ECONOMICS U$A

PROGRAM #9

# LABOR AND MANAGEMENT: HOW DO THEY COME TO TERMS?

AUDIO PROGRAM TRANSCRIPT

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MUSIC PLAYS)

Announcer: Funding for this program was provided by Annenberg Learner.

FRANK STASIO: This program was originally recorded in 1985. Though times have changed, the basic economic principles presented here remain as relevant today as they were when this series was produced. Also, please note that individuals interviewed on this program may no longer hold the same titles they held when this program was recorded.

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FRANK STASIO: Economics U$A. One of a series of programs designed to explore twentieth-century micro and macroeconomic principles. The subject of this edition is Labor Unions and the Demand for Labor. Our guest is James Medoff, Economics Professor at Harvard University. I'm Frank Stasio.

FANNIE SUSKIND: "We came here with the needle in our hand. I worked since twelve years old when I came here."

FRANK STASIO: Fannie Susskind worked in a sweatshop, a steamy dark and dusty clothing factory where men, women and children worked long hours for little pay earning their keep in a foreign land. Susskind was one of thousands of immigrants who came to

America around the turn of the century hoping to find a job and make a fortune. For most garment workers, only half of the dream came true.

JO-ANN ARGERSINGER: “The sweatshops that emerged in the late nineteenth century really came about because of the structure of the industry.”

FRANK STASIO: Jo-Ann Argersinger is a history professor at the University of Maryland.

JO-ANN ARGERSINGER: “There was a, um, chaotic industry, was intensely competitive, and there were large number of workers, particularly women and imm…immigrants, who were easy prey for many of the employers.”

FRANK STASIO: Conditions were miserable and individual workers were powerless to change anything.

FANNIE SUSSKIND: “There was no use asking the boss for a raise. He used to laugh at you we would ask for a raise. And piecework when we used to work it used to be at waste.”

FRANK STASIO: The garment workers organized a union in 1900. But it did nothing to stop the deteriorating conditions until nine years later when the International Garment Workers Union went on strike. The strike lasted three months. When it was over, garment workers were earning up to fifteen percent more in wages, their work week was shortened, and they now had some say in working conditions and pay. Why were garment workers paid so low to begin with? What was the true value of their labor? Is labor just another production input? Or do workers deserve special consideration? And can labor demand too much? Before we can answer these questions, it’s important to understand that there is some disagreement among economists about the nature of labor markets. James Medoff is an economics professor at Harvard University who along with coauthor Richard Freeman wrote the book *What Do Unions Do*?

JAMES MEDOFF: “Well the neoclassical economists views the market, the labor market, like any market and therefore he or she believes that forces of supply and demand will determine the ultimate price of the commodity at hand. In the case of the labor market the commodity that we would be talking about is people's time. People who disagree with the neoclassical view of the labor market don't believe that the forces of supply and demand are what ultimately determine what labor of different sorts will be paid."

FRANK STASIO: The argument over how to determine the value of labor stems from a disagreement about how the labor market actually operates in the economy.

JAMES MEDOFF: "If you go back in the history of economic thought, you'll see that there are really two strands about how…two strands of thought about how labor markets operate. The first was associated or is associated with Adam Smith, and that is what we call the theory of compensating differentials or the theory of equalizing differences. This really is the neoclassical view of labor markets. In this view workers are free to move from one workplace to another so that they maximize the net…so that they maximize the utility taking into account both working conditions and wages from where they end up. So the labor market in the neoclassical or equalizing differences or compensating differentials view is a like a boars. It's a market where there are no barriers to exit, no barriers to entry, where workers have the information needed to make the decision as to where they want to work. On the other hand there's a view of labor markets which is associated with John Stewart Mill and there have been other followers since Mill wrote. And according to this view, which has been labeled the theory of non-competing groups, according to the non-competing groups' view of labor markets, workers do not have the mobility to move freely from one workplace to another workplace. And if you want to understand labor markets you have to recognize that there are all sorts of islands and on these islands different sets of rules and sets of customs develop and they are ultimately what determine the pricing and the allocation of labor."

FRANK STASIO: If we were living in a perfectly competitive economy like the one envisioned by neoclassical economists, the demand for labor would be determined just like any other input.

JAMES MEDOFF: "According to the neoclassical view, the firm compares the wage that would…that it would have to pay an additional worker to the value of that worker's contribution to the firm. In the neoclassical view of the world firms are concerned only with the maximization of profits, and as long as they can get more in terms of contribution from a worker than they have to pay the worker, then their profits will be increased if they hire the worker. So too if a worker is being paid more than his or her current contribution, the firm would do well to get rid of that worker so that their profits would be increased."

