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Anticompetitive mergers in labor markets

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ANTICOMPETITIVE MERGERS IN LABOR MARKETS

Ioana Marinescu & Herbert Hovenkamp*

Introduction

Mergers of competitors are conventionally challenged under the federal antitrust laws when they threaten to lessen competition in some product or service market in which the merging firms sell. In many of these cases the threat is that in concentrated markets – those with only a few sellers – the merger increases the likelihood of collusion or collusion-like behavior. Mergers can also injure competition in markets in which the firms purchase, however. Although that principle is widely recognized, very few litigated cases have applied the merger law to buyers.¹ This article concerns an even more rarefied subset, and one that has barely been mentioned. Nevertheless, its implications are staggering. Some mergers may be unlawful because they injure competition in the labor market by enabling the post-merger firm anticompetitively to suppress wages or salaries. To the best of our knowledge no court has ever condemned a merger because of its anticompetitive effects in labor markets.

Concentration in labor markets is very likely as high or higher than in many of the product markets in which firms sell.² As a result, the antitrust law against anticompetitive mergers affecting employment markets is certainly underenforced, very likely by a significant amount. This is critical for several reasons. First, the share of the gross domestic product (GDP) going to labor has been declining at an alarming rate.³ This may result from

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¹ See discussion *infra*, text & note 12.

² See discussion *infra*, text at notes 23-26.

³ See, e.g., David Autor, David Dorn, Lawrence F. Katz, Christina Patterson, and John Van Reenen, *The Fall of the Labor Share and the Rise of Superstar Firms* (MIT working paper, May 1, 2017), available at <https://economics.mit.edu/files/12979>. See also David Autor, et al, *Concentrating on the Fall of the Labor Share*, 107 AM. ECON. REV., Papers & Proceedings 180 (2017); Council of Economic Advisers, *Labor Market Monopsony: Trends, Consequences, and Policy Responses* 2, Issue Brief,

several things, including suppression of unions and increasing concentration in product markets, but lax antitrust enforcement could be a major source as well. Second, antitrust law does not condemn unilateral price setting by dominant firms. Rather it requires an anticompetitive exclusionary practice.⁴ As a result, a dominant firm that unilaterally sets a very high price for its sales or a very low price for its purchases, including purchases of labor, does not violate the antitrust laws. In that case a second best solution to the problem of suppressed wages is merger law, which can interdict wage-suppressing mergers before they occur.⁵ Third, under the consumer welfare principle antitrust law is properly directed at output reducing practices no matter what their source, and there is certainly no principled reason for excluding anti-competitive effects in labor markets.

Here, we offer a first but reasonably comprehensive and empirically based assessment of the problem of mergers that facilitate anticompetitive wage and salary suppression. We analyze the empirics and consider the most likely problems that courts will encounter in such litigation, including market definition, assessment of market concentration, the role of non-compete and non-poaching agreements as aggravating factors for concentration, and application of the government's Merger Guidelines.⁶ Although many of the queries that this analysis requires might seem unique, the principles being applied are derived entirely from well established economic doctrine and traditional antitrust rules concerning competitive harm. We comprehensively apply these well-established principles to purchasing rather than selling, and to labor rather than products.

Section 7 of the Clayton Act and Labor Market Competition

The goal of antitrust policy toward mergers is to protect consumers from noncompetitive price increases or reductions in output, which can be measured by quantity, but also by reductions in quality or innovation. Under antitrust's merger provision, §7 of the Clayton Act, the court must identify

White House Washington DC (2016), available at https://obamawhitehouse.archives.gov/sites/default/files/page/files/2016_1025_monopsony_labor_mrkt_cea.pdf. The data given here indicate that the labor share of nonfarm income fell from 65% in 1948 to 58% in 2016.

⁴See 3A PHILLIP E. AREEDA & HERBERT HOVENKAMP, ANTITRUST LAW ¶720 (4th ed. 2015).

⁵See Hovenkamp, *Prophylactic Merger Policy* (Penn, Inst for Law & Econ, Res. Paper No. 18-3, Jan. 2018, available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3090650).

⁶ See discussion *infra*, text at notes 87-119.

some “line of commerce” and “section of the country”⁷ in which a contemplated merger threatens lower output and higher prices. This approach is reflected in the enforcement Agencies’ Horizontal Merger Guidelines.⁸

The most commonly recognized competitive harm from mergers is higher prices charged by sellers. This does not tell the entire story, however. Mergers can also lead to anticompetitive output reductions resulting from diminished competition on the buying side of the market. The antitrust laws pertaining to mergers do not distinguish between seller side and buyer side competitive harm. Section 7 of the Clayton Act simply requires that the merger involve an activity affecting “commerce” that may “substantially ... lessen competition” or tend to “create a monopoly.”⁹ Coverage that includes both sellers and buyers is not universal in the Clayton Act. For example, §3 of the Act, which reaches anticompetitive tying and exclusive dealing, applies only to sales, not to purchases.¹⁰ This is also true of most of the provisions of the Robinson-Patman Act, which outlaws certain discriminations in price between “different purchasers,” thus indicating that this provision applies only to sellers.¹¹ By contrast, the Clayton Act merger law was drafted so as to apply to anticompetitive mergers by both sellers and buyers.

While the use of §7 to pursue mergers among buyers is well established, there is relatively little case law.¹² This paper is concerned with one

⁷ 15 U.S.C. §18 (2012).

⁸U.S. Department of Justice and Federal Trade Commission, Horizontal Merger Guidelines (2010), available at <https://www.ftc.gov/sites/default/files/attachments/merger-review/100819hmg.pdf>.

⁹15 U.S.C. §18 (2012).

¹⁰15 U.S.C. §14 (2012), making it unlawful “to lease or make a sale or contract for sale” on the condition or understanding that the “lessee or purchaser” not deal in a competitor’s goods were the effect may be substantially to lessen competition. *See also* 11 PHILLIP E. AREEDA & HERBERT HOVENKAMP, ANTITRUST LAW ¶¶1801, 1803 (4th ed. 2018) (in press) (output contracts).

¹¹15 U.S.C. §13(a). (2012), making it unlawful for a firm “to discriminate in price between different purchasers...” However, the Robinson-Patman Act does have a separate provision applying to buyers that makes it unlawful for them “knowingly to induce or receive” a discriminatory sale prohibited by the statute. 15 U.S.C. §13(f).

¹²United States v. Pennzoil Co., 252 F. Supp. 962 (W. D. Pa. 1965) (granting preliminary injunction); United States v. Cargill, No. Civ.A.

particular aspect of mergers that involve buyers, which is anticompetitive mergers threatening to suppress employee wages or salaries to infracompetitive levels. Anticompetitive wage suppression goes hand in hand with suppression of employment and output below the competitive level.

Mergers affecting the labor market require some rethinking of merger policy, although not any altering of its fundamentals. For example, mergers that threaten wage suppression are horizontal when the merging firms compete in the labor market, and this may be true whether or not they are competitors in any product market.¹³ As we show below, one useful way to think of the extent of horizontal competition in the market for employees is to look at the participants in the relatively large number of “anti-poaching” cases that involve agreements among firms not to hire one another’s employees. This is quite consistent with the general principle of market definition in merger cases that a market consists of a grouping of firms that, if unified by a cartel, would have market power,¹⁴ or more specifically, an ideal collusive group.¹⁵ So if two firms agree with one another not to

991875GK, 2000 WL 1475752 (D.D.C. June 30, 2000) (consent decree) (grain purchasers); *United States v. Aetna*, No. 3-99 CV 1398-H, 1999 WL 1419046 (N.D. Tex. Dec. 7, 1999) (health care operations). On the case law generally, see 4A PHILLIP E. AREEDA & HERBERT HOVENKAMP, *ANTITRUST LAW* ¶¶980-982 (4th ed. 2016) (mergers among buyers).

The flip side of the oligopsony issue is that powerful buyers can serve to discipline the higher sales prices of the post-merger firm. See Herbert Hovenkamp, *Mergers and Buyers*, 77 VA. L. REV. 1369 (1991); Peter C. Carstensen, *Buyer Power and the Horizontal Merger Guidelines: Minor Progress on an Important Issue*, 14 UNIV. PA. J. BUS. L. 775 (2012); Cory Capps, *Buyer Power in Health Plan Mergers*, 6 J. COMP. L. & ECON. 375 (2010).

¹³ See discussion *infra*, text at notes 98-102.

¹⁴ See 2B PHILLIP E. AREEDA & HERBERT HOVENKAMP, *ANTITRUST LAW* ¶530 (4th ed. 2014); Herbert Hovenkamp, *Markets in IP and Antitrust*, 100 GEO. L.J. 2133 (2012).

¹⁵ See Kenneth D. Boyer, *Industry Boundaries* 70, 73-74 in *ECONOMIC ANALYSIS AND ANTITRUST LAW* (Terry Calvani & John Siegfried, eds., 2d ed. 1988) (relevant market is “ideal collusive group”); Gregory J. Werden, *The Use and Misuse of Shipments Data in Defining Geographic Markets*, 26 ANTITRUST BULL. 719, 721 (1981) (“A market for antitrust purposes is any product or group of products and any geographic area in which collective action by all firms (as through collusion or merger) would result in a profit maximizing price that significantly exceeded the competitive price”); Gregory J. Werden, *The History of Antitrust Market Delineation*, 76 MARQ. L. REV. 123

exchange employees they must be competitors in that portion of the labor market covered by the agreement. That would make a merger among those two firms horizontal, although not necessarily unlawful. Naked collusion is condemned without regard to market structure. By contrast, mergers that might threaten coordinated interaction are unlawful only if certain structural conditions are met. One of the things we do in this paper is identify those conditions, considering whether they should differ when we are addressing a buying market rather than a selling market and – more particularly – when that buying market involves labor.

To illustrate the difference between collusive groups that involve products and those that involve labor, consider eBay, Inc., and Intuit, Inc.¹⁶ A federal district court approved an antitrust settlement in a state's federal antitrust challenge to a labor "non-poaching" agreement between these firms. Intuit's principal products are TurboTax, a popular income tax preparation program, and Quickbooks, a popular business program for bookkeeping and accounting. By contrast, eBay is a popular online auction site, which is not in the business of producing and selling software. Looking at the product side, a merger between eBay and Intuit would very likely be quickly approved. The firms appear not to be substantial competitors in any market in which they sell products or services. Nevertheless, the two firms found it profitable to agree with one another not to poach each other's "specialized computer engineers and scientists."¹⁷

The fact that the two firms found it profitable to enter into this agreement is a strong indicator that (1) the firms were competitors in this particular portion of the labor market and (2) that between the two of them they had enough market power to make the agreement profitable. For example, if two out of ten equivalent firms agreed to divide a market the agreement would be unprofitable because the remaining eight would be free to compete as they pleased. They would steal workers from any cartel member who sought to decrease its wage. Successful collusion requires that the colluding firms in the aggregate have a sufficient share of the market so that their own agreement cannot quickly be offset by the actions of their competitors.¹⁸ As

(1992) (on development of concept of relevant antitrust market as collusive group).

¹⁶California v. eBay, Inc., 2014 WL 4273888 (N.D.Cal. Aug. 29, 2014). The decision is discussed in more detail *infra*, text at notes 101-103.

¹⁷On the identity of the employees subject to the non-poaching agreement, see Third Amended Complaint for Violations of the Sherman Act, Cartwright Act, and Unfair Competition Law ..., No. CV12-5874-EJD-PSG (N.D.Cal. May 5, 2014), 2014 WL 9912567.

¹⁸See HOW CARTELS ENDURE AND HOW THEY FAIL: STUDIES OF INDUSTRIAL

a result, a merger between eBay and Intuit should invite very close scrutiny in this particular section of the labor market. This section of the market would also qualify as a “line of commerce” under §7 of the Clayton Act, and a challenger need identify only one such section in which anticompetitive results would be substantially likely to occur.¹⁹ If they were the only firms in this particular labor market, this would be a merger to monopoly.

