THE HAMILTON PROJECT

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A Proposal for Protecting Low-Income Workers from Monopsony and Collusion

Alan B. Krueger and Eric A. Posner

MISSION STATEMENT

The Hamilton Project seeks to advance America's promise of opportunity, prosperity, and growth.

We believe that today's increasingly competitive global economy demands public policy ideas commensurate with the challenges of the 21st Century. The Project's economic strategy reflects a judgment that long-term prosperity is best achieved by fostering economic growth and broad participation in that growth, by enhancing individual economic security, and by embracing a role for effective government in making needed public investments.

Our strategy calls for combining public investment, a secure social safety net, and fiscal discipline. In that framework, the Project puts forward innovative proposals from leading economic thinkers — based on credible evidence and experience, not ideology or doctrine — to introduce new and effective policy options into the national debate.

The Project is named after Alexander Hamilton, the nation's first Treasury Secretary, who laid the foundation for the modern American economy. Hamilton stood for sound fiscal policy, believed that broad-based opportunity for advancement would drive American economic growth, and recognized that "prudent aids and encouragements on the part of government" are necessary to enhance and guide market forces. The guiding principles of the Project remain consistent with these views.

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A Proposal for Protecting Low-Income Workers from Monopsony and Collusion

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This policy proposal is a proposal from the author(s). As emphasized in The Hamilton Project's original strategy paper, the Project was designed in part to provide a forum for leading thinkers across the nation to put forward innovative and potentially important economic policy ideas that share the Project's broad goals of promoting economic growth, broad-based participation in growth, and economic security. The author(s) are invited to express their own ideas in policy papers, whether or not the Project's staff or advisory council agrees with the specific proposals. This policy paper is offered in that spirit.

BROOKINGS

Abstract

New evidence that labor markets are being rendered uncompetitive by large employers suggests that the time has come to strengthen legal protections for workers. Labor market collusion or monopsonization—the exercise of employer market power in labor markets—may contribute to wage stagnation, rising inequality, and declining productivity in the American economy, trends which have hit low-income workers especially hard. To address these problems, we propose three reforms. First, the federal government should enhance scrutiny of mergers for adverse labor market effects. Second, state governments should ban non-compete covenants that bind low-wage workers. Third, no-poaching arrangements among establishments that belong to a single franchise company should be prohibited.

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Introduction

In recent decades, rising income inequality and stagnating wages among all but the highest-paid workers have raised alarms about the health of the U.S. labor market and its capacity to provide workers with the means to adequately support themselves. Alongside the familiar explanations, including automation and foreign competition, a new and perhaps surprising one has emerged: monopsonization of, or collusion in, labor markets. As firms have grown in size, they have become capable of dominating local labor markets—a phenomenon referred to as monopsonization—and of using their market power to suppress wages.[1] There is also evidence that some firms have colluded, entering into no-poaching and similar arrangements that restrict workers' choices among employers. Various impediments to perfect competition, including reluctance among many workers to relocate to change jobs, have added to this problem.

The problem has been serious enough to draw the attention of the U.S. government. In 2016 the White House and the Department of Treasury issued reports critical of non-compete agreements (U.S. Department of the Treasury 2016; White House 2016). In the same year, the Department of Justice (DOJ) and the Federal Trade Commission (FTC) together issued a guidance document advising human resource professionals that it is illegal under the antitrust laws for rival firms to agree not to hire each other's workers or to compete on wages (DOJ and FTC 2016). DOJ has brought lawsuits against firms that have allegedly engaged in such arrangements, including a hospital association in Arizona, and technology companies, including Apple and Google. The FTC has brought cases against firms that tried to collude in the labor market for nurses and fashion models (FTC 1995).[2] In 2017 DOJ noted that it was conducting several investigations of labor market collusion that might lead to criminal prosecutions (Nylen 2017).

But given the scale of the problem and burdens of litigation, ad hoc legal interventions based on existing antitrust law will not be enough to solve it. To prevail in litigation, plaintiffs must offer proof about complex economic phenomena, such as the scope of markets and the relationship between wages and market power, which can be difficult to evaluate. Furthermore, antitrust authorities have limited resources. For these reasons, new approaches are needed for protecting workers from wage suppression and similar anticompetitive behavior.

We focus on three types of business behavior that have contributed to the current problems in the labor market. First, a combination of several decades of mergers and growth in industries where network effects tilt toward one dominant firm have created massive employers who apparently enjoy market power in various labor markets (Autor et al. 2017). While it is illegal for firms to merge for the purpose of dominating a labor market, the government does not focus on labor market effects when it screens mergers under the Horizontal Merger Guidelines (DOJ and FTC 2010). We propose a beefed-up screening procedure that alerts regulators of the risk that a merger will create anticompetitive effects in labor markets.

Second, it has recently become clear that firms use non-compete agreements to suppress labor market competition among low-wage workers. In a non-compete agreement (also called a covenant not to compete), the worker agrees that he or she will not work for competing employers for a period of time after termination. In principle, a non-compete agreement could violate antitrust law if it is used to enhance or exploit market power, but non-compete agreements are almost never the subject of antitrust litigation.

There are limits to the enforceability of non-compete agreements in the common law. If a non-compete agreement is not "reasonable" in the light of legitimate business goals—such as recovering the cost of training or preventing the disclosure of trade secrets—then a court will refuse to enforce it.[3] The practical effect of this rule is that if a worker knows his or her legal rights, or can afford a lawyer to explain them and defend him or her in court, then the non-compete agreement may not be harmful, and could enhance efficiency.[3] For example, the risk of turnover can result in insufficient investment in firm-specific training. But with non-competes a worker and firm can jointly reach a bargain in which the firm pays the cost of industry-specific training and shares some of the return from that investment in exchange for the worker agreeing to refrain from moving to another firm in the industry. The problem is that, typically, only high-level executives and professionals can afford a lawyer to review such agreements and ensure that the worker's interests are fully represented. And even in these cases, there is a concern that in "thin" labor markets for critical talent, an employer can use non-compete agreements to bind workers and discourage competitors from entering the market because they will face a scarcity of available labor. Many employers use non-competes for low-wage jobs (Starr, Prescott, and Bishara 2017), where workers do not know their rights, cannot afford lawyers, receive little training, and are susceptible to threats from their former employers. Accordingly, we propose that non-compete agreements involving low-wage workers be banned or heavily restricted. A handful of states have recently been considering such actions.