FRANK STASIO: Deciding whether or not it will be profitable to higher extra employees depends to a large extent on the productivity of those employees. If, for example, the demand for a firm's product increases and the price goes up, the firm would make more money per unit of output. So it may be wise to put on additional workers in order to expand output. The same is true if a firm gets new equipment that allows workers to turn out more units per hour, the productivity of those workers increases and again the firm earns more profit per employee so it should add workers to maximize profit. Although Medoff points out that when technological changes lead to increased productivity, it does not always mean more jobs.

JAMES MEDOFF: "The impact of productivity on employment is a very controversial subject. It has involved the leading economists of the world for a very long period of time. If we go back to England, we can read the writings of Malthus and Ricardo and we'll see that one said that technological advancement, which would increase productivity, will definitely come at the expense of workers' jobs. The other said no this is wrong; as we adopt new technology, the prices of commodities will decline, employ—em…em…consumers will therefore consume more and that will increase jobs. If we choose a particular industry, say the newspaper industry, we can see that at various points in time technological advancement had very different effects on employment. I have in mind the introduction of the line-a-type machine, which ultimately led to an increase in the employment of people who had the types of skills involved in setting type. What happened in the printing industry when this occurred was that that the price of print or printed materials went way down and therefore the demand went way up and employment surged as a result. It turns out also that the typesetters who were unionized were very much in demand and they enjoyed increased wages and they enjoyed a greater opportunity to have more workers become fellow members of the union. If we look at a later point in time in the same industry, we will see that the, uh, computer comes to the industry and workers who had skills that were important to the production of newspapers were no longer as necessary as they were prior to the advent of the VDT. Now in the newspaper industry somebody who can type can do the job of an employee who had important skills. So what's happened in the industry is that the skilled employees to a great extent have been replaced by the computer by the VDT, by the terminals which can be operated by very unskilled workers."

FRANK STASIO: Whenever the issue of productivity is raised, a discussion of labor unions is not far behind. Clearly, garment workers at the beginning of this century needed to organize in order to be heard and lift themselves out of their dreadful conditions. But many economists have argued that more recently labor unions have had a bad effect on the economy by reducing efficiency and lowering productivity growth. James Medoff argues that much of the criticism of the recent effect of unions is not very well grounded in fact. Medoff says that a close look shows that unions may actually increase efficiency.

JAMES MEDOFF: "There has been a fair amount of empirical research which has involved comparing the productivity of unionized and non-unionized workers in comparable work places, that is in the same industry, in workplaces of equal size with roughly similar technology. And what these studies have shown is that the unionized workplaces tend to be somewhat more productive, not less productive, than the non-union workplaces. Why might this happen? Well there was some evidence that the quit rate in unionized workplaces is reduced by the coming of the union. That is, with a union workers have less need to vote with their feet when they're happy; that is they have less need to just leave the workplace and look for some other workplace. What they do in a unionized workplace is turn to the appeals system, the grievance system, file a grievance and let that be…and let themselves be heard through this channel. Or they talk to their union representatives and say, 'gee this problem should be discussed and dealt with at the next bargaining round,' be it one year or two year or three years from now. It's also the case that the coming of a union represents what has been called a shock to management, and also over time represents a source of…of pressure on management to manage better. There's evidence that after the…the union succeeds in…at a workplace management becomes much less authoritarian or paternalistic and much more willing to have a rational system for production. So a combination of a reduced need to leave one's employer because the union will provide voice to you and better management practices because the union represents a form of sustained pressure leave productivity to be somewhat higher in many workplaces than it was before the coming of the union."

FRANK STASIO: Medoff is quick to point out that firms are not likely to embrace unionism anytime soon just because they appear to increase productivity.

JAMES MEDOFF: "Saying that productivity is higher is not the same as saying that profitability is higher. So in addition to raising the productivity of some workplaces, unions can be expected to raise the amount the employers have to pay in terms of wages and also increase the amount that employers have to devote to fringe benefits. So when the dust settles, productivity may go up, profitability may go up or it may go down. The evidence indicates that on average employers have a lower rate or return, that is have a lower amount of profits per unit of capital, in unionized workplaces than they do in comparable non-union workplaces. So while unions increase productivity in many workplaces, they reduce profitability in many of the same workplaces."

FRANK STASIO: Some economists argue that reducing profitability is a bad thing since it lowers the return to capital and distorts the allocation of capital throughout the economy. But Medoff says this is not the case.