This paper examines a number of issues that are relevant to merger challenges in employment markets, focusing on the traditional rationale for challenging horizontal mergers – namely, that increased market concentration in labor markets will threaten to facilitate coordinated interaction²⁰ among employers that could lead to lower output, as well as wage suppression, in employment markets. Because most mergers are challenged prior to their occurrence, the threat is not of observed coordinated interaction, but rather of an “appreciable danger” that it may occur if the merger is permitted to proceed.²¹

COLLUSION 117-129 (Peter Z. Grossman, ed., 2004); Margaret C. Levenstein & Valerie Y. Suslow, *Breaking up is Hard to Do: Determinants of Cartel Duration*, 54 J. L. & ECON. 455 (2011); Margaret C. Levenstein and Valerie Y. Suslow, *What Determines Cartel Success?*, 44 J. ECON. LIT. 43 (2006).

¹⁹ See discussion *infra*, text at notes 75-76; Herbert Hovenkamp, *Prophylactic Merger Policy*, *supra* note 5.

²⁰ The term “coordinated interaction” is commonly used in merger policy to speak of mergers that threaten either express price fixing or else some kind of oligopoly or other follow-the-leader pricing. See 2010 Horizontal Merger Guidelines, *supra* note 8, at §7 (“A merger may diminish competition by enabling or encouraging post-merger coordinated interaction among firms in the relevant market.”). As such, the term can speak about a variety of behaviors. See *United States v. H & R Block, Inc.*, 833 F.Supp.2d 36, 77 (D.D.C. 2011) (“As the Merger Guidelines explain, coordinated interaction involves a range of conduct, including unspoken understandings about *how* firms will compete or refrain from competing”).

²¹ See, e.g., *Hospital Corp. of Am. v. FTC*, 807 F.2d 1381, 1389 (7th Cir. 1986) (Posner, j.) (“Section 7 does not require proof that a merger or other acquisition has caused higher prices in the affected market. All that is necessary is that the merger create an appreciable danger of [collusive practices] in the future.”); *FTC v. Staples, Inc.*, 190 F.Supp.3d 100, 114-115 (D.D.C. 2016) (“Proof of actual anticompetitive effects is not required; instead, the FTC must show an appreciable danger future coordinated interaction based on predictive judgment,” quoting *FTC v. Arch Coal, Inc.*, 329 F.Supp.2d 109, 116 (D.D.C. 2004).

We also outline the major issues that enforcement agencies, both federal and state, are likely to encounter, in assessing mergers threatening competitive harm in labor markets. Much of this analysis would also apply to private plaintiff challenges. While employees generally lack standing to use the antitrust laws to challenge antitrust violations in product markets, they clearly have standing when the harm occurs in the labor market in which they are employed.²² An employee who can provide satisfactory proof that he or she was injured by lower wages that resulted from a merger of the employer would have standing to obtain either damages or an injunction.

Recent economic literature has shown that labor market concentration is a widespread phenomenon, with many labor markets exhibiting high concentration.²³ Increasing labor market concentration has very likely contributed to one widely observed phenomenon – namely, that the share of labor participation in American Gross Domestic Product (GDP) has fallen substantially.²⁴ Indeed, the markets in which firms purchase labor are often significantly more concentrated than the markets in which they sell their products.

Just to be clear here, the term labor market concentration refers to the concentration that exists among the firms who hire and employ labor, not to the concentration among the laborers themselves. For example, if an area has two coal mines that employ coal miners, we would speak of that labor market as highly concentrated, even though there might be 1000 miners who are employed or seeking employment in those two mines. That would be an example of a highly concentrated labor market on the employer side, even though the market of the employees themselves is diffuse. In that case, very likely all the bargaining power would be on the side of the mines. Many product markets have similar characteristics. For example, while the automobile production market has relatively few sellers its customers number in the millions.

We measure the correlation between wages and labor market concentration by the Herfindahl-Hirschman Index (HHI),²⁵ just as we do for product markets. That correlation is at least as strong as is the correlation

²² See 2A PHILLIP E. AREEDA & HERBERT HOVENKAMP, *ANTITRUST LAW* ¶352 (4th ed. 2014) (employee antitrust standing to sue for violations that occur in labor markets).

²³ Jose Azar, Ioana Marinescu, and Marshall Steinbaum, *Labor Market Concentration* at 7-8 (NBER Working Paper No. 24147, Dec. 2017), available at <http://www.nber.org/papers/w24147>.

²⁴ See, e.g., Autor, et al, *supra* note 3; Autor, *supra* note 3; Council of Economic Advisers, *Labor Market Monopsony*, *supra* note 3.

²⁵ On the HHI and its use, see discussion *infra*, text at notes 36-40.

between product prices and HHIs.²⁶ As a result, the approach taken to concentration levels in the 2010 Merger Guidelines, linking the level of scrutiny to the concentration level, should work equally well in labor markets.

Mergers can also be condemned under a “unilateral effects” theory in product differentiated markets. The theory is that a merger between firms who are reasonably adjacent in product space in a product differentiated market might permit the two firms to increase their own price without coordinating prices with the remaining firms in the market.²⁷ In such cases the price of the output of the post-merger firm increases, while that of more remote rivals in the same market does not. Because labor markets are also differentiated there is no reason in principle that the same theory could not apply to mergers suppressing labor market competition. But that problem has not been theorized in any literature of which we are aware and we reserve it for another time. This paper is concerned with labor market mergers that present an appreciable risk of collusion or collusion-like behavior by the employers in a labor market.

Merger Policy and Monopsony

When few firms dominate selling in a product market, we call it an oligopoly, or supply-side lack of competition. When few firms dominate buying in a market, we call it an oligopsony, or demand-side lack of competition.²⁸ In an extreme case, when just one buyer dominates the market, we have a monopsony, a term coined by economist Joan Robinson in *The Economics of Imperfect Competition* in 1933.²⁹ The classic case of a labor market monopsony is the company town, where a single company, such as a mine, dominates employment. This monopsony situation is especially likely to arise in specialized jobs, e.g. miners, for which there is literally only one company hiring in town. The term “monopsony” is used today in labor economics to refer to both a monopsony proper and to an oligopsony, where

²⁶On the latter correlation, see Herbert Hovenkamp & Carl Shapiro, *Horizontal Mergers, Market Structure, and Burdens of Proof*, ____ YALE L.J. ____ (2018) (forthcoming), available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3046224.

²⁷See *id.*

²⁸ See C. Scott Hemphill & Nancy L. Rose, *Mergers that Harm Sellers*, ____ YALE L.J. ____ (2018) (forthcoming), available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3113679.

²⁹JOAN ROBINSON, *THE ECONOMICS OF IMPERFECT COMPETITION*, LONDON: MACMILLAN (1933). See also Robert J. Thornton, *How Joan Robinson and B.L. Hallward Named Monopsony*, 18 J. ECON. PERSP. 257 (2004).

the number of purchasers of labor is small, but greater than one.³⁰ In the remainder of this paper the term “monopsony” refers to situations where a few companies dominate hiring in the labor market.

Just as a monopoly depresses production, a labor monopsony also depresses employment below the level that would obtain in a perfectly competitive market.³¹ By employing fewer workers, the monopsonist makes a higher profit because it can pay workers less than their productivity, capturing the surplus for itself. In a perfectly competitive labor market each worker would receive the marginal value of his or her labor.³² But the firm with market power in the market where it purchases labor will suppress its purchases, driving the price down. Compared to a perfectly competitive labor market, monopsony leads to lower employment and lower wages. *Ceteris paribus*, lower employment also entails lower production on the output (product) side. Ultimately, imperfect competition in the labor market has the same kind of depressing effect on production as imperfect competition in the product market has in decreasing production.

Until recently, imperfect competition in the labor market has not received much attention in antitrust enforcement. One possible reason is the belief that there are many jobs out there, so a merger is unlikely to lead to a monopsony and to substantially affect workers’ opportunities in the labor market. However, a growing body of empirical evidence indicates that labor market monopsony is a real issue. A number of studies have focused on specific US labor markets.³³ A 2017 paper by Azar, Marinescu and Steinbaum, shows

³⁰William M. Boal and Michael R Ransom, *Monopsony in the Labor Market*, 35 J. ECON. LIT. 86 (1997).

³¹Just as the monopolist seeks to maximize profits by equating marginal cost and marginal revenue, the monopsonist tries to equate marginal outlay with marginal revenue. See HERBERT HOVENKAMP, *FEDERAL ANTITRUST POLICY: THE LAW OF COMPETITION AND ITS PRACTICE* §1.2b & n.25 (5th ed. 2015).

³² By contrast, if the *workers* had market power, they would receive more than the marginal value of their labor. For example, if a town had four hospitals requiring anesthesiologists but only two local anesthesiologists, the hospitals would bid up their salaries to supacompetitive levels, assuming that the local area was a geographic market; that is, that bringing in anesthesiologists from outside at current prices was not feasible.

³³Jordan D. Matsudaira, *Monopsony in the Low-Wage Labor Market? Evidence from Minimum Nurse Staffing Regulations*, 96 REVIEW ECON. STAT. 92 (2013) [https://doi.org/10.1162/REST_a_00361.]; Michael R. Ransom and David P. Sims, *Estimating the Firm’s Labor Supply Curve in a ‘New Monopsony’ Framework: Schoolteachers in Missouri*, 28 J. LABOR ECON. 331

that monopsony is likely to be an issue in many areas of the United States and for many of the most common occupations.³⁴ That paper defines a labor market as a 6-digit SOC (“Standard Occupational Classification”)³⁵ by commuting zone (e.g. accountants and auditors in the Philadelphia commuting zone).³⁶ Data on job postings from the large job board CareerBuilder.com, which contains about a third of all US vacancies, show that the Herfindahl-Hirschman index (HHI) is above 2,500 in the average United States labor market among these most common occupations. Furthermore, an increase in HHI is associated with lower wages advertised by companies in their job postings.³⁷ By definition, a horizontal merger increases concentration because it reduces by one (in the case of a two-firm merger) the number of firms in the market.

As our principal index of concentration we use the Herfindahl-Hirschman Index (HHI), which is equal to the sum of the squares of the market shares of each firm in the market.³⁸ That index has become conventional in industry concentration measures and has been used in the government’s Merger Guidelines for some thirty-five years.³⁹ Under the 2010 Merger Guidelines in use today, if a market had five equal size firms each would have a twenty percent market share and the market’s HHI would be $20^2 + 20^2 + 20^2 + 20^2 + 20^2$, or 2000. If two of these firms should merge there would now be one firm with a 40% market and three with 20% shares. The HHI would read $40^2 + 20^2 + 20^2 + 20^2$, or 2800. The 2010 Horizontal Merger Guidelines define markets with post-merger HHIs exceeding 2500 as

(2010) [<https://doi.org/10.1086/649904>.]; Douglas O. Staiger, Joanne Spetz, and Ciaran S. Phibbs. “Is There Monopsony in the Labor Market? Evidence from a Natural Experiment,” 28 *Journal of Labor Economics* 211 (2010). [<https://doi.org/10.1086/652734>.]

³⁴ Azar, Marinescu, & Steinbaum, *Labor Market Concentration*, *supra* note 23 at 7-8.

³⁵ See discussion *infra*, text at notes 62-64.

³⁶ On the relevance of a commuting zone, see discussion *infra*, text at notes 81-83.

³⁷ See discussion *infra*, text at notes 50-52.

³⁸ On use of the HHI in merger assessment, see 4 PHILLIP E. AREEDA & HERBERT HOVENKAMP, *ANTITRUST LAW* ¶¶940-932 (4th ed. 2014); HOVENKAMP, *FEDERAL ANTITRUST POLICY*, *supra* note 31, §12.4.

