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The Role of Labor Unions in Fostering Economic Development

John Pencavel

Mandating higher wages is not a durable source of improvements in workers' living standards. Improving workers' standard of living requires growth in productivity. What is needed is a framework for collective bargaining that directs unions' efforts to the ultimate lasting source of their members' welfare: the firm they work for.

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Summary findings

In this essay on how labor unions work, Pencavel proposes a framework for the law on collective bargaining in developing countries.

The structure of developing economies cannot sustain as high a level of unionism as in industrial economies. Typically less (often much less) than a quarter of the workers in a developing country are covered by collective bargaining agreements — and those covered (the labor elite) are likely to be employed by the state and by large private sector employers.

In this setting, says Pencavel, states sometimes adopt either a *patronage* regime (nourishing unionism and collective bargaining) or an *obstructionist* regime (undermining and subverting it).

Patronage regimes are found in Bangladesh, India, and certain African and West Indian countries (many of them former British colonies), countries in which close ties exist between political parties (sometimes including the governing party), and labor unions. Some of the features of obstructionist regimes are found in certain countries in Southeast Asia and North Africa.

In both patronage and obstructionist regimes, unions are highly politicized. Because the state routinely figures in defining the union's effective environment, the union's relationship with state and political leaders becomes more important than its dealings with the employers of the workers they represent. Not only may agreements bear no relation to a firm's economic circumstances, but they increase dissonance between workers and union leaders.

What is needed instead is a system of collective bargaining that directs unions' efforts to the ultimate

lasting source of their members' welfare: the firm they work for.

Ultimately, improving workers' standard of living requires growth in productivity, argues Pencavel. Raising a worker's earnings by redistributing income from profits, dividends, and interest cannot sustain a persistent rise in earnings. And mandating or encouraging high wage policies (as in Latin America and the Caribbean) discourages the economic growth that is the ultimate durable source of improvements in workers' living standards.

Unions can help raise productivity in the workplace by participating with management in the search for better ways of organizing production. It is important for workers not to feel alienated from the system and to believe they have a stake in it. They value the fact that they or their agents help to shape the working environment.

In determining the "rules of the game" in which labor unions operate, societies have wrestled with the problem of finding the proper balance between upholding the principle of free association, on the one hand, and on granting entitlements that result in resource inefficiencies at best and ultimately in challenges to the authority of the democratic state at worst.

Governments' main responsibility in labor relations is to set up the regulations that underpin labor market interactions, including the legal framework for unions and collective bargaining. That legal framework should neither encourage nor discourage unionism, says Pencavel, but should keep the activities of unions in the domain where they can be productive: the enterprise.

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THE ROLE OF LABOR UNIONS IN FOSTERING ECONOMIC DEVELOPMENT

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I. Introduction

This is an essay about the activities of labor unions in an economy and, given those activities, the appropriate structure of the law on collective bargaining. The type of economy in mind is a developing economy such as those of Latin America, Africa, and South and East Asia. With such a wide sweep of countries, it would be remarkable if labor unions operated or should operate in these economies in just the same way. Local circumstances have an impact on the manner in which institutions work so there is real value to a detailed study of a country's institutions that recognizes the wider historical and cultural context in which they fit. Therefore, the cost of attempting a statement about the operation of unions that is designed to be so widely-applicable is that it will undoubtedly not describe accurately each and every situation.

At the same time, there is also value to generalization and to determining what statements can be made about the typical or representative situation. The difficulty is that most developing economies lack the sort of scientific studies upon which informed conclusions about the operation of unions should depend. The consequence is that a statement made today about labor unions in these economies must rely in large part on two types of information: one consists of inferences from theoretical models whose value in other circumstances has been shown to be useful; and the other consists of inferences from empirical studies of labor unions in developed economies. Of course, both of these sources of information may be unreliable.

It may be that the type of theoretical reasoning that has worked well to describe the behavior of many different types of markets in developed economies does not operate as satisfactorily for drawing inferences about labor markets in poorer economies. Or it may be that the particular findings from the study of labor markets in developed countries do not extend to developing economies. This is why it is important to emphasize that the arguments that follow in this essay rest on considerably less assured foundations than we should like. Although the statements and arguments sound confident and unambiguous, they rest on quite fragile underpinnings.

In fact, studies of labor markets in developing economies usually yield inferences remarkable consonant with our orthodox models provided these models are appropriately amended to take account of the particular circumstances of time and place.¹ Hence, although the detail and rigor of the studies may not always match those conducted on the more developed economies, there is good reason to believe that the type of reasoning applied to developed economies will apply to the developing countries, too.

* The basic arguments in this paper were first presented in a manuscript prepared in May 1979. This is a much expanded version of that paper and it has been commissioned by the World Bank. The opinions expressed are mine and not necessarily the World Bank's. This version has benefitted from comments on an earlier draft from Ben Craig, Alejandra Cox Edwards, Gary Fields, Hafez Ghanem, Paul Glewwe, David Lindauer, Julie Anderson Schaffner, and Michael Walton.

¹ See, for instance, Rosenzweig's (1988) assessment.

In this essay, I first consider some general features of labor markets in developing countries as they bear upon the issue of collective bargaining and unionism. With these features in mind, I then consider the wage effects of labor unions. I do so in the context of a three-sector model where the wages of union workers and the wages of certain nonunion workers interact with one another. The employment ramifications of these interactions are felt in part by workers in the low wage, competitive, sector. I then consider other activities of unions at the place of work and consider whether their participation in the exchange of labor services enhances or reduces productivity. The role of the union as a distributional pressure group on government is considered. Out of this argument will emerge a rough assessment of who benefits and who loses from unionism.

With a better understanding of the effects of labor unions, I move to an unabashedly normative analysis of the appropriate structure of the law with respect to collective bargaining. In other words, given the arguments in the earlier sections of the essay about the operation of labor unions in an economy, I then address how the law about collective bargaining ought to be designed. This is a topic that is well suited to the perspective of the economist although in recent years economists have shied away from making such statements.

II. Collective Bargaining in Developing Economies

One very important difference between the highly developed economies and the less developed economies is that, as a rule, the structure of the developing economies cannot sustain as high a level of unionism as the more developed economies. This is because unions are agents of employees and, in less developed economies, a larger fraction of workers are not employees but are self-employed and unpaid family workers. Moreover, given the costs of organizing workers in geographically-dispersed rural areas, the locus of unionism is in urban areas and, within urban areas, in what is sometimes called the "formal" sector, the prototype being large, conspicuous, enterprises. The consequence is that the fraction of the economy's labor force that is potentially unionizable in less developed countries is smaller than in highly urbanized, more highly developed, economies. Indeed, the fraction of workers in developing economies covered by collective bargaining agreements is typically less than one-quarter, often substantially less than this.² The workers represented by collective bargaining are more likely to be those employed by the state and large private-sector employers, sometimes described as among the elite of the economically active population.

In this setting, states have adopted different postures with respect to unionism and collective bargaining. It is useful to distinguish two types of posture: there is the Patronage regime where the state nourishes unionism and collective bargaining and there is the Obstructionist regime where the state undermines and subverts unionism and collective bargaining.

In Patronage regimes, collective bargaining is explicitly endorsed as a proper system for organizing labor markets and the state facilitates the new unionization of enterprises. The activities of unions are supported by measures that restrict the discretionary behavior of employers of nonunion and union labor alike. Examples of such regimes are provided by India, Bangladesh, and certain

² For instance, Joshi and Little (1994) estimate the formal sector of India's economy as constituting about 9 percent of total employment and they estimate unionism as representing between one-fifth and one-third of all formal sector employment. About twenty percent of manufacturing employment is estimated to be in the formal sector with unionism covering between 30 percent and 45 percent of such formal sector manufacturing. As a percentage of the nonagricultural labor force (note the different base), Frenkel (1993) estimates union densities at 17 in Singapore, 19 in Hong Kong, 33 in Taiwan, 24 in South Korea, 14 in Malaysia, and 6 in Thailand.

African and West Indian countries (many of them former British colonies). Firms are often required to pay substantial severance pay to workers laid off from their jobs, there are mandatory employer-financed fringe benefits, and firms may not close their plants without government permission.³ As the visible manifestation of an import-substitution policy, the unionized firms often enjoy substantial protection from foreign competition. In these countries, close ties exist between political parties (sometimes including the governing party) and labor unions.

