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Labor Watch

The Union Difference

A Primer On What Unions Do To The Economy

By James Sherk

Summary: *What are unions, and what do they do? The AFL-CIO has an unhelpful answer: "Labor unions are made up of working people working together to solve problems, build stronger workplaces and give working families a real voice." A more straightforward answer would explain that labor unions are job cartels that try to restrict the number of people who can work for an employer. By reducing the supply of available labor, unions are able to raise their members' wages. That's the theory, but in today's competitive economy it often doesn't work. Want proof? Just look at what the unions have done to the auto industry in the once-great city of Detroit.*

Union auto workers on strike in Detroit, 1937

Everyone knows that unions try to raise their members' wages. But far fewer people understand how they try to do it. Unions cannot simply demand that companies hire their members for above-market wages. Employers would raise their eyebrows and simply say no.

To raise their members' pay unions must control the supply of jobs in a company or an industry. Unions must prevent employers from hiring anyone without their permission. If they can do this, they can expect the laws of supply and demand to work in their favor. Holding down employment drives up union members' wages. In other words, successful unions are job cartels.

The National Labor Relations Act (NLRA) gives unions this power. When a union "organizes" a company it obtains a monopoly over its jobs. The law authorizes a single union to act as the "exclusive bargaining representative" for employees in dealing with their employer. Businesses cannot directly hire workers. Instead they must first come to an agreement with the union over how many workers to hire and what to pay them. The monopoly gives the union the power to raise the wages of the company's employees.

For decades the Detroit auto industry offered a model for demonstrating the power of a union cartel in action. By the early 1940s the United Auto Workers (UAW) union had organized the Big Three automakers—General Motors, Ford, and Chrysler. The companies could not hire employees except on terms specified by the union.

Under the leadership of UAW President Walter Reuther, the UAW insisted on very generous compensation at each company. Reuther engaged in "pattern bargaining"—targeting one of the Big Three during contract negotiations for terms of a new (and usually generous) contract.

If the automaker would not pay, the union would strike, shutting down operations, sending business to the other two companies, and costing the targeted firm billions. So the target company routinely conceded to union demands. Reuther forced the other two automakers to accept contracts with similar terms. This strategy allowed the UAW to raise labor costs across the Big Three without putting any of the automakers out of business.

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This arrangement worked incredibly well for UAW members. Until the automakers were forced into bankruptcy proceedings in 2008 their labor costs (wages and benefits) exceeded $70 an hour. UAW members enjoyed seven weeks of paid vacation and they could retire to generous pension benefits after 30 years on the job, irrespective of age. They earned more than many Ph.D. scientists.

However, the UAW—like all cartels—helped its members at the expense of the rest of the economy. Detroit automakers passed along the cost of inefficient work rules and higher labor costs by raising their prices. Since the Big Three controlled almost the entire U.S. market for cars, and since Reuther did not allow them to compete on labor costs, American consumers had little choice but to pay more for their product. That meant higher monthly car payments and less money to spend elsewhere. For some people the higher costs made buying a car unaffordable. So Detroit built and sold fewer cars—and needed to hire fewer workers. The UAW raised its members' wages by raising prices and by restricting the job opportunities for everyone else.

The Power of Competition

For many years this was the pattern of auto industry employment and wages. But what eventually happened to Detroit automakers demonstrates the limits of union power. After General Motors and Chrysler filed for bankruptcy they negotiated new contracts that substantially reduced their labor costs. And despite promises of job security many UAW members lost their jobs.

What happened? Competition.

The UAW lost its control over the supply of jobs in the auto industry. In the late 1970s foreign automakers entered the U.S. auto market. In many cases they did not make "foreign cars." Instead, they produced vehicles built by American workers in the United States—but built by nonunion workers in southern states. Consumers could now choose whether or not to buy cars made by UAW members who worked for automakers headquartered in Detroit.

This competition hugely benefited the economy. Consumers decided that foreign automakers transplanted to America were making cars of higher quality and lower cost than Detroit's. To stay competitive Detroit automakers had to cut their costs and increase their quality. When that began to happen every American outside the UAW who purchased a car was better off.