Third, new evidence suggests that franchise companies have used no-poaching agreements to suppress labor market competition. In a no-poaching agreement, two or more employers agree that they will not hire each other's employees. When these agreements are made between independent companies, they clearly run afoul of the antitrust laws, as DOJ and FTC guidance makes clear. However, in recent years no-poaching agreements have increasingly been included in franchisors' contracts with their franchisees, where antitrust law is harder to enforce. When a franchisor requires the different franchisees within its chain not to poach each other's workers, a claim can be made that the antitrust laws do not apply because the rules are internal to a single organization, while antitrust laws apply to the relationships among independent firms. However, if more than one franchisee exists in a single labor market, and those franchisees are collectively a dominant employer in that labor market, the no-poaching agreement is anticompetitive, and will tend to suppress the wages of workers. We argue that no-poaching agreements in franchises should be banned.

The Challenge

THE ECONOMICS OF LABOR MARKET MONOPSONIZATION AND COLLUSION

Under perfect competition, workers are paid the value of their contribution to output. A perfectly competitive labor market requires that workers can move freely to seek the most desirable opportunities for which they are qualified, and that neither employers nor employees have the ability to set pay. If employers have market power, however, they can pay workers less than the value of their contribution to output. The Joan Robinson (1969) variant of monopsony occurs when there is a single employer in a labor market. In this situation, the employer faces the market supply curve for labor, and must pay a higher wage to hire additional labor. The profit-maximizing decision for such a monopsonist is to hire less than the quantity of labor that would be hired under perfect competition, and pay workers below the value of marginal product of the last worker hired. A monopsonist makes do with unfilled jobs, which typically appear as vacancies; it is unable to find workers at the low wages it offers and unwilling to raise pay to attract more workers.

Burdett and Mortenson (1998), Manning (2003), and others show that a similar situation arises even if there are many small employers competing for labor in an otherwise competitive market, to the extent that labor market frictions—for example, from turnover and recruitment costs—cause employers to face a rising cost of labor.

These forms of monopsony power arise by natural forces, and are not a legal cause of action, much as a firm that achieves monopoly pricing power in the product market because of scale economies is not in violation of antitrust laws. Historically, labor unions played a greater role in counterbalancing such monopsony power, but with only 7 percent of private sector workers unionized, unions play a much smaller role today.

Employers can exert monopsony power through deliberate means, however, by restricting competition for labor or by colluding with other employers to suppress pay or benefits below the competitive level. These cases are of much greater concern for the law. The notion that employers have an interest in manipulating the labor market and restricting competition is hardly new. In *The Wealth of Nations*, for example, Adam Smith (1776, 81) observed, "[Employers] 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." If employers act in concert to suppress wages below the prevailing level, then they jointly act as a monopsonist, which reduces pay and employment for workers. Likewise, if employers restrict their employees' outside options by pressuring or deceiving them to sign non-compete clauses, they can reduce worker mobility and suppress wages below the competitive level. If a labor market is already concentrated, non-compete agreements between incumbent firms and workers may deter new firms from entering the market and bidding up wages by depriving those firms of a ready source of labor. And agreements among employers to not hire or recruit from other employers—so-called no-poaching agreements—are a form of collusive behavior that restricts competition and suppresses pay and employment opportunities.

EVIDENCE

Collusion and Monopsonization in the Labor Market

Until recently economists assumed that labor markets are fairly competitive. The company towns of the past are long gone, and the vast majority of workers live in urban areas where employers are plentiful. But recent events—including agreements among technology companies not to poach engineers and among hospitals not to poach nurses—have led many economists and government officials to question this assumption (Council of Economic Advisers [CEA] 2016). Of course, such cases are hardly new, but legal scrutiny of them remains relatively rare. We have found fewer than two dozen cases since 2000 where courts have considered allegations of improper use of labor market monopsony power or collusion, most of them involving specialized settings such as sports leagues.[5]

However, the most powerful evidence for increased monopsony power relates to broad changes in the labor market. CEA (2016) provides a thorough summary of evidence regarding monopsony power in the labor market. Among the evidence that CEA cites are these: (1) Firm concentration has increased in recent years. (2) Labor market dynamism and geographic mobility have trended down in recent decades, enabling noncompetitive wage differentials to persist with less external pressure from worker mobility. (3) Other forces that tend to counteract monopsony power and collusion are weaker than has historically been the case in the United States, due to the decline in the real value of the minimum wage and the decline in the fraction of workers represented by labor unions. (4) And, in the current recovery, wage growth has not been stronger in industries that have experienced greater job openings. Next we provide evidence on two types of contractual practices that support employer monopsony power: non-compete agreements and no-poaching agreements.

Non-Compete Agreements

Non-compete agreements are contracts or clauses in contracts that prohibit an employee from working for a competitor after the employee separates from the employer. In an employment contract, a non-compete clause may prohibit the employee from working for a rival firm when employment terminates (i.e., the employee quits and/or is fired). An employee might also sign a non-compete agreement at the time of termination in return for consideration such as money. A typical non-compete specifies the relevant industry in which the employee is prohibited from finding employment, the time period during which the noncompetition obligation remains in effect, and the geographic scope of the noncompetition obligation. For example, a non-compete for a salesperson who specializes in business software might specify that the person may not work as a salesperson for firms that sell business software, for a period of one year, and in the area in which the employer operates, such as a county or state. The scope of non-compete clauses varies significantly from industry to industry, and even within industries, and from place to place. Some are written narrowly and some are written broadly.