By contrast, Obstructionist regimes strictly regulate if not suppress collective bargaining. Each union must obtain the sanction of the state to operate as a collective bargaining agent, the organization of large sectors of the economy is prohibited, the content of collective bargaining agreements is restricted, and strikes are often illegal. In some cases, union members and leaders are routinely intimidated by the "security forces". Some of these features are found in certain countries in South-East Asia and North Africa.

Some countries exhibit a mixture of these two types of regimes. In much of Latin America, employer-financed severance payments and fringe benefits are mandatory and alliances between unions and political parties are common. At the same time, the state may intervene heavily in union affairs and in the collective bargaining process.⁴ In Brazil, for instance, the executive branch of government not only determines whether a union may represent a group of workers, it also fixes its dues and its allocation of expenditures. Union representation requires the sanction of the Ministry of Labor and, until 1988, the state had the power to seize union funds whenever the public good was served by that action, the Minister of Labor being the individual making the determination. The state determined eligibility to union positions, a substantial power in an economy where many labor grievances and disputes were handled by an elaborate system of labor courts on which state-sanctioned union representatives were guaranteed a position. The result was a system whereby the union leaders were often dependent more on the favor of the ruling political party than on the support of the workers whom they were supposed to represent. Until the 1988 Constitution, the right to strike was severely restricted and yet, in many years, Brazil experienced frequent strikes, a consequence in part of the fact that workers' participation in strikes was subsidized; that is, when part of a union's original strike demands had been met, employers were obliged to pay employees for the workdays lost through strikes.⁵

Both Patronage and Obstructionist regimes share the unfortunate feature that unions are highly politicized. To the unions, it appears as if the discretionary activities of local or national political leaders assume much greater importance than the economic realities at the workplace. Because the state figures routinely in defining the effective environment of unions, their relation with the state and political leaders becomes more important than their dealings with the employers of the workers they represent. Resolving questions with politicians tends naturally to remove these issues from the particular context and circumstances of a single firm with the result that not only may ultimate agreements bear little relation to the economic circumstances of each firm, but it increases the dissonance between the rank-and-file union members and the union leaders. Indeed, the union

³ In India, companies get around the law by paying workers enough money to induce them to leave voluntarily in which case government permission to close down a plant is not needed. Although there has been talk of changing the law, labor unions oppose change out of fear that mass closures would result.

⁴ See Edwards (1992).

⁵ On Brazil's labor laws and industrial disputes, see Amadeo and Camargo (1993) and Sandoval (1993).

movement is often the route to political power: many leading politicians in developing countries embarked on their career by gaining influence within the union movement.⁶ Labor unions and their leaders are apt to exert disproportionate influence on economic policy in developing countries because (along with the military) "...they are among the few interest-group power centers that have organizational structure, leadership, and a more or less clear idea of objectives" (Essenberg, 1981, p.94).

When the links between the political process and unionism are so strong, the conditions are ripe for what has been called the macroeconomics of populism, the attempt to use macroeconomic policy tools to engineer a redistribution of income. The political system is seen as the agent for delivering economic outcomes so that it is natural for union leaders to believe that, if only political power can be captured, then macroeconomic policy can be steered to deliver higher incomes for wage-earners. The experience of populism has been appalling for wage-earners; short-term real wage gains end up as drastic real wage losses.⁷ Though a highly politicized collective bargaining system is neither a necessary nor a sufficient condition for the macroeconomics of populism, the risks of macroeconomic instability are greater in a system where workers see the source of their welfare emanating from the political system. What is needed is a system of collective bargaining that directs the efforts of unions to the ultimate lasting source of their members' welfare, namely, the producing unit with which they are associated.

In Section VI of this essay, to deal with the politicized nature of unionism, I shall propose an alternative framework for collective bargaining in these economies. Before this, I describe the activities of unions starting with their wage-making activities.

III. The Wage-Making Activities of Unions

The Two-Sector Model of Unionism

A primary concern of labor unions is to raise the wages of the workers they represent. Analytically, because they act as wage-makers rather than wage-takers, this role identifies unions as monopolies⁸. If a union raises wages higher than they would otherwise be, if the union's other activities do not offset the higher costs thus imposed on the firm, and if the pay of workers in competitive firms is not raised correspondingly, the wage-making activities of the union cannot persist in the long-run unless the firm's product markets possess some monopolistic features.

⁶ For instance, in Bombay, a survey of 45 labor unions indicated that the union leaders were not drawn from the rank-and-file of the workers they represent, but were "outsiders" pursuing their personal political goals by allying with one or more labor unions. Only seven leaders spent their time on a single union; most leaders were devoting their time to between two and five unions. The survey was taken in 1958, but Essenberg (1981) claims that "the situation has not changed appreciably since the survey was taken" (p.96).

⁷ See the essays in Dornbusch and Edwards (1991).

⁸ A union is sometimes labelled a monopoly for other reasons. For instance, in the United States, once a union is certified by the National Relations Labor Board, it has an exclusive area of operation in representing workers in the specified bargaining unit and the employer must recognize the union as the sole bargaining agent. This sense of the union as a monopoly arises from the particular features of U.S. law and not from the economic setting.

In other words, in a competitive industry where some workers are unionized and some are not, unionized firms tend to lose business to their nonunion competitors and ultimately the unionized firms are driven from the industry. Though this sometimes takes years and other times decades to manifest itself, there are many examples of this process and it means that unions have constantly to organize new workers simply to maintain their market share. This is because, other things equal, unionized firms tend to shrink in size while their lower cost competitors expand. This Red Queen feature of unionism⁹ implies that far-sighted unions should care about the rules governing the unionization of new workers because the cheaper it is to organize new firms, the easier it is for unions to maintain their presence in an economy.

This feature of unionism's shrinking importance operates more slowly in industries where virtually all firms are unionized or where the unionized firms in the industry possess some product market power. In the latter case, by pushing up wages, the union shares monopolistic rents with the firm. Even in this case, however, the lower return on capital than would obtain in the absence of the union will tend to discourage the entry of new capital into the monopolistic industry. The feature also works less rapidly in public sector labor markets where firms may be monopolies by statute or where competitive pressures are attenuated.

This reasoning would suggest, therefore, that unions tend to be found in industries where firms have some product market power unless unions are able to offset their wage leverage with productivity-enhancing activities or unless unions use the authority of the state to confer analogous cost disadvantages on nonunionized establishments.¹⁰ And, indeed, across countries, it is in monopolistic product markets (whether the monopolies are public or private) that are most hospitable to unionism. For instance, usually, the incidence of unionism in the public sector exceeds that of the private sector¹¹ and union density tends to be lower in agriculture, financial services, and trade where competition in the product market is keen than in manufacturing and transport where firms may enjoy some product market power.

The reasoning outlined in the previous paragraphs rests on a model of the economy in which the workers in one sector are unionized and the workers in the rest of the economy are not unionized. It was once standard to make use of such a two-sector model to understand the manner in which labor unions affect resource allocation: monopolistic unions raised wages and firms reduced employment by moving back on their labor demand functions in the unionized sector and the released workers induced a reduction of wages and increased employment in the nonunion sector.¹² There are several shortcomings to this model.

⁹"Now, here, you see, it takes all the running you can do, to keep in the same place. If you want to get somewhere else, you must run at least twice as fast as that" (The Red Queen from Lewis Carroll, Through the Looking-Glass and What Alice Found There).

¹⁰ For instance, many countries have rules requiring nonunion firms to pay higher wages than they would otherwise pay. Sometimes these rules prescribe nonunion firms to pay their workers the wage that collective bargaining has established in neighboring or related firms.

¹¹ For instance, in Malaysia in 1985, private sector union density is put in the range of 7 to 10 percent while among government employees the percentage is about 43. (See Arundsothy and Littler (1993).) The OECD (1991) estimates that, averaged over eighteen developed economies, union membership in the late 1980s constituted 61 percent of public sector workers and 41 percent of private sector workers.

¹²See Rees (1963) and Johnson and Mieszkowski (1970).

First, it does not allow for any unemployment. In this model resource misallocation arises from the fact that (assumed) homogeneous factors were priced differently, but there is no misallocation resulting from some resources not being employed.

