What's the Deal with Unions?

By Kush Kapoor

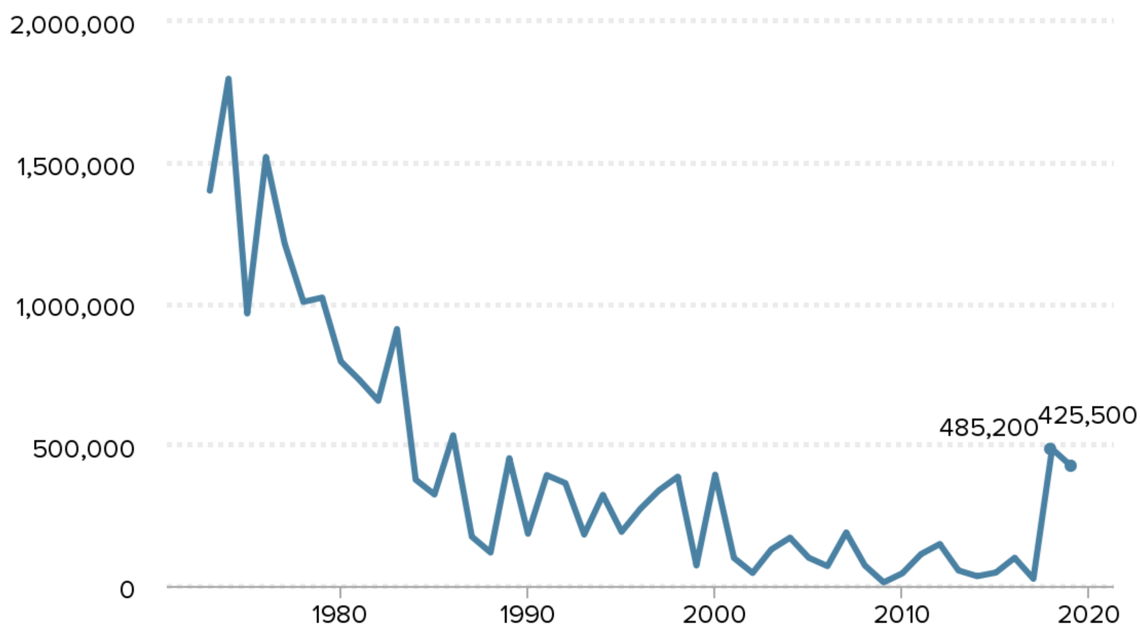
Employers and workers both seem to approach employment from vastly different perspectives. So how can the two parties reach an agreement? The answer lies in unions. Organized labor has played a role in the worker-employer dialogue for centuries, but in the last few decades, many aspects of the business environment have changed. With this in mind, it's important to understand how unions fit into the current business environment and their role in the modern economy.

Unions, as defined by Investopedia, "are organizations that negotiate with corporations, businesses, and other organizations on behalf of union members. There are trade unions, which represent workers who do a particular type of job, and industrial unions, which represent workers in a particular industry." Private sector unionization has been falling, despite increased focus from the Biden Administration. Collective bargaining has always been a hot topic for both public and private entities but has recently come into the news with Starbucks. A group of employees at a Starbucks location in Buffalo, New York is organizing the popular coffee chain's first union. This decision came after a wave of understaffing and unhappy customers. Unionization allows for understaffing to cease and improves working conditions, benefits, and wages for workers. Starbucks has vigorously opposed unions in the past, however, this decision was welcomed by the White House considering President Biden's support of an increase in union jobs. However, industry deregulation, increased competition, and labor mobility have made it difficult for traditional unions to operate. In hindsight, there are both advantages and disadvantages of unionization, both of which come with macroeconomic effects.

Many economists believe that unions make a positive contribution to productivity and efficiency. First, as reported by the Bureau of Labor Statistics, the average hourly earnings of union members were $16.30 compared to $13.10 for non-union members. Increased wages have a positive effect on productivity and allow workers to work more efficiently. The second is the increase in investment and technological progress, union wage increases may accelerate the substitution of capital for labor and hasten the search for cost-reducing (productivity-increasing) technologies. The third is the idea of unions as a collective voice. The collective voice mechanism of unions contributes to labor productivity by voicing worker grievances and therefore reducing labor turnover and increasing worker security and managerial efficiency. The collective voice may be effective in correcting job dissatisfaction that otherwise would result in worker turnover. The fourth argument from economists surrounds seniority and informal training. The union's insistence on the primacy of seniority enhances worker security, incentivizing workers to participate in informal activities which enhance worker quality and productivity. The final argument is from the perspective of managerial performance; union-wage pressure may precipitate a positive shock that is favorable to productivity. Confronted with a strong union and higher wage demands, firms may be forced to adopt better personnel and production methods to meet the union's wage demands and maintain profitability.