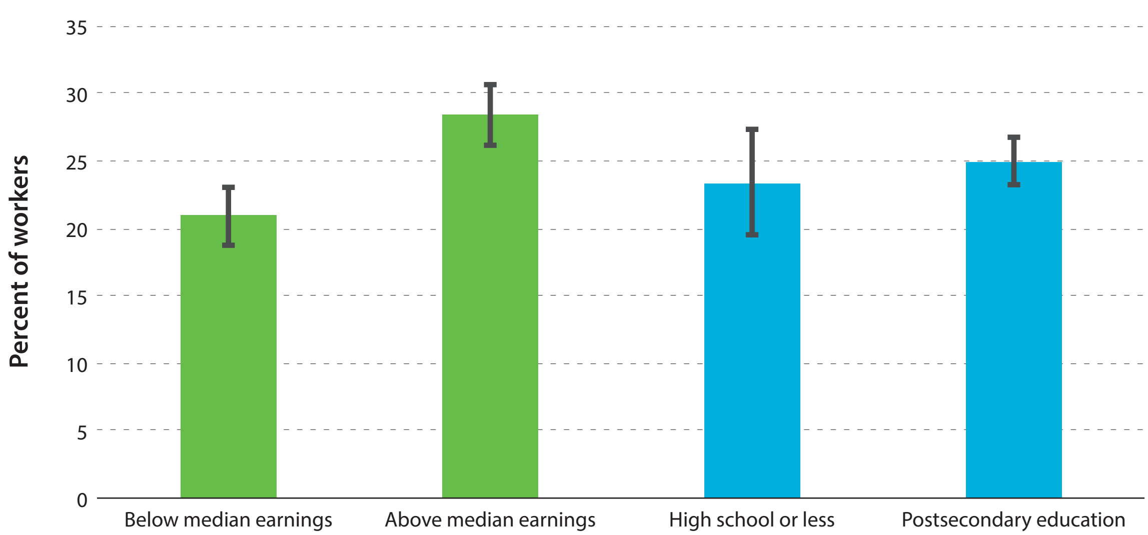
Until recently, academic and policy discussion about non-competes presumed that they were used only for high-skill workers. But in 2014 it was revealed that Jimmy John's, a fast-food franchise, required low-level employees to sign contracts with non-competes that prohibited them from taking jobs at any business that obtained more than 10 percent of its revenue from "selling submarine, hero-type, deli-style, pita and/or wrapped or rolled sandwiches" within two (later extended to three) miles of any franchise, anywhere in the United States (Jamieson 2014). The non-compete covenant extended for two years. Its effect would have been to prevent a worker from obtaining a new job as a sandwich maker in large areas, including the entire city of Chicago.

Anecdotal evidence suggests that Jimmy John's practice—since discontinued—is not uncommon (Dougherty 2017a). And survey data reported in a recent paper by Starr, Prescott, and Bishara (2017) indicate that 12 percent of low-income workers—those lacking a college education with incomes less than $40,000 per year—were subject to non-competes in 2014. Over all income levels, Starr, Prescott, and Bishara estimate that one in five workers was bound by a non-compete clause.

To supplement these findings, we contracted with Survey Sampling Inc. (SSI) to conduct a short internet survey of 919 workers in February 2017 to assess the extent to which workers are covered by non-compete clauses. After deleting

FIGURE 1.

Share of Workers Covered by a Non-Compete Agreement in Current or Former Job, by Weekly Earnings and Education



Source: Authors' calculations based on SSI survey; see text.

Note: The length of the error bars indicate the standard errors of the respective estimates.

responses by self-employed individuals, we have a sample of 795 employees. We derived sampling weights for respondents based on their income, race, sex, education, and age to make the weighted sample representative of the U.S. workforce. Specifically, workers were asked, "Does your employment relationship restrict you in any way from taking another job, such as through a non-compete clause or no-raid pact?" If they answered in the affirmative, they were asked whether a non-compete clause, no-raid pact, or other arrangement was the source of the restriction.

In the weighted sample, 15.5 percent of workers responded they were currently covered by a non-compete clause. This figure is similar to Starr, Bishara, and Prescott's (2017) estimate before they made an adjustment for underreporting. The percentage of workers who said they were covered by a non-compete clause was slightly higher for those with a high school diploma or less (17.5 percent) than for workers with post–high school education (14.6 percent), on average.

For those who responded that their employment relationship does not restrict them in any way from taking another job, we asked, "Have you ever worked for a company that restricted where you could work after you left that company because of a non-compete clause or some other reason?" Taking into account previous employment as well as current employment, 24.5 percent of the workforce is bound by a non-compete restriction on their current job, or was bound by a non-compete from a previous job. Figure 1 displays the proportion of workers who are restricted by a non-compete agreement in their current job or have been so restricted in a former job, disaggregated by earnings (above or below the median weekly earnings) and education (high school or less versus some postsecondary education or more). As one would expect, higher-income workers are more likely to be covered by non-compete agreements, but a remarkably high 21 percent of workers who earn less than the median salary are currently or have been restricted by a non-compete agreement. And workers with a high school diploma or less are almost equally likely to be covered by a non-compete agreement in a current or former job as are workers with some postsecondary education.