JAMES MEDOFF: "What unions tend to do is find out where there is a rate of return on capital beyond what might be called normal. That is beyond what is really needed to keep capital in the place where it's found. These returns have been called elsewhere monopoly returns to capital or excess returns to capital. For instance, if you take an industry where there is very little non-union competition or very little foreign competition then the profits enjoyed by capitalists will be extremely high. Unions understand this and when they bargain say we want a share of this excess profits pie and they have been quite able to get a share of the excess profits pie. Now when events occur like the deregulation of industries which increase the amount of competition in those industries or changes in the degree of foreign competition coming from either a dramatic increase in the exchange rate or efforts on the part of foreign governments to crowd or get into U.S. markets, then the pie, the excess profits pie, available to both capitalists in those industries and to the unions in those industries diminishes. Therefore, unions are now confronted with having to give or…or having to enjoy less of the excess profits and this will usually take the form of some type of wage concession. So again the bottom line here is that productivity and profitability are not the same thing. Employers are driven by profits. Therefore, they are very unlikely to open their arms to unions unless they believe that for some reason their productivity will be increased more than their, uh, wage infringe bill. It's important to recognize that for citizens the really relevant issue is productivity. For the individual wearing the hat of Joe or Mary Citizen, the issue is how productive is my society. The citizen is less concerned about who exactly gets what piece of the pie. That's a question of distribution. And the rents or the excess profits might go to labor or they might go to owners of capital, but to the citizen that's much less important than the size of the pie itself."

FRANK STASIO: Critics have also said that unions stand in the way of technological progress in order to preserve jobs. But again Medoff argues that the evidence is scarce.

JAMES MEDOFF: "Unions in this country have historically understood that they cannot block technological change. It's going to occur. What they can try to do is get on the bandwagon, um, make the lives of their members better in a new economy. Now there are some exceptions. There are some unions who have tried to stop technological change. You probably wouldn't have heard of them because they no longer exist. I'm talking about unions like the cigar makers or the unions involved in the production of…of glass for, um, window glass. And when there were important technological changes in those industries or…or in the industries of concern, they tried to negotiate contracts that would prohibit employers from adopting these new advances. And this had to lead to failure in a reasonably competitive society which we…which we live in."

FRANK STASIO: When unions cannot stop firms from using new technology, they've sometimes tried to protect jobs by insisting that worker not be replaced even though they're no longer needed. This is a practice known as featherbedding.

JAMES MEDOFF: "When you look at the facts, what you find is that featherbedding is not the norm but rather is a rare event. It's not…it's not…I…I should not say and I would not say that it doesn't exist in some settings, it clearly does. But when you go to…to industries like manufacturing which are highly competitive, both, um, domestically and now in a…in international market, you find that the firm that is not cost effective is going to go out of business. Unions have understood that. They have not, for the most part, negotiated work practices that reduce productivity."

FRANK STASIO: Perhaps the most serious charge leveled against unions is that they were mostly to blame for the high spiral inflation of the Nineteen Seventies. Critics point to huge wage settlements negotiated by union, but for their part unions insisted that they were only trying to keep up with inflation.

JAMES MEDOFF: "To say that unions were responsible for the inflation that recently has plagued the economy is really quite incorrect. Unions had nothing to do with the energy price increases. Unions had virtually nothing to do with the, uh, anchovies swimming out to sea which caused the prices of food to go up. And in fact what you would find is that the prices…prices changed in the economy before the wages of the unions that we're talking about change. So it…it's hard to argue that this is cost push inflation, at least in the recent period. Now having said that, and again what I'm saying is that it's just wrong to say that unions are a primary source of…of or…or…or that unions were the primary or the key factor in causing the recent inflation, and I should add to that the fact that only eighteen percent of the U.S. workforce is unionized, so you wonder what's going on with the other eighty-two percent. It's not as if a hundred percent of the workforce or even…even eighty-five or ninety percent or even fifty percent of the workforce is unionized; it's only eighteen percent. So we have to be careful that we don't' have the tail wagging the dog here. And I think to say that unions were the primary cause of the recent inflation really does have the tail wagging the dog. Now having said that, I don't want to say that unions are not responsible for any of the inflation that occurred recently. They are in the way that they are responsible is that when this recent inflation occurred what was going on was that the Arabs were demanding more money for their oil and they were going to get richer, and we as a country had to get somewhat poorer. Unions recognized this and they said we're not going to get poor; we're going to fight for our members. And throughout the 1970s unions were very successful in fighting for their members. In fact, if you look at the pay differential before union and non-union workers, that is if you compare the union wage to the wage received by comparable non-union workers, you'll see that while 19—in the beginning of the 1970s, unionized workers received about fifteen percent higher pay than comparable non-union workers. By the end of the 1970s, they were receiving roughly twenty-five percent more. This is because during the '70s non-union workers had much less power to prevent these wage, um, had much less power to prevent a reduction in their real standard of living."