Second, the two-sector model necessarily implies that, for resources to be affected by unionism, there must be a positive union-nonunion wage differential. This is often but not always the case. There are a number of instances in which such wage differentials do not exist. For instance, this will be the case if wages determined through collective bargaining in the unionized sector are extended to nonunion workers as well. Indeed, in some economies, the pay of only a few workers are unaffected directly by collective bargains. For instance, Jimeno and Toharia (1991) estimate that at least 75 percent of employees in Spain are covered by at least one collective bargaining agreement though the fraction of employees who are members of labor unions is probably between 10-15 percent (ILO Mission (1985)).

Even without such automatic extension to the nonunion sector of wages negotiated by labor unions, the pay of union workers may not differ from the pay of nonunion workers who are otherwise similar. Thus consider Schaffner's (1993) sophisticated analysis of wage differentials among urban male Peruvian workers in 1985. She finds that unionized workers tend to be paid more than nonunion workers, but this is principally because union workers are employed in larger establishments and there exist substantial wage differences by size of establishment. Once wage differences across size of establishment are taken into account, the take-home pay of union and that of nonunion workers differs trivially.¹³ In other words, among workers with approximately the same skill and employed in similar types of firms (here measured by the size of the plants), there are very small union-nonunion wage differentials.

This result is not unusual. Kim (1993) reports union-nonunion wage differentials among South Korean production workers of 2.2 percent for men and 2.8 percent for women in 1988 after controlling for skill differences among workers and their place of employment.¹⁴ Analogously, in his analysis of earnings differentials among urban Malaysian workers in 1975, Mazumdar (1981) states that, once differences in schooling, experience, establishment size, and other characteristics are taken into account, "the unionization variables generally turned out to be of little importance" (p. 160).¹⁵

Usually the explanation for the absence of a positive union-nonunion wage differential is that wage increases secured by unionized workers spill over to raise the wages of certain non-union workers and this suggests that a simple division between a unionized sector and a nonunionized sector is not a fruitful perspective on labor markets. A more useful characterization is one that distinguishes

¹³ The regression equations are fitted to a sample of about 1,100 male workers and the equations also include variables measuring a worker's labor market experience, his schooling, whether he works in Lima, and whether he is the head of his household.

¹⁴ Without controlling for these other factors, the union-nonunion wage differentials were 30 percent for male and 8 percent for female production workers.

¹⁵ There is a great variety of experiences and I do not mean to suggest that union-nonunion wage differentials in developing economies are always non-existent. Far from it. For instance, Teal (1994) measures union-nonunion earnings differentials in Ghanaian manufacturing industry in 1992-93 of the order of thirty percent. My point is simply that the absence of union-nonunion wage differentials should not be interpreted as meaning that labor unions have not had an impact on earnings.

at least three sectors, only one of which is unionized. In addition to the unionized sector, there is another relatively high wage sector that is influenced by wage-setting practices in the unionized sector. I shall label this high wage, nonunion sector, the administered wage sector.

Firms in the administered wage sector may be required by law to pay union-negotiated (or close to union-negotiated) wages or the firms may choose to pay higher wages to discourage the unionization of their work forces. Or, to reduce turnover, firms in the administered wage sector may select wages closely related to those in the union sector. For all these reasons, the wages in the unionized sector and the administered wage sector are closely related.

There is a third, non-unionized, low wage sector - the competitive wage sector - that absorbs workers who cannot obtain employment in the two high wage sectors though, if an effective minimum wage binds employment in this third sector, unemployment will result. A sketch of this three sector model follows.¹⁶

The Union Sector

In this sector, wages (and perhaps other variables) are determined by bargaining. To describe the determination of wages, we need to specify the objectives of the parties to the bargain and the manner in which the parties' conflicting objectives are reconciled and an acceptable contract negotiated.

For the union, its objectives are normally taken to include not only the level of wages and employment in the bargaining unit represented by the union, but also the wages received by some comparison set of workers. Denote the union wage by W^u and the comparison wage by W^a . The notion here is that the workers' perception of the degree to which their wage goals are realized is indicated by comparing W^u with some alternative wage which we take here to be W^a . In this specification, therefore, relative economic status affects the union workers' welfare perhaps because the union rank-and-file use their relative wage position as a way of gauging their leadership's performance.¹⁷ For the purposes of the three sector model here, W^a is the wage in the administered wage sector.

The management's objectives are profits. This would not be appropriate in the public sector although, provided the public sector's managers cannot run deficits indefinitely, the same sort of considerations will operate on the public sector's managers as on those in the private sector.

With the objectives thus specified, the parties bargain about the values of the relevant variables.¹⁸ We shall assume a recursive contract according to which wages are first determined

¹⁶ It is expressed more fully in Pencavel (1991).

¹⁷ It is customary, for example, for one set of union workers to evaluate their wage goals in terms of what another group of (union or nonunion) workers are currently being paid or what wage increases they have recently obtained.

¹⁸ The first issue is to specify which variables are subject to negotiation. It is almost universal for wages to belong to the bargaining set, but the role of employment differs from one situation to another. In some contexts, an explicit level of employment may be negotiated. More common, the contract may specify employment indirectly as when minimum crew sizes or machine-labor ratios are stipulated. Or the contract may leave employment to be determined by management although in so doing the contract requires management to follow

through negotiation and then employment is set by management. This may be expressed by writing the wage determination equation as $W^u = u(W^a, X_1)$ where X_1 denotes variables that affect management's profit but over which they have no control (such as the prices of nonlabor inputs and product market variables such as consumers' incomes).

This wage equation suggests that the wage negotiated by management and the union will depend, among other things, upon the comparison wage, W^a : because an increase in W^a is assumed to reduce the union's welfare, u should have the property that an increase in W^a induces a higher value of W^u . That is, an increase in W^a makes the union more intransigent in the wage bargain so that a higher W^u is negotiated as the union attempts to restore its welfare.

A number of close observers of industrial relations have documented this relationship between unionized wages and wages in another sector. This other sector may be another unionized labor market or, as in the case of the model here, a nonunion market. In practice, unlike the "timeless" model here, the response of W^u to changes in W^a usually takes place over time or the dependence of W^u on W^a may have a forward-looking element so that it is expected values of W^a (expected, that is, during the lifetime of the union contract) that is relevant.

The Administered-Wage Sector

The critical feature of the administered-wage sector for our purposes is that the wage paid to workers in this sector, W^a , depends positively on the wage paid in the unionized sector, W^u . There are several reasons for this. All rest on the notion that a firm's profit-maximizing wage policies in this sector are aimed at occupying and preserving a particular location in the interfirm distribution of wages. Many firms undertake regular wage surveys and try to maintain a given position in the wage distribution. Relative wages matter to a firm because of the effects of relative wages on turnover, on work effort, and on discouraging unionization.

An increase in a firm's wages reduces labor turnover and, therefore, the costs of hiring and training new workers. Also, an increase in a firm's wages increases the efficiency of the firm's labor input by increasing the quality of workers and by improving morale. In this way, a firm's wages appear not only in a firm's costs, but also as an item that affects the firm's revenues through impacts on its input of effective labor.

Further, an increase in a firm's wages reduces the likelihood of its work force becoming unionized. A non-union employer who dislikes having to deal with a labor union would be willing to pay something to deter his work force from being organized: Among the deterrents is to reduce the returns to becoming unionized by reducing the wage differential between current wages and the wages that would be negotiated in a unionized setting; other things equal, a firm is more likely to be the target of unionization, the greater the difference between its current wages and the wages it

certain procedures with respect to laying off workers or hiring them. These procedures may include the payment of severance pay to those laid off or the expenditure of training costs for those hired. In this case, again the union's influence on employment is indirect. Or the contract may be completely silent about employment and tacitly this means it is determined exclusively by management. In this last instance, the contract has a recursive structure: wages are first negotiated through bargaining and then management unilaterally determine employment according to their employment demand function. Of course, what operates in one contract may be quite different from another contract. Fortunately, for the qualitative features of our model here, it is not of primary importance whether employment is the subject of joint negotiation or not.

would pay if its work force were covered by a collective bargaining agreement. Increasing wages is a standard device used by non-union employers to discourage the organization of its work force.¹⁹

Therefore, we may write $W^a = a(W^u, X_2)$: wages in the administered-wage sector, W^a , depend positively upon wages in the unionized sector, W^u , and upon X_2 , other exogenous variables from the firm's profit function including determinants of the threat of unionization over which the nonunion employer has no control. Although the wage W^a responds to conventional forces affecting the supply of and demand for labor (these are summarized in X_2), it does not equate the demand for and supply of labor in a manner described by a textbook, auction, market. In the administered-wage sector, a firm is not a wage-taker, but a wage-maker. Increases in the union wage, W^u , are likely to induce increases in the administered wage, W^a , and in this sense the wage increases engineered by the unions are spilling over and increasing the wages of certain nonunion workers.