Franchise No-Poaching Agreements

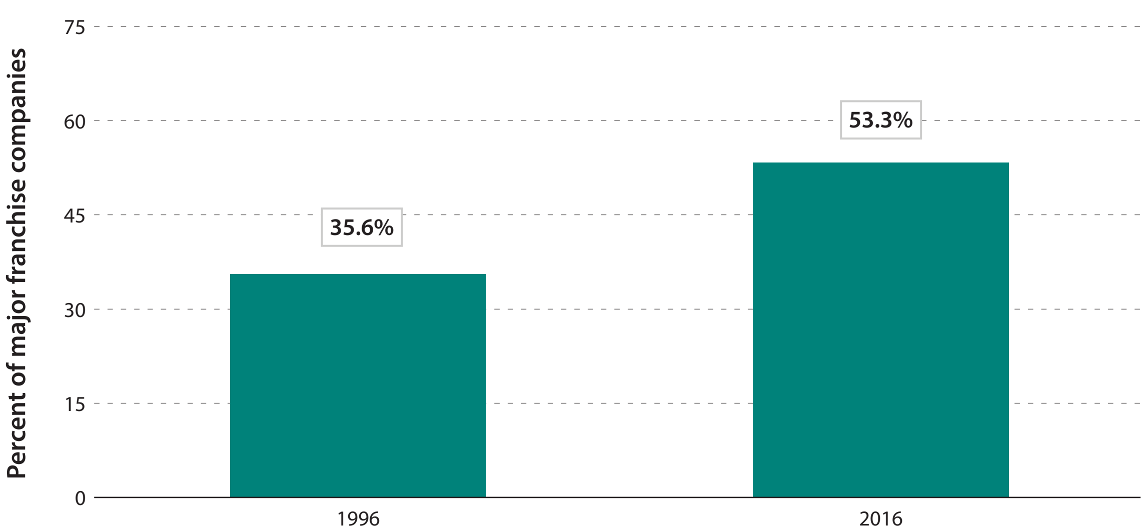
Like non-competes, no-poaching agreements went unnoticed by many labor market observers until recently. There was little evidence that companies used them, and in any event no one challenged that they were illegal. But in 2017 employees of McDonald's sued the company under the antitrust laws for subjecting its franchisees to a no-poaching arrangement.[6]

Since at least 1987 until early in 2017, McDonald's has included the following no-poaching clause in its standard franchise contract:

> *Interference With Employment Relations of Others.* During the term of this Franchise, Franchisee shall not employ or seek to employ any person who is at the time employed by McDonald's, any of its subsidiaries, or by any person who is at the time operating a McDonald's restaurant or otherwise induce, directly or indirectly,

FIGURE 2.

Share of Major Franchise Companies with a No-Poaching Clause, 1996 and 2016



Source: Based on data provided by FRANdata (frandata.com); and Krueger and Ashenfelter 2017.

> such person to leave such employment. This paragraph 14 shall not be violated if such person has left the employ of any of the foregoing parties for a period in excess of six (6) months.[7]

This clause was dropped from McDonald's franchise contract in early 2017, around the time that CKE Restaurants Holdings was sued for having a similar clause in its Carl's Jr. franchise contract.

By examining franchise disclosure documents for 156 franchisors with more than 500 franchise units operating in the United States in 2016, Krueger and Ashenfelter (2017) show that 56 percent of major franchisors have no-poaching agreements in their franchise contracts. They provide an illustrative calculation indicating how no-poaching agreements within franchisors can greatly increase the effective Herfindahl-Hirschman index—a measure of industry concentration used to evaluate market competitiveness—and create employer market power over workers. In essence, if all units of a franchise chain act as if they are one company in terms of hiring practices, then an otherwise competitive labor market can become much more concentrated.

To determine whether this practice has increased or decreased over time, we obtained franchise disclosure documents filed in 1996 for the 45 largest franchisors in 2016 that were in operation in 1996 from the same source used by Krueger and Ashenfelter (2017). Figure 2 reports the share of these franchise chains with a no-poaching agreement in 1996 and in 2016. Over the past 20 years the share of major franchise companies that included a no-poaching covenant in their standard franchise agreement increased from just over one-third to slightly more than half.[8] An example of a chain that added a no-poaching clause in the past twenty years is the International House of Pancakes, which currently requires the following of its franchisees:

> *Non-Solicitation*. During the Term of this Agreement and for one year following the expiration or termination and each Assignment, Franchisee shall not, without the prior written consent of Franchisor, directly or indirectly: (a) employ or attempt to employ any person who at that time is employed by Franchisor, an Affiliate of Franchisor, or any other Franchisee or area developer of Franchisor, including, without limitation, any manager or assistant manager; (b) employ or attempt to employ any person who within six months prior thereto had been employed by Franchisor, an Affiliate of Franchisor, or any other Franchisee or area developer of Franchisor; or (c) induce or attempt to induce any person to leave his or her employment with Franchisor, an Affiliate of Franchisor, or any franchisee or area developer of Franchisor.[9]

In all likelihood, the proliferation of no-poaching agreements has increased franchise companies' monopsony power over workers in recent decades.

THE LIMITS OF THE LAW: WHY A NEW APPROACH IS NEEDED

Collusion and Monopsonization

Labor market concentration poses a difficult challenge to antitrust enforcement. A firm that enjoys monopsony power over a labor market and uses that power to pay its workers below the competitive rate is not liable under the antitrust laws, as long as the firm did not take intentional actions to obtain that power. For example, if a large factory dominates the labor market of a small town because other factories in the area have shut down, the factory owner is free to pay below-market wages without violating antitrust laws.

In contrast, when firms achieve labor market power through mergers or collusion—such as through no-poaching agreements—they do violate the antitrust laws. Firms obtain labor market power through merger when two employers who compete for workers combine into a single entity. If the labor market is already relatively concentrated or the firms are large employers, the increase in labor market power may be significant. Firms can obtain market power even without merging by agreeing to not compete over labor. They can do this in many ways—for example, agreeing not to hire away each other's workers, agreeing to draw from different pools of labor, coordinating on wages and benefits, sharing information, and so on.

