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The Effect of Labor Unions on Real Wages and Prices

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THE EFFECT OF LABOR UNIONS ON REAL WAGES AND PRICES

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Introduction: Brief history of union beginnings

I. Wages have risen

A. How much they have risen

B. Factors causing rise

II. Ways unions affect wages

A. Minimum wage legislation

B. Collective bargaining

III. Effect unions have on economy

A. Cause wages to rise

B. Inflationary

Conclusion: Unions have contributed greatly to inflation

The Effect of Labor Unions on Real Wages and Prices

In order to discuss the effect of unions, I feel we should first discuss the growth of unions; for at first they had very little power. Although there were unions of some sort or another existing in America since colonial days, it was late in the eighteen century when they really began to have an influence. This influence began with the rise of the American Federation of Labor. "Led by Samuel Gompers and Adolph Strasser of the Cigarmaker's International Union, this group was composed primarily of represenatives of the skilled trades. ... These trades unionists felt that the mass movement of the Knights of Labor was doomed to defeat, that trade unionism could best succeed if confined to those who were able to organize themselves, in other words, skilled or strategically located groups; and that trade-unionism should confine itself to the immediate issues of improving workers' wages and working conditions rather than to work for a Socialist Utopia, or to get entangled with other political movements or 'uplift' campaigns.

"The philosophy of the AFL leaders was a pragmatic one; to the great mass of workers they said in effect: 'Organizing will help you, but until you are ready for organization, we can best aid you by pulling up our wages and thus indirectly influencing yours to rise also.'"[1]

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[1] Gordon F. Bloom and Herbert R. Northrup, Economics of Labor Relations, Richard Irwin, Inc., Homewood, Ill., (1961), p.48-9

It was this policy that caused great strides to be made unions in the wage rate of labor. The wage paid to labor rose greatly in the period from about 1900 to the present time. The following chart and accompanying graph shows the increase in hours and earnings for production workers in manufacturing from 1909-1967.

year	weekly earning	hourly earning	weekly hours
1909	$9,74	$.191	51
1914	10.82	.221	49.4
1919	21.84	.472	46.3
1924	23.67	.541	43.7
1929	24.76	.560	44.2
1930	23.00	.546	42.1
1931	20.64	.509	40.5
1932	16.89	.441	38.3
1933	16.65	.437	38.1
1934	18.20	.526	34.6
1939	23.64	.627	37.7
1940	24.96	.655	38.1
1941	29.48	.726	40.6
1942	36.68	.851	43.1
1943	43.07	.957	45.0
1944	45.70	1.011	45.2
1949	44.20	1.378	39.1
1954	70.49	1.74	39.6
1959	88.29	2.19	40.3
1964	102.97	2.53	40.7 [2]

Now the above chart is an 'adjusted one'. That is, the average hourly wages are corrected for changes in living costs. A great deal of the rise in wages has been due simply to the economic growth of our nation. This can be seen by drawing several parallels between rises and falls in real wages and the changes in the economy as a whole.

For instance, the most glaring drop in the wages was in the period of from 1929-33. This as we know was the period of the depression, and by comparing the wage rate with changes in the Gross National Product, it will be shown

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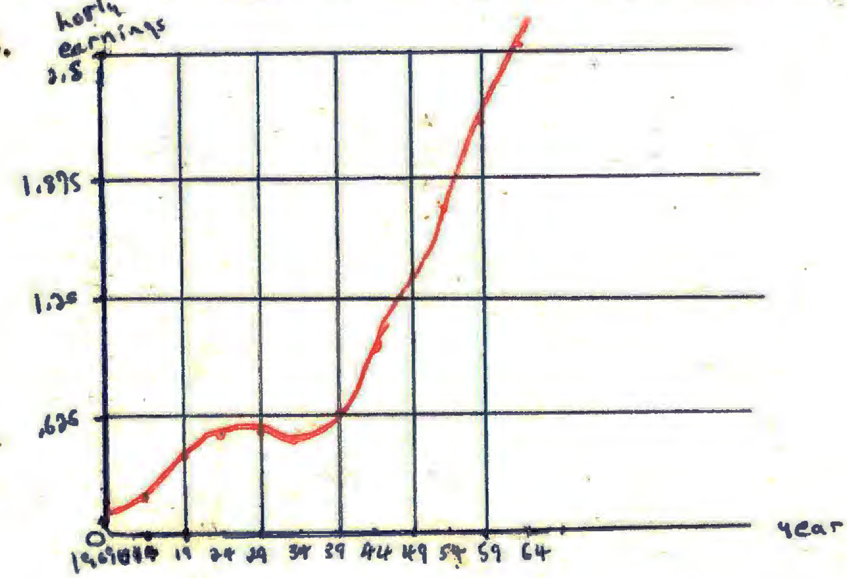
[2] Employment and Earnings Statistics for the United States 1909-1965, Bulletin 1312-3, United States Department ofLabor, 1965, p. xxv

