Economic Security Series: Part 3 Collective Bargaining

Research InBrief No. 88

April 2024

Tom McDonnell

Summary:

This inBrief is the 3rd in the NERI's economic security series. It considers the economic case for wider collective bargaining. The majority of income for the majority of households comes from wages. Decent wages are therefore critical to living standards, to economic security and well-being, and to the minimisation of poverty and deprivation. Wealth is much more unequally distributed than income across all advanced economies. This means that policies that work to increase the labour share, such as supports for collective bargaining, will tend to reduce market inequality over time. Well-designed collective bargaining structures can mitigate power asymmetries between employers and employees and thus ameliorate market failures in the 'price' of labour and the distribution of income. Collective bargaining also tends to promote wage compression within firms and sectors and this too acts to reduce inequality over time. Finally, collective bargaining can push economies into a more 'high road' or high value-added equilibrium and cross-country comparisons of economic outcomes in Europe suggest that concerns about negative economic impacts from collective bargaining are misplaced.

Introduction

Widespread collective bargaining (CB) is a critical component of any economic model concerned with economic security and adequate incomes. A lower union rate reduces the bargaining power of labour which exacerbates wage inequalities and reduces the overall share of income going to labour. Research from the IMF indicates that less prevalent trade unions and CB are associated with greater market inequality. The Fund also notes that inequality hampers poverty reduction, and fuels economic, financial and political instability which in turn reduces investment and growth.

IPPR research show that declines in union density and CB coverage have been associated with falling labour shares in advanced economies since 1979.

As it happens, there has been a decline in the labour share and in trade union density in most though not all OECD countries since the 1970s with larger declines in the labour share tending to occur in those countries with higher falls in union density and CB coverage. The New Economic Foundation finds that the decline in union density in the UK is responsible for up to 9.3 percentage points of decline in its labour share. They also estimate that a 1% increase in the share of profits in national income reduces GDP by 0.13%.

Heightened political concern about worsening inequality, social fracturing, and slowing productivity growth have increased attention on the potential for CB to reverse these trends and improve welfare and well-being outcomes for wage earners and for society as a whole.

Declining Collective Bargaining Rates

Labour income is much more evenly distributed than capital income across the population with capital income broadly concentrated at the top of the income distribution. As such, a declining labour share fuels an increase in inequality and insecurity. Most OECD countries have experienced declines in their CB coverage and trade union membership over recent decades. It is reasonable to assume that this decline in trade union influence may have diminished the bargaining power of households reliant on wages as their main source of income. This effect is likely to have been particularly pronounced for workers without highly specialised skills or economic leverage. As it turns out, the decline in coverage internationally has indeed coincided with declines in the shares of income going to labour.

Impact on Income Distribution

Why should collective bargaining (CB) matter for wages and income distribution? There are two avenues for workers to obtain economy-wide wage growth over the sort-to-medium term. It can be done through productivity gains or, alternatively, through increases in the share of the economic pie going to labour. The effect of CB is to fully or partially offset the asymmetric power advantage held by employers over individual employees in the realm of wage negotiations. This should lead to a rebalancing of the economic pie to the advantage of workers.

In addition, as trade unions act in the interest of all the workers they represent, their presence tends to help ensure the labour share is itself more fairly distributed between workers in the firm or the sector. The median or 'middle' worker will invariably earn less than the mean wage within a firm, sector or economy. This is due to greater compression at the bottom of the wage distribution than at the top – essentially, high paid workers at the top skew the mean upwards. Thus, workers acting collectively will tend to vote to ameliorate existing wage disparities within firms and sectors. In the absence of trade unions, managers and more skilled workers acting individually will leverage their skills and access into higher wages, but this will be at the expense of other workers unless aggregate wages also rise. Trade unions are thus interested not just in aggregate pay but also relative pay. Wage compression policies that favour lower paid workers will also reduce gender pay inequalities as well as the impact of discriminatory wage policies on minority groups.

To the extent that increases in the labour share and greater wage compression reduce inequality and improve incomes they should also lead to lower levels of social conflict and to a higher standard of living for the average worker.

