Do Trade Unions Really Give Rise to Social Losses?

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I. Introduction

In the economic literature there has long existed a view that a trade union gives rise to social losses in the same way as a monoply firm in the commodity market. An example of this view was presented by Levis Kochin in a recent issue of this journal.[1] Kochin states that

> Unions have obtained higher wages for their members. The cost to society of these higher wages are caused by (1) A misallocation of labor – too little employment at unionized work and too much elsewhere (2) Rent Dissipation – the cost of competition for union jobs and of efforts to create and destroy unions (3) Rigidity – Union rules cause an increase in the rigidity of work practice and of wages. A low bound estimate of the social cost of unionism allowing only for the first two categories finds unions had a social cost of $ 58.5 Billion in the U. S. in 1979.[2]

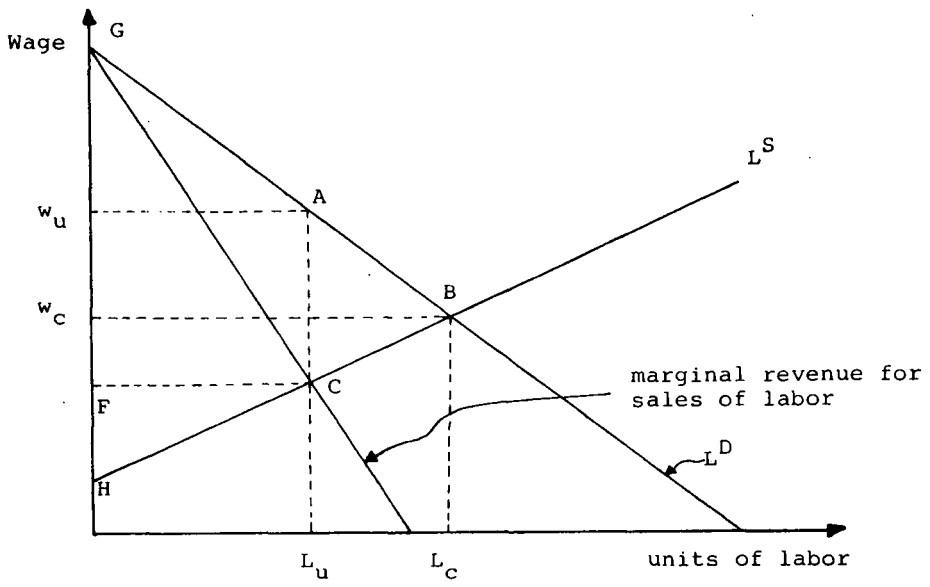
This article questions Kochin's analysis and estimates of social losses.

II. Is Perfect Competition the Alternative?

Kochin starts from the implicit assumption that in the absence of trade unions the labor market can be characterized as being perfectly competitive. It is then relatively easy to demonstrate that there is a risk of losses of the first type mentioned by Kochin. To illustrate this we use the same type of figure as Kochin.[3]

If the market is characterized by perfect competition, equilibrium in Figure 1 is attained at the point of intersection of the demand and supply curves, denoted L^D and L^S respectively, and L_c units of labor will be employed at the competitive wage w_c. There will then be a social surplus equal to the area GBH.