the two are related:
From 1929-33 the GNP fell from 104.4 billion to 56.0 billion in 1933. That is a drop of 46%.
At the same time the average weekly earnings of production workers fell from $24.76 to $16.85 or a drop of 32%.
As another example, during World War II, the GNP rose 113% while the wage rate of labor rose 77%.
So, it can be seen that the wage of labor is related very strongly with the economy in general.[3]

However, unions do have an effect on the wage rates of workers, for unions have secured many contracts which have caused the wage rates of workers throughout the economy to rise. They have done this in many ways; through collective bargaining, establishing of minimum wages, and others. The result has been a rise in the wage level of the worker; for as the chart pn page two showed, the wage level has risen 132%.

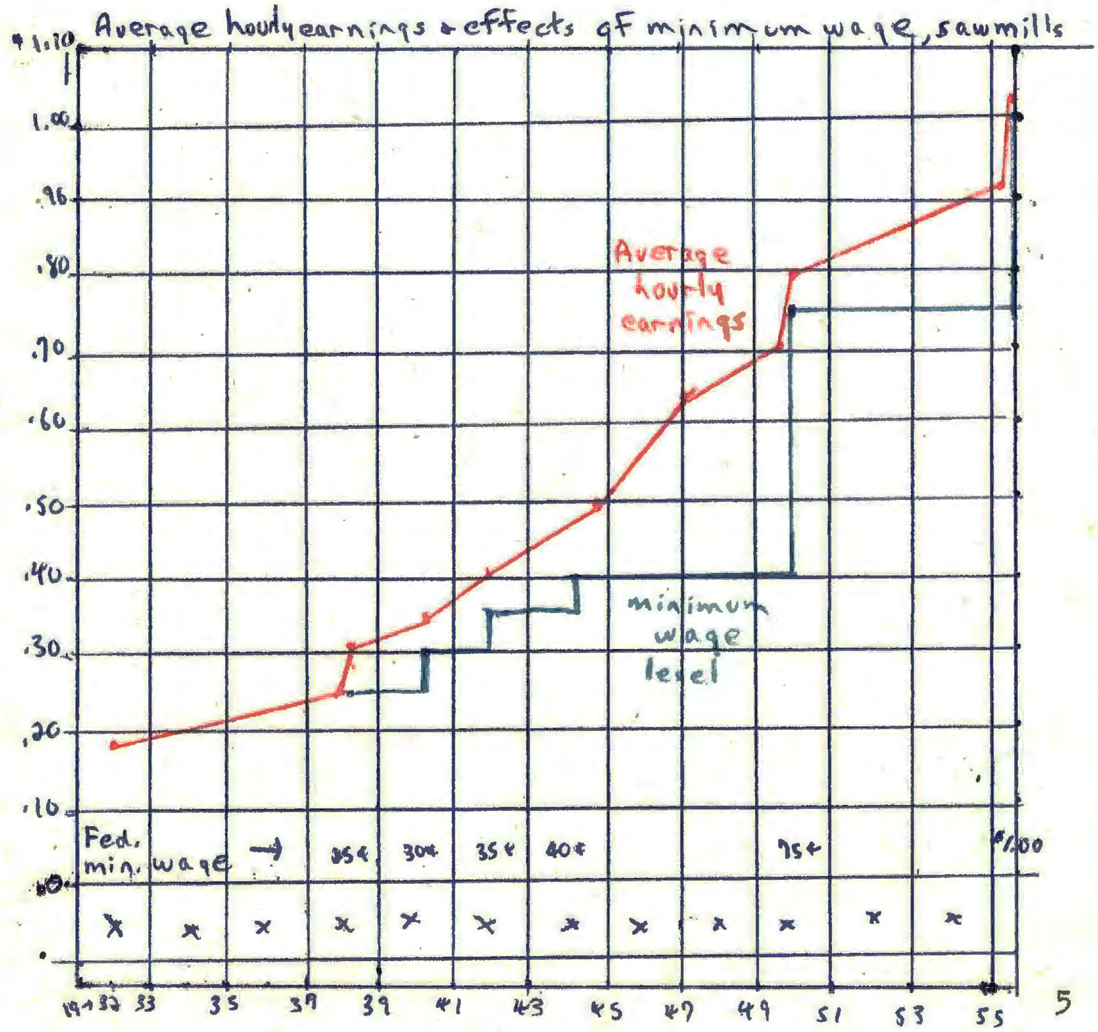


"In postwar research, explanations of union influences on wage relationships have tended to fall into two categories; (1) Those which emphasize the same market determinants of wage already known and (2) those which, without denying any underlying market influence, stress that unions introduce

[3]The figures in above section were taken from the United States Department of Labor's Bulletin 1312-3 and from the 1965 Statistical Abstract of the United States.

a new element."[4]

The two main methods of new elements that unions have introduced have been collective bargaining and pressure for minimum wage laws. Let us take minimum wage legislation first. Although this is a governmental change on wage structure, it should be agreed that without the pressure of union groups it would not be as likely to have come about. The effect on the wage structure is marked, as the following chart will probably show.