Firms that obtain labor market power in these ways violate the antitrust laws. The problem lies in enforcement. Firms accused of violating the antitrust laws can defend themselves by arguing that apparently anticompetitive behavior allows them to lower prices by exploiting economies of scale. Anticompetitive behavior can result from hard-to-prove, and not always illegal, tacit coordination rather than explicit agreement. Thus, even when firms do not enter no-poaching agreements, firms may be able to coordinate wages without entering into explicit agreements, for example, through sharing of information about compensation, or adopting parallel practices of not raiding each other's workforce (DOJ and FTC 2016). When firms engage in these more ambiguous types of activities, plaintiffs will have trouble persuading courts that their actions are illegal.

An additional hurdle to antitrust enforcement is the cost of bringing lawsuits. Individual employees will almost never have the resources or incentives to sue employers for antitrust violations because of the vast cost of an antitrust suit along with the relatively small sums at stake. Private wage suppression suits therefore require a class action, which imposes considerable costs and risks on law firms. While the government can bring such suits, and has in a few cases, it faces a similar problem of limited resources and high risk. In contrast, product-market antitrust claims are often brought by large firms that are harmed by the alleged anticompetitive practices.

Non-Compete Agreements

Common Law

In the common law, courts make an exception to the principle of freedom of contract and refuse to enforce non-compete agreements that are "unreasonable."[10] To determine whether a non-compete clause is unreasonable, a court typically asks whether the clause is broader than necessary to protect the employer's legitimate business interest. Accordingly, a court might determine that the geographic scope of a non-compete clause is too broad if the employee works in a much smaller area, or the industry scope is too broad if not all employers within the designated industry actually compete with the employer in question.

Employers usually argue that the clause is needed to protect trade secrets, such as client lists, or to protect their investment in the employee, who may have received training. The worry is that if employees are permitted to work for rivals of their employers, then they will be able to transfer information to those rivals, which would discourage employers from sharing information with employees, force them to use elaborate firewalls and other protections, or refuse to invest in trade secrets in the first place. Employers might also underinvest in their employees if employees can take their new skills to rivals.

While the courts' approach to non-compete agreements may provide some protection to low-income workers, it is plainly inadequate. First, employees frequently do not read or understand employment agreements because they are long and complex, and the workers do not have the means to hire a lawyer to interpret the contract for them. Poorly educated workers who can command only low wages are at a greater-than-usual disadvantage. In some cases, employees may be first informed of the non-compete clause after they begin work or when they quit. Second, the remedy for an unreasonable non-compete clause is generally either nonenforcement or reformation of the clause so that it is less broad; the employer is not penalized or forced to pay damages to the employee. This means that employees threatened with a lawsuit if they try to work for a rival firm will not be able to attract a lawyer to defend them. Lawyers must be paid, and low-wage workers cannot afford to pay lawyers; since they will not receive damages, lawyers cannot be paid out of any recovery. Given the frequency of the practice, employers appear to understand that they face no sanction if they insert unenforceable non-compete clauses in contracts even if the clauses enable the employers to intimidate the employees. Finally, because of the vagueness of the legal standard that governs non-compete clauses, it is always possible that an employee will lose a case. This will further deter an employee from seeking legal relief, and a lawyer from helping him or her.

Another problem with the common law approach to noncompetition agreements is that these agreements might have significant anticompetitive effects even when they are permissible. Imagine that a monopsonistic employer requires all employees to sign non-competes as a condition of employment. The non-competes may be deemed reasonable under the common law because of their limited scope and duration, but nonetheless deter other employers from entering the market for labor because they fear that they will not be able to find enough employees to run their businesses. From a social standpoint, it may be optimal to prohibit such non-competes because of their collective anticompetitive effect even though they are individually reasonable.

Legislation

In most states, non-compete agreements are mainly governed by the common law only. But in California, North Dakota, and Oklahoma, non-competes are generally prohibited by statute.[11] In recent years several state legislatures, including those of Hawaii, New Mexico, Oregon, and Utah, have considered or passed legislation that puts limits on non-competes (Lohr 2016). Notably, in 2016 Illinois passed a law banning non-competes for low-wage workers, defined as those who earn no more than $13 per hour or the relevant legal minimum wage, whichever is higher.[12]

Maine, Maryland, Massachusetts, and New Hampshire are currently considering legislation to restrict non-compete clauses, particularly with respect to low-wage workers (Beck 2017; Quinton 2017). The bills vary greatly, but some of them entail fairly sweeping changes. For example, one bill being considered in Massachusetts tightens the common law analysis of all non-compete agreements, while also prohibiting their use for low-wage workers (nonexempt workers under the Fair Labor Standards Act, who are lower-income and paid on a wage basis). For all non-competes, the bill requires employers to give workers notice of non-competes, to supply additional consideration when non-competes are created after employment begins, to review the agreement with the worker every three years, and to notify the worker of the agreement at termination. It also tightens the common law limits on duration, geographic scope, and industry scope.[13] Going in the other direction, Idaho recently passed a law that makes it more difficult for employees to challenge a non-compete (Dougherty 2017b).

Overall, the legal regime is insufficient to address the antitrust problems posed by non-competes for several reasons. First, the common law and much of the statutory law do not address problems of market power in an adequate way. When employers enjoy monopsony power, this type of law offers no protection to workers who must either accept unfavorable terms or do without wages. Second, the remedies are too weak. Even when non-competes are illegal, the normal remedy is simply nonenforcement. This means that employers have nothing to lose from inserting non-competes into contracts. Since employers may be able to deter workers from quitting and finding new jobs in the same industry simply by pointing out the existence of the clauses in the contracts, the law does nothing to deter employers from using the clauses. Third, while some states have taken strides to restrict non-competes for low-wage workers, these types of agreements remain lawful nearly everywhere. Fourth, while non-competes can be challenged under the antitrust laws, which provide for significant remedies, defendants can often avoid liability by showing that the non-competes serve a reasonable business purpose.[14]

No-Poaching Agreements within Franchises

When firms are independent, no-poaching and related agreements are clear violations of antitrust law.[15] Antitrust law forbids independent firms from agreeing not to compete, and in a no-poaching agreement firms agree not to compete for workers.