FRANK STASIO: This leads to yet another criticism of unions. That unions gain wage and benefit increases at the expense of their fellow workers who are not organized.

JAMES MEDOFF: "In talking about this, it's important to recognize that there is a lot of diversity within the non-union workforce. While I'd say that the non-union workers suffered to a much greater extent throughout the '70s than did the union workers, I should clarify that a bit by saying that the non-union workers in smaller companies suffered much more during the '70s than did the union workers. In the large non-union companies, wages tended to grow throughout the '70s in way…in a way quite similar to how they were growing under union contracts."

FRANK STASIO: Medoff says that most of the recent criticism of unions stems from the attention given to the strength of unions as a monopoly force in the workplace which can give them powerful leverage to gain better wages and benefits. But he argues that unions have another face. According to Medoff, unions give workers a voice in areas that affect them but which they might not be able to influence as individuals.

JAMES MEDOFF: “In economic theory we refer to these goods as public goods. These are goods which are enjoyed or not enjoyed by all the individuals in a given state or a given workplace. In addition to public goods, we talk about externalities. And externalities are actions on the part of one person that affect the well being of some other people. Now when you have public goods and externalities, what you have is a market failure. The market will not lead to the right amount of consumption or production of these goods. What is needed here is some supra individual force, some referee to come in and say well you really are getting this benefit from this good or you really are imposing this cost and therefore…fore we want to have a tax system that will lead to the optimal production and consumption of various commodities that are affecting all the individuals in the organization or fisk at hand. A union can do this. A union can come in and say we have collective goods in the workplace, be they a pension plan or a set of rules determining who will be laid off if someone has to be laid off. These are goods which will affect everyone and therefore no one individual will make a decision that really takes into account the well being or harm that the collective feels. And we the union can look into the minds of all the individuals and make a determination as to what is wanted and then tell the employer at the bargaining table what his or her workforce does indeed want.”

FRANK STASIO: An example of a breakdown in the simple supply and demand concept of the labor market is the way older employees might be treated. According to neoclassical theories, workers are free to leave an employer if they are not happy with the wage they’re getting.

JAMES MEDOFF: “Senior workers do not have the same ability as junior workers. So if they are going to be heard, it’s going to be necessary to have them be heard through some vehicle other than the voting process. That is vo—the process of voting with one’s feet. The union, in aggregating all the preferences, takes into account the preferences of the senior workers, and that’s why it recognizes that these infra-marginal workers, these workers who are not at the coming or going margin, have important desires that are not being met by the market itself. These desires will be for things like a pension plan or for life, accident, and health insurance.”

FRANK STASIO: Medoff says that labor unions might improve their somewhat tarnished public image if they placed a greater emphasis on the voice aspect of their activity. Now let's look back at some of the key ideas in our discussion about labor unions and the demand for labor. The neoclassical view of the labor market holds that the price of labor is set by the supply and demand for labor and that workers are free to find an employer who will pay the highest possible wage for their services. An opposing view holds that, for a variety of reasons, workers do not have complete freedom to find that employer and therefore the labor market is not completely competitive. A firm will add extra labor as long as the cost of hiring an extra worker does not exceed the value added by that employee. According to James Medoff and Richard Freeman of Harvard University, there are a number of unsubstantiated myths about the effects of labor unions on productivity. They argue that contrary to popular opinion, labor unions do not always decrease productivity growth and in fact may actually increase efficiency. Medoff and Freeman say that unions are usually successful at gaining higher than average wages in industries that enjoy monopoly profits. Further, they argue, that union's effect on inflation has been overstated, as has the amount of featherbedding – that is forcing firms to keep unnecessary workers on the payroll. They say that unions do more than gain better wages and benefits for their members. By giving voice to workers in areas they might not be able to influence as individuals, unions may improve the efficiency of the economy as a whole.

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FRANK STASIO: You've been listening to Economics U$A, one of a series of programs on micro and macroeconomic principles. Our guest has been James Medoff, Professor of Economics at Harvard University. Economics U$A has been produced by the Educational Film Center in Annandale, Virginia. I'm Frank Stasio.

(MUSIC ENDS)

Announcer: Funding for this program was provided by Annenberg Learner.