Conversely, some economists argue that unionization has a negative impact on the efficiency and productivity of workers and firms. Unions might exert a negative impact on efficiency in three basic ways. First unions often impose work rules that reduce efficiency within the firm. One of the most common manifestations of this effect is the negotiation of contract clauses that restrict management's ability to organize work activity. Unions impose jurisdictional restrictions on the kinds of jobs workers may perform. Unions often insist that workers be promoted in accordance with seniority rather than ability and efficiency. Second, strikes can reduce the aggregate output of the economy. Simple statistics on strike activity suggest that strikes are relatively rare and the associated aggregate economic losses are relatively minimal. The figure below provides data on major work stoppages, defined as those involving 1,000 or more workers and lasting at least one full day or one work shift. However, this data can be misleading as a measure of the costliness of a strike.

Number of workers involved in major work stoppages, 1973–2019



Note: The Bureau of Labor Statistics does not distinguish between strikes and lockouts in its work stoppage data. However, lockouts (which are initiated by management) are rare relative to strikes, so it is reasonable to think of the major work stoppage data as a proxy for data on major strikes. Data are for work stoppages that began in the data year.

Source: Bureau of Labor Statistics, "Major Work Stoppages in 2019" (news release), February 11, 2020, and related table, "Annual Work Stoppages Involving 1,000 or More Workers, 1947–2019."

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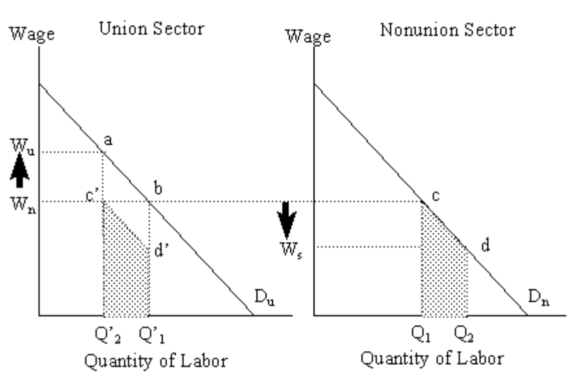
On the one hand, employers in the affected industry may have anticipated the strike and worked their labor force overtime to accumulate inventories to supply customers during the strike period, so that the work lost data overstates the actual loss. On the other hand, the amount lost can be understated by the data if production in associated industries (those that buy inputs from the struck industry or sell products to it) is disrupted. As a broad generalization, the adverse effects of a strike on nonstriking firms and customers are likely to be greater when services are involved and less when products are involved. Remember, strikes are the result of the failure of both parties to the negotiation, so it is inaccurate to attribute all costs associated with a strike to labor alone. Finally, the union wage differential distorts the wage structure, causing a misallocation of labor between union and nonunion firms and industries. The figure below illustrates the effect of the union wage advantage on the allocation of labor. The higher wage achieved by the union causes a displacement of labor which reduces the wage in nonunion sectors of the economy. This movement of labor causes total output to fall as workers were more productive in their previous jobs than they are in the jobs in the nonunion sector that they are forced to migrate to.



(Source: Indiana State University Department of Economics)

Although unions have both advantages and disadvantages, either way, they have an impact on macroeconomic conditions. Virtually all empirical studies associate unionization with diminished profitability. Is this redistribution from profits to wages desirable? There are two polar scenarios. The first is if the unionized industry is highly concentrated or monopolistic, then the effect of a union may simply be to transfer unwarranted excess profits from owners to workers, with no negative effects on productivity. The second lies within a competitive market in which industry and profits are normal, then the reduction in profits will impair investment in capital and technological progress, and in the long run, firms will leave the industry.

The next effect to analyze is the distribution of earnings. Those who argue that unions increase inequality in the distribution of wages contend the following: The first is that unions simultaneously increase the wages of union workers and depress the wages of nonunion workers through the spillover effect. Second, they raise the wages of skilled blue-collar workers relative to unskilled blue-collar workers. Finally, unions also increase the demand for skilled labor within unionized firms. When unions force employers to pay above-equilibrium wages, the long-run response is to hire more skilled employees. This constitutes a shift in the structure of labor demand away from lower educated and toward more-skilled workers. The net result is a widening of the dispersion of wages or, in short, greater wage inequality. However, other aspects of union wage policies suggest that unionism promotes greater, not less, equality in the distribution of earnings by promoting uniform wages within firms, among firms, and by reducing the white-collar to blue-collar differential.

The final few effects are minuscule, but also extremely relevant to the macroeconomy. The first is inflation. Economists generally agree that union wage determination is NOT a basic cause of inflation. Most inflationary pressures are caused by excess aggregate demand or supply shocks. The other is unemployment; due to the downward inflexibility of wages created by unions, wage reduction cannot cushion the impact of a recession on unemployment. In addition, unionism is associated with lower turnover, which tends to reduce unemployment and, by raising wages, unions may increase unemployment by attracting additional workers into the labor force.

All in all, unions are here to stay, regardless of the negative connotation that it has gained over the past few decades. The Biden Administration is working hard to increase unionized workers and will continue to do so through the new infrastructure plan that has been announced by President Biden. Only time will tell whether these changes will have a substantial effect on the economy of the United States.