The type of markets where such behavior is likely to be found are those for skilled workers and especially specifically skilled workers whose skills are of value to a single firm. Here a situation of bilateral monopoly obtains even in the absence of labor unions. The specific skills embodied in workers create an asset that is of greater value to one firm than to all other firms. The wage paid to a worker with specific skills will be no less than the value of the worker's general skills (i.e., what this worker is worth in his next best job) and no more than it would cost an employer to hire and train a replacement. It is the turnover of specifically trained workers that impose particular costs on the firm. Also it is specifically trained workers whose association with the firm is likely to be of long duration and, therefore, to whom an investment in unionism is likely to be particularly attractive. Hence, it is firms employing workers with specific skills that are likely to be in the administered-wage sector and that are likely to be concerned with relative wages.

Other types of firms in the administered wage sector are foreign multinationals who are sensitive to being characterized by their shareholders or by local politicians as "exploiting" their workers. The firms are likely to have monopolistic power and are using some of their monopoly profits to enjoy a "quiet" life.²⁰ Large firms with government contracts or who lobby the government are likely to be in the administered wage sector as are public sector workers (such as police officers, fire fighters, nurses, and government employees) where explicit rules about the comparability of their pay may link their wages directly to those of unionized workers. Governments sometimes want to provide an example of how employers ought to behave and as a consequence set public sector wages and working conditions that compare favorably with what the most successful of unionized employees have negotiated.

The Competitive Wage Sector

There are labor markets that are neither unionized nor characterized by the administered wage setting described in the previous section. In these markets, the workers either possess few skills or what skills they have are general. This means that turnover is typically high, but

¹⁹ Nonunionized employers may imitate not only the wages of unionized workers, but also other features of the employment contract. For instance, in Malaysian manufacturing industry, Mazumdar (1993) reports that nonunion employers typically fix wages for the two or three or four years that characterizes the contract length of unionized workers and that nonunion firms adjust wages automatically with seniority in just the way that union contracts stipulate.

²⁰ "The best of all monopoly profits is a quiet life" (Hicks, 1935).

because the workers who leave have few skills or have easily replaceable skills (so the firm does not have to undertake expensive in-house training) turnover is not as costly to the firm and administered wage policies to discourage turnover are not required. The threat of unionization is small. As a first approximation, these markets resemble textbook auction-type labor markets.

The workers may be predominantly low skill and, in view of their little specific training, shocks to the demand for output are transmitted to the labor market through variations in their employment and wages. These labor markets are typically found in agriculture and many urban services. Employment is often irregular and volatile. Wage increases engineered by unions in the union sector are imitated by wage increases in the administered wage sector, but employment in these sectors is discouraged. Some of the workers who would otherwise work in the high wage sectors seek employment in the competitive wage sector and this puts downward pressure on wages in the competitive wage sector. If minimum wage regulation acts as an effective floor on wages in the competitive wage sector (something requiring not merely the existence of the law but also its enforcement), then unemployment may be evident. If a worker cannot or chooses not to be fully employed in the competitive sector and at the same time seek and be available for work in the union and administered wage sectors, then "wait" unemployment may arise as workers find it profitable to wait for job openings rather than be employed at lower wages in the competitive wage sector.²¹

Summary

According to this analysis, therefore, unions raise wages of their members and also raise the wages of some other high-wage workers. This has a very important implication: the wage gains of unions (over what would have existed in the absence of unionism) are not equivalent to the wage gap between unionized and nonunionized workers.²² The impact of unionism on the wage structure is not measured by the wage differential between union and nonunion workers. Employment in the union and administered-wage sectors falls below what it would otherwise be. This lower employment manifests itself in lower wages in the competitive wage sector or in unemployment or in both. The benefits of unionism are thus extended to some other high wage workers, but they are enjoyed at the cost of lower wages and lower employment among unskilled workers. The implications of this model of the wage-setting activities of unions for the appropriate posture of the law with respect to collective bargaining is postponed to Section VI. We consider now other activities of unions at the workplace.

²¹ Consider Sri Lanka's unemployment as an example of this. According to Glewwe's (1985) analysis of urban labor markets in Sri Lanka in the 1970s, ".....unemployment is primarily a characteristic of young, relatively well-educated, unmarried adults with no previous work experience who can rely on the [income] support of other household members.....[T]hese young people are searching for jobs that are commensurate with their educational background.....and it appears that they are searching for the better paying jobs, which are primarily government jobs". Glewwe estimates that urban males earn at least 45 percent higher wages if employed by the government (holding constant their age, schooling, ethnic background, marital status, and certain household characteristics). Because it is the relatively well-off who are experiencing unemployment, Myrdal (1968) characterized it as a "bourgeois problem".

²² On the distinction between wage gains and wage gaps, see Lewis (1986), Chapter 2.

IV. Unions as Participatory Institutions

The wage-making activities of unions discussed in the previous section concern the price at which labor is transacted, but what is to be exchanged? What services are to be undertaken by workers, what are the workers supposed to do, and what constitutes the employer's part of the bargain?

Although there are many instances where workers are paid in part if not entirely on the basis of what they produce (i.e., piece-rates or payment-by-results), usually an employer purchases a worker's time. What a worker is to do during this time is rarely specified with any precision. In this sense labor contracts are routinely incomplete so much so that chaos results when workers "work to rule" (i.e., work to the specific terms of their contracts). Similarly management's part of the bargain is normally unspecified in full. Even if it were possible to provide a lengthy statement of what services workers are to supply and what management are to do in return, a substantial margin would remain for disputing whether the contract had been violated.

In such circumstances, because the nature of the transaction - what work is to be done, how it is to be done, and the precise meaning of the terms and conditions of work - is often so difficult to determine prior to exchange, labor services have "experience characteristics". That is, only by actually working on a job for a while can a worker learn what is required of him and can management assess the quality of work performed. When a satisfactory match has been made, subsequent contracting is facilitated and the cost of transacting falls with the duration of employment so long-term contracts develop. In this way, the contract becomes singular: the worker's current job involves the use of skills that are specific to this job and this makes his earnings in this job greater than those he could earn in his next best opportunity; for its part, management determines a new employee to be an imperfect substitute for an existing employee. The labor contract becomes defined by previous practice so that understandings that arise out of convention replace what for other contracts would be the specifications of a written agreement.

The role of a labor union in this context differs in various circumstances. In most cases, the union tries to make the labor contract more explicit and it does so by engaging in the process of spelling out what the exchange of labor services is to consist of. For example, even oral collective bargaining agreements in relatively poor economies specify the employees' hours of work and the frequency of wage payment and, as economies grow richer, so the content of collective bargaining agreements embrace more issues such as the procedures an employer will follow to change employment, the assignment of workers to particular tasks, and the conditions under which employees will be dismissed. In other words, in these instances, a labor union is participating with management in determining what labor services are to be exchanged and under what conditions.

By involving workers or their agents in explicitly determining their labor contract, industrial relations scholars have sometimes conjectured there may be efficiency gains from participation. As Slichter wrote: "The very fact that the workers have had an opportunity to participate in determining their working conditions is in itself favorable to efficiency.... [E]fficiency depends upon consent. Even though the specific rules and policies adopted in particular instances may not be ideal, the process of joint determination of working conditions at least offers the possibility of achieving greater efficiency than could be obtained under rules and conditions dictated by one side" (Slichter (1941, p.575)).

For instance, in many jobs the worker may be better informed about the potential for productivity improvements within his department than his supervisor. The worker will be more willing to provide that information if he is confident that any change in organization will benefit him. The presence of an agent of the worker, that is, the union, may make the worker less suspicious that the information he reveals will benefit only management. There is evidence that participation by workers in a firm's decision-making sometimes raises productivity and, if the union involves the workers in efficiency-enhancing activities, then unionism is associated with a more productive organization.