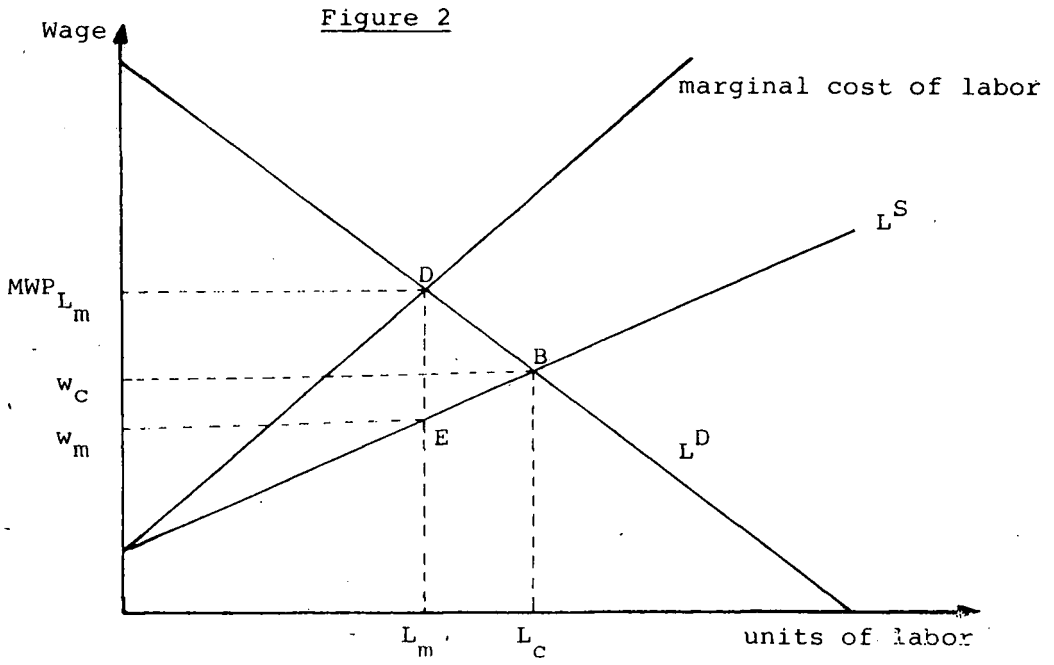
Figure 1



If a trade union is formed and obtains control over the supply of labor, the market equilibrium will change. As the sole seller of labor, the union knows that in order to maximize the surplus, defined as the difference between the sum of wages and the opportunity cost of labor (represented by the curve L^S), the employment level should be determined by the intersection of the curves describing the marginal revenue for sales of labor and supply of labor.[4] Consequently, with a surplus maximizing union, L_u units of labor will be employed at the wage w_u. Comparing this situation with that of perfect competition, we find that there are employers demanding labor who are willing to pay a wage in excess of the opportunity cost of labor. From a welfare point of view, we note that the surplus to the employers will be reduced from GBw_c to GAw_u, whereas the surplus to the unionized workers will increase from HBw_c to $HCAw_u$. Thus, the emergence of the union will give rise to a social loss equal to the area ABC in Figure 1.

It is important to remember that the above analysis begins from the assumption that perfect competition prevails in the labor market. Kochin makes no comment on this crucial assumption. As a rule the assumption of perfect competition is not valid in labor markets.[5] In many countries without trade unions we would expect to find a monopsony in the labor market, especially if we restrict the perspective to local and regional markets. If a trade union is formed in a labor market characterized by a monopsony the effects will differ radically from those derived by Kochin and illustrated in Figure 1. The employer knows that he has to bid up the wage if he wants to use more labor. If perfect wage discrimination cannot be applied, the employer also knows that it is not only the last worker but also all workers previously employed who will receive the higher wage. In Figure 2 the incremental labor cost associated with increased employment is described by the marginal cost curve for labor. The monopsonist maximizes profits at the employment level where the curves describing the marginal cost of labor and the demand for labor intersect. In Figure 2, this gives employment of L_m units of labor at the wage w_m. There is a social loss in this market situation represented by the area DBE.

Figure 2



An interesting question is what happens to this loss when the workers form a trade union for collective action in the labor market. It is obvious that there will be a change in the social loss. However, whether this change is positive or negative depends on the outcome of the bargaining process in the new situation. In the case where the agreed wage is less than the monopsonist was willing to pay for the employment of L_m units of labor, MWP_{L_m}, the social loss will be reduced since employment will increase towards the competitive level, L_c. In fact, it may be the case that a situation identical to the competitive equilibrium arises and the social loss is eliminated by the trade union activities. From this we can see that if there is initially a monopsony in the labor market, the formation of trade unions cannot be generally rejected by reference to the traditional analysis of loss under monopoly. In fact, the formation of a trade union may well give rise to a social gain.[6]

III. Do Trade Unions Give Rise to Socially Valuable By-Products?

Now, let us turn to the second cause of social losses due to trade unions referred to by Kochin. To the loss ABC in Figure 1 Kochin, with reference to Tullock (1967) and Posner (1975), adds a social loss described by the area w_uACF. This loss is made up of 'the expenses incurred in efforts to form, maintain and obtain entry into unions as well as the costs incurred in efforts to obstruct, destroy, harass or otherwise hinder the efforts of trade unions to maintain wages above those that would exist in the absence of union monopoly.'[7]

One may raise objections to this analysis. First, this loss may well exist also in the absence of trade unions if workers try to establish a union but fail to do so due, for instance, to the employers' efforts to prevent unionization. So that even if a labor market is characterized by perfect competition, resources may be used for the same type of activities underlying the loss w_uACF in Figure 1. Furthermore, from Posner's (1975) analysis of the assumptions necessary for the existence of a loss of size w_u ACF in a monopoly market it emerges that one of the critical assumptions is that 'the costs incurred in obtaining a monopoly have no socially valuable by-products'.[8] It is then important to investigate whether the formation of a trade union gives rise to such by-products and thereby reduces, or even eliminates, this type of loss.