But Detroit's response to the new competition was insufficient. Americans voted with their wallets and the Big Three's market share shrank. By 2007 Detroit automakers were producing less than half the vehicles sold in the United States. By 2008 their financial position had so deteriorated that the recession pushed General Motors and Chrysler into bankruptcy. As a result, labor costs in the new UAW contracts are now little higher than what nonunion autoworkers make.

Competition works to prevent cartels from benefiting their members or damaging the economy. If consumers have nonunion choices, then unionized firms cannot pass their higher costs on to them. Only if unions can restrict competition for jobs can they benefit union members..

How Unions Restrict Competition for Labor

An incident last September in Washington state illustrates the importance unions attach to restricting competition for jobs. In a scene that could have come from the 1954 movie *On the Waterfront* the *Associated Press* reported, "Hundreds of angry longshoremen stormed through a grain shipping terminal in Longview, Wash. early Thursday and held security guards at bay while descending on a disputed train full of grain, cutting brake lines and dumping cargo."

The International Longshore and Warehouse Union (ILWU) attacked the terminal to prevent another union from competing with it for dock work. The ILWU had previously organized every port on the West Coast. And it used its monopoly on dock labor to drive up the average wages of its member employees to $125,000 a year, plus $80,000 in benefits.

An employer called EGT Development built a grain terminal at the Port of Longview and hired workers from a different union to run it. This gave farmers a port from which to ship their grain without paying ILWU members $200,000 a year.

The ILWU didn't want farmers to have that choice. So its members overpowered guards, threw out grain, and sabotaged trains. The union tried to physically prevent other American workers from competing with it.

How Unions Use Government's Monopoly Powers

In this case the union overstepped a boundary because there are laws against violence and a judge quickly issued an injunction against the ILWU. More typically, however, unions today use government to restrict competition for them.

Unions lobby for government trade barriers that prevent Americans from buying from foreign competitors. They campaign for Project Labor Agreements that force construction contractors to sign collective bargaining agreements before beginning work. They take full advantage of the government rules and mandates by using regulations to shut down competitors.

For example, a few years ago the Ausra Corporation applied to build a solar power plant in the California desert. Most environmentalists consider solar power a "green" energy source. Nonetheless a coalition of construction unions called California Unions for Reliable Energy (or CURE), demanded that Ausra first study the project's effect on the short-nosed kangaroo rat and the ferruginous hawk. These environmental impact assessments tied up the company with delays and prevented the project from moving forward.

One of Ausra's competitors, BrightSource Energy, also applied to build a solar plant in California. This project was larger and it would affect the habitat of the imperiled desert tortoise. But this time CURE urged regulators to approve the application as quickly as possible.

What made the difference? BrightSource agreed to hire only union workers on its project while Ausra refused to sign a similar deal. The union used environmental lawsuits to tie up Ausra in green tape. That's one way a union can use government regulations to freeze out nonunion competition.

More Competition, Freer Markets Make A Difference

Fortunately for consumers, but unfortunately for unions, the American economy has become much more competitive over the past generation. Both Republican and Democratic Administrations have deregulated parts of the economy. President Carter deregulated the trucking industry, while President Reagan's Justice Department broke up the Bell monopoly. And both Republican and Democratic Administrations passed free-trade deals that opened up American markets. In 1975 the value of imports amounted to 7.5 percent of the U.S. economy. By 2011 that figure had risen to 16 percent.

Technology has also increased the pressure of competition. In recent decades transportation costs have fallen sharply thanks to improvements in supply chain technologies, which lets out-of-state companies compete with local businesses. And the internet makes it easy for consumers to compare prices and order from distant competitors.
These changes mean less expensive and higher quality products for Americans. They also make it very difficult for unions to prevent Americans from buying products made by nonunion workers. The union business model—designed during and immediately after the Great Depression—fits poorly into the modern competitive economy. As a result, unions can no longer deliver the same benefits to their members that they used to.

The Perverse Effect of Unions on Wages

Unions like to point to studies that compare the pay of union and nonunion workers. After controlling for other factors—education, experience, etc.—these studies typically find that union members earn 20 percent more than comparable nonunion employees. But economists have exhaustively examined the effects unions have on wages, and have discovered one surprising finding: unions cannot take most of the credit for these higher wages. For many employees being a member of a union no longer delivers a substantial wage premium.

How can this be, since union members do earn more? The answer is that unions are not the reason their members have higher wages. Union contracts make it difficult to lay off unproductive employees. As a result unionized companies become very selective about whom they hire. Knowing they cannot get rid of bad apples companies take more care to hire higher quality workers.

