09/09/your-money/balance-sheet-bottom-line-is-survival.html>.

firms hoped to preserve the existence of their competitor in order to avoid federal antitrust regulation.<sup>73</sup> This particular action may not have been illegal for precisely that reason. But it demonstrates at minimum a history in this industry of parallel labor practices.

Salaries within investment banks follow a similar structure. Nearly all large investment banks pay the same salaries to employees at the same levels of seniority.<sup>74</sup> And like law and accounting firms, tacit coordination is facilitated by lockstep salaries within the firms.<sup>75</sup> Even salaries for physicians, which one might expect to vary widely depending on whether the physician works for a hospital, an HMO, or in some other capacity, tend to bunch at similar levels. Here, there are centralized sources of information—the Medical Group Management Association, the American Medical Group, and the American Medical Association—that conduct regular surveys of physician salaries and publish the results, which are then used to set salaries.<sup>76</sup> According to the Medical Group Management Association, “Ninety-nine percent of the time, compensation will be consistent with the marketplace,” with “the marketplace” defined by the survey data the Medical Group Management Association has gathered.<sup>77</sup> Here, the central repository of salary information may be facilitating parallel wage-setting, just as central repositories of pricing data (such as on gasoline) have historically been used to facilitate parallel price-setting.<sup>78</sup>

To sum up, there is strong reason for believing that identical or similar salaries across firms for several major professions do not reflect the law of one price (or wage), but either tacit or explicit collusion. This also means that these professionals are paid below their marginal revenue product, resulting in the undersupply of their services and inflated prices.

## B. Warehouse and Retail Workers

The market dynamics described above are not limited to highly educated and highly compensated professionals. To demonstrate their ubiquity across the economy we offer a brief discussion of a very different group of workers: lower-wage warehouse and retail employees at major retailers such as Amazon, Walmart, Target, and similar firms. These workers are paid hourly wages instead of (much larger) yearly salaries. The jobs typically do not require college degrees, much less graduate degrees. The market for these employees is also far less structured than the markets for lawyers, accountants, investment bankers, or doctors.

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<sup>73</sup> Prem Sikka, *Enterprise Culture and Accountancy Firms: New Masters of the Universe*, 21 ACCOUNTING, AUDITING, & ACCOUNTABILITY J. 268, 279-80 (2008).

<sup>74</sup> Brian DeChesare, *Investment Banker Salary and Bonus Report: 2021 Update*, MERGERS & INQUISITIONS (2021) available at: <https://www.mergersandinquisitions.com/investment-banker-salary/>; Wall Street Prep, *Investment Banking Analyst Salary Guide*, available at: <https://www.wallstreetprep.com/knowledge/investment-banking-analyst-salary-guide/> (last visited Jan, 10, 2022).

<sup>75</sup> Wall Street Prep, *supra*.

<sup>76</sup> Bonnie Darves, *Physician Compensation Models: The Basics, the Pros, and the Cons*, NEW ENGLAND JOURNAL OF MEDICINE CAREER CENTER (Oct. 18, 2011), <https://resources.nejmcareercenter.org/article/physician-compensation-models-the-basics-the-pros-and-the-cons/>

<sup>77</sup> *Id.*

<sup>78</sup> John Asker & Volker Nocke, *Collusion, Mergers, and Related Antitrust Issues*, (Nat'l Bureau of Econ. Research, Working Paper 29175, 2021) at 12-13.

Yet recent research by Ellora Derenoncourt, Clemens Noelke, David Weil, and Bledi Taska has revealed evidence of parallel wage-setting in this market as well.<sup>79</sup> In recent years, these national retail firms have raised wages, often nationally—as in the case of Amazon, which increased the minimum hourly wage for all of its workers nationwide to \$15 per hour in 2018.<sup>80</sup> At the time Amazon initiated this wage increase, 56% of comparable businesses in the markets where Amazon operated were paying less than \$15 per hour.<sup>81</sup> These wage increases were highly public, both because they made national news<sup>82</sup> and because wages in this market have become more transparent through websites such as Glassdoor.<sup>83</sup> In the wake of the wage increases by Amazon and others, smaller firms followed suit, raising their own wages to very similar levels such that wages across the market “bunched” at the level set by Amazon.<sup>84</sup> Derenoncourt and her co-authors found small employment elasticities.<sup>85</sup>

One interpretation of these findings is that these employers are engaged in a type of parallel wage-setting.<sup>86</sup> Their wages were set in parallel at a level beneath the competitive wage and remained relatively stable until the announcements of wage increases by leading firms such as Amazon.<sup>87</sup> The fact that so many firms increased wages to \$15 in the wake of Amazon’s announcement is also evidence that the firms had been paying their workers below their marginal product, which implies that wages were being held down artificially.<sup>88</sup> Announcements of wage increases by Amazon, Walmart, and others can be interpreted as exogenous shocks to the market that forced other firms to adapt.