³⁹ The first version of the Merger Guidelines to employ the HHI was issued in 1982. All versions are maintained by the federal antitrust enforcement agencies in an archival website. See <https://www.justice.gov/archives/atr/1982-merger-guidelines>.

“highly concentrated,” and state that mergers in such markets that also increase the HHI level by more than 100 points “raise significant competitive concerns and often warrant scrutiny.” Further mergers in such markets that increase the HHI by more than 200 points “will be presumed to be likely to enhance market power” unless rebutted by persuasive evidence.⁴⁰ This hypothetical merger would fall within that category.

Below, we present the economic theory and evidence for monopsony in the US labor market. We discuss market definition for the labor market and argue that HHIs based on US vacancy data⁴¹ can be used to make a *prima facie* case against a horizontal merger based on the existing Horizontal Merger Guidelines. We then discuss several related issues, including the relevance of widespread use of noncompete agreements⁴² and how the efficiency defense may be mobilized by companies to combat the *prima facie* case.⁴³

To have a chance of succeeding, an efficiency case for a merger affecting a labor market must show that post-merger reorganization will decrease the need for workers *and* will not lower total production. Both of these requirements are essential. A merger that decreases the need for workers may represent nothing more than an exercise of monopsony power, but in that case, *ceteris paribus*, it will also reduce production. By contrast, a merger that eliminates duplication can also reduce the need for workers, but production will not go down. Indeed, it should go up to the extent that the post-merger firm has lower costs. For example, a merger of two automobile manufacturers, such as Daimler (Mercedes-Benz) and Chrysler might result in a consolidation of dealerships. To the extent these dealerships can sell both brands in one facility, thus reducing distribution costs, the merger might qualify for the efficiency defense even if employment in dealerships is reduced.⁴⁴ But in that case we would expect that the firm’s output would, if anything, increase as its distribution costs went down.

Lack of Competition in the Labor Market: Theory and Evidence

⁴⁰ 2010 Horizontal Merger Guidelines, *supra* note 8, at §5.3

⁴¹ These data can be obtained from aggregators such as EMSI (<http://www.economicmodeling.com/>), Burning Glass (<http://burning-glass.com/>), and Indeed (<https://www.indeed.com/>)

⁴² See discussion *infra*, text at notes 104-119.

⁴³ See discussion *infra*, text at notes 120-146.

⁴⁴ The situation is hypothetical. Although the Daimler-Chrysler merger did occur, it was not challenged. On the merger, see <https://www.daimler.com/company/tradition/company-history/1995-2007.html>

To understand the impact of a lack of competition in the labor market, consider the only hair salon in a small town.⁴⁵ As the only purchaser of the labor of hair dressers, it is likely to have monopsony power in that market. To simplify further, assume that the labor of hairdressers is the only input that the salon needs in order to function. Suppose the hair salon owner works with one hairdresser, who is paid \$8 per hour. This one hairdresser generates a revenue of \$11 per hour and there are no other costs. As a result, the owner makes a profit of \$3 per hour (\$11 revenue minus \$8 wages) on this first hire. To attract a second hairdresser, the owner would have to pay \$10 per hour, because this second hairdresser would rather not work than earn just \$8 per hour, or perhaps because she lives further away from the hair salon than the first hairdresser. This is consistent with the general economic observation that supply curves slope upward, including those in the labor market. That is, a firm starts out with the lowest cost sources of supply and each incremental unit of supply comes in at a higher cost.⁴⁶

A second hairdresser would generate an additional revenue of \$11 per hour as well. This hairdresser still brings in \$1 (\$11 revenue minus \$10 wages) of net profit and should be hired if nothing else changes. A profit-maximizing employer would continue to hire additional hair dressers as long as the incremental revenue each one produces exceeds his or her wage.

However, workers who work in the same role typically have to be paid the same amount.⁴⁷ So, if the salon owner hired this second hairdresser, he or she would also have to pay the first hairdresser \$10 per hour instead of \$8, and would make only \$1 of profit per hour from the first hairdresser instead

⁴⁵On the simple economics, see William M. Boal & Michael R Ransom, *Monopsony in the Labor Market*, 35 J. ECON. LIT. 86 (1997), Richard Dickens, Stephen Machin, & Alan Manning, *The Effects of Minimum Wages on Employment: Theory and Evidence from Britain*, 17 J. LABOR ECON. 1 (Jan., 1999); V. Bhaskar, Alan Manning, & Ted To, *Oligopsony and Monopsonistic Competition in Labor Markets*, 16 J. ECON. PERSP. 155 (2002).

⁴⁶See RONALD G. EHRENBURG & ROBERT S. SMITH, *MODERN LABOR ECONOMICS: THEORY AND PUBLIC POLICY* 135 (12th ed. 2016)

⁴⁷That is, the theory of monopoly generally assumes that the monopolist is not able to engage in price discrimination. The availability of price discrimination can result in greater or smaller output, depending on the circumstances, and also has ambiguous welfare effects. See, e.g., MICHAEL E. WETZSTEIN, *MICROECONOMIC THEORY: CONCEPTS AND CONNECTIONS* 551 (2d ed. 2015). On antitrust implications, see 3A PHILLIP E. AREEDA & HERBERT HOVENKAMP, *ANTITRUST LAW* ¶1721 (4th ed. 2015)

of \$3. If the salon owner hires the two hairdressers for \$10 per hour each, the owner makes \$1 profit on each, for a grand total of \$2. Two dollars an hour of profit is less than the \$3 an hour of profit that the owner can make when he or she works with just one hairdresser. Therefore, the most profitable strategy in this case is for the owner to hire just one hairdresser, pay a low wage of \$8 instead of \$10, and produce only \$11 of revenue per hour instead of \$22, or a 50% cut in production.

This example illustrates the depressing effect of monopsony on wages and production. The nondiscriminating monopsonist declines to hire incremental workers even though each of those workers considered individually brings in more revenue than that worker's wage. This outcome also produces a "deadweight" loss identical to the loss produced when a monopolist reduces output in a product market. In this case the resources that would have been provided by the second hair dresser go unused, even though they were worth more than they cost.

There are several important conclusions to draw from this illustration. First, the whole story cannot even take off if workers are paid according to the revenue that they are adding, i.e. – in economics jargon – if wages are equal to marginal productivity. In this case, the first hairdresser would be paid \$11 already, so there is nothing to gain by not adding the second hairdresser.

Second, the existence of monopsony power has important implications for the levels of wages and production. In a competitive labor market, each recruiting firm is small (a drop in the proverbial bucket) and it can hire as many workers as it wants at the market wage. In a monopsonistic labor market, the hiring firm has market power and hiring more workers necessitates an increase in wages. Therefore, if the labor market is perfectly competitive, wages are equal to marginal productivity and there is no incentive for companies to hire fewer workers to make higher profits by depressing wages. If the labor market is not perfectly competitive and companies are in a position to be able to pay workers below their marginal productivity, then wages and production are both lower than under the competitive equilibrium.

Third, this example shows that having to increase wages in order to attract more workers is a sign of monopsony power. In a competitive market, a firm can already have all the workers it wants by paying the market wages. So, a firm that unilaterally increases its wage by even a little bit can attract all of the workers in the market: in economics jargon, we say that the elasticity of labor supply (the % increase in employment in reaction to a 1% increase in wages) to the individual firm is infinite when the market is perfectly competitive. In a monopsonistic labor market, the hiring firm has market power and hiring more workers necessitates an increase in wages. In this case, the elasticity of labor supply to the individual firm is not infinite, but finite:

only a few more workers will come to the firm for any small increase in wages. Therefore, empirically speaking, a small elasticity of labor supply to the individual firm (i.e. the fact that an increase in wages only attracts a limited number of workers, or equivalently the fact that a decrease in wages only drives away a limited number of workers) is a sign of labor market monopsony.

The key message from economic theory is that as one moves away from the competitive equilibrium towards a situation of monopsony in the labor market, wages and production *both* generally tend to decrease. This also explains why labor cartels such as the eBay/Intuit anti-poaching agreement are anticompetitive. If the marginal value of a software engineer to each firm is \$50 per hour, then each would hire as long as the next engineer produced more revenue than labor cost. But the no-poach agreement enables the two firms together to behave in the same way that a single firm monopsonist would behave in our hairdresser example above.⁴⁸ In that case the firms maximize their own profits by restricting output and paying less than the marginal contribution of each employee.

Empirical labor economics has studied the topic of monopsony for some time. The key findings from this literature are convincing that monopsony power exists, and that workers are paid below their marginal productivity.⁴⁹ This literature has examined a number of different occupations and industries in the US. The elasticity of labor supply to the individual firm (% increase in employment in reaction to a 1% change in wages) is estimated to be between 0.1 and 4, with most estimates being below 2. In a competitive labor market, this elasticity should tend towards infinity. The fact that these numbers are small indicates that the labor market is not perfectly competitive and monopsony power exists. The inverse of the elasticity also gives us an estimate of the level of worker productivity relative to wages. An elasticity of two implies that worker productivity is 50% (1/2) higher than wages. Hence, workers are paid significantly less than their marginal productivity.

⁴⁸This is simply the flip side of the observation that a well functioning cartel has the same price and output that a monopolist in the same market would have. See HOVENKAMP, FEDERAL ANTITRUST POLICY, *supra* note 31, §4.1.

⁴⁹See ALAN MANNING, MONOPSONY IN MOTION: IMPERFECT COMPETITION IN LABOR MARKETS (2003); Alan Manning, *Imperfect Competition in the Labor Market* 973, in 4 HANDBOOK OF LABOR ECONOMICS (Orley C. Ashenfelter & David Card, eds., 2011), <http://www.sciencedirect.com/science/article/pii/S0169721811024099>; Orley C. Ashenfelter, Henry Farber, and Michael R. Ransom, *Labor Market Monopsony*, 28 J. LABOR ECON. 203 (2010); William M. Boal & Michael R. Ransom, *Monopsony in the Labor Market*, 35 J. ECON. LIT. 86 (1997).

For the purpose of a merger review in labor markets, the most important question is whether a merger is likely to increase the amount of labor monopsony in a market, thus reducing wages and output. In the case of a merger to a monopsony with a 100% market share that answer is clear, based on little more than the theory of monopsony presented above. For example, if eBay and Intuit are the only two firms bidding for a particular group of software engineers, a merger between them would create a monopsony in that market.

But what if the hiring market contains more than two firms, and the merger simply lessens the number of firms who are hiring; that is, it increases labor market concentration in that market as measured by the HHI?⁵⁰ Here the theory of labor market monopsony takes its cue from the vast literature linking market concentration in selling markets to noncompetitive performance.⁵¹

The sources of the relationship between concentration and price/output are manifold and complex, and there is no point in rehearsing the entire literature here.⁵² Nevertheless, a few observations are important. First, because most mergers are reviewed prior to their occurrence⁵³ we do not test actual relationships between merger-induced increases in concentration and product (or labor) prices in each specific market individually. Rather, we employ concentration data plus some evidence of other market factors to make predictions.

Ceteris paribus, as labor market concentration levels rise, predicted wages decline. This can be true for several reasons. Most simply, a market with fewer firms is more susceptible to express collusion, or agreements

⁵⁰ See discussion *supra*, text at notes 20-21.

⁵¹ See, e.g., Richard Schmalensee, *Inter-Industry Studies of Structure and Performance*, in 2 HANDBOOK OF INDUSTRIAL ORGANIZATION 988 (Richard Schmalensee & Robert D. Willig eds., 1989) (finding strong correlations between concentration and price levels); William N. Evans, Luke M. Froeb & Gregory J. Werden, *Endogeneity in the Concentration Price Relationship: Causes, Consequences, and Cures*, 41 J. INDUS. ECON. 431 (1993) (same; airline industry).