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[4] Neil W. Chamberlain, The Labor Sector, McGraw-Hill Book Company, New York, (1965), p. 397

[5] Gordon F. Bloom and Herbert R. Northrup, Economics of Labor Relations, Richard Irwin, Inc., Homewood, Ill., (1961), p.563

This is a graph of wage level in Southern sawmills, and it can be seen, that each time a minimum wage level went into effect, there was a much greater than normal change in the overall wage level of the industry.

The reasons in favor of the minimum wage laws are numerous, with perhaps four having the greatest impact. "First, it is said that in the absence of legal wage minima, unscrupulous employers who are in a favorable bargaining position will hire worker at sweatshop wages. The cost advantage which they derive at the expense of the workers whom they employ permits them a competitive edge over their business rivals. ....

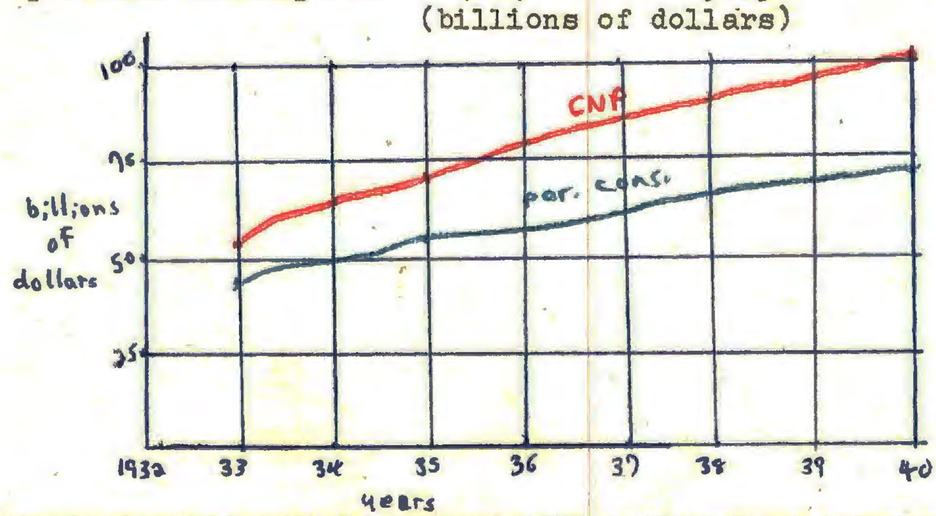
"The second major justification for minimum wage legislation lies in what is presumed to be t e fole it plays in restraining the downward drift in depressions. As expenditures fall off, and in the absence of a lower limit to wages, employers will seek to stimulate sales by cutting prices; with mounting unemployment, they will be ablle to accomplish this through reducing the wage rates of their employees .... But with declining wage rates, workers will have less to spend, so sales will continue to fall off, prices and wages decline further, and so on, in a downward spiral.