Another perspective of this arises from the recognition that working conditions in some enterprises have the character of public goods in that their consumption by one worker does not reduce their consumption by another worker. The pace at which an assembly line moves is an obvious illustration: each employee's work effort adjusts to the rate at which the assembly line moves and the pace of work is "consumed" in equal amounts by all employees. Job safety is another work characteristic with public goods aspects. Workers will select their work pace and safety by job shopping, but in the presence of costly mobility there is the potential for savings in transaction costs if an agent of the workers, i.e., a union, can efficiently communicate workers' preferences. In this sense, labor unions tend to arise as an instrument to help determine the optimal production of working conditions.²³

There are also arguments to suggest that unionism harms productivity. For instance, a union may protect indolent or careless workers from disciplinary action. Or a union may increase the costs of technological change (and especially labor-saving technological change) and thereby retard an organization's development. Or a union may successfully negotiate capital-labor ratios that oblige the firm to use more workers per machine than relative input prices would call for.

The point here is neither to argue that unions necessarily harm or enhance productivity - this will vary in different circumstances and calls for empirical investigation - but simply to point out that unionism usually alters the nature of the employment relationship. Collective bargaining allows workers to participate in determining features of their work and their work environment and these may have implications for their productivity.

V. Unions as a Pressure Group on Government

Although the union's proximate concern is with the representation of its members at their place of work, it is common for unions to act in concert and act as a pressure group on government. This is natural as many of the factors that affect their members' welfare are determined by the legislative, executive, and judicial acts of government so, as the agent of their members, they concern themselves with activities beyond the workplace.

The form that this pressure takes depends upon the nature of the existing government. Thus, over the past decade or so, unions in Poland and South Africa, for instance, have been in the forefront among organizations in these countries pushing illiberal regimes toward more representative and civil government. In open societies (that is, those characterized by representative government and a respect and support for individual freedoms), labor unions are often among the most active of organizations pressing their interests upon governments. In countries such as Argentina, Singapore, Venezuela, and Mexico, links between the government and labor unions have been strong and the

²³ See Duncan and Stafford (1980).

unions have constituted a prominent pressure group.²⁴ These pressure group activities take the form of endeavoring to secure changes in the legal system and in government policy that advance the position of unions as organizations. These cover not only immediate issues regarding the formation of labor unions and the conduct of collective bargaining, but also questions such as the pay of nonunion workers, the private ownership and regulation of industry, international trade in goods and services, and macroeconomic policy.

As a generalization, most labor unions have supported government policies that have frustrated the unimpeded working of markets. These have involved not only supporting minimum wage regulations and working against free trade in international transactions, but also advocating greater government regulation, even state ownership, of industry. In macroeconomic policy, unions have tended to support a goal of minimizing unemployment and have been tolerant of inflation. Indeed, in Latin America especially, whenever union-negotiated wage settlements tend to result in increased unemployment, unions have often encouraged government to apply expansionary policies to curtail the rise in unemployment.

The success of labor unions varies from society to society naturally, but it is routine for unions to characterize their activities as those designed to enhance the welfare of workers in general and to portray those whose incomes are classified as profits, rents, interest, and dividends as the opponents of their efforts. It is often a successful characterization as union agents are habitually called upon by government to serve on commissions and councils as representatives of the interests of all workers.

No doubt, there are circumstances when the activities of unions in this regard do have the effect of raising the welfare of many workers. However, there are other occasions when the pressure group activities of unions on government enhance the welfare of union workers but damage the welfare of nonunionized workers. In these instances, the conflict is not between people receiving their incomes in the form of wages and people receiving their income in the form of profits or dividends; the conflict is among wage-earners.

For instance, unions customarily support measures that impede the flow of goods and services across economies. They are not well-known as advocates of free trade. Impediments to free trade benefit those people (wage-earners as well as dividend and profit recipients) whose incomes derive from the production and sale of those goods whose consumption increases as a consequence of tariffs or quotas and harms those people whose incomes derive from the production and sale of those goods whose consumption decreases. In other words, the classification of winners and losers from tariffs and other protectionist measures does not typically divide neatly into workers and owners of physical capital nor into people in one country and people in another country; rather workers and owners of physical capital figure on both sides of the balance sheet as do foreigners and natives.

An illustration of the communality of employees' and employers' interests in capturing the power of the state over international trade is illustrated by Paul Schultz' (1982) study of male income differentials in Colombia in 1970. After accounting for differences among men in their labor market experience and schooling, he finds workers' incomes are significantly higher in those industries effectively protected from foreign imports. The elasticity of incomes with respect to protection is

²⁴ There is a great variety of forms of influence across countries. Thus, in some of these countries, the unions may constitute an element of a larger political coalition while in others they form an independent pressure group regardless of the party in power. See Nelson (1994).

about 0.34 in manufacturing industry and even larger if all industries are examined. The quasi-rents earned in protected sectors benefitted both employees and employers in these sectors at the expense of other sectors of the economy, the gains of employers exceeding those of employees.²⁵ He concludes, "...the structure of effective protection in Colombia in 1970 increased the inequality in personal income distribution, induced a misallocation in factors of production among sectors, and stimulated rent-seeking activity that is commonly associated with a deadweight loss to the society" (p. 110).

Although there may well be particular instances in which a union raises the pay of its members by diverting income to workers that would otherwise be paid out in the form of profits or dividends, this cannot be the typical situation. Consider a particular economy and the opportunities for the transfer of incomes. Take Colombia as an example. Suppose all property and entrepreneurial income earned in 1985 in Colombia were appropriated and distributed among all wage-earners without any attempt to compensate people such as the retired whose consumption derives largely from such income. This radical action would have raised the average earnings of workers by 15 percent and this would have been a once-and-for-all bonus. As another example, the same operation for Peru in 1980 yields a wage increase of a little less than 11 percent.²⁶ In other words, the combination of a large number of workers and a relatively small fraction of national income in the form of profits, dividends, and interest implies that collective bargaining is less of a struggle between labor and capital for the division of national income and more of a competition among different groups of workers and between workers as a whole and the population receiving income in the form of transfers through the state.²⁷

Even if unions were able to effect a significant shift in the distribution of income away from entrepreneurial income and toward wage income, there is the question of the impact of this redistribution on economic growth. There is little convincing empirical research on this issue so speculation must take the place of a solid body of evidence. But the natural conjecture suggested by writing on rent-seeking activities is that gains achieved by a distributional coalition such as a labor union discourage the allocation of resources to additional output.

There are at least two reasons for this. The first arises from the fact that economic growth does not usually proceed uniformly across all sectors of the economy. Typically sectoral differences in productivity growth will call for changes in relative prices and this will entail alterations

²⁵ This point is important because it has sometimes been argued that the activities of labor unions as a pressure group on government should be encouraged so that they offset the pressure of employers. The flaw in this argument is that often the interests of labor unions and their employers coincide. The example of protection from foreign trade is a case in point. The suitable posture would seem to call for discouraging the pressure group activities of all parties.

²⁶ The years 1985 for Colombia and 1980 for Peru were selected simply because I was able to locate estimates of the number of wage-earners for those years. In these calculations, I exclude the self-employed from the transfers and do not consider expropriating the profits of unincorporated businesses which includes the income of the self-employed. In other words, the operation involves transferring income from the major enterprises to employees leaving the self-employed neither losers nor gainers.

²⁷ One does not have to rely on these speculative numbers in this paragraph to make the point. There are episodes of populist government policies that illustrate the limits of aggressive redistributive policies. For instance, in Chile, in his first year of government, Salvador Allende's redistributive policies succeeded in raising real wages by 17 percent and the share of labor income in GNP rose from 52.3 percent in 1970 to 61.7 percent in 1971. The following year, 1972, real wages fell by 10 percent and fell again in 1973 by 32.1 percent. For other examples, see Sachs (1990).

in expenditures on the output of the sectors. Hence resources need to be reallocated to maintain efficiency if the economy is to exploit fully the increase in productivity. If there are impediments to resource mobility across sectors, economic growth will be impaired. Labor unions typically frustrate resource mobility: they do so first by raising wages which tends to discourage the employment of labor in covered employments; they also do so by lobbying government for support on behalf of those sectors whose output has suffered from reductions in demand.

Labor unions may also harm economic growth insofar as the resources they garner are at the expense of entrepreneurial income. This reduces the rate of return on physical capital investment in these industries, discouraging investment, and retarding economic growth. In other words, current gains achieved by distributional coalitions such as labor unions are appropriated in part at the expense of the next generation.

In short, in closed societies, labor unions have sometimes been a progressive force toward more liberal and representative government. In open societies, labor unions constitute a pressure group on government that, through impediments to market processes, tend to increase the incomes of unionized workers at the expense primarily of nonunion workers, consumers, and future generations.