Research shows that more productive workers, whether unionized or not, earn higher wages—and this helps explain some union members' higher pay. In many of these cases it's not that unions are responsible for negotiating higher pay for workers; it's that unionized companies have an incentive to pay more to hire and retain productive workers knowing that whomever they hire can't be easily fired. Economists have tracked the wages of individual workers as they join and leave unionized companies. This enables economists to account for higher unobserved individual productivity. These studies find a much smaller than expected union premium—only 8 to 12 percent.

A similar perverse effect can be found in how unions pick companies to organize. You might think that unions would try to organize small and weak companies. In fact, they target larger and more profitable companies for unionizing drives. Unions know that workers have little appetite for unionizing when their firm is unprofitable and on the brink of collapse. They are more likely to unionize if they believe their company has earnings to spare. The irony is that larger and more profitable companies tend to pay higher wages—with or without a union.

Several studies have compared workers at companies who vote to unionize with workers at similar companies that vote against unionizing. They come to the surprising conclusion that—at these companies at least—unionizing did not raise pay. This does not prove that union cartels do not raise wages. But it does show that in today's competitive economy unions do not raise pay nearly as much as they claim to. In some companies unions don't raise pay at all.

Unions Reduce Corporate Investment

The companies where unions can raise pay are those that have a competitive advantage in the marketplace. Unions raise wages at companies that are sheltered from foreign competition or those with a growing demand for their product. Unions can also redistribute profits away from a company's research and development projects or long-term investments to unionized employees. The companies that can afford to grant union pay demands are those that have less fear of losing business.

Try this thought experiment. Imagine if General Motors had invested heavily in R&D and invented an inexpensive hybrid car that got 150 miles to the gallon. The company's sales and profits would soar. Toyota or Honda would not be able to produce comparable vehicles. How would the UAW react?

Instead of making concessions that lowered their members' compensation to nonunion rates, which is what happened when Detroit automakers were driven to bankruptcy, the UAW would be demanding even higher pay. Union officials would want their members to make $100 an hour instead of $70. In essence, unions seek to tax the profits of successful investments. If the investments pan out then unions demand that a part of the profits go to their members. But this reduces the return on investing for unionized companies.

Businesses respond to union "taxes" in the same way that they respond to government taxes: they invest less. Studies show that unionized companies invest about 15 percent less in both physical capital and R&D than comparable nonunion companies. Research shows that unions directly cause this reduction, it is not just a correlation. Investment falls at companies after unions organize them. One study found that being unionized has the same effect on business investment as a 33 percentage increase in the corporate income tax. Less investment makes businesses less competitive.

Less Flexibility and Competitiveness

Unions have a harmful effect on business efficiency in other ways. Collective bargaining—by definition—prevents a company from dealing directly with its employees. Changes to working conditions must be negotiated through the union. Unions claim this arrangement gives employees an institutional "voice" to amplify their demands to management. However, it also prevents companies from treating their employees as individuals. One master contract covers all workers. One result is that at a unionized firm seniority, not individual performance, dictates who gets a promotion or raise. Unionized firms cannot reward individual excellence.

Unions also reduce the flexibility of the companies they organize. Unionized employers cannot respond to competitive pressures by immediately changing their business plan. They must first negotiate with their unions. Contract negotiations can take many months and cost hundreds of thousands of dollars in legal fees. Unions often insist on concessions in exchange for new contract provisions. The upshot is that unionized businesses often try to avoid making changes because they are not worth the cost or time spent at the bargaining table. This sluggishness makes unionized businesses less competitive. They cannot respond as rapidly or flexibly as their unorganized competitors.

Fewer Jobs

If unionized companies are less flexible and invest less than nonunion companies, then we would expect them to grow more slowly and create fewer jobs. Unsurprisingly, research shows that this is exactly what happens. Employment drops 5 to 10 percent after unions organize a business. Thereafter, jobs in unionized companies grow more slowly (or shrink more rapidly) by an average of about 3 to 4 percentage points than at comparable nonunion companies. Of course unions try to avoid pushing the businesses they organize over a cliff. Research shows that unionized companies do not go out of business at higher rates than nonunion firms. Nonetheless, unions accept slower growth and gradual job losses as the price they are willing to pay for the contract provisions they want for their existing members.