⁵² See Hovenkamp & Shapiro, *supra* note 26. Recent literature is summarized in Jonathan B. Baker, *Market Power in the U.S. Economy Today* (Washington Center for Equitable Growth, March, 2017), available at <file:///C:/Users/sherm/Downloads/032017-baker-antitrust-ib.pdf>.

⁵³ Under the Hart-Scott-Rodino Act mergers of the requisite minimum size are reported in advance and the government has an opportunity to challenge them before the transaction is completed. 15 U.S.C. §18a (2012).

setting wages or dividing markets. Further, the history of enforcement in that area shows that many firms are prone to fix wages when they can.⁵⁴ In addition, the firms may engage in one of several types of oligopsony behavior which, while falling short of express collusion, nevertheless serves to coordinate their wages and output.⁵⁵ Indeed, many of these agreements are unreachable under the antitrust laws because the price fixing statute, §1 of the Sherman Act, requires an express agreement.⁵⁶ As a result it is all the more important that merger law be applied in these cases because, once the merger has occurred, the law of collusion will not be able to reach them.⁵⁷ Prima facie there is no reason to doubt that the same concentration factors that facilitate oligopoly behavior in product (selling) markets work in labor (purchasing) market as well. Indeed, follow-the-leader wage pricing and inter-employer exchanges of wage and salary information⁵⁸ appear to be common in employment markets just as similar types of behaviors are observed in product markets.⁵⁹

In sum, well accepted methodologies justify making a prima facie case against a merger based on the overall level of concentration in the affected labor market, as well as the extent to which the merger increases concentration.⁶⁰ Labor market concentration can be defined by analogy with product market concentration. One can use the share of each company among job vacancies in a labor market in order to calculate labor market concentration using the Herfindahl-Hirschman index.

The HHI for the labor market using vacancy shares can be calculated using a database of US vacancies acquired from vendors such as EMSI (<http://www.economicmodeling.com/>), BurningGlass (<http://burning-glass.com/>), or Indeed (<https://www.indeed.com/>). One important question is what the definition of the labor market should be: we offer a plausible but preliminary discussion of the appropriate definition here.

Azar, Marinescu and Steinbaum calculate labor market concentration

⁵⁴ See note 98, *infra*.

⁵⁵ The literature on implicit oligopoly coordination is also substantial. See, e.g., MICHAEL E. PORTER, *COMPETITIVE STRATEGY* 93-95, 106 (1980).

⁵⁶ 15 U.S.C. §1 (2012) (prohibiting “contracts,” “combinations,” and “conspiracies”).

⁵⁷ See Hovenkamp, *Prophylactic Merger Policy*, *supra* note 5.

⁵⁸ See, e.g., *Todd v. Exxon*, 275 F.3d 191 (2d Cir. 2001) (condemning exchange of salary information of geologists among petroleum refiners where the intent was to suppress wages).

⁵⁹ See e.g., *United States v. Container Corp.*, 393 U.S. 333 (1969) (condemning exchange of product price information).

⁶⁰ Hovenkamp & Shapiro, *supra* note 26.

using 2010-2013 job postings data from the largest online job board in the United States, CareerBuilder.com.⁶¹ They define a labor market as an occupation by commuting zone by quarter: this would be, for example, accountants and auditors in the Philadelphia commuting zone in the first quarter of 2011.⁶² They thus calculate vacancy shares and HHIs of market concentration for over 8,000 labor markets, defined by a combination of occupation at the SOC-6 level⁶³ and commuting zone. An SOC-6 level occupation is a reference to a list of “Standard Occupational Classifications” maintained by the Bureau of Labor Statistics.⁶⁴ The “6 level” reference is to the level of detail.⁶⁵ Occupations are assigned a six digit code, and the sixth digit is the highest level of classification.

The HHI for a market m (occupation and commuting zone) and quarter t is:

$$HHI_{m,t} = \sum_{j=1}^J s_{j,m,t}^2$$

Where J is the total number of firms posting in market m and quarter t . $s_{j,m,t}$ is the share of a firm in the market defined as the sum of vacancies posted on CareerBuilder by firm j in market m and quarter t divided by total vacancies posted on CareerBuilder in market m and quarter t by all firms J . To use the numerical example for the HHI developed above, imagine a labor market with five firms each posting 10 jobs in the market. Then, each firm

⁶¹Azar, Marinescu and Steinbaum, *supra* note 23. *Monster.com* is similar in size.

⁶² *Ibid.*

⁶³ On the meaning of this classification, see discussion *infra*, text at notes 91-92.

⁶⁴ See United States Dept. of Labor, Occupational Employment Statistics (2016), available at https://www.bls.gov/oes/current/oes_stru.htm.

⁶⁵ See *id.*:

For example, "Life, Physical and Social Science Occupations" (19-0000) is divided into four minor groups, "Life Scientists" (19-1000), "Physical Scientists" (19-2000), "Social Scientists and Related Workers" (19-3000), and "Life, Physical and Social Science Technicians" (19-4000). Life Scientists contains broad occupations such as "Agriculture and Food Scientists" (19-1010), and "Biological Scientists" (19-1020). The broad occupation Biological Scientists includes detailed occupations such as "Biochemists and Biophysicists" (19-1021), and "Microbiologists" (19-1022).

has a twenty percent market share and the market's HHI is $20^2 + 20^2 + 20^2 + 20^2 + 20^2$, or 2000. If two of these firms should merge there would now be one firm with a 40% market share and the HHI would read $40^2 + 20^2 + 20^2 + 20^2$, or 2800.

The occupations covered in Azar, Marinescu and Steinbaum⁶⁶ include the most frequent occupations among CareerBuilder vacancies, plus the top occupations in manufacturing and construction. On average, labor markets are highly concentrated: the average HHI is 3,157, which is well above the 2,500 threshold for high concentration according to the Merger Guidelines. Concentration varies by occupation and city, with larger cities being less concentrated. This is consistent with the intuition that a larger urban area will have more employers of a particular type within a commuting zone. For example, while the small town may have only one hair salon, a large city almost certainly has several, who compete with one another for qualified hair dressers. Assuming that the hair dressers have sufficient mobility,⁶⁷ the result will be higher wages or salaries. Figure 1 shows these concentration levels across the country.⁶⁸

⁶⁶See note 34.

⁶⁷ On the relevance of noncompetition covenants *see* discussion *infra*, text at notes 104-119.

⁶⁸ The figure is taken from Azar, *et al*, *supra* note 23 at p. *25.

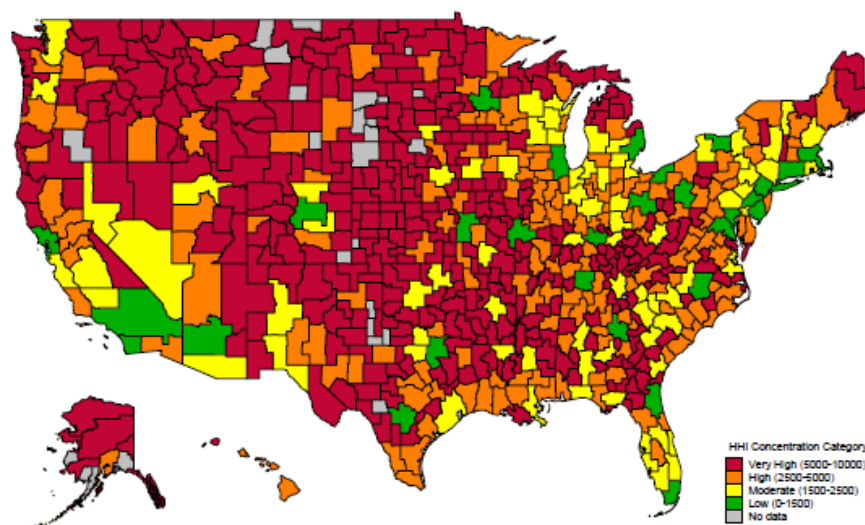


Figure 1. Average HHI by commuting zone, based on vacancy shares. This figure shows the average of the Herfindahl-Hirschman Index by 6-digit SOC occupation code for labor markets over the period 2010Q1–2013Q4. The categories we use for HHI concentration levels are: "Low": HHI between 0 and 1500; "Moderate": HHI between 1500 and 2500; "High": HHI between 2500 and 5000; "Very High": HHI between 5000 and 10000. These categories correspond to the DOJ/FTC guidelines, except that we add the additional distinction between high and very high concentration levels around the 5,000 HHI threshold. Market shares are defined as the sum of vacancies posted in CareerBuilder.com by a given firm in a given market and year-quarter divided by total vacancies posted in the website in that market and year-quarter.

This methodology enables one to determine the relationship between concentration and the wages that companies advertise in their job postings. It shows that average posted wages are strongly negatively correlated with labor market concentration as measured by HHI.⁶⁹ However, this correlation alone cannot be counted as strong evidence that higher concentration depresses wages in a causal sense. Indeed, economic conditions can differ considerably across labor markets: for example, in more depressed labor markets, there are fewer job postings, which mechanically leads to higher concentration. Since wages in depressed labor markets also tend to be lower, this could drive the negative correlation between concentration and wages.

As a result, it is necessary to look at the data in other ways in order to

⁶⁹Azar, *et al*, *supra* note 23 at Figure 2 p. *26. Accord Efraim Benmelech, Nittai Bergman, & Hyunseob Kim, *Strong Employers and Weak Employees: How Does Employer Concentration Affects Wages* (NBER Working Paper #24307, Feb. 2018), available at <http://www.nber.org/papers/w24307>; Council of Economic Advisers, *Labor Market Monopsony*, *supra* note 3.

show that concentration likely does lead to lower wages in a causal sense. In particular, instead of comparing different labor markets, one can look at how changes in concentration within a given market over time affects wages. The data indicate that when labor market concentration increases, posted wages decrease.⁷⁰ Furthermore, to account for economic conditions in each specific market, one must control for the number of job postings divided by the number of job applications, also called “labor market tightness” in economic jargon.⁷¹ When tightness is high, the market is more favorable to workers in that there are many job postings compared to the number of applications, and wages are therefore higher. Tightness is a very good control for the market situation because it accounts for both changes in labor demand (changes in job postings) and changes in labor supply (changes in the number of job applications). Even after controlling for tightness, the impact of labor market concentration on wages remains negative and statistically significant.⁷² This, together with additional empirical analysis performed in the paper, shows that the negative effect of concentration on wages is likely to be causal and not just driven by unaccounted for market conditions.

How large is the impact of labor market concentration on posted wages? Depending on the specific statistical model used, a 10% increase in concentration leads to a 0.3% to 1.3% decrease in wages.⁷³ Furthermore, the impact of concentration on wages is larger in smaller cities⁷⁴. Therefore, smaller cities are doubly disadvantaged by having higher levels of labor market concentration and by suffering more from an increase in concentration.

In sum, the evidence shows that it is straightforward to calculate labor market concentration with vacancy data. Labor market concentration can be very high, especially in smaller cities where it is routinely above the 2,500 HHI threshold for high concentration according to the Horizontal Merger Guidelines.

Assessing the Relevant Market for Labor Market Mergers: SSNIP and SSNRW

Section 7 of the Clayton Act requires a court to identify some “line of commerce” and some “section of the country” in which a merger threatens to

⁷⁰ *Id.* at Table 2, p. *24.

⁷¹ *Id.* at p. *11.

⁷² *Id.* at Table 2, p. *24.

⁷³ *Id.* at Table 2, p. *24.

