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Trade unions, collective bargaining and economic performance

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SUMMARY

A key goal of workers and unions is to achieve wage growth that outstrips increasing costs of living.

Trade unions can influence the labour share and the productivity channels, to the benefit of workers. Unions increase the bargaining power of labour, which enables workers to negotiate a larger slice of the economic pie. In addition, coordinated wage bargaining can impede cost competition strategies and encourage productivity enhancing measures, thereby pushing the economy towards a high wage and high productivity equilibrium.

Nordic countries provide concrete examples of countries with high levels of collective bargaining alongside high levels of employment and productivity. Their 'high-road' model shows that collective bargaining is consistent with high levels of productivity and strong economic performance.

KEY POINTS

- A main goal of workers and unions is to achieve wage growth that outstrips increasing costs of living.
- Trade unions can influence both the labour share and the productivity channels, to the benefit of workers.
- Competitiveness is consistent with a 'high-road' approach based on driving productivity, but also 'low-road' approachs based on driving wages and other costs downwards. Only the high-road approach is consistent with inclusive growth.
- There is no clear relationship between collective bargaining and unemployment. Some of the best performing countries have strong union influence.
- Empirical evidence suggests there may be small positive net effects of collective bargaining on productivity.
- Research finds that less prevalent trade unions and collective bargaining are associated with higher market inequality.

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Research for new economic policies

Introduction

A main goal of workers and unions is to achieve wage growth that outstrips increasing costs of living. We call this 'real' wage growth and it is necessary for improving living standards.

In the short-to-medium term, workers can achieve real wage growth by increasing the productivity of their labour, or by negotiating a larger share of GDP through collective bargaining. In the long-term, an economy can only sustainably achieve high real hourly wages if it also achieves high levels of productivity.

Trade unions can influence both the labour share and the productivity channels, to the benefit of workers. On one hand, unions increase the bargaining power of labour thereby enabling workers to negotiate a larger slice of the pie. At the same time, coordinated wage bargaining can impede cost competition strategies and encourage productivity enhancing measures, and in so doing push the economy towards a high wage and high productivity equilibrium.

Competitiveness is consistent either with a 'high-road' approach based on driving productivity, or a 'low-road' approach based on driving wages and other costs as low as possible. However, only the high-road approach is consistent with inclusive growth.

Nordic countries provide concrete examples of countries with high levels of collective bargaining alongside high levels of employment and high levels of productivity. These countries' 'high-road' model shows that collective bargaining is consistent with high levels of productivity and strong economic performance.

Therefore, there need be no intrinsic tension between collective bargaining and economic efficiency. Alongside this, collective bargaining strength is positively associated with a higher labour share and with lower economic inequality.

Wage bargaining coverage and employment

Algan, Carlin, Bowles and Segal (2017)[1] use OECD data to compare the unemployment rates and wage rates of a group of advanced economies over the period from 1970 to 2010. They find that some of the best performers, such as Norway, Finland, Sweden and Germany, have powerful unions. While this does not imply a causative relationship, it does at least suggest that collective bargaining is not a drag on economic performance.

In a study of the economic effects of collective bargaining coverage, Traxler and Brandl (2009)[2] find no significant impact on any of a range of measured labour costs, working hours, or the unemployment rate.

Visser (2016a)[3] examines wage bargaining coverage and average unemployment across the OECD over the period 2000 to 2014. He finds that several countries with high levels of collective bargaining[4] have averaged low unemployment, most notably Norway, the Netherlands and Austria. Spain stands out as the outlier country with a high level of collective bargaining and high unemployment.

The situation for countries with a low level of collective bargaining is even more mixed. There are examples of countries with low levels of collective bargaining averaging high rates of

[1] Algan, Y., Carlin, W., Bowles, S. and Segal, P. (2017) 'Technological Progress, Employment, and Living Standards in the Long-run' in '*The Economy: Economics for a Changing World*'. Oxford University Press: Oxford.
[2] Traxler, F. and Brandl B. (2009) 'The Economic effects of Collective Bargaining Coverage: A Cross-National Analysis'. ILO: Geneva.
[3] Visser, J. (2016a) 'ICTWSS: Database on Institutional Characteristics of Trade Unions, Wage Setting, State Intervention and Social Pacts in 51 Countries between 1960 and 2014' Amsterdam Institute for Advanced Labour Studies.
[4] Measured as the percentage of employees covered by union wage bargains.

unemployment over the 2000 to 2014 period, for example Poland and Slovakia, but also examples of countries with low levels of collective bargaining averaging low rates of unemployment, for example Korea and Japan.

Overall, there is no clear empirical relationship between collective bargaining and the unemployment rate. Is this surprising given the assumed role that trade unions play in keeping wages above the market-clearing rate.[5]

Forward looking actors

Employers do not generally pay the lowest possible amount as they have an incentive to pay above the minimum to attract and retain a motivated and productive workforce.

At the same time, trade unions have an incentive not to bargain for a wage rate that would reduce profits at a firm to zero. Such a rate would also reduce investment levels in the firm to zero and may even cause the employer to exit the market.

If investment falls, then productivity growth will fall, and this will erode the long-term viability of the firm. Falling investment reduces the potential for future real wage increases because there is a link between the firm's capacity to pay and the productivity of capital and labour inputs.