"A third argument is based on the positive benefit which may come from added wages in the pockets of workers. If employers are forced to redistribute income in faver of empleyees, by bringing wages up to some legislated minimum, this added purchasing power in the hands of low-income groups- who may be expected to spend it promptly- will increase the demand for mass-production goods and services and act as a forward thrust to the economy."[6]

Although this particular incident was not a result of minimum wage legislation, it does back up quite well the third argument. With the beginning of the Roosevelt administration in 1933, there was a great amount placed in the hands of the consumers through the WPA, CCC, and like ventures. Although this money was transferred from government to consumer rather than from business to consumer, the results would be parallel. The results were that with the increase in income of low-income groups, the national economy grew rapidly, for because these people had little, they spent nearly all the money they received, thus causing a greater amount of currency being spent in the economy.

	1933	1935	1940
GNP	56.0	72.5	100.6
personal consumption	46.4	56.3	71.9 [7]

(billions of dollars)



[6] Neil W. Chamberlain, The Labor Sector, McGraw-Hill Book Company, New York(1965), p. 507-8.

[7] United States Bureau of Census, Statistical Abstract of United States; 1965 (86th edition), Washington, D. C., 1965, p.324

"Fourth, low wages, it is said, constitute a kind of sub- to the employer who pays them. Workers cannot maintain their families on a standard of health and decency if they are paid substandard wages. The consequence is that the community must maintain free health clinics, provide relief in times of emergency, establish houses of correction for those whose waywardness has its roots in poverty-bred slum conditions and so on. These costs are borne by society, at least in part, becouse some employers exploit their labor. ... Thus society is subsidizing those employers low cost operations. If a wage floor is established, raising the wages of the lowest paid wage earning group, these social costs can be reduced since those workers will now be better able to provide for themselves."[8]

Through these arguments and others, labor unions have "been the principle pressure group behind such legislation."[9] It has been successful pressure, for minimum wages which were first set in 1938 at $.25 an hour have risen to $1.25 an hour 1966 with a proposed raise to $1.60 an hour pending for next session of Congress. So, it can be seen that unions, through pressure for minimum wage, has raised wages in this manner.

Of course, the primary way unions have affected wages is through the use of collective bargaining. Unions have achieved great power in this nation through the use of collective bargaining and the sanctions connected with it - such as strikes, walkouts, boycotts, etc.

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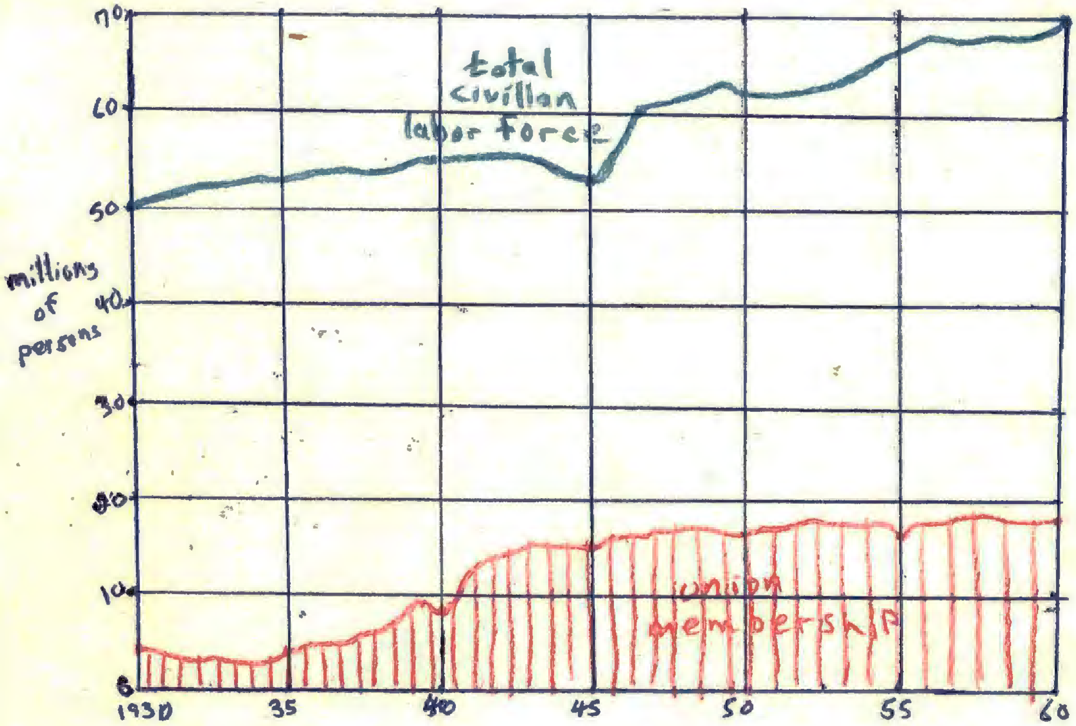
[8]Neil W. Chamberlain, The Labor Sector, McGraw-Hill Book Company, New York, (1965), p.508
[9]Ibid, p.506