If union members really wanted to help their employer succeed it's conceivable that they could decide not to "tax" away its profits at the bargaining table. That would encourage unionized companies to invest more and create more jobs. But given a choice between demanding higher pay for current union members or creating more company jobs in the future, unions usually pick higher pay.

Similarly, one can imagine that unions might negotiate very broad "management rights" clauses allowing businesses the flexibility to respond to changing business conditions without going back to the bargaining table. But it's clear that most unions prefer to exercise as much veto power as possible over a firm's employment decisions. At unionized firms layoffs occur on the basis of seniority, so the most senior union members know they are least likely to lose their jobs if the company gets in trouble. Most union members (who are not new hires) prefer layoffs.

Unions typically choose not to accept the changes necessary to prevent unionized companies from shrinking in a competitive economy.

Why Unions Won't Recover Their Lost Members

In 1973 almost a quarter of private sector workers belonged to unions. That figure has now fallen to below 7 percent. The number of unionized jobs in the private sector has fallen by an average of 3 percent a year over the past generation. Unions would have to organize hundreds of thousands of new members each year just to keep up with the jobs they are losing at unionized firms. Union organizers can't keep up.

Private sector union membership is unlikely to rebound. Unions make companies less attractive to investors. As a result investment—and jobs—tend to move toward nonunion companies and regions. In a competitive economy investors can do this quite easily.

The recent notorious National Labor Relations Board complaint against Boeing shows how union activism discourages corporate investment and job creation. After repeated union strikes at its plants in Washington state cost Boeing billions of dollars in lost orders, the company decided to build a $750 million factory to produce its new 787 Dreamliner aircraft in right-to-work South Carolina.

The NLRB filed suit claiming that Boeing's action was an effort to punish the union. Recently the Machinists union withdrew its complaint after Boeing agreed to a collective bargaining agreement guaranteeing that a different Boeing aircraft would be produced in Washington. But Boeing's decision to invest in non-union South Carolina prevailed.

Union-Heavy States Lose Jobs

Heavily unionized states are hurt by corporate decisions like Boeing's. But as the economy becomes increasingly competitive it's inevitable that states that make workers join unions will drive jobs away to states that don't. The classic example is what happened to the auto industry in the industrial Midwest.

In the late 1970s 41 percent of all American auto and auto parts manufacturing jobs were located in Michigan. Another 12 percent was located in Ohio. But in the 1980s "foreign" nameplates like Toyota began building vehicles in the U.S., and they did not build their factories in Michigan.

Foreign automakers located their plants in right-to-work states in the South. These jobs paid well—around $45 an hour in wages and benefits —but they were nonunion jobs. The United Auto Workers tried repeatedly to organize the new plants but it was rebuffed by their workers.

As auto-related jobs grew in the South they declined in Michigan and the rest of the Midwest. Between 1990 and 2007 the number of auto manufacturing jobs in Michigan fell from 102,000 to 58,000. Over a longer period, from the late 1970s to 2006, Michigan's share of U.S. auto and auto parts manufacturing jobs fell by almost a third, from 41 to 28 percent.

Other heavily unionized states saw their share of auto-related employment fall as well. New York's share fell by 3.5 percentage points, Wisconsin lost 1.5 points, Ohio 1.4 points.

Auto-related manufacturing jobs increased in the mostly non-union south during the same time period. Between the late 1970s and mid-2000's the share of auto-related manufacturing jobs grew by 2 to 3 percentage points in Tennessee, Alabama, South Carolina, and Kentucky. In Alabama, for example, the number of auto manufacturing jobs went from 400 to 12,000 between 1990 and 2007.

Developments like these affect other jobs beyond the auto industry. Economists who have examined counties that border each other across state lines find that the proportion of manufacturing jobs in counties in right-to-work states is a third higher than the neighboring counties in non right-to-work states. The evidence makes clear that jobs are migrating away from heavily unionized states.

The Government Exception

There is one exception to this long term and widespread trend. The forces of competition are hurting unions in every sector of the economy but one: the government. The benefits of competition are not available to Americans who make use of unionized government services. Citizens only receive public services from the state they reside in. The only way for residents of California or New Jersey to receive non-union police protection or a non-union public education is to move to a state without government unions.