However, no-poaching agreements remain common and have grown in usage in franchise contracts, as we show above. The difference is that typically a single franchisor enters an agreement with each individual franchisee under which the franchisee promises the franchisor that it will not poach employees from other franchisees or company-owned units. This type of arrangement does not as clearly run afoul of antitrust law for two reasons. First, the components of a franchise may be considered a "single economic entity," in which case antitrust law does not apply. Second, the agreement in the franchise setting is technically a "vertical" rather than a "horizontal" agreement, which is evaluated under a more generous standard in antitrust law. In *Williams v. I. B. Fischer Nevada*, a court recognized both of these issues in the course of holding that a no-poaching agreement between the Jack in the Box franchise and each of its franchisees did not violate section 1 of the Sherman Act.[16] It is unclear whether this holding remains good law after the Supreme Court narrowed the definition of a "single economic entity" in 2010, making it easier for courts to see franchisees as independent companies that may enter conspiracies in violation of the Sherman Act.[17]

Nonetheless, franchisors who enter no-poaching agreements with franchisees face little risk of antitrust liability. The law remains unsettled; even if it becomes clear that the single economic entity rule has been relaxed for franchises, it will remain difficult for victims of no-poaching agreements to win cases because of the complexity of the rule-of-reason analysis applied to vertical agreements. As in the case of non-competes, workers who seek to vindicate possible legal claims face fundamental logistical problems. Because antitrust cases are complex, expensive, and risky, and no-poaching agreements may be secret, it may not be worth the time and money to bring lawsuits. Class actions remain possible but they, too, pose considerable risk to the lawyers who bring them.[18] In addition, in recent years the Supreme Court has erected new barriers to class actions by workers against employers.[19]

A New Approach

HORIZONTAL MERGER GUIDELINES

DOJ and the FTC review mergers between large firms under the Horizontal Merger Guidelines (DOJ and FTC 2010). The Guidelines focus on the problem of product market competition, and provide rules that help regulators determine whether a merger will have anticompetitive effects in such markets. While the Guidelines acknowledge that regulators should also be on guard against mergers that enhance market power for buyers vis-à-vis suppliers, they do not address the special issues that arise when those suppliers supply labor rather than other inputs (DOJ and FTC 2010). This omission needs to be corrected.

The Guidelines (DOJ and FTC 2010) should include a new section that directs the government to screen mergers based on their likely effects on labor markets. Such an analysis can be based on the normal approach to analyzing the effects of mergers on product markets. First, the agency should define the labor activity—for example, sandwich maker, waiter, barista, or retail clerk. It may be appropriate to use very broad definitions in some cases (e.g., unskilled labor). The frequency of movements of workers between occupations—which is informative about the similarity of tasks involved in various occupations—could be a useful guide for defining the scope of labor activity.

Second, the agency should identify the various labor markets affected by the mergers. These are geographic areas that encompass the commuting range of workers of the relevant skill level. Some labor markets are national in scope (e.g., skilled professionals) and some are more limited.

Third, the agency should assess the effect of the merger on concentration in the labor market. Specifically, the agency would calculate the premerger and postmerger Herfindahl-Hirschman index levels of the labor market, and recognize a presumption against a merger if the postmerger absolute level of concentration and/or the increase indicate too high a risk of wage suppression.

Fourth, merging firms should be allowed to rebut this presumption by showing special characteristics of the labor market, such as high worker mobility, or evidence that the merger will create significant benefits—economies of scale, for example—that sufficiently offset any losses to workers.

Under our proposal, the regulators would be on guard against effects on both product market competition and labor market competition. The two are obviously different. Imagine that two manufacturers seek to merge, and that they both sell goods into a national market in which many other competitors are involved. The merger would pass the Guidelines as currently written. But imagine that the factories of the two competitors are located in the same town, and those factories are the largest employers of the town's low-skill workers. The merger should be blocked because of its negative labor market effects unless the merging companies can show that the labor market will remain competitive or that there are other significant benefits from the merger.

Because this proposal may require more analysis by the Antitrust Division at DOJ, we also suggest that the resources of this department be expanded, with special attention to hiring labor market economists. This would also provide more capacity to investigate wage collusion or no-poaching agreements.

NON-COMPETE AGREEMENTS

Non-compete agreements may be justified when employers heavily invest in training employees, or trust them with valuable information, including trade secrets, but this is rarely the case with unskilled or low-skilled workers. In these cases, the most plausible explanation for non-competes is their anticompetitive value for employers. Moreover, because many low-income workers rarely read and understand their employment contracts, the risk of harm is far greater than in other contexts. Accordingly, we believe that states should pass laws, modeled on Illinois' laws, that flatly ban non-competes for workers earning less than $13 per hour. Specifically, we propose that non-competes be uniformly unenforceable and banned if they govern a worker who earns less than the median wage in her state.

It is possible to argue that such an approach is too crude. Some low-income workers are given significant training, and some are entrusted with trade secrets. It could be argued that employers should be allowed to use non-competes—if not too strict in terms of geographic scope, industry definition, and duration—when they can show the non-compete advances these interests. But this would just duplicate current law, which is plainly inadequate, and in any event trade secrets are protected by another area of the law that we would leave undisturbed. Experience in California, where Silicon Valley flourishes despite (or perhaps in part due to) the unenforceability of non-competes, suggests that the strong claims made on behalf of the value of non-competes are greatly exaggerated (Fallick, Fleischman, and Rebitzer 2005; Gilson 1999). Accordingly, we believe that the best approach is a flat ban of the kind we describe.

A further problem needs to be addressed, which is the deterrent effect of even unenforceable non-competes against workers who lack the resources and sophistication to challenge them in court. To address this problem, states should pass laws that require firms to delete from employment contracts non-competes that are legally unenforceable; and to pay penalties if the firms incorrectly tell employees that they are governed by non-competes and threaten to sue them if they quit and accept jobs elsewhere in the industry. The latter types of action can be likened to fraudulent conduct and business torts that are already illegal. The regulation we advocate can also be seen as akin to the type of disclosure rules that require employers to inform workers of their employment and labor rights.