Union membership has risen greatly in the last sixty years. In 1900 there were 791,000 union members in a labor force of 27,640,000. The percentage of union members in the labor force was about three percent. This percentage rose to a high of 33 percent of the non-agricultural civilian labor force in 1955, with a union membership of 17,749,000.[10]



Also, the unions have achieved strategic positions for their members in the large industries. It is within their power to shut down almost any manufacturing or carrier industry in this nation, and it has been through exertion of this power that they have obtained the increases in wages they want. They increases in contracts obtained through collective bargaining have far more reaching effects than those obtained through minimum wage legislation.

[10] The figures came from the Statistical Abstract of the United States, 1965 (86th edition), and the United States Bureau of Census, Historical Statistics of the United States, Colonial Time to 1957, Washington D.C., (1960), p. 247 and p. 97, respectively.

Drastic changes in the wage structure has been brought about various new contracts in different industries. For instance, in the coal mining industry, one of our more important industries until the last ten years, there have been repeated new contracts; each one calling for higher wages. Let us look at some of the wqge changes:

1. In May, 1937, the inside workers received a wage increase of 14.28 percent an hour.
2. On May 1, 1943, there was a 4.6 cent an hour increase.
3. On February 1, 1959, there was a 14.3 cent an hour increase.[11]

This is only one industry and one union of the many which are present in our nation. However, it is probably characteristic of all the others, in that most contracts are three to five year contracts, and at the renewal of each contract there is a substansial wage increse.

The feasibility of these wage increases is made possible by many factors. One of the major ways is improvements in production techniques. "This Improvement reduces the number of hours of labor required per unit of output, and provides something of a 'cushion' from which the employer may grant wage increases or other benefits to his workers without actually increasing the dollar amount he must pay for labor per unit of output." [12]

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[11] Data taken from the United States Department of Labor Bulletin #1494, Anthracite Mining Industry, Wage Chronology, 1930-66, (April, 1966), p. 7

[12] Melvin Reder, Labor in a Growing Economy, John Wiley and Sons, Inc., New York(1957), p.143-4

Another factor which determines if wage increases requested by unions can be granted is the actual profit margin of the firm. If it is higher than the average for that industry and all other things are equal, then a request could most probably be given. However, if the firm is only making average or below average profits, then they would be justified in turning down union demands, "for the owner must make some minimum return on capital invested in the firm or the owners will eventually remove and invest it elsewhere. Indeed, if there are consistent losses, the capital will be dissipated and eventually disappear. ..... Consequently, an employer will often (correctly) reply to a given union demand: 'I just can't pay this and stay in business.'" [13]

The third factor involved in raising of wages is the subject of price and elasticity of the demand for the firm's product. If the profit margin is at minimum, and there is no 'technological cushion', then the only way the firm can maintain its minimum profit is by raising prices. It is through this factor that many of the wage raises are absorbed, and this has a profound effect on the economy. In fact the wage-price issue is one of the dominant ones of our economy today, and I feel that a discussion of it, and relating of it to statistics on wage and price increases will give an excellent picture on the effect of labor unions on real wages.

There is much discussion on this subject, for it is around it that a great part of our economy moves. The cost of labor (wages) and the cost of goods (prices) are a large percentage

[13] Ibid.

of our nation's national income and gross national product, and how they affect each other determines the actual effect that unions have on the wages of their members and the public in general.

	(billions of dollars)				
	1960	1961	1962	1963	1964
GNP	502.6	518.7	556.2	583.9	622.6
per. cons. expen.	328.2	337.3	356.8	375.0	399.3
national income	414.5	426.9	455.6	478.5	509.8
wages	293.6	302.2	323.1	340.3	361.7

[14]

It can be seen that with wages and prices forming such a large percentage of our economy, there is bound to be some effect on a movement of either. It is this effect which has caused the rise in 'the buying power of the dollar', not to be as much as the rise in actual wage rates achieved by unions.