VI. The Legal Framework of Collective Bargaining

The purpose of this Section is to draw upon the review of labor union activities above to sketch the appropriate legal framework for dealing with unionism and collective bargaining. Throughout I assume as desirable a representative government and respect for individual freedoms, in short, an open society, and ask how such societies should define the rights and responsibilities of unions and collective bargaining.

The Dilemma

Along with other associations of men and women, labor unions raise a dilemma for an open society: on the one hand, the principle of freedom to form associations and clubs is an integral element in a liberal society; but, on the other hand, if in the name of this principle such associations secure too many privileges, a new source of coercive power is created with the accompanying risk of the abuse of that power. Dicey (1914, pp. 467-7) provides a classic statement of this dilemma:

"....some forms of association force upon public attention the practical difficulty of so regulating the right of association that its exercise may neither trench upon each citizen's individual freedom nor shake the supreme authority of the State....How can the right of combined action be curtailed without depriving individual liberty of half its value; how can it be left unrestricted without destroying either the liberty of individual citizens, or the power of government?"

In determining the "rules of the game" within which labor unions operate, societies have wrestled with the problem of finding the proper balance between, on the one hand, upholding the principle of free associations and, on the other hand, granting entitlements that result in resource inefficiencies at best and ultimately in challenges to the authority of the democratic state at worst. It is toward finding that balance that the arguments in this section are directed.

According to the reasoning provided in previous sections, the wage gains of labor unions may well be extended to some non-union workers. However, these tend to be workers who are

already paid relatively high wages. For example, in those countries where public sector workers are not unionized, their wages are often tied to those of unionized workers so wage increases of teachers, police officers, fire fighters, and hospital workers often imitate those negotiated by union workers. By contrast, low wage workers tend not to be unionized and their wages do not rise when union workers secure wage increases. For instance, in many developing countries, many workers in urban areas are employed in small enterprises and there are large wage differentials by size of firm and size of plant²⁸; the workers employed in small enterprises are much less likely to be unionized and their wages are not tied to the wages of unionized workers in the large establishments.

In their enterprise participatory activities, unions have the potential for being either socially productive or unproductive organizations. On the one hand, there are clear instances in which unions interfere with the use of the most productive methods, sustain defective or careless work, and increase the costs of responding to changes emanating from product markets and production technology. A labor union tends to represent more fully the interests of workers currently employed in a firm and is less inclined to enhance the interests of those people currently unemployed and seeking work in that firm. Labor unions have devised many ways of making it more difficult for firms to lay off workers, but they have spent much less energy and thought to facilitate the hiring of new workers.

On the other hand, by involving individuals in determining the shape of their work environment, the union may help in making workers identify more fully with the success of the enterprise. By acting as an agent for the workers' interests and concerns and shaping the working environment accordingly, the union may make the enterprise not merely more pleasant, but also more productive. Moreover, it is likely to be less costly and more effective for complaints about arbitrary and capricious treatment against individual employees to be dealt with at the plant than through the law courts or through market processes and the presence of a labor union makes the effective representation of workers' grievances much more meaningful than workers' committees that are the creation of the employer. Furthermore, some labor unions operate as classical friendly societies providing financial support to their members to cover contingencies as unemployment, illness, and retirement.

Finally, in their activities as a pressure group on government, labor unions are a classic distributional coalition acting to increase their wealth at the expense of the wealth of those poorly organized. Their activities in this regard usually take the form of hampering market processes and introducing resource inefficiencies especially by retarding economic growth. It is sometimes argued that the pressure group activities of unions are desired to offset the pressure group activities of employers. This presumes that the interests of employers are opposed to the interests of unions. In fact, as Paul Schultz' analysis of incomes in Colombia indicated in the previous Section, employers and employees may have common interests in increasing rents to their firms and industries before dividing these rents between each other. The appropriate stance calls for inhibiting the pressure group activities of both employers and unions.

In short, this evaluation suggests that unionism may yield benefits at the level of the enterprise, but that its wage activities at the microeconomic level and its pressure group activities on government produce resource inefficiencies that should be mitigated. This assessment would call for a legal framework that neither encouraged unionism nor discouraged it, but which contained the

²⁸ See, for instance, Mazumdar (1989) and Schaffner (1993).

activities of unions to the domain where it has the potential as a productive force, namely, the enterprise.²⁹

Enterprise-Level Collective Bargaining

If collective bargaining takes place at the enterprise or plant level, the ability of the union to effect monopoly wage increases is tempered (because the competitive pressures on the firm from the product market are greatest) and yet the potential exists for the union to act as a participatory organization for the workers. Of course, even with collective bargaining limited to the enterprise, the discipline on monopolistic wage behavior is diminished if product markets are not competitive and if the nonunion labor market is uncompetitive. That is, if the state so encumbers the nonunion labor market with wage constraints (such as implied by incomes policies or minimum wage statutes), restrictions on the hiring and firing of workers, and regulations on employment practices that its flexibility is substantially diminished, then it will operate much less effectively as a constraint on monopolistic wage practices in the unionized sector of the labor market. The appropriate posture with respect to the law on collective bargaining, therefore, calls for policies that foster competitive and flexible nonunion labor markets.

Not only does a competitive nonunion labor market discipline the monopolistic wage practices of unionism, but the corollary also applies: the more regulated and non-competitive the nonunion labor market, the more inclined will an authoritarian government be to contain union activity by engaging in explicitly coercive anti-union activities. Other things equal, governments are more likely to adopt coercive policies with unions (such as arresting union leaders and violently suppressing strikes) when the operation of nonunion labor markets has been restricted such that these markets are not constituting an effective check on the activities of agents in the union sector.³⁰

If collective bargaining takes place at the level of the enterprise, its content may be determined by the parties themselves and there is no need for legislation to prescribe what the parties may or may not contract over. If management are willing to make agreements with the union concerning capital-labor ratios, entry into apprenticeship programs, and the conditions under which temporary workers are hired, then the law should not forbid it. The fact is that, in a competitive product market, the costs of these agreements will fall in large part upon the firm and union and this fact will deter such agreements.

Similarly, there is no need for the law to prescribe one and only one union per enterprise. Although there may well be instances in which, by virtue of the production technology, a small group of workers possesses considerable bargaining power (i.e., the amount of specific capital in

²⁹By enterprise, I mean the plant or group of plants under a single ownership. The proposition that collective bargaining be limited to enterprises has a long history. One statement of it is in Lewis (1951).

³⁰ Of course, there are many other factors affecting the disposition of governments to adopt coercive anti-union activities so the "other things equal" condition in this statement is rarely satisfied. However, many authoritarian military governments (certainly not all) in Latin America that have pursued aggressive anti-union policies have also adopted labor market policies which, in practice, place constraints on the flexibility of both union and non-union labor markets. For instance, the military coup in Brazil in 1964 brought to power a regime that actively persecuted the unions and also introduced extensive wage regulations embracing the labor markets of the entire formal sector. Indeed, as a rule, the military governments of Latin America have combined an anti-union posture with heavy-handed intervention in the operation of all labor markets.

these workers is such that there is a wide range of wages compatible with equilibrium), this does not create a sufficient reason to mandate that all workers must join together in a single union for collective bargaining. These instances are unlikely to be sufficiently frequent to warrant ignoring workers' preferences for separate associations. If management should have strong preferences for a single union to minimize bargaining costs, then it is up to management to provide sufficient incentives for the unions to join together in one organization for the purposes of collective bargaining. Moreover, facilitating the formation of other unions provides a check on the likelihood of an established union being managed to serve the interests of a small oligarchy. In countries that are moving from authoritarian governments toward more open systems, the inherited labor unions are often those that were created by the *ancien régime* to help control the society. A policy of facilitating the formation of new enterprise unions dispenses with the need to identify those old unions that do not serve the interests of their members and to dismantle those.