NO-POACHING AGREEMENTS

Employers sometimes defend no-poaching agreements on the grounds that they allow employers to protect their investments in employees. This is simply not an accepted view in antitrust law. There are more-efficient ways to protect investments—for example, by offering employees bonuses if they stay with the employer—that do not pose such a significant risk to labor market competition.

The same logic holds for no-poaching agreements between franchisors and franchisees. While franchisors sometimes argue that within-franchise no-poaching agreements lead to more-specific training, that training would not be lost to the franchise if no-poaching agreements were illegal; there is even less economic justification for a no-poaching agreement among franchisees in the same chain than among other unrelated employers.

Accordingly, we propose a per se rule against no-poaching agreements regardless of whether they are used outside or within franchises. In other words, no-poaching agreements would be considered illegal regardless of the circumstances of their use.

Questions and Concerns

1. Are problems with non-competes really a matter of inadequate information (e.g., Marx and Fleming 2012) rather than a problem of labor market concentration? If so, isn't the appropriate remedy a disclosure rule?

The problem with disclosure rules is that they rarely work as intended, likely because of information overload. In the context of consumer protection, study after study shows that consumers ignore or misunderstand information that is disclosed as a result of legal mandates (Ben-Shahar and Schneider 2014). This problem is especially acute for people with little education and who are often desperate for work.

2. Isn't market power more of a problem with high-skill and hence high-income workers than with low-skill workers?

Sandwich makers might be indifferent between taking a job at another sandwich shop and at any other employer of low-skill workers, e.g., a warehouse or factory. If so, the non-compete that is limited to the sandwich industry will not prevent them from switching jobs. In contrast, computer programmers whose skills and training are specific to that industry might have trouble finding new positions if they are subject to a non-compete.

We focus on the case of low-income workers because it has been overlooked and the hardship is greater. If labor markets for low-wage workers are at least somewhat disconnected from each other, then restricting mobility will suppress low-wage workers' ability to move to higher-paying jobs. Moreover, even if all employers offered low-wage workers the same pay, non-competes could depress the entire wage scale by crowding low-wage workers into certain sectors. The fact that employers at Jimmy John's and other franchises use (or have used) non-competes suggests that they think that it increases their market power over workers. In addition, low-skilled workers are less likely to move across geographic boundaries than high-wage workers, which gives employers local monopsony power over low-wage workers. Finally, if monopsony power and anticompetitive practices suppress pay, low-wage sectors may, in fact, be a manifestation of such features of the labor market.

3. Are there less-aggressive, more-tailored measures to address the problems we identify (including disclosure rules, as discussed above)?

There may be, but it is important to note the considerable confusion over whether non-competes are enforceable, as well as widespread employer abuse of the practice. We argue that a simple, easily understood rule, such as an outright ban of non-competes for workers earning less than the state median wage, is likely to be effective and ultimately more efficient than a more tailored approach that in principle could be economically efficient, but in practice would be very complicated to administer and follow. The fact that some states, like Illinois, have begun to ban non-competes is a sign that political economy forces are aligned behind this approach, because of its simplicity, popularity, and efficacy.

4. Is there a federal remedy for problems of employer wage collusion, non-competes, and no-poaching agreements?

If states do not adequately regulate non-competes and no-poaching agreements, then the federal government should step in. Congress could pass laws that ban these practices. In addition, under its existing legal authority, the FTC could likely ban non-competes and no-poaching agreements as unfair trade practices. While federal regulation can be applied only to "interstate commerce," that term has been interpreted broadly by the courts, so that a federal intervention would likely be valid and effective.

5. If these proposals are implemented, won't employers find other ways to exercise monopsony power?

Even if non-competes and no-poaching agreements are prohibited, and mergers are subjected to greater scrutiny, employers likely will seek out new ways of extending and exercising monopsony power. But it is doubtful that these other methods are equally effective substitutes for the practices that we seek to constrain. In any event, we advocate additional research and, if appropriate, legal regulation to address these other practices.

Conclusion

The problems we have focused on—mergers, non-competes, and no-poaching agreements—are part of a much larger problem: employer concentration and market power within labor markets. While the exact contours of the problem remain obscure, there is little doubt that shifting market power has contributed to income inequality, wage stagnation, and sluggish economic growth. Even if our solutions are adopted, we expect that labor market concentration and unequal bargaining power will continue to be a problem as employers find new ways to enhance their market power.

We hope, then, to stimulate reflection on this larger problem. There seem to be three general avenues for future research and policy. First, it may be necessary to strengthen and reorient antitrust law so that it is more usable for labor market concentration than it currently is. Merger screening is only one part of this process. There may be other commonly used practices—like information sharing, coordination of hiring through headhunters and networks, and so on—that facilitate coordination on wages and hiring, or enable monopsonists to extend their market power.

Second, researchers should also evaluate anew employment regulations that may enhance workers' bargaining power. While a great deal of attention has been devoted to minimum wage laws, other laws that control aspects of the employment relationship—including hours, working conditions, and benefits—may have desirable competitive effects by offsetting unequal employer bargaining power. Contract terms (beyond non-competes) that reduce worker mobility also may be a matter of concern.

Third, there are broad public-policy strategies that might meaningfully improve the bargaining power of workers. These include public infrastructure, which can increase the size of labor markets by reducing commute times; education; immigration policy; and union regulation.