⁷⁴ *Id.* at Figure 3, p. *27.

injure competition.⁷⁵ Ever since the Supreme Court's *Brown Shoe* decision it has become conventional to identify these two statutory requirements, respectively, as a relevant product market and a relevant geographic market,⁷⁶ subject to the ordinary antitrust tools of market definition.⁷⁷ Labor markets are no exceptions. The boundaries of labor product markets are driven mainly by employee skills or training. Geographic markets are driven mainly by the location and mobility of current or prospective employees.

On the latter point, applications for a job decline rapidly with distance, although most applications are still for employers located outside the applicant's zip code.⁷⁸ We suggest a provisional definition of a labor market as a commuting zone by 6-digit Standard Occupational Qualification (SOC) by quarter.⁷⁹ We now justify the choice for each of these three elements: the geography, occupation, and time.

Traditional geographic markets for products are frequently defined in terms of shipping costs: the higher the cost in relation to value, the smaller the market.⁸⁰ Under that definition markets for many manufactured products are nationwide or even worldwide, although markets for perishable items or those with high shipping costs in relation to value can be much smaller. Service markets are often smaller as well. Measuring geographic markets for labor is more complex. Commuting "costs" include not merely the price of a subway ticket or gasoline, but also time and convenience, and these things frequently vary from one commuter to another.

Observed Commuting Zones (CZs) can be used to define geographic labor markets.⁸¹ Commuting zones are geographic area definitions comprising clusters of counties that were developed by the United States Department of Agriculture (USDA). They are based on data from the 2000

⁷⁵ 15 U.S.C. §18 (2012).

⁷⁶ See *Brown Shoe Co. v. United States*, 370 U.S. 294, 324-325 (1962) ("The 'area of effective competition' must be determined by reference to a product market (the 'line of commerce') and a geographic market (the 'section of the country')").

⁷⁷On market definition under the antitrust laws, see 2B AREEDA & HOVENKAMP, *supra* note 14, Ch. 5C-5F.

⁷⁸Ioana Marinescu and Roland Rathelot, *Mismatch Unemployment and the Geography of Job Search*, 10 AM. ECON. J.: MACROECONOMICS __ (2018) (forthcoming), available at <https://doi.org/10.1257/mac.20160312>.

⁷⁹This follows the methodology in Azar, Marinescu and Steinbaum, *supra* note 23.

⁸⁰See 2B AREEDA & HOVENKAMP, *supra* note 14, ¶1552.

⁸¹See Azar, Marinescu and Steinbaum, *supra* note 23.

Census on commuting patterns across counties to capture local economies and local labor markets in a way that is more economically meaningful than county boundaries.⁸² According to the USDA, “commuting zones were developed without regard to a minimum population threshold and are intended to be a spatial measure of the local labor market.” More than 80% of job applications occur where the job applicant and prospective employer are within the same commuting zone.⁸³

6-digit SOC codes can assist us in defining markets by occupational category. To determine whether this definition is sensible for the analysis of a monopsonistic labor market, it is important to examine how posted wages affect the number of applicants that a job posting receives. This relationship between wages and the number of applicants is a version of the elasticity of labor supply discussed above. A small elasticity of labor supply, i.e. a wage increase that has a small effect on the number of applicants, signals a less competitive labor market.⁸⁴ However, whether the market is competitive or not, we expect that higher wages attract as many or more applicants than lower wages.

Surprisingly, within a 6-digit SOC occupation, job postings with higher wages attract significantly *fewer* applicants than jobs with lower wages.⁸⁵ This negative relationship between wages and the number of applicants prevails on average across all 6-digit SOC codes and is driven by the fact that workers within a 6-digit SOC code can be very different from each other. For example, among accountants and auditors, which is a 6-digit SOC code, job postings with the title “senior accountant” pay higher wages and attract fewer applicants than job postings with the title “junior accountant.” This shows that generally, a 6-digit SOC is likely too broad a definition of the labor

⁸²See U.S. Dept. of Agriculture, Commuting Zones and Labor Market Areas (2012), available at <https://www.ers.usda.gov/data-products/commuting-zones-and-labor-market-areas/>.

⁸³See Marinescu and Rathelot, *supra* note 78. Cf. the Elzinga-Hogarty test for geographic markets, which looks at the extent to which goods are shipped across a line provisionally defined as the boundary of the geographic market. See Kenneth G. Elzinga and Thomas F. Hogarty, *The Problem of Geographic Market Delineation in Antimerger Suits*, 18 ANTITRUST BULL. 45 (1973); 2B AREEDA AND HOVENKAMP, *supra* note 14, ¶1550a3.

⁸⁴Boal and Ransom, *supra* note 30.

⁸⁵Ioana Marinescu and Ronald Wolthoff, *Opening the Black Box of the Matching Function: The Power of Words*, National Bureau of Economic Research (Working Paper #22508, 2016), available at <https://doi.org/10.3386/w22508>.

market. One can also define a labor market by a job title and examine the relationship between wages and applicants for all job titles.⁸⁶ Within a job title, the relationship between wages and the number of applicants is no longer negative but becomes positive: a 10% increase in the posted wage is associated with a 7.7% increase in the number of applicants (an elasticity of 0.77). Therefore, the elasticity of labor supply is far from being infinite as it would be in a perfectly competitive labor market.

Based on the elasticities of labor supply within a 6-digit SOC occupation and within a job title, we can use the equivalent of a SSNIP test for the labor market to determine which labor market is relevant for antitrust analysis. Since 1982, the Horizontal Merger Guidelines have included the hypothetical monopolist test to determine whether a product market could be profitably monopolized.⁸⁷ The idea of the hypothetical monopolist test is to use as the relevant antitrust market the smallest market for which a hypothetical monopolist (or cartel) that controlled that market would find it profitable to implement a "small significant non-transitory increase in price" (SSNIP).⁸⁸

In practice, the methodology hypothesizes a specified price increase, typically 5% and for a period of at least a year, and considers whether the monopolist or cartel that increases the price would lose so many sales that the price increase would be unprofitable.⁸⁹ This is a function mainly of the number of lost sales (elasticity) and price-cost margins.⁹⁰ The more elastic the demand, the more sales will be lost in response to the price increase. The higher the margin, the more costly those losses will be.

The analogous question for considering monopsony in the labor market

⁸⁶ See *id.*

⁸⁷ See Gregory J. Werden, *The 1982 Merger Guidelines and the Ascent of the Hypothetical Monopolist Paradigm*, 71 ANTITRUST L.J. 253 (2003); Janusz A. Ordover and Robert D. Willig, *Economics and the 1992 Merger Guidelines: A Brief Survey*, 8 REV. INDUS. ORG. 139 (1993).

⁸⁸ See HOVENKAMP, FEDERAL ANTITRUST POLICY, *supra* note 31, §3.2; David Scheffman, Malcolm Coate and Louis Silvia, *Twenty Years of Merger Guidelines Enforcement at the FTC: an Economic Perspective*, 71 ANTITRUST L.J. 277 (2003)

⁸⁹ The methodology is referred to as "critical loss analysis." See Barry Harris and Joseph Simons, *Focusing Market Definition: How Much Substitution is Necessary*, 12 RES. L. & ECON. 207 (1989). See also Joseph Farrell & Carl Shapiro, *Improving Critical Loss Analysis*, 7 ANTITRUST SOURCE 1 (Feb. 2008).

⁹⁰ Carl Shapiro, *The 2010 Horizontal Merger Guidelines: From Hedgehog to Fox in Forty Years*, 77 ANTITRUST L.J. 49 (2010).

would be to identify the smallest labor market for which a hypothetical monopsonist in that market would find profitable to implement a "small and significant but non-transitory reduction in wages" (SSNRW). The more elastic the labor supply, the more workers will be lost to a decrease in wages. The formula for the critical elasticity of labor supply to the individual firm is the direct equivalent of the formula for the critical elasticity of demand. If the elasticity of labor supply is below the critical elasticity, then the market is an appropriately defined relevant market for the purpose of antitrust merger analysis. If the elasticity of labor supply is greater than the critical elasticity, then the market is defined too narrowly. Since the critical elasticity is always positive and the elasticity of labor supply is estimated to be negative within a 6-digit SOC, a 6-digit SOC is typically too broad a market definition under this methodology. A job title would be a more reasonable market definition according to this test.

Standard SOC occupational codes may also affect assessments of the degree of competition in a market in other ways. To illustrate, at the sixth level, the occupation of "cooks" is divided into "fast food," "institutions and cafeteria," "private household," "restaurant," "short order," and "all other" cooks.⁹¹ While this classification might be useful for labor purposes it is hardly clear that employees in these individual sixth-level classifications do not compete with one another on the job market. For example, a "short order" cook might compete for a job notice requesting a "restaurant" or "fast food" cook, or vice-versa. As a result, there may be a greater amount of competition for a particular job than the SOC classifications suggest. As is true in so many areas involving government classifications, including census of manufacturing data, the correlation between government classification data and relevant antitrust market can be poor.⁹² One reason that this is true is that antitrust market definition proceeds not by looking merely who is currently in a market, but rather who would be in the market in response to a wage

⁹¹See *Id.*, which adopts the following classification scheme:

[35-0000 Food Preparation and Serving Related Occupations](#)

35-2000 Cooks and Food Preparation Workers

35-2010 Cooks

- 35-2011 Cooks, Fast Food
- 35-2012 Cooks, Institution and Cafeteria
- 35-2013 Cooks, Private Household
- 35-2014 Cooks, Restaurant
- 35-2015 Cooks, Short Order
- 35-2019 Cooks, All Other

⁹²See W. KIP VISCUSI, JOSEPH E. HARRINGTON, & JOHN M. VERNON, *ECONOMICS OF REGULATION AND ANTITRUST* 158-159 (4th ed. 2005).

decrease.⁹³

In sum, 6-digit SOC codes may be too broad, depending on the circumstances, and job titles may be a better definition of a labor market. However, it may be prudent to adopt the more conservative definition of a labor market. Therefore, we conclude that a 6-digit SOC occupation is a reasonable and perhaps conservative *presumptive* definition of a labor market, in the sense that it may under-estimate effective labor market concentration. In any event, the SSNRW equivalent of the SSNIP test would have to be estimated individually for each proposed merger under consideration because of possible anticompetitive impact on wages, much as the SSNIP test is used in product markets today.

Once the market is defined, concentration must be computed. For this, one must choose a time period: this is particularly important for the labor market because job seekers can only afford to be unemployed and looking for a job for a limited period of time. The median duration of unemployment is about 10 weeks.⁹⁴ That is, unemployed job seekers typically are hired or drop out of the market within about one quarter. This is why it is presumptively sensible to calculate labor market concentration over a quarter.

Having computed the HHI for the labor market based on vacancy shares in the commuting zone, 6-digit SOC and quarter, one can use the thresholds from the horizontal merger guidelines to make a *prima facie* case against a merger that significantly increases labor market concentration.

Identifying “Horizontal” Mergers in Labor Markets

Under conventional merger analysis a merger is “horizontal” if the merging firms are competitors in some relevant product and geographic market. The same principle applies to mergers threatening increasing concentration in the labor market. Such a merger is horizontal if the two firms compete for hiring in the same labor market, whether or not they compete for hiring in the product market. A *prima facie* case against a merger that significantly increases labor market concentration can be made based on the HHI, *independently* of whether the merger would also increase concentration in the product market.

Extreme product differentiation can complicate this analysis, particularly in cases where the products alleged to be competing use different inputs or technologies in their production. A well known example in a

⁹³See HOVENKAMP, FEDERAL ANTITRUST POLICY, *supra* note 31, §3.6d.

⁹⁴See U.S. Bureau of Labor Statistics, “Unemployed Persons by Duration of Unemployment,” available at <https://www.bls.gov/news.release/empsit.t12.htm> (last updated Feb. 2, 2018).

product market is mergers involving firms that make metal cans with those that make glass bottles.⁹⁵ While the two are interchangeable for many uses, such as commercial production of processed foods, they nevertheless exhibit significant differences in inputs, technology and production costs. These may qualify or even prevent one from concluding that the two are in the same relevant market for merger analysis.