If Amazon continues to act as a wage leader and raises wages periodically in response to labor market shocks, wages across the market could continue to rise alongside Amazon’s.<sup>89</sup> As one industry analyst noted, “Amazon is almost becoming like the negotiator for all hourly wage workers to a certain extent.”<sup>90</sup> It is tempting to argue that this is good for workers. But Amazon is an employer, not a union. While it is true that workers benefit when Amazon enters a labor market, Amazon has every incentive to use its wage leadership to ensure that a cartel wage is maintained rather than the competitive wage. Wages will increase as worker productivity

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<sup>79</sup> Ellora Derenoncourt et al., *Spillover Effects from Voluntary Employer Minimum Wages*, (Nat’l Bureau of Econ. Research, Working Paper 29425, 2021).

<sup>80</sup> Sara Salinas, *Amazon Raises Minimum Wage to \$15 for All U.S. Employees*, CNBC (Oct. 2, 2018), <https://www.cnbc.com/2018/10/02/amazon-raises-minimum-wage-to-15-for-all-us-employees.html>.

<sup>81</sup> Derenoncourt et al., *supra*, at 10.

<sup>82</sup> Salinas, *supra*.

<sup>83</sup> *Id.* at 9 (describing Glassdoor).

<sup>84</sup> Derenoncourt et al., *supra*.

<sup>85</sup> *Id.* at 1.

<sup>86</sup> *Id.* at 3 (“The company-wide minimum wages we study and the spillovers they induce provide direct evidence of employer wage-setting power over low-wage workers.”).

<sup>87</sup> David Autor et al., *The Fall of the Labor Share and the Rise of Superstar Firms*, 135 Q. J. ECON. 645 (2020).

<sup>88</sup> It is notable that real wages for workers in this market have declined across the past four decades. David Cooper, Elise Gould, and Ben Zipperer, *Low-wage Workers Are Suffering From a Decline in the Real Value of the Federal Minimum Wage*, ECON. POLICY INSTITUTE (Aug. 27, 2019), <https://www.epi.org/publication/labor-day-2019-minimum-wage/>. Derenoncourt and her co-authors also find that the unemployment rate rose slightly in the wake of Amazon’s wage increases. Derenoncourt et. al, *supra* note, at 21-22. However, as the authors note, they cannot distinguish

<sup>89</sup> In September 2021 Amazon announced that it would again be raising starting wages for warehouse workers, this time to \$18 per hour.

<sup>90</sup> *Id.*

increases but they will remain below the wage that would prevail if Amazon and the other employers competed with each other for workers.

To sum up, at the lower end of the labor market, like at the higher end, there is evidence that employers set wages through tacit coordination. (Explicit coordination may also occur, but there is no direct evidence of it.<sup>91</sup>) This means that workers are underpaid relative to their contribution to the firm, and this could result in higher prices for consumers as well if output is artificially suppressed.

### Conclusion

We have shown that there are strong theoretical reasons, and a smattering of evidence, to believe that explicit and tacit collusion takes place in labor markets, and that this problem is large rather than small. But we have proved nothing, and so instead hope that labor economists conduct more studies of wage-setting in labor markets.

If further research establishes that both explicit and implicit collusion is ubiquitous as we suspect, then policymakers and courts should consider two remedies. First, they should weaken the *Twombly* standard for allegations of explicit labor market collusion. With so little known about labor markets, and general secrecy about salaries, plaintiffs should be given a chance to develop their cases through discovery. The government can also chip in by redoubling its investigative efforts.

Second, policymakers and courts should give serious thought to relaxing the immunity extended to firms that engage in parallel behavior in labor markets. While the remedy problem identified by Turner is a serious one, it is not a reason to block lawsuits that challenge tacit collusion. Whenever plaintiffs can show that tacit collusion leads to wages below what would be paid in a but-for world in which tacit collusion does not take place, they should be entitled to damages.<sup>92</sup> Economists will sometimes be able to calculate damages by using similar markets with a larger number of agents as a baseline.

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<sup>91</sup> Aside from the no-poaching terms in franchise contracts documented by Kreuger and Aschenfelter, *supra*.

<sup>92</sup> For a tentative suggestion along these lines, see Posner, *How Antitrust Failed Workers*, *supra* note 4.