Let us analyze one specific example of what happens when a labor union achieves a wage increase. It must be remembered that many factors are actually involved, and that this case is purely hypothetical. However, it is intended to show what happens in the wage-price relation of economy.

> The Acme Steel Company produces steel. The worker's bargaining agent is the Steelmaker's International. It is time for a new contract, and over the protests of Acme, the union has obtained a 5% hourly wage increase. Now this increase will affect one of the factors of production of Acme, and means that unless they raise their prices, their profit margin will dro p, due to increased labor cost. To maintain the margin they want they either must raise prices or improve their business. If improvement is made, the wage increase will be absorbed in the firm, and the men will have received a real wage increase of 5%. However, if the plant is unable to improve technologically, it must raise prices.

[14]United States Bureau of Census, <u>Statistical Abstract of the United States</u>: 1965(86th edition), Washington, D.C., p.324.

If labor cost was 50% of total cost, a 5% wage increase would mean a 2½% rise in total cost. To retain their profit margin they would have to raise prices about 2.4%. Exactly how much would be determined by the elasticity of demand for steel. "Elasticity may be defined more precisely as the relationship between a given percentage change in the price of a commodity and the consequent percentage change in quantity demanded."[15] This is an inverse relation, that is, if the price increases, the quantity demanded decreases. In most cases the demand would be such that as the price was increased, the quantity would fall.
So, it would take slighty more than a 2.4% price increase . Let us say it takes a 2½% price increase. That means that everyone buying Acme Steel will have their factor costs raised by some percentage, which means they will have to raise their prices. This process would continue to other sectors of the economy, and results in a price rise in the economy as a whole. The following chart should show how this would work.

Acme Steel workers 5% more wage → 2½% more cost to Acme

↓

2½% greater price to BC Wheels → 1% greater cost to BC Wheel → 1% greater price on wheels → Acme Steel workers 5% more wage

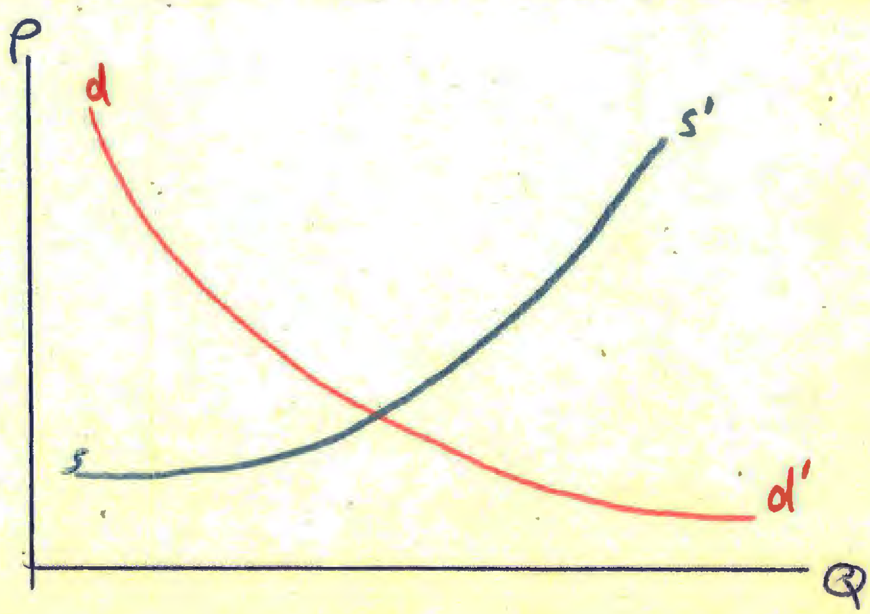
So, the overall result would be about 4% real wage increase.

As I said, the above is only a hypothetical example. There are many other factors; however, it doesshow a simplified example of how an increase in wage to workers of one group can cause an increase in price of a commodity. This effect serves to nullify part of the wage increase and also to help aid a price rise in the economy. It is the wage-price effect that determines how much unions have affected wages and prices in our nation.

[15] John F. Due and Robert W. Clower, Intermediate Economic Analysis, Richard Irwin, Inc., Homewood, Ill., (1961), p.86