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Endnotes

1. For evidence on the effect of employer concentration on wages, see Azar, Marinescu, and Steinbaum (2017). For evidence on growing firm concentration in the labor market, see Autor et al. (2017).
2. See also U.S. and State of Arizona v. Arizona Hospital and Health Care Association & AzHHA Service Corp., No. CV07-1030-PHX (D. Ariz. Final Judgment filed September 12, 2007), www.justice.gov/atr/case/us-and-state-arizona-v-arizona-hospital-and-healthcare-association-and-azhha-service-corp.
3. States vary substantially in terms of what they consider to be a reasonable non-compete agreement, and how they approach the enforcement of non-competes more generally. For example, some states will allow a court to enforce a modified version of a contract that is otherwise unenforceable, while other states do not permit this.
4. Non-competes can nevertheless still be damaging for workers with adequate legal representation and knowledge, as the examples in Dougherty (2017a) suggest.
5. For some notable cases involving more general settings, see Todd v. Exxon, 275 F.3d 191 (2d Cir. 2001) (petrochemical companies shared salary information of certain employees); Nobody in Particular Presents, Inc. v. Clear Channel Commc'n, 311 F.Supp. 2d 1048 (D. Co. 2004) (DJs); Jung v. Ass'n of Am. Med. Coll., 300 F.Supp.2d 119 (D. D.C. 2004) (physicians); In re Animation Workers Antitrust Litig., 123 F.Supp.3d 1175 (N.D. Cal. 2015) (animation workers).
6. Class Action Complaint, Deslandes v. McDonald's USA, LLC et al, No. 1:17-cv-04857 (N.D. Ill. filed June 28, 2017).
7. Deslandes v. McDonald's USA, 18.
8. The 18-percentage-point increase in the share of major franchise chains with a no-poaching restriction over the past two decades was unlikely to have occurred by chance; a paired t-test of no change has a p-value of 0.004.
9. Section 16.16 of the International House of Pancake 2017 Franchise Agreement, registered with the Wisconsin Department of Financial Institutions, https://www.wdfi.org/apps/FranchiseSearch/details.aspx?id=615829&hash=177165780&search=external&type=GENERAL on January 1, 2018.
10. There is considerable variation in the relevant common law across states. The discussion abstracts away from the many differences in law.
11. Cal. Business & Professions Code § 16600; N.D. Cent. Code § 9-08-06; OK Stat. § 15-219A.
12. Illinois Public Act 099-0860 (2016).
13. H.2366, 2017 Gen. Court, 190th Sess. (Mass. 2017).
14. 15 U.S.C. § 1–2. Under standard antitrust analysis, plaintiffs can prevail either by showing that the non-compete was the result of a conspiracy (§ 1) or that it furthered an effort to monopolize (or monopsonize) (§ 2). But an ordinary non-compete clause is not a conspiracy, because it involves an agreement between the employee and the employer, who are not competitors, rather than between two firms. And Section 2 can usually be enforced only against firms that achieve or attempt to achieve significant market dominance, and not in the case that concerns us, where common usage of non-competes across firms create labor market frictions that enhance employers' bargaining power without giving them full-blown monopsonies. For an attempt to challenge a fairly significant non-compete arrangement that failed because a court was persuaded that it served legitimate business purposes, see Eichorn v. AT&T Corp., 248 F.3d 131 (3rd Cir. 2001).
15. In 2010 Adobe Systems, Apple, Google, Intel, Intuit, and Pixar entered a consent decree after the government accused them of entering no-poaching agreements in violation of antitrust law. United States v. Adobe Sys., Inc., No. 1:10-cv-01629 (D.D.C. filed Sept. 24, 2010); United States v. Lucasfilm Ltd., No. 1:10-cv-02220 (D.D.C. filed Dec. 21, 2010); DOJ 2010.
16. 999 F.2d 445, 447-448 (9th Cir. 1993).
17. Am. Needle, Inc. v. Nat'l Football League, 560 U.S. 183, 186-187 (2010). For a discussion, see Lindsay and Santon (2012).
18. See e.g., Weisfeld v. Sun Chem. Corp., 84 Fed.Appx. 257 (3rd Cir. 2004), which provides a vivid illustration of the difficulties that lawyers face in constructing a class of workers. To obtain class certification, a plaintiff must show that the alleged wrongful conduct affected all members of the class in a similar way. The Court held that the plaintiff could not make such a showing because of variation among putative class members, including:

    > whether a covenant not to compete was included in a particular employee's contract; the employee's salary history, educational and other qualifications; the employer's place of business; the employee's willingness to relocate to a distant competitor; and [employees'] ability to seek employment in other industries in which their skills could be utilized (e.g., pharmaceuticals, cosmetics).

    Id., citing Weisfeld v. Sun Chemical Corp., 210 F.R.D. 136, 144 (D.N.J.2002).
19. Wal-Mart v. Dukes, 564 U.S. 338 (2011).

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THE HAMILTON PROJECT

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Highlights

New evidence that labor markets are being rendered uncompetitive by employers suggests that the time has come to strengthen legal protections for workers. Labor market collusion or monopsonization—the exercise of employer market power in labor markets—may contribute to wage stagnation, rising inequality, and declining productivity in the American economy, trends which have hit low-income workers especially hard. Alan Krueger and Eric Posner propose three reforms to address these problems.

The Proposal

Enhance scrutiny of mergers for adverse labor market effects. The authors propose that the Horizontal Merger Guidelines include a new section that directs the government to screen mergers based on their likely effects on labor markets.

Ban non-compete covenants that bind low-wage workers. The authors propose that non-competes be prohibited for workers who earn less than the median wage in their state.

Prohibit no-poaching arrangements among establishments that belong to a single franchise company. The authors propose that no-poaching agreements between franchisors and franchisees be uniformly banned.

Benefits

Mergers that reduce labor market competition, non-compete agreements, and no-poaching agreements are part of a much larger problem: employer concentration and market power within labor markets. While the exact contours of the problem remain unclear, there is little doubt that shifting market power has contributed to income inequality, wage stagnation, and sluggish economic growth. The policies in this proposal would limit some of the more harmful employer practices.

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