By-products that have been discussed in the literature are the unions effects on worker-management relations, on workers' firm-specific training and on workers' morale and motivation.[9] It is obvious that unions can play an important role in providing and exchanging information in a production unit. A union can make the management aware of potential changes that can improve the workers' situation at the same time as they can improve the efficiency of production. This may reduce labor turnover in the production unit. Thus, firm-specific training and other forms of investment in human capital become more profitable than is the case when workers' discontent results in quits. Quits are a costly way of providing information on working conditions from the point of view of both the employee and the employer but it is the major alternative to the provision of worker-management information by means of trade unions.[10] It is also argued that trade unions increase the morale and motivation of the labor force. Partly this can be explained by the unions role in providing information as described above. In addition, however, by collective bargaining and by monitoring agreements the unions may be able to change the attitude of the workers and raise their motivation. These effects of trade unions, which arise mainly from the union's role as a source of information between workers and management, tend to increase the productivity of workers and the efficiency of the production unit. Consequently, from this point of view, trade unions tend to affect economic growth positively.

These effects are touched on by Kochin but are assumed to be negative or small and are, therefore, not taken into account in the estimates of the social costs of unions.[11] However, the validity of Kochin's argument for assuming these effects to be small or negative depends critically on the initial assumption of perfect competition in the absence of trade unions. The estimates of the influence of trade unions on worker productivity made, for instance, by Brown and Medoff (1977) indicate that the productivity effects of trade unions are positive and significant. In fact, the Brown-Medoff estimates are interpreted by Kochin as indicating that unions do not raise wages more than productivity. However, Kochin does not place much faith in these estimates. He argues that if these estimates were true 'employers would have no reason to resist unions but could be induced to welcome union organization.'[12] This conclusion is highly sensitive with respect to the assumption made concerning labor market characteristics in the absence of trade unions.

As long as the labor market in the absence of trade unions can be characterized as a perfectly competitive market, the conclusion is correct. However, if monopsony is the alternative, as discussed above, the conclusion may well turn out to be wrong. The reason is that in this case the wage increase associated with the formation of a trade union is an outcome of a bargaining process between the union and the buyer of labor. It is not unrealistic to assume that the union has tried to get higher wages than are achieved in the final outcome of the bargaining process. Consequently, even if unions do not succeed in raising wages more than they raise productivity, they may well be resisted by the employers, especially as the productivity gains can be assumed to be unique in each production unit and may be difficult to estimate for a single employer. To this we should add that employers may well resist trade unions for non-economic reasons.

However, to balance the above account, there are also negative productivity effects arising from union activities.[13] First, it is obvious that in the case with trade unions some workers and managers have to be involved in bargaining and related questions instead of taking part in pure production activities and, thus, average productivity is negatively affected. Secondly, trade unions are said to impose make-work rules. This often means that there are imposed 'limits on the load handled by workers, restrictions of the tasks performed by employees in given occupations, requirements that work be done twice or that unnecessary work be done, requirements for unneeded standby crews or crews of excessive size, enforcement of loose production standards or limits on work pace, and interference with technological changes sought by management.'[14] Thirdly, it is sometimes argued that trade unions give rise to more open discontent and open conflicts such as strikes. Both the second and third aspects are mentioned explicitly by Kochin. The second aspect represent the last of his causes of social costs due to trade unions and with respect to the third aspect, he comments that 'There is evidence indicating that, ... the working conditions of unionized workers are worse than those of non-unionized workers. Unionized workers report themselves considerably less satisfied with the non-wage conditions of their employment than do non-unionized workers.'[15] However, to some degree this is a necessary circumstance if trade unions are to have the function of acting as an information channel between workers and management. Furthermore, to evaluate the argument that unions imply more open discontent, conflicts and strikes, it is important to keep in mind that the absence of open discontent, conflicts or strikes does not mean no discontent, nor no work days lost due to such discontent. It is necessary to look closely at changes in the frequency of absenteeism, the numbers leaving the job without notice, quits, lazyness on the job, sabotage, etc.[16]

The implication of the above analysis is that the trade union effects on efficiency cannot be analysed from a narrow perspective including only the trade union influence on wages. The analysis must be complemented so that effects on such factors as worker-management relations, workers' morale and motivation are also considered. If this is done, the negative relationship between unionism and economic efficiency may become weak, if, indeed, it does not turn out to be positive, One important conclusion to be drawn from this is that the implicit assumption behind the second cause of social costs of trade unions, the rent dissipation, seems to be highly doubtful since the necessary condition for the loss $w_u ACF$ to exist, namely, that the monopoly, here the trade union, does not give rise to socially valuable by-products, is not satisfied.