There is a concern that a policy permitting the formation of more than one union per enterprise will lead to disputes and rivalry among unions. This is, indeed, a possibility and the question is whether that rivalry will or will not serve the workers' interests. The claim that it will not serve the workers' interests offers as evidence the situation in the Indian sub-continent where the strength of unions is sapped through disputes among themselves rather than in bargaining with employers. This evidence is, however, not fully convincing: the situation in the Indian sub-continent reflects on the highly politicized nature of unionism there where links between unions and political parties are close and formal. The political process and political parties are viewed as the mechanism for workers to enhance their welfare; workers do not see their place of work as the source for improving their wages and working conditions. In such a highly-politicized environment, the unions are simply the manifestation of competition among political groups for support. The appropriate response to this situation is not to mandate one bargaining agent per enterprise, a situation that invites the development of an entrenched and unresponsive oligarchy of union leaders and that aids state control of collective bargaining,³¹ but to end the notion that the origin for improvements in the welfare of workers lies in the political system. Once the state leaves to employers and workers the determination of wages and conditions of work, then competition among democratic unions for the support of workers is something to be desired.

Confederations of Unions

With enterprise-level bargaining, the locus of collective bargaining is decentralized. This is sometimes regarded as a defect because, in such a system, a confederation of unions lacks the power and authority that it would have in a more centralized system. It is argued there are occasions when such a central union confederation can help to devise and implement major stabilization programs. This argument offers as evidence the part played by the union confederation in Israel in the mid-1980s in contributing to the design and political acceptance of the stabilization programs in those countries.³²

³¹ It is common in sub-Saharan Africa for the law to prescribe one and only one union in a given sector of an economy. The purpose of mandating such a system is to facilitate the control of the union movement by the state. As Panford (1993) writes, "The imposition of single unions may violate workers' rights where they restrict workers' choices and force them to join only state approved unions.....workers have only two choices. They either join organizations sanctioned by the state or they cannot join any unions at all"(p.37).

³² The literature comparing labor markets of developed economies in terms of their ability to respond effectively to shocks such as oil price increases has sometimes concluded there are benefits of a system where confederations

It is certainly easier to secure popular acceptance of a radical reform package if an economy's major organizations endorse and support it. To this extent, the argument has merit: the reform package has a greater probability of success if a powerful and authoritative labor confederation backs it. However, this argument should examine the prior steps: what is the likelihood of a union confederation supporting a stabilization package; how are the components of that package altered to secure the confederation's support; and have the confederation's activities contributed to the conditions that necessitate a major stabilization program? There are many instances in which union confederations have contributed to the failure of promising stabilization reforms, Argentina's Austral plan in 1985 being one example. And Israel's union confederation - mentioned above as contributing to the success of the country's stabilization programs - is a classic example of an organization that is closely allied to the political system and that uses the political process to extract rents for itself.

Israel's trade union confederation, the Histadrut, is unusual in being an owner of some firms, a health service provider, and a pension fund manager in addition to acting as the principal agent for the union movement. (Some independent unions are not affiliated with it.) These many activities dilute its voice as exclusively a representative of unionized workers although it has regularly engaged the confederation of employers in discussions over prices and wages and it routinely negotiates with the government over economic policy affecting investment. Collective bargaining is highly politicized and confrontational. "From a cross-national perspective, strike activity in Israel is high.....The 'political' shape of strikes - typically brief but broadly based - also stands out, and is symptomatic of the high concentration of labor disputes in the public sector (including state-owned transport, communication, and utilities).....[I]n Israel, a corporate labor organization enters into social contracts with the state, while at the same time members of marginalized social groups form an exposed underclass in the labor market, with clearly inequalitarian consequences" (Shalev, 1992, p.246).

In a frank characterization of the fundamental goals of the confederation, a representative of the holding company for all Histadrut enterprises has stated, "Relations between the manufacturers and the Histadrut are characterized not by conflict of interest but rather by dialogue. Both sides have the same interest.....There aren't two separate world views, but rather a single view shared by both. The community of interests is very great, and both view the government as a foreign element - both as a cow to be milked and also as a body to be feared lest it hand down undesirable decrees" (quoted in Grinberg, 1991, p.73). This is a remarkably clear and candid statement of the cartels' conception of the state, "as a cow to be milked", of the mutual interests of the confederation of employers and unions, and of the fallacy in envisaging a union confederation as a necessary counterbalance for the pressure group activities of employers.

It can be argued that the need for monetary stabilization is enhanced by the presence of large, rent-seeking, organizations such as union confederations. Each cartel seeks to increase its share of national income at the expense of others and, to forestall the unemployment and resource misallocation that would naturally result, the monetary authorities are apt to engineer a general increase in prices. If this process is repeated, the economy experiences an inflation, the proximate cause of which is the monetary authorities' loss of control. But this loss of control is attributable to

of unions bargain with confederations of employers. This conclusion rests on the supposition that the wages of all employees are covered by collective bargaining contracts and there is no nonunion sector. The labor markets of Sweden and Austria provide the prototype. (This literature is reviewed in Moene and Wallerstein (1993).) The arguments are of little relevance to developing countries where there almost always exists a substantial fraction of the labor force whose wages are uncovered by collective bargaining contracts.

the authorities' attempt to conceal the resource misallocation consequences of rent-seeking activities by cartels. (Elements of this account are to be found in the experiences of Israel in the 1970s and 1980s and in many Latin American countries.) Ultimately, attempts are made to restore control through a stabilization program and, as a major actor in the economy, the union confederation will usually be invited to cooperate in determining its structure and in gaining acceptance for it. It is somewhat incongruous that the confederation is applauded for its cooperation in helping to end a process it contributed to initiating.

In some countries, the state has encouraged the formation of a powerful confederation of unions so that the state itself may control the union movement. For instance, this was the unabashed goal of Ghana's first post-colonial governments where labor unions were designed to be agencies of the state, mobilizing the workers to serve the interests of the government.³³ The term "responsible trade unionism" was concocted and, to ensure "responsibility", the government played a heavy role in the selection of union officials, in organizing new workers, and in the incidence and form of industrial disputes. To help the state control workers, not merely are only state approved unions permitted to function, but in some sectors of the economy union membership is mandatory!³⁴ In this way, more effective control may be exercised over workers than if these workers were not unionized. Of course, the state has not always been successful in controlling workers in this way and, when the state has lost control, the industrial disputes assume huge political significance. However, for many countries in sub-Saharan Africa (such as Kenya, Zambia, and Nigeria, as well as Ghana), the state has seen a central union confederation as a necessary component of a union movement that it seeks to control. This is a further reason to encourage the devolution of labor union authority and to avoid conferring prerogatives on centralized confederations of unions.

Enterprise-level collective bargaining will make it more difficult for union confederations to pursue aggressive rent-seeking policies, will reduce the degree to which collective bargaining is politicized, and will diminish the ability of authoritarian governments to act arbitrarily.

Disputes

The previous paragraphs have concerned the procedures for maximizing the likelihood of unions acting as a source for social and productive efficiency and for minimizing their resource misallocation impacts. In addition to the costs of settlements, we should consider the costs of reaching settlements. Here the guiding principle should be to design procedures such that, insofar as possible, the costs of bargaining are borne by the parties to the contract themselves and not by those unrepresented in the negotiations. When production in a single firm in a competitive industry is interrupted in a management-union dispute, the costs of the dispute tend to fall on the parties themselves and not on consumers who will have alternative sources of supply.

In a dispute in private industry in conditions of competition, the state should occupy as neutral a position as possible. This implies it should not provide loans or payments to either party

³³ In introducing the 1958 Industrial Relations Bill, the Minister of Labor stated, "The government....agrees with the view....that the needs of the workers and of the nation as a whole would best be served by a strong centralized trade union organization whose central body is recognized by government and is given certain powers and duties; and over which....the government will be able to exercise some supervision to ensure that those powers are not abused".

³⁴ See the discussion in Panford (1994), p. 46-7.

during a strike or lockout (so the firm remains liable for its tax payments during the period of the work stoppage while workers are not eligible for unemployment compensation). There is no reason why workers involved in the strike or lockout should not be eligible for temporary (or, indeed, permanent) work elsewhere. Analogously, the employer should have the option of hiring temporary (or, again, permanent) workers in an attempt to resume production. There is no need for government to mandate that strikers should be paid wages during an interruption in production (as is common in Latin America) nor that strikers not be paid. Again, this is a matter for the parties to the dispute to determine and not for the state to regulate one way or the other. In general, the state should occupy a "hands-off" position.

