RESEARCH BRIEF • MAY 2023

Merger Guidelines for the Labor Market

Based on BFI Working Paper 2023-57, "Merger Guidelines for the Labor Market," by David W. Berger, Duke University; Thomas Hasenzagl, University of Minnesota; Kyle F. Herkenhoff, University of Minnesota; Simon Mongey, University of Chicago; and Eric A. Posner, University of Chicago

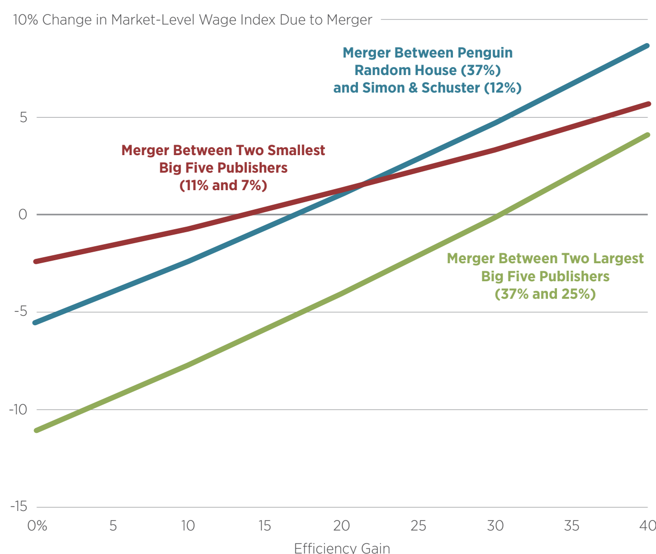
This new theoretical framework shows that if the objective of regulators is to conserve resources by reviewing only those mergers most likely to harm workers, while ensuring that workers are unharmed by permitted mergers, then the more stringent 1982 guidelines are more effective than the more lenient 2010 guidelines.

This work builds on recent work by three of the authors that reveals the sizable welfare losses (including wages and employment) attributable to the labor market power of single firms,[1] to also include multi-plant ownership. This issue loomed large in November 2021 when the Department of Justice sued to block the merger of Penguin Random House and Simon & Schuster on grounds of "harm to American workers, in this case authors, through consolidation among buyers … referred to as 'monopsony'."

Absent efficiency gains, the authors' main proposition establishes that a merger between two plants in the same market depresses market-level wages and employment, and wages decline unambiguously at both plants. The authors conduct three exercises, including one that affirms the Penguin/Simon case above (see accompanying Figure), but for the purposes of this Brief, we will focus on their main exercise, which measures the effects of applying the 1982 and 2010 merger review guidelines to the labor market.

Before proceeding further, a note about Herfindahl-Hirschman Index (HHI)-based review thresholds, on

Figure 1 • Expected Change in Wages in Penguin Random House and Simon & Schuster Merger



Note: This figure plots the change in the market level wage index for various efficiency gains assumed in the Penguin Random House case (blue line). The merger generates a reduction in the market-level wage index for any efficiency gain below 17%. In the absence of any efficiency gain, the merger generates a 5% reduction in market-level worker (author) wages. This figure also shows that substantial productivity gains would need to be demonstrated to achieve worker surplus neutrality for any merger in this market. A merger between the two largest publishers (green line) generates even larger market-level wage losses of 10% in the absence of efficiency gains, with a required efficiency gain of 30% for worker (author) surplus neutrality. A merger between the two smallest Big Five publishers (red line) generates fewer wage losses but still has a substantial REG of 13%.

[1] Berger, D., K. Herkenhoff, and S. Mongey (2022): "Labor Market Power," American Economic Review, 112(4), 1147–93. Also, BFI Working Paper No. 2021-58.

which the 1982 and 2010 merger review guidelines rely. The HHI is a measure of market concentration used to determine market competitiveness, often of pre- and post-merger and acquisition transactions. The index measures the size of companies relative to the size of their industry, and the amount of competitiveness. Calculations aside, a market with an HHI of less than 1500 is considered competitive, an HHI of 1500 to 2500 is moderately concentrated, and an HHI of 2500 or greater is highly concentrated.

The HHI formed the basis of guidelines issued in 1982 for regulators to determine whether to approve affected mergers. Those guidelines presume anticompetitive effects whenever post-merger HHIs exceed 1,800. However, those guidelines were revised in 2010 to presume anticompetitive effects whenever post-merger HHIs exceed 2500.

Back to the authors' primary exercise in this paper: The authors compare the 1982 and 2010 product market merger review guidelines when applied to the labor market. They apply these guidelines to a representative set of simulated mergers, which assumes that the government blocks mergers that are in markets where the post-merger HHI exceeds the threshold specified by the guidelines, and in markets where the post-merger change in HHI exceeds the threshold specified by the guidelines. If the authors adhere to 1982 guidelines and block mergers that generate post-merger HHIs above 1800, they find that the guidelines' average required efficiency gains (REG) of permitted mergers is 4.68 percent. In other words, permitted mergers must generate an average productivity gain of 4.68 percent for workers to be as well off as they were before the merger. However, when the authors adhere to 2010 guidelines and block mergers that result in post-merger HHIs above 2500, the average REG of permitted mergers is 5.96 percent. This means that under the standard assumed efficiency gain of 5 percent, permitted mergers yield worker surplus losses, and therefore workers are harmed.

Bottom line: On average, workers are worse off under the enforcement of the more lenient 2010 merger guidelines, and better off under the enforcement of the more stringent 1982 merger guidelines. Therefore, if efficiency gains are assumed to be 5 percent, and if the goal of regulators is to conserve resources by only reviewing those mergers most likely to harm workers, while ensuring that workers are unharmed by permitted mergers, the 1982 guidelines of achieve that goal, whereas the 2010 guidelines do not.

READ THE WORKING PAPER

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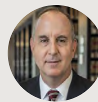

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