IV. Working Conditions as Local Public Goods

Finally, we will take up one aspect of trade unions that Kochin neglects completely. Many specific working conditions apply to all workers in a given production unit. Therefore, exclusion is often impossible or very expensive. This is the case, for example, with different aspects of occupational health and safety. In such cases working conditions can be characterized as local public goods. From economic theory, it is well-known that private optimization easily gives rise to an inoptimal production of public goods.[17] In cases where the explicit valuations of individual consumers, as reflected by, say, interviews, are connected with a payment responsibility, the revealed demand will be less than the true demand. Consequently, production of the public good will be below the optimal level.

In the same way we can expect that working conditions with public good characteristics are inoptimal in a monopsonistic labor market.[18] When workers do not express their preferences

over various working conditions collectively, non-pecuniary working conditions characterized by non-excludability cannot be differentiated among the workers at the same work place. Therefore, the quality of such working conditions, that arise out of the monopsonist's profit maximization will be based on the marginal worker's marginal valuation of these working conditions and not on all workers' valuations which would be the relevant ones from a social welfare, or social surplus, point of view. There is empirical evidence which indicates that intramarginal workers are older and wealthier than the marginal worker and therefore tend to place a greater valuation on non-pecuniary working conditions.[19] When this is the case, non-pecuniary working conditions characterized by non-excludability will be sub-standard in monopsonistic labor markets.

If workers in a specific work place form a union and act collectively in negotiations with their employer, a situation of bilateral monopoly arises. The outcome of the resulting bargaining process, with respect to various working conditions, depends on the relative strength of the two parties involved and is in principle indeterminate. As demonstrated in the preceding section, the formation of a trade union in a monopsonistic labor market may, but need not, give rise to increased social surplus and welfare. In fact, we found that it is possible that it will give rise to a socially optimal outcome. In the case when non-pecuniary working conditions characterized by non-excludability are present there is an increased likelihood that a positive welfare effect will arise out of the formation of a trade union in a monopsonistic labor market. The reason is that the trade union attitude towards various working conditions will be based on all workers' valuations rather than on the valuation of the marginal worker.

V. Summary

In a recent article Kochin estimated the social losses of trade unions. In this article we have questioned these losses and found them to be very doubtful.

First, we found that if the labor market in question can be characterized in the absence of trade unions as a monopsonistic market, which seems to be a more realistic assumption than the one of perfect competition implicitly made by Kochin, it is very doubtful if there will be a social loss due to increased misallocation of labor when trade unions are formed. In fact, in such a labor market situation the formation of trade unions may well result in a reduced misallocation of labor and, thereby, give rise to social net gains.

Secondly, Kochin's 'rent dissipation' cause of social losses was found to be of doubtful significance. According to Posner (1975), this loss can only arise if the formation of the monopoly, here the trade union, has no socially valuable by-products. The formation of a trade union certainly has such by-products. This is admitted by Kochin but assumed away by providing an argument that relies critically on the assumption of perfect competition in the absence of trade unions.

Finally, since important working conditions have the character of local public goods, collective action is often needed when working conditions are being determined in order to avoid a misallocation of resources. For such action some form of trade union is needed. This aspect of unions is not dealt with at all in Kochin's analysis.

In short, from a welfare economic point of view there seem to be at least as strong arguments in favour of trade unions as against.

Footnotes

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1 Kochin (1980).
2 Ibid., p 325.
3 In Kochin (1980) the marginal revenue for sales of labor is not explicitly denoted.
4 In a static world this is also true for a wealth maximizing union of the kind that Kochin analyses.
5 For instance, see Mortensen (1970) and Viscusi (1979) and (1980).
6 In the same way the formation of an employer organization may give rise to social gains in a labor market with a trade union monopoly.
7 Kochin (1980), p 325.
8 Posner (1975), p 809.
9. See Brown och Medoff (1978) and Clark (1980), and references therein.
10. Freeman (1976).
11 See Kochin (1980), pp 329, 331, and 332.
12 ibid., p 331.

[13] For references, see note 9.
[14] Brown and Medoff (1978), p 359.
[15] Kochin (1980), p 330.
[16] According to Kassalow (1969) p. 159: '. . . The more firmly the labour movement is institutionalized and "accepted", particiularly in the sphere of labour-management relations, the greater the likelihood that there will be fewer strikes.'
See also Parker (1920) p 76: 'Resistance by the worker to an employer's labor policy takes one of two forms: either an open and formal revolt, such as a strike; or an instinctive and often unconcious exercise of the 'strike in detail' – simply drifting off the job.'
[17] Samuelson (1954).
[18] See Viscusi (1980). See also Drèze (1976).
[19] Viscusi (1980) and references therein.

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