This hands-off posture is sometimes difficult to maintain because the costs of a dispute sometimes appear considerable. The media are inclined to report huge "costs" of the strike or lockout even though these numbers are typically manufactured by one side of the dispute in order to put leverage on the other. Often these numbers are derived by multiplying the daily gross revenues of the firm prior to the strike or lockout by the number of days of interrupted production. But if consumers are able to purchase the good from inventories or from alternative suppliers, then these "costs" are borne by the parties and should not occasion concern. The union and management can avoid these costs immediately by reaching agreement. Moreover, in this popular characterization of the dispute, these "costs" are not contrasted with the alternative costs of reaching agreement on terms currently being demanded by one side or the other. The tacit comparison is usually with an outcome assuming there were no bargaining with the two sides reaching immediate agreement on some unstated compromise.

In fact, where the commodity is durable, inventories can be run down and the firm can often make up for "lost" production during a strike or lockout through additional production before or after the dispute has been resolved. This argument may not apply to a non-storable good or service (such as the services provided by the police or firefighters), but as these tend to be produced under monopolistic conditions we discuss these below.

Naturally, violence and intimidation that sometimes accompanies strikes (be it initiated by management or the union) should not be tolerated. "Sympathetic" action by other management or workers represents the extension of collective bargaining beyond the single enterprise and, therefore, would be unlawful.

Private Monopolies and the Public Sector

The prescriptions regarding collective bargaining and disputes above relate to the private sector of the economy or, more precisely, to those firms producing under competitive conditions. The public sector poses special problems because the product markets of services produced in the public sector tend to be monopolistic. Although rudimentary price theory suggests that the wage gains of unions are likely to be greater where product markets are monopolistic, these wage premia are insufficient cause to deny public sector workers the right to form associations to represent their interests if they wish.

The principal problem posed by public sector unionism is that disputes tend to be more costly for consumers because there are no ready substitutes for the interrupted production of the service. For instance, the services of police officers cannot be stored and consumed from the inventory and the use of substitutes is difficult to arrange and organize. Similar arguments to a greater

or lesser extent can be made with respect to the work performed by fire fighters, teachers, hospital workers, utility (gas, electricity, and water) workers, and public transport.

The critical element here is not that the state often has a controlling interest in the production of these services; the critical element is that these services tend to be produced monopolistically (public or private) so that substitution possibilities by consumers are substantially limited. This implies that, for these services, a larger part of the costs of a strike or lockout are borne by parties not represented in collective bargaining negotiations.

In these circumstances, in the public sector and for private sector monopolies, it is natural to seek alternatives to strikes and lockouts.³⁵ Arbitration by third parties is the obvious policy. What evidence we have regarding the uses of alternative arbitration mechanisms recommends the use of final offer (or pendulum) arbitration whereby the arbitrator is constrained to choose either management's "final" offer or the union's "final" offer.³⁶ The reason for the preference for final offer arbitration over conventional arbitration (according to which the arbitrator may fashion any agreement she wishes) does not lie in the fact that wage agreements tend to be different under one system from the other. On the contrary, there is little powerful evidence suggesting that conventional and final offer arbitration produce different outcomes.

However, with each party fearing the imposition of a very unfavorable outcome, final offer arbitration tends to encourage the parties to reach an agreement on a contract and it is generally believed that the parties themselves can usually devise a better agreement than one dictated by a third, probably less well-informed, party.³⁷ That is, if the parties are risk averse, the fear that one party's offer will appear more reasonable to the final offer arbitrator induces the other party to moderate its position so that agreement between the parties becomes more likely. In other words, if the system is working well, then (after a period of becoming familiar with its operation) the arbitrator under final offer arbitration will be called upon infrequently.³⁸

The parties in the dispute are aided if they know what criteria guide the arbitrator's choice between management's and the union's last offers so it would help if the law were explicit on this. In particular, recent movements in the general cost of living and in labor productivity in the

³⁵ In New York, in the event of public sector workers going on strike, each striking worker loses one day's pay (in addition to the pay lost through being on strike) for each day on strike. This penalty is applied by the state government and has been routinely enforced.

³⁶ Of course, final offer arbitration need not be restricted to monopolies. In the competitive sector of the economy, private employers and their unions may choose to avoid strikes by having their unresolved disputes settled by arbitration. Many of the so-called "new style deals" in Britain introduced in the 1980s involved agreements characterized by a single union in each establishment and by no-strike clauses. Final-offer arbitration was a common method of resolving disputes in these enterprises.

³⁷ Moreover, a contract that both parties have framed is more likely to be honored and made to work than one in which one party has had less to say in its design.

³⁸ I have written "the" arbitrator in this paragraph although, in practice, the system usually operates with several arbitrators acting together. There are a number of different mechanisms for selecting arbitrators and they usually involve both the union and management deleting from a longer list names not preferred to each party. For a description of the various arbitration systems operating for public sector workers in different states in the U.S.A., see Lester (1984).

particular enterprise are valid criteria for the arbitrator to apply. The arbitrator should be more inclined toward increasing wages when hiring workers of the sufficient quality has become difficult than when they are in abundant supply.

VII. Conclusion

It is important to emphasize that, ultimately, an increasing standard of living for workers requires growth in productivity. As argued above, the opportunity to raise workers' earnings by redistributing income from profits, dividends, and interest is meager and certainly cannot form the basis of a persistent rise in earnings. If growth in productivity is essential for raising the living standards of workers, the direction of causation here needs to be stressed: in the economy as a whole, increases in productivity are associated with changes in the demand for and supply of labor that lead to increases in real wages; economy-wide wage increases do not cause increases in productivity.

The increase in the standard of living of workers in developed economies over the past century has not been achieved by engineering distributional reallocations of a fixed income, but by the benefits of a growing national income being distributed among the population. Or, to draw upon more recent evidence, the growth in living standards of workers in South Korea, Taiwan, Hong Kong, and Singapore in the last thirty years or so has been achieved by expanding the production potential of these economies, not by movements around a given production frontier.³⁹ As Fields (1984) and Fields and Wan (1989) have argued, a comparison of the economic performance of East Asia with the Caribbean and certain other countries in Latin America indicates that government policies mandating or encouraging high wage policies⁴⁰ discourage the economic growth that is the ultimate durable source of improvements in workers' living standards. Therefore, a question to ask of labor unions is how will their policies contribute to the growth in national income and to the growth of workers' standards of living in the future.

The answer is that unions have the potential to help raise productivity in the workplace by participating with management in the search for better ways of organizing production. It is important also for workers not to feel alienated from the economic and social system and to believe they have a stake in it. Process matters: even if outcomes were identical, employees value the fact that they or their agents help to shape their working environment. The labor union has been the primary vehicle for accomplishing this. Devising a regulatory system such that these potential benefits of unionism are accomplished without incurring resource inefficiencies has been the purpose of Section VI of this paper.

³⁹ I hasten to add that this point should not be interpreted to mean that I applaud and recommend the policies that governments in countries such as South Korea and Singapore have applied to unionism. On the contrary, it should be evident that the policies I have argued for are inconsistent with coercive practices toward unions and intrusive government mandates in the labor market. The South Korean and Singaporean cases simply illustrate that free and active labor unions are not necessary for an improvement in workers' material living standards and that these increases in workers' real incomes have been achieved by expanding the economy's wealth.

⁴⁰ These policies include not merely encouraging centralized collective bargaining and the application of such union-negotiated wages to nonunion workers, but also aggressive minimum wage laws, rents to government employees in the form of higher wages than those needed to attract the required quantity and quality of workers, and pressure on multinational firms to pay high wages.

The predicament is that productivity growth is often accompanied by distress for those workers suffering from technological displacement or from the shifting patterns of consumers' expenditures. It is natural to sympathize with defensive actions by labor unions to protect these workers' immediate interests. The trouble is that the cost of such protection comes out of the living standards of future workers, workers whose interests are not explicitly represented in any organization or union. There are policies that can be adopted to mitigate the drop in living standards for individuals whose worth in the labor market has unexpectedly deteriorated, but these should not include ensuring these individuals continue to produce goods that consumers would prefer not to buy.

Finally, it should be noted that unionism need not be the only vehicle for worker participation. As firms owned and managed by their workers, worker cooperatives should be able to reap any potential benefits of worker participation. Worker cooperatives exist in all open societies although nowhere are they the dominant form of organization. Governments have not always been receptive to worker ownership and have sometimes frustrated their development in part because some advocates of worker ownership have also espoused the violent overthrow of the status quo. However, there is a very real and legitimate case for worker ownership and only by permitting such organizations to compete on equal terms with conventional firms will the areas where such firms have a comparative advantage be identified.

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