One way of approaching this problem is by considering whether a grouping of sales is an appropriate “collusive group”—that is, whether it is a group that could profitably reduce aggregate output and increase price.⁹⁶ Indeed, most of the analysis in that portion of the Merger Guidelines that deal with concentration-increasing mergers presumes that the feared harms to competition will come from either collusion or some kind of coordinated interaction.⁹⁷

Recent anti-poaching litigation can thus shed some light on the question of identifying mergers that are horizontal in the markets in which they purchase labor.⁹⁸ “Anti-poaching” agreements are simply collusion by

⁹⁵ United States v. Continental Can Co., 378 U.S. 441 (1964).

⁹⁶See Herbert Hovenkamp, *Markets in IP and Antitrust*, 100 GEO. L.J. 2133 (2012); Gregory J. Werden, *The History of Antitrust Market Delineation*, 76 MARQ. L. REV. 123 (1992). The idea came from Kenneth D. Goyer, *Industry Boundaries* 70, 73, in *ECONOMIC ANALYSIS AND ANTITRUST LAW* (Terry Calvani & John Siegfried, ed., 2d ed. 1988); and Gregory J. Werden, *Is There a Principle for Defining Industries? Comment*, 52 S. ECON. J. 532 (1985). See also Gregory J. Werden, *The Use and Misuse of Shipments Data in Defining Geographic Markets*, 26 ANTITRUST BULL. 719, 721 (1981) (“A market for antitrust purposes is any product or group of products and any geographic area in which collective action by all firms (as through collusion or merger) would result in a profit maximizing price that significantly exceeded the competitive price.”).

⁹⁷2010 Horizontal Merger Guidelines, *supra* note 8, §7.

⁹⁸See, e.g., *In re VHS of Michigan, Inc.*, 601 Fed. Appx. 341 (6th Cir. Feb. 3, 2015) (approving employee class action in case alleging that eight hospitals conspired to suppress nurses’ wages); *Todd v. Exxon*, 275 F.3d 191 (2d Cir. 2001) (Sotomayor, j.: employees’ allegations of information exchanges sufficient to support claim of conspiracy to suppress wages of oil refining defendants); *Law v. NCAA*, 134 F.3d 1010 (10th Cir. 1998) (condemning agreement among NCAA colleges to limit salaries of junior basketball coaches); *In re High-Tech Employee Antitrust Litigation*, 985 F.Supp.2d 1167 (N.D.Cal. 2013) (tech firms’ “non-poaching” agreement not to solicit one another’s employees; certifying employee class); *Reed v.*

another name. They occur when employers agree with each other not to hire one another's workers.⁹⁹ A fundamental principle of market definition for merger analysis is that if two firms can profit by agreeing with one another to fix prices or divide markets, then they are in the same collusive group, which means that they should be treated as competitors for the purpose of merger analysis. This can occur in the labor market whether or not it also occurs in the product markets of the firms who employ those workers.¹⁰⁰

For example, eBay has reached a settlement in a case charging eBay and Intuit with participating in an anti-poaching agreement.¹⁰¹ eBay is an auction site, mainly for third party sellers of used and new merchandise. Intuit is primarily a manufacturer of computer software, including the popular programs TurboTax and QuickBooks, as well as a number of other programs that mainly provide accounting, payroll, or other management aids to businesses. The firms are not competitors in any product except in the trivial

Advocate Health Care, 268 F.R.D. 573 (N.D.Ill. 2009) (complaint of hospital conspiracy to suppress nurses' wages; denying class certification for failure to show impact by common proof); *California v. eBay, Inc.*, 2014 WL 4273888 (N.D.Cal. Aug. 29, 2014) (approving settlement in case alleging agreement among tech firms not to hire each other's employees); *Hall v. Thomas*, 753 F.Supp.2d 1113 (N.D. Ala. 2010) (excluding expert testimony concerning causation in case alleging that defendant unlawfully suppressed wages of workers in poultry processing plant); *Mueller v. Wellmark, Inc.*, 818 N.W.2d 244 (Ia. 2012) (rejecting most parts of claim that health insurer paid discriminatorily low reimbursement rates to chiropractors). Cf. *Mendoza v. Zirkle Fruit Co.*, 301 F.3d 1163 (9th Cir. 2002) (sustaining documented agricultural laborers' complaint that fruit growers imported undocumented workers with intent of suppressing wages of documented workers). See Orly Lobel, *The New Cognitive Property: Human Capital Law and the Reach of Intellectual Property*, 93 TEX. L. REV. 789 (2015); Robert E. Bloch & Scott P. Perlman, *Reed v. Advocate Health Care: Anatomy of Class Certification Proceedings in a Wage Conspiracy Case*, ANTITRUST 63 (Summer 2010).

⁹⁹See Alan B. Krueger & Eric A. Posner, *A Proposal for Protecting Low-Income Workers from Monopsony and Collusion* (2018) (mss. on file with author).

¹⁰⁰Some anti-poaching agreements involve competitors in the product market as well. See e.g., *United States v. Lucasfilm, Inc.*, 2011 WL 2636850 (D.D.C. June 3, 2011) (agreement between Lucasfilm and Pixar not to poach one another's digital animators; court references the firms as "direct competitor[s]," referencing the product market).

¹⁰¹*California v. eBay, Inc.*, 2014 WL 4273888 (N.D.Cal. Aug. 29, 2014).

sense that a few eBay sellers offer programs such as Zoho or Xero that compete with Intuit's Quickbooks; and TaxAct or H & R Block Tax software that compete with TurboTax. But for these, eBay functions merely as a broker. The two firms also have a very minor vertical relationship to the extent that a few third party sellers also sell TurboTax or Quickbooks on the eBay auction site.¹⁰² Once again, eBay is merely the broker.

But the hiring market is different, and the overlap between eBay and Intuit is sufficient that the two firms can profit from price fixing or market division agreements covering each other's software engineers.¹⁰³ As a result, a complete analysis of a (purely hypothetical) merger between eBay and Intuit would have to look at labor market overlap and concentration. On the product market side, one can assume that the investigating agency would quickly conclude that the merger does not provide any threat to competition. On the labor market side, however, they may find significant overlaps for different groups of specialized employees and, if concentration levels and the increase in labor concentration are sufficiently high, challenge the merger on that basis. As noted previously, the fact that eBay and Intuit have entered into a no-poaching agreement is alone sufficient to suggest that the employees subject to that agreement constitute a relevant market and that a merger between the firms would be anticompetitive. A merger between any two companies that have been shown to engage in anti-poaching agreements

¹⁰²In the vertical context, there has also been some discussion of possible anti-poaching agreements between Amazon and its own suppliers. See <https://www.cnn.com/2018/01/10/amazons-poaching-tactic-leads-lemonade-to-consider-ditching-aws.html>.

¹⁰³California v. eBay, Inc., 2014 WL 4273888 (N.D.Cal. Aug. 29, 2014). See also *In re High-Tech Employee Antitrust Litigation*, 985 F.Supp.2d 1167 (N.D.Ca. 2013) (certifying class action, in alleged no poaching agreement involving Adobe, Apple, Google, Intel, Intuit, Lucasfilm, and Pixar; the plaintiff class members were identified as "software engineers"). The allegations also included claims of interlocking directorates between Apple and at least one director at the other companies. See also Bill Singer, "After Apple, Google, Adobe, Intel, Pixar and Intuit, Antitrust Employment Charges Hit eBay," FORBES (Nov. 19, 2012), available at <https://www.forbes.com/sites/billsinger/2012/11/19/after-apple-google-adobe-pixar-google-and-intuit-antitrust-employment-charges-hit-ebay/#5b95024625bf> (noting explicit no-poaching agreements involving Apple, Google, Adobe, Pixar, Intel, and Intuit, including circulation of a "do not call" list instructing employees with hiring authority not to contact the employees of the other participating companies).

is prima facie problematic because of the fear of anticompetitive effects in the labor market. Additionally, however, a merger of two firms that are capable of profiting from such an agreement also raises competition concerns, whether or not they have actually done so.

The Relevance of Noncompetition Agreements

A noncompetition agreement is between an employer and an employee and restricts that employee's ability to work for a different employer in the event that the employee quits his or her job.¹⁰⁴ The difference between a noncompetition agreement and a no-poaching agreement is that the former is purely vertical: it refers to agreements between a single employer and its various employees. The common law generally addressed employee noncompetition agreements under a rule of reason¹⁰⁵ and generally upheld them if they were reasonably confined to a specified subject area, geographic range, and duration. The trend today is to treat pure noncompetition clauses under tort law or some other statute relating to employment practices.¹⁰⁶ Relatively few of them have been condemned under the federal antitrust laws.¹⁰⁷ In any event, a purely vertical noncompetition agreement would also have to be treated under antitrust's rule of reason.¹⁰⁸

The historical justification for employee noncompete agreements is that

¹⁰⁴For a good legal survey of issues and policy, see J.J. Prescott, et. al., *Understanding Noncompetition Agreements: the 2014 Noncompete Survey Project*, 2016 MICH. ST. L. REV. 369.

¹⁰⁵For a recent example, see *Innovation Ventures v. Liquid Manufacturing*, 499 Mich. 491, 885 N.W.2d 861 (2016). The court did not discuss market power, which antitrust's rule of reason requires. Although the courts have generally not recognized it, the market power at issue should be the power that the employer has in the employment market, which can be quite different from its power in the product market in which it sells.

¹⁰⁶See Michael J. Garrison & John T. Wendt, *The Evolving Law of Employee Noncompete Agreements: Recent Trends and an Alternative Policy Approach*, 45 AM. BUS. L.J. 107, 110-11 (2008).

¹⁰⁷See *United States v. Empire Gas Corp.*, 537 F.2d 296 (8th Cir. 1976), which refused to condemn the defendant's widespread use of employee noncompetition agreements as an attempt to monopolize under §2 of the Sherman Act.

¹⁰⁸See *NYNEX Corp. v. Discon, Inc.*, 525 U.S. 128 (1998) (purely vertical agreement must be treated under rule of reason).

they limit various forms of free riding. In particular, employees might receive costly on-the-job training or knowhow that they could then port uncompensated to a different employer. Alternatively, an employee might learn trade secrets, including such things as customers lists, that could be shared with a new employer to the older employer's detriment. As a result, the law of employee noncompetition agreements has frequently been assessed as a type of quasi-intellectual property protection.¹⁰⁹

Today, however, employee noncompetition agreements are receiving far more critical reviews, with recent writing emphasizing the restrictions on employment mobility that they can impose.¹¹⁰ A White House Report issued in 2016 concludes that noncompetes, particularly among lower salary workers, can reduce worker welfare "and hamper the efficiency of the economy as a whole by depressing wages, limiting mobility, and inhibiting innovation."¹¹¹ Recently several states have enacted or considered legislation to limit the range of noncompete agreements or make them unenforceable.¹¹²

One noticeable and disturbing trend is toward the increased use of employee covenants not to compete by lower wage and less well trained employees for whom the quasi-IP rationale is less tenable.¹¹³ This has

¹⁰⁹See, e.g., Ronald J. Gilson, *The Legal Infrastructure of High Technology Industrial Districts, Route 128, and Covenants not to Compete*, 74 NYU L. REV. 575 (1999). For some empirical evidence that this use of employee noncompete agreements is counterproductive, see Orly Lobel & On Amir, *Driving Performance: A Growth theory of Noncompete Law*, 16 STAN. TECH. L. REV. 833 (2013). See also ORLY LOBEL, *TALENT WANTS TO BE FREE: WHY WE SHOULD LEARN TO LOVE LEAKS, RAIDS, AND FREE RIDING* (2013).