Impact on Productivity and Unemployment

Competitiveness is a relative concept. It can be achieved by weakening labour standards and cutting labour costs – the 'low road' or low-cost model - or by increasing productivity – the 'high road' or high productivity model. Both models are consistent with low unemployment but only the high road model is consistent with reducing in-work poverty, and improving living standards and well-being.

A collective approach involving workers and employers can resolve collective action problems related to skill formation and foster higher levels of horizontal innovation within firms. Appelbaum et al argue that workplaces with a trade union are more likely to demonstrate higher productivity work practices while Acas point to the importance of collective employee voice as an important source of creativity and innovation. Within-firm CB can catalyse economic growth by incentivising or even requiring higher levels of productivity. This is because the possibility of individual firms pursuing an approach to competitiveness based on low wages, i.e. the 'low-road' option, is shut off.

The Nordic economies provide concrete examples of this 'high-road' model successfully operating in practice. In these countries high rates of CB are complemented by very high employment rates and high average levels of productivity. Common wages are set for particular types of work. In a competitive globalised market, this will advantage high value-added activities and more productive firms, and will disadvantage low value-added activities and firms that fail to improve their productivity over time. Notably, the highly coordinated model of sectoral bargaining allows for firm-level negotiations to derogate from sector-level agreements. This enables workers and employers to dynamically respond collaboratively to negative shocks that might endanger specific business models, for example an increase in product specific input costs or a decline in demand.

Overall, multi-employer coordination of CB will have a positive impact on long-run economic performance to the extent that CB impedes or precludes pressure to drive downward wage competition and instead forces firms to improve their productivity in order to pay wages and make profits. In this environment, the economy's comparative advantage should gradually transition towards a high skill, high wage and high productivity equilibrium as low productivity firms and sectors reduce their relative share of employment over time. Firms and workers will both have an incentive to take steps to increase productivity within the firm, and to support measures to boost the economy's international competitiveness such as opportunities for occupational retraining and up-skilling, and government funding on education, infrastructure, R&D and the general innovation ecosystem.

The expected impact of trade union density and CB on the unemployment rate is ambiguous theoretically. For example, Algan et al used OECD data to compare unemployment rates and the percentage of workers covered by union wage deals in a group of 28 advanced economies over a 15-year period from 2000 to 2014. They found that some of the best performing countries like Norway, Finland, Sweden and Germany have powerful unions but that overall there was no tendency for unemployment to be higher or lower in countries where unions are more influential in wage setting.

Shifting Policy

The economic benefits of CB are now being acknowledged by governments and think-tanks. The ETUC points out that wage levels are tied closely to whether workers are covered by CB while the ETUI argues that CB is necessary to ensure decent wages for all and that minimum wages by themselves will not be sufficient to achieve this goal. The European Commission notes that countries with high CB coverage tend to display a lower share of low wage workers, lower wage inequality and higher wages than others. Similarly, the OECD has pointed to the contribution that CB and employee voice can make to employment growth, labour market inclusiveness and job quality. The OECD's research also suggests that the Irish and the United Kingdom systems of collective bargaining will tend to produce inferior economic performance compared to the organised decentralised systems in place in countries like Austria, Denmark, Finland, Germany, the Netherlands, Norway and Sweden

The arguments underpinning the economic and social merits of CB are increasingly driving policy reform. In particular, the European Union's historic Adequate Minimum Wage Directive (AMWD) marks an important milestone in the development of a genuine 'social' Europe consistent with its European Pillar of Social Rights. The idea is that the European social market economy will compete and drive growth based on innovation and productivity not erosion of living standards.

The AMWD explicitly requires EU Member States to establish an action plan to promote CB including a framework of enabling conditions to achieve a target of 80% CB coverage. Possible examples of supporting measures could include less restrictive criteria for establishing sectoral agreements and extension mechanisms, protection against victimisation of workers that exercise their rights to CB or union membership, and a right of trade union access to the workplace. The Irish government is required to transpose the directive by November 2024.