Unlike private sector employers, the government does not risk losing market share when it is inefficient. Government unions can raise agency costs without fear of losing their jobs. As a result, government union membership holds steady even as union membership in the private sector keeps falling. In fact, a majority of union members now work for agencies of government. Twice as many union members work in the Post Office as in the domestic auto industry.

The increase in government union membership is good for the union movement but bad for taxpayers. In many states government employees earn considerably more than their private sector counterparts. Cash wages may be comparable, but government employees receive far greater benefits. In California, for example, government employees make 30 percent more than they would in the private sector. The rest of society pays for public employee benefits through higher sales, income, and property taxes.

Conclusion

What unions do has hardly changed since the end of World War II. They still try to organize workers and win pay increases and benefits for their members by controlling the supply of jobs at a company or in an industry.

But while the union movement insists on using traditional methods to organize workers and negotiate with employers, the American economy and workforce is undergoing very dramatic changes. New technologies and expanding global trade are weakening union attempts to maintain job cartels. Unions are driving investment and jobs away from the industries and states where they predominate.

The union movement has to develop a new model for doing business. If it can't or won't, the answer to the question "What do unions do?" will soon be: "Not much."

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Many thanks,

Terrence Scanlon
President

LaborNotes

The drop in the national unemployment rate from 9 to 8.6 percent in November was hailed by many as a welcome bit of good news. A closer look at the numbers, however, shows little reason to cheer. For one, many of the new jobs added in November were seasonal, temporary positions. For another, as *Business Week* noted, “In November about two-thirds of the improvement in the jobless rate came from people dropping out of the labor force and thus out of the calculation of the unemployed. Only one-third was because of actual job creation.” We still have a long way to go.

Unions fought Wisconsin Gov. **Scott Walker**’s 2011 collective bargaining reform law because they suspected it would devastate their membership. Turns out they were right: The Racine, Wisconsin *Journal Times* reports: “Two area teachers’ unions have disbanded in relation to Gov. Scott Walker’s legislative changes to public union rules. The **North Cape School District teachers’ union** last week did not get a majority of members to vote for recertification, something now required annually because of Walker’s changes, which also essentially eliminated collective bargaining for teachers’ unions. The **Yorkville School District teachers’ union** did not hold a recertification vote, instead voting earlier this fall to simply disband.”

A Big Win for Big Labor: The union shakedown of **Boeing** over the company’s decision to locate some of its airline production in right-to-work South Carolina has been a resounding success. The **National Labor Relations Board**, which sided with the **International Association of Machinists and Aerospace Workers** in the dispute, has agreed to drop its suit against Boeing - after, note the editors of the *Washington Examiner,* “the company agreed to keep production of a new version of its familiar 737 jet with the unionized workers in the Seattle area.” Suspiciously, the deal also included “substantial raises for the union workers and increased job security for them.”

On December 12th, **Occupy Movement** forces moved to disrupt port activity up and down the West Coast, from California to Oregon to Vancouver. To their credit, some unions distanced themselves from these antics; the **International Longshore and Warehouse Union** and the **Building Trades Council** have condemned the protests. Unfortunately, however, as the *LA Times* noted, “the **Oakland Education Association**, which represents teachers, is backing the protest and encouraging members to participate on their own time. The union has participated in Occupy events since the movement’s inception, contributing to sanitation at the Oakland City Hall plaza encampment before it was razed.”

If you love freedom, you’re an extremist in the throes of an outdated idea - or so says one legendary labor leader. **Andy Stern**, former president of the **Service Employees International Union** (SEIU) recently took to the pages of the *Wall Street Journal* to praise China’s state-managed economy and urge the U.S. to follow a similar path: “The conservative-preferred, free-market fundamentalist, shareholder-only model - so successful in the 20th century - is being thrown onto the trash heap of history in the 21st century. In an era when countries need to become economic teams, Team USA’s results - a jobless decade, 30 years of flat median wages, a trade deficit, a shrinking middle class and phenomenal gains in wealth but only for the top 1 percent - are pathetic. This should motivate leaders to rethink, rather than double down on an empirically failing free-market extremism.” Such sentiments should come as no surprise: As CRC senior editor **Matt Patterson** noted in the pages of the *Washington Times*, organized labor and communism have a long and sickening history together.