Worker voice

Related to this is the concept of worker 'voice'. If employers and workers can establish a constructive relationship then employers can benefit from a more cooperative, motivated and ultimately more productive workforce, while workers can benefit from better pay and conditions.

Trade unions trade better working conditions in exchange for employers getting higher productivity, including from worker-led initiatives. Employers also gain from lower supervisory and learning costs, and from lower employee churn costs.

We can apply a similar logic at both the sectoral and the economy-wide levels. The labour market effect of worker voice is to shift the wage curve so that it is possible to maintain a given employment rate at a higher wage rate.

However, there is no inherent reason to suppose that the union 'wage bargaining' effect (which raises wages) and the union 'voice' effect (which raises productivity and wages) will have offsetting effects. This means that the actual impact of collective bargaining and trade unions on *employment* is theoretically ambiguous, and as we have seen, the empirical evidence is inconclusive.[6]

Medium-term wage claims

A trade union or trade union body that represents many firms and sectors in the public and/or private sector will want the economy to grow quickly but sustainably and to have low rates of unemployment. This means they will want to avoid a high inflation dynamic coupled with a trade deficit.

Such a dynamic might provoke restrictive aggregate demand policies from governments and central banks, whether in the form of fiscal contraction or tightening monetary

[5] The market-clearing rate derives from the idea of a perfect and homogeneous market, which itself presupposes that none of the economic actors has the power to exert influence and set prices. In practice, power relations are always present, and, in the labour market, there is an asymmetry in power between business and labour. Therefore, the market-clearing rate that emerges does so in the context of this power imbalance – there is nothing 'natural' or 'efficient' about it. The presence of a trade union or collective bargaining agreement helps to counter this power imbalance and could, in theory, lead to a more efficient outcome.

[6] Another thing to consider is that the higher wages arising from the union wage bargaining effect act as an additional source of short-run demand in the economy. The short-run effect might therefore be to increase employment. While the potential for wage growth will remain tied to productivity in the long-run, the labour share of GDP should be higher when collective bargaining coverage is higher.

policy. Such policies lead to higher unemployment rates and would reduce or reverse the trade union's advantage in wage negotiations with employers.

Trade unions will also want to avoid a scenario whereby firms reduce their investment in capital goods and training as this would slow the rate of productivity growth and therefore real wage growth.

Finally, trade unions also want low unemployment rates as a low rate gives them an advantage or 'leverage' over employers in wage bargaining. In terms of its medium-term strategy, the forward-looking trade union will pursue wage claims linked to productivity growth and consumer inflation, with an appropriate adjustment based on the perceived adequacy of labour's share of GDP.

Productivity

The potential for long-term real wage growth is equal to the economy's long-run potential to generate productivity growth.

Traxler and Brandl (2009)[7] note that a collective approach to labour market regulation involving workers and employers can resolve collective-action problems related to skill formation, leading to an increase in vocational training and further training, and therefore to an increase in human capital. Similarly, Appelbaum, Hoffer Gittell and Leana (2011)[8] argue that workplaces with a trade union are more likely to demonstrate higher productivity work practices.

Acas (2015)[9] finds that countries with stronger participation rights, such as collective bargaining, do indeed tend to perform better on several productivity related measures, while Dromey (2018)[10], using OECD data, finds a weak but positive relationship between collective bargaining coverage and productivity. Studies by Bryson and Forth (2015)[11] and by Barth, Bryson and Dale-Olsen (2017)[12] showed that increases in union density were associated with improved productivity and wage performance. The OECD (2018)[13] finds that:
'Empirical evidence on collective bargaining…suggests either no or small positive net effects on firm productivity.'

Inequality

Finally, research from the IMF (Dabla-Norris et al, 2015)[14] finds that less prevalent trade unions and collective bargaining are associated with higher market inequality, while Dromey (2018) uses OECD data to show that higher levels of collective bargaining are associated with lower inequality for OECD member states.

There has been a decline in the labour share and trade union density in most 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 collective bargaining coverage. Onaran et al (2015)[15] find that the decline in union density in the UK is responsible for a 4.4 percentage point decline in the labour share of GDP.

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[7] Traxler, F. and Brandl B. (2009) 'The Economic effects of Collective Bargaining Coverage: A Cross-National Analysis'. ILO: Geneva.
[8] Appelbaum, E., Hoffer Gittell, J., and Leana, C. (2011) 'High Performance Work Practices and Sustainable Economic Growth' Researchgate Publication.
[9] Acas (2015) 'Building Productivity in the UK' ACAS Report.
[10] Dromey, J. (2018) 'Power to the People: How Stronger Unions can deliver Economic Justice' IPPR Discussion Paper.
[11] Bryson, A. and Forth, J. (2017) 'The UK's Productivity Puzzle' NIESR Discussion Paper No. 448.
[12] Barth, E., Bryson, A. and Dale-Olsan, H. (2017) 'Union density, Productivity and Wages' IZA Discussion Paper No. 11111.
[13] OECD (2018) 'Good Jobs for All in a Changing World of Work', OECD: Paris.
[14] Dabla-Norris, E., Kochhar, K., Suphaphiphat, N., Ricka, F. and Tsounta, E. (2015) 'Causes and Consequences of Income Inequality: A Global Perspective' IMF: Washington.
[15] Onaran, O., Guschanski, A., Meadway, J., and Martin, A. (2015) 'Working for the Economy: The Economic Case for Trade Unions' Greenwich Papers in Political Economy, University of Greenwich.