¹¹⁰E.g., OFFICE OF ECON. POLICY, U.S. DEP'T OF THE TREASURY, *NON-COMPETE CONTRACTS: ECONOMIC EFFECTS AND POLICY IMPLICATIONS* (2016), www.treasury.gov/resource-center/economic-policy/Documents/UST%20Non-competes%20Report.pdf; Krueger and Posner, *supra* note 99.

¹¹¹WHITE HOUSE, *NON-COMPETE AGREEMENTS: ANALYSIS OF THE USAGE, POTENTIAL ISSUES, AND STATE RESPONSES* 5 (2016), obamawhitehouse.archives.gov/sites/default/files/non-competes_report_final2.pdf.

¹¹²These are summarized in Yifat Aran, *Beyond Covenants Not to Compete: Equilibrium in High-Tech Startup Labor Markets* *11, 70 STAN. L. REV. ____ (2018) (forthcoming), available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3111045.

¹¹³Krueger and Posner, *supra* note 99; Alan B. Krueger and Orley Ashenfelter, *Theory and Evidence on Employer Collusion in the Franchise*

resulted in pushback from several state courts.¹¹⁴ For example, prior to a 2017 settlement, Jimmy John's, a fast food franchisor that produces mainly sandwiches, required all of its employees to sign noncompete agreements.¹¹⁵ The agreements lasted for two years post termination and forbade a worker from accepting a job with any seller of "submarine, hero-type, deli-style, pita, and/or wrapped or rolled sandwiches" within two miles of any Jimmy John's location."¹¹⁶ Because these covenants applied to all employees, it is highly unlikely that Jimmy John's had any quasi-intellectual property rights, including customer lists¹¹⁷ or trade secrets, that justified the covenants.

Although employee noncompetition agreements are vertical, they can have horizontal effects, particularly if multiple employers in a labor market use them. As a result, they can be relevant to the analysis of horizontal mergers. While labor concentration indexes measure the range of competitive choices that employees face, noncompetition agreements serve to limit employee mobility within that range. Most significantly, they can serve to increase the level of effective market concentration to the extent that employees subject to such agreements face fewer competitive choices. To illustrate, suppose an employment market contains five firms, A, B, C, D & E, and that they hire equal numbers of employees in a certain specialty. But suppose that the employees of two of the firms, A and B, are bound by noncompete agreements that effectively prevent the remaining three firms, C, D & E, from bidding for their services. Assuming that the noncompete

Sector (Princeton Industrial Relations Section working Paper 614, 2017), available at <http://dataspace.princeton.edu/jspui/bitstream/88435/dsp014f16c547g/3/614.pdf>.

¹¹⁴On recent trends, see Michael J. Garrison & John T. Wendt, *The Evolving Law of Employee Noncompete Agreements: Recent Trends and an Alternative Policy Approach*, 45 AM. BUS. L.J. 107, 111-12 (2008). See also Jenna L. Brownlee & Caitlin A. Kelly, *To Compete or Not to Compete: Illinois' Movement to Eliminate Noncompete Agreements*, 48 LOY. U. CHI. L.J. 1233 (2017).

¹¹⁵See *Brunner v. Liautaud*, 2015 WL 1598106 (N.D.Ill. Apr. 8, 2015) (approving nonantitrust complaint alleging inter alia unreasonably broad noncompete agreements by Jimmy John's); Matthew Hector, *Jimmy John's Settles Suit over Noncompete Agreements*, 105 ILL. B. J. 14 (2017).

¹¹⁶Viva R. Moffat, *Human Capital as Intellectual Property? Non-Competes and the Limits of IP Protection*, 50 AKRON L. REV. 903, 909 (2016).

¹¹⁷To the extent that fast food franchises sell to customers on demand customer lists seem relatively unimportant.

agreements are enforceable, existing employees of A and B are in a situation of monopsony, since there is only one employer that can hire them for the present job function.

From the point of view of the employers, this situation is not quite the same as one in which only three firms in the market are able to compete. While C, D, E cannot compete away existing employees of A and B, firms A and B can compete to hire employees away from C, D, E. That is, a noncompetition agreement prevents a rival firm from competing for the employees of the firm imposing the restraint, but it does not limit that firm from hiring the employees of other firms who are not bound by such agreements. As a result, we would not simply recompute market concentration to count only the three unencumbered firms. For example, in a merger of C and D, two firms that do not use noncompetes, firms A & B would still be able to bid for their employees, meaning that they should be counted as in the market.

Rather, we would count the widespread existence of noncompetition agreements as an exacerbating factor in reducing competition in the labor market that calls for closer scrutiny.¹¹⁸ It should thus be added to other factors mentioned in the Merger Guidelines as affecting the significance of a given concentration level.¹¹⁹

¹¹⁸ In addition, authorities may seek modification of existing noncompetition agreement or to limit the enforceability of noncompetes executed prior to a company's merger. See William Vorys, *Unreasonable State Restrictions on Business Transactions: the Enforceability of Non-Compete Agreements Post-Merger or Acquisition*, 43 CAP. U.L. REV. 721 (2015). Some state courts are reluctant to enforce employee noncompetition agreement executed in favor of the acquired firm prior to the merger. See, e.g., *Acordia of Ohio, LLC v. Fishel*, 133 Ohio St.3d 356, 978 N.E.2d 823 (2012), which concluded that while pre-merger agreements were not unenforceable per se, the impact of the merger should be considered in examining whether they continued to be reasonable after the merger – “the employees still may challenge the continued validity of the noncompete agreements based on whether the agreements are reasonable and whether the numerous mergers in this case created additional obligations or duties so that the agreements should not be enforced on their original terms”).

¹¹⁹See, e.g., 2010 Merger Guidelines, *supra* note 8 at §3 (price discrimination); §6.3 (excess capacity) §8 (presence of powerful buyers), §9 (entry); §11 (failure and exiting assets)

The Efficiency Defense and Labor Market Mergers

While §7 of the Clayton Act does not expressly create an “efficiency defense” against prima facie unlawful mergers, both recent case law and the Horizontal Merger Guidelines recognize such a defense.¹²⁰ At the same time, however, situations in which merging firms have successfully defended a prima facie unlawful merger by showing the requisite efficiencies are rare.

Under the approach laid out in the 2010 Horizontal Merger Guidelines,¹²¹ the government first makes out a prima facie case that a merger is likely to result in an anticompetitive price increase in at least one affected market. This prima facie case contains a built-in allowance for the “ordinary” efficiencies that are reasonably expected to result from a merger.¹²² The form that the allowance takes is typically an adjustment of the concentration standards so as to be more tolerant than the structural factors would otherwise indicate.¹²³ As a result, predicted levels of anticompetitive harm to consumers already assumes that the merger will produce unspecified “ordinary” efficiencies. So once the prima facie case has been made out, only additional or “extraordinary” efficiencies can be used to rebut the prima facie case. Given that this efficiencies “allowance” seems to be very generous,¹²⁴ it is not surprising that few proponents of mergers are able to show extraordinary efficiencies. Indeed, recent literature indicates that merger policy is, if anything, underdeterrent and has permitted several mergers that have resulted in actual price increases.¹²⁵ This could be the result of concentration thresholds that are too generous to the merging firms,¹²⁶ but it could also be because the approach taken in the Guidelines gives the firms a

¹²⁰See Hovenkamp, *Appraising Merger Efficiencies*, 24 GMU L. REV. 703 (2017).

¹²¹2010 Horizontal Merger Guidelines §10, *supra* note 8.

¹²²Hovenkamp, *Appraising Merger Efficiencies*, *supra* note 120 at 708-711; Daniel A. Crane, *Rethinking Merger Efficiencies*, 110 MICH. L. REV. 347, 364-367 (2011) (laying out the considerations, including administrative convenience, for and against this approach).

¹²³See Crane, *id.*, at 365.

¹²⁴See Hovenkamp, *Appraising Merger Efficiencies*, *supra* note 120 at 708-711.

¹²⁵*Ibid.*

¹²⁶Earlier editions of the Merger Guidelines identified markets as “highly concentrated” when the HHI exceeded 1800. The 2010 Guidelines moved that number for 2500. All versions of the Merger Guidelines are maintained in enforcement agency archives, available at <https://www.justice.gov/archive/>.

greater efficiency credit than their merger actually produces.

The 2010 Guidelines do offer a statement about the magnitude of proven efficiencies: they must be sufficient to warrant the conclusion that the post-merger price will be no higher than pre-merger prices.¹²⁷ As a result, the net harm to consumers must be zero. For example, if structural evidence predicts a 20% price increase from a horizontal merger after “ordinary” efficiencies are taken into account,¹²⁸ then the defendants must show efficiencies that are sufficient to reverse that increase and that these efficiencies will be passed on to the consumer.¹²⁹ The result must be that the predicted post-merger price is no higher than the prices charged prior to the merger. While the government has the obligation to make out its *prima facie* case, the burden for the efficiency defense is on the merging firm or firms.¹³⁰ This is a sensible

¹²⁷ Horizontal Merger Guidelines, *supra* note 8, §10.

¹²⁸On how efficiency claims are initially taken into account, see Darren S. Tucker, *A Survey of Evidence Leading to Second Requests at the FTC*, 78 ANTITRUST L.J. 591, 601–02 (2013). See also Elizabeth M. Bailey et al., *Merger Screens: Market Share-Based Approaches versus “Upward Pricing Pressure,”* ANTITRUST SOURCE 1, 6–7 (Feb. 2010), http://www.americanbar.org/content/dam/aba/publishing/antitrust_source/Feb10_Leonard2_25f.authcheckdam.pdf; Serge Moresi, *The Use of Upward Price Pressure Indices in Merger Analysis*, ANTITRUST SOURCE 1, 2–4 (2010), http://www.americanbar.org/content/dam/aba/publishing/antitrust_source/Feb10_Moresi2_25f.authcheckdam.pdf.

¹²⁹Horizontal Merger Guidelines, *supra* note 8, §10.

¹³⁰ Fed. Trade Comm’n v. H.J. Heinz Co., 246 F.3d 708, 721–22 (D.C. Cir. 2001). See *id.* at 715:

First the government must show that the merger would produce a firm controlling an undue percentage share of the relevant market, and [would] result [] in a significant increase in the concentration of firms in that market. Such a showing establishes a presumption that the merger will substantially lessen competition. To rebut the presumption, the defendants must produce evidence that show [s] that the market-share statistics [give] an inaccurate account of the [merger's] probable effects on competition in the relevant market. If the defendant successfully rebuts the presumption [of illegality], the burden of producing additional evidence of anticompetitive effect shifts to the government, and merges with the ultimate burden of persuasion, which remains with the government at all times.

See also Richard J. Gilbert & Hillary Greene, *Merging Innovation into*

assignment of the burden of proof, since firms are in the best position to understand the efficiencies likely to result from their own merger.¹³¹ Significantly, this approach represents an incorporation of a consumer welfare standard, which will not tolerate any price increase at all. By contrast, under a general welfare standard a price-increasing merger would be tolerated, provided that the efficiency gains exceeded consumer losses from reduced output and higher prices.¹³²

Virtually any type of productive efficiency can be used to prove the efficiency defense, provided that it is “merger specific” – that is, that the defendants can also show that this particular efficiency could not readily be attained except by the merger.¹³³ This means that transactional efficiencies count, just as much as pure engineering or other production cost efficiencies. For example, if the merging firms can show that after the merger they can negotiate for supplies in larger volumes and thereby obtain lower prices, that evidence could support a successful efficiency defense. If the particular supply market is competitive, then the only likely effect of the claimed efficiency is resource savings. For example, if two Italian restaurants in a small community should merge and can show that they can purchase tomatoes in larger quantities at a lower price, that would count in favor of the merger. The Italian restaurants serve a local market, which we assume is highly concentrated. By contrast, they purchase tomatoes in a much larger and competitively structured market and certainly do not have the power to suppress the output of tomatoes by reducing the price they are willing to pay. Any lower price results from a reduction in transaction costs that accompany larger scale purchases.

By contrast, when the merging parties have a strong position in the market in which they are purchasing and the supply market is not as competitive, then this claimed “efficiency defense” may be nothing more than monopsonistic price suppression. In the general run of product markets, the difference between efficient reduction in transaction costs and monopsonistic price suppression is that output increases under the former but decreases under the latter. Further, because monopsony represents an exercise of market power, one must be able to infer that the allegedly monopsonized market is sufficiently noncompetitive to make this exercise plausible.

Antitrust Agency Enforcement of the Clayton Act, 83 GEO. WASH. L. REV. 1919, 1927 (2015).

¹³¹See Hovenkamp, *Appraising Merger Efficiencies*, *supra* note 120 at 724-726.

¹³²*E.g.*, as in Oliver E. Williamson, *Economies as an Antitrust Defense: the Welfare Tradeoffs*, 58 AM. ECON. REV. 18 (1968).

¹³³See 2010 Horizontal Merger Guidelines, *supra* note 8, §10.

To take another example, Amazon is a major retailer with a reputation as a hard bargainer for the products that it purchases for resale. It sells automobile tires, which are presumably sold in a national or larger geographic market. Its share of online tire sales is 8%, however,¹³⁴ and online tire sales constitute only 6% of the total tire market, indicating that if the market is all tire sales Amazon has perhaps one half of one percent.¹³⁵ In that case any lower wholesale price that Amazon is able to obtain for tires is not likely to be monopsonistic, but rather an efficient reduction in purchasing costs. By contrast, Amazon accounts for roughly 83% of the eBook downloads in the United States,¹³⁶ with much of the balance shared by Apple (9%) and Barnes & Noble (4%), along with several smaller firms. Those numbers make claims of monopsonistic price suppression more plausible.

In the case of labor, resorting to quantity or “bulk” discounts is probably not a feasible efficiency, because each worker sells his or her labor individually. Indeed, employers more typically obtain lower wages by *breaking* unions, thus forcing individual bargaining, rather than entering into collective bargaining with them. One could argue that hiring more people can save companies some human resources costs, but these would show up as administrative costs, not as lower wages or salaries. Furthermore, the empirical evidence does not offer strong support for economics of scale in hiring: in fact, the opposite is often found, with hiring costs increasing rather than decreasing with the number of workers hired.¹³⁷

The most plausible efficiency defense would be to argue that an efficient re-organization of production will lead to the firm’s needing fewer workers, i.e. lower labor inputs. Therefore, the firm would be required to demonstrate how the re-organization will lead to the same or greater output with significantly fewer workers. For example, a merger might enable a firm to adopt labor saving technology. Alternatively, it may enable the post-merger firm to eliminate costly duplication, particularly in distribution, accounting, or other divisions whose labor could be spread across the entire post-merger firm. This efficiency must be demonstrated for the specific labor market where anticompetitive effects are likely to occur according to the *prima facie* case. For example, it does not help the company to show that it is saving on the number of accountants needed if the anticipated anticompetitive effects

¹³⁴ <https://stevensoncompany.com/amazon-online-retailer-share-lame-dominating-game/>.

¹³⁵ <http://www.moderntiredealer.com/article/721519/your-next-great-competitor-is-the-odds-favor-amazon-com-over-sears-automotive>

¹³⁶ <https://www.bloomberg.com/news/articles/2018-01-25/apple-is-said-to-ready-revamped-e-books-push-against-amazon>

¹³⁷ See Manning, *Imperfect Competition*, *supra* note 49.

are on the market for nurses.¹³⁸

The D.C. Circuit's *Anthem* decision involved a merger among health insurers that the government challenged as anticompetitive in two geographic markets.¹³⁹ The defendants, which operated managed care programs, bargained with various physician groups, hospitals and other health care providers for coverage, which it then priced out to consumers through health care premiums. The defendants offered to show that, as a consequence of the merger, they would be able to bargain for lower rates from some of the providers. The court majority rejected this efficiency defense as inadequately proven. A dissenting judge would have found the proof of efficiencies adequate, but he also acknowledged that the evidence could indicate "monopsony power in the upstream market where Anthem-Cigna negotiates provider rates with hospitals and doctors."¹⁴⁰ The majority had also agreed that if the lower rates actually reflected an exercise of monopsony power in the merging firms' supply markets it would not constitute a defense.¹⁴¹ That position is also reflected in the Merger Guidelines, which refuse to recognize as an efficiency "anticompetitive reductions in output or service."¹⁴²

But in the case of labor market supply, how does one tell the difference between efficient bargaining that reduces costs and monopsonistic reductions in labor supply? Is the ability to obtain a lower rate from providers an "efficiency defense" or merely an exercise in monopsony power? Here, the basic economics of monopsony can be helpful, although perhaps not decisive in every case. If the labor supply market is unconcentrated and the merging firms purchase only a small portion of it, then they probably lack the power to exercise monopsony power in that market. They would be more like the two Italian restaurants in the previous example, who operate locally in the

¹³⁸On the problem of offsetting harm in one market against benefits in a different market, see discussion *infra*, text at notes 143-146.

¹³⁹*United States v. Anthem, Inc.*, 855 F.3d 345, 356 (D. C. Cir. 2017). *Cf.* *West Penn Allegheny Health Sys., Inc. v. UPMC*, 627 F.3d 85 (3d Cir. 2010) (sustaining complaint that large hospital system and health insurer conspired to suppress reimbursement rates paid to providers); *New Mexico Oncology and Mematology Consultants, Ltd. V. Presbyterian Health Care Serv.*, 54 F.Supp.3d 1189 (D.N.M. 2014) (sustaining cancer treatment facility's complaint of conspiracy between hospital and insurer to suppress reimbursement rates).

¹⁴⁰*Anthem*, 855 F.3d at 377.

¹⁴¹*Id.* at 371.

¹⁴²Horizontal Merger Guidelines, *supra* note 8, §10. *Accord*, Hemphill & Rose, *supra* note 28.

market in which they sell but purchase tomatoes in a very large market.¹⁴³ In that case bargaining for lower rates is very likely efficient. By contrast, if the labor supply market is concentrated and the merging firms account for a high proportion of it, that at least raises the inference that their ability to obtain lower rates results from a reduction in competition for the purchase of labor rather than any bargaining efficiencies. To the extent output is measurable, that evidence can also be helpful: efficient reductions in transaction or bargaining costs will tend to increase output while monopsonistic suppression of wages will tend to reduce it.

There is also the problem of “offsets,” or whether consumer harm in one market can be offset by efficiency gains in a different market. In its *Philadelphia Bank* decision the Supreme Court said no,¹⁴⁴ and that outcome seems consistent with the statutory language which provides that a merger is unlawful if it harms competition in “any” line or commerce and section of the country. Importantly, since the harm and the benefits occur in different markets, we would effectively be asking one set of consumers to pay the price of an anticompetitive merger, while another set would enjoy the efficiency benefits. Further, making quantitative assessments of benefits in one market and harms in a different market would place heroic demands on the courts.¹⁴⁵

Adding labor market effects could serve to complicate this analysis. For example, suppose a merger is challenged as anticompetitive in a labor market but the merging firms offer evidence that the merger will lead to reduced costs in the product market in which they sell. Once again, they would be asking the court to tolerate an anticompetitive outcome in one market, labor, for the benefit of a different group who purchase in the product market. Existing law would not countenance such an approach, nor as a general matter should it.¹⁴⁶

Measuring “Consumer Welfare” Effects in Labor Markets

The defining attribute of the consumer welfare standard is the elimination of monopoly, which entails higher output and, in the case of output restraints, lower prices. For example, under the consumer welfare standard merger law does not recognize an efficiency defense unless the

¹⁴³See discussion *supra*, text at note 133.

¹⁴⁴*United States v. Philadelphia Nat’l Bank*, 374 U.S. 321, 370-371 (1963).

¹⁴⁵See Hovenkamp, *Appraising Merger Efficiencies*, *supra* note 120 at 733-734.

¹⁴⁶One might want to reserve an exception for very small harmful effects in one market, offset by very large benefits in a different market. See Gregory H. Werden, *Cross-Market Balancing of Competitive Effects: What is the Law, and What Should it Be?*, 43 J. Corp. L. 119, 122 (2017).

efficiencies are so substantial that they reduce the profit-maximizing price of the post-merger firm to a level that is no higher than the pre-merger level. As a result, it does not accept “tradeoffs” that are willing to tolerate increased monopoly power and actual output decreases, provided there are offsetting gains in productive efficiency.¹⁴⁷ Properly defined, the consumer welfare standard applies in exactly the same way to monopsony. Its goal is high output, which comes from the elimination of monopoly power in the purchasing market.

The monopsony case can sow some confusion, however, because suppressed buying prices are low rather than high. In some cases, an exercise of monopsony power in the labor market will also harm consumers in the product market. This will occur when the post-merger firm has market power on both sides of the market. In that case, exercising market power on the labor side will entail the purchase of less labor. *Ceteris paribus*, less labor will lead to less output on the product side. If the firms have power on that side, the result would be higher product prices as well and consumer harm is obvious.

But harm to consumer welfare occurs just as certainly if the firm exercising monopsony power in the labor market is a competitor in the product market. In that case suppressed purchasing of labor will result in lower product output but not higher prices, given that the product market is competitive. The post-merger firm’s lost output will be replaced by the production of competitors. Here, however, the harm to suppliers of labor from suppressed output is just as certainly an injury to consumer welfare.

The consumer welfare principle also guides cases when the two firms are not competitors at all in the product market. For example, in the hypothetical Google/Intuit merger discussed above,¹⁴⁸ the acquisition does not reduce competition between the two firms in the product market. However, because the two firms will hire fewer software engineers (or other affected employees) they will very likely produce less in the product market. Assuming the firms have some power in the product markets in which they sell, product prices would go up as well even though the firms are not product market competitors. The general language of §7 of the Clayton Act counts this as a qualifying injury to competition, although to date no courts of which we are aware has recognized it. That is, even though the merger does not increase concentration in any product market, it does result in a product price increase.

¹⁴⁷See discussion *supra*, text at notes 120-140; and Steven C. Salop, *Question: What is the Real and Proper Antitrust Welfare Standard? Answer: the True Consumer Welfare Standard*, 22 LOY. CONSUMER L. REV. 336 (2010).

¹⁴⁸See discussion *supra*, text at notes 101-104.

In sum, when consumer welfare is properly defined as targeting monopolistic restrictions on output, it is well suited to address anticompetitive consequences on both the selling and the buying side of markets, and those that affect labor as well as the ones that affect products.

Conclusion

Horizontal mergers threatening labor market competition present a significant competition problem and several legal issues that have not previously been explored. Labor market concentration – measured by the fewness of employers recruiting in a given labor market – seems to be very high, as high or higher overall than product market concentration. This suggests that a mature policy of pursuing mergers because of harmful effects in labor markets could yield many cases, although *prima facie* we do not know how many. Also significant is that some of these mergers might be horizontal in the labor market but not in the product market in which the merging firms sell their goods or services. Once again, we do not predict the extent that this is true, but it does suggest that those reviewing mergers cannot simply assume that lack of competition in the product market entails the same for the labor market. So to say that merger analysis focusing on labor will take evaluators into uncharted territory seems clear, and perhaps even more so for courts.

At the same time, however, we are not recommending any significant changes in the economic analysis applied to mergers. The mechanisms of market definition, measurement of concentration, the construction of *prima facie* cases based on concentration effects, and assessments of consumer welfare, can readily be adapted to merger cases involving labor markets. The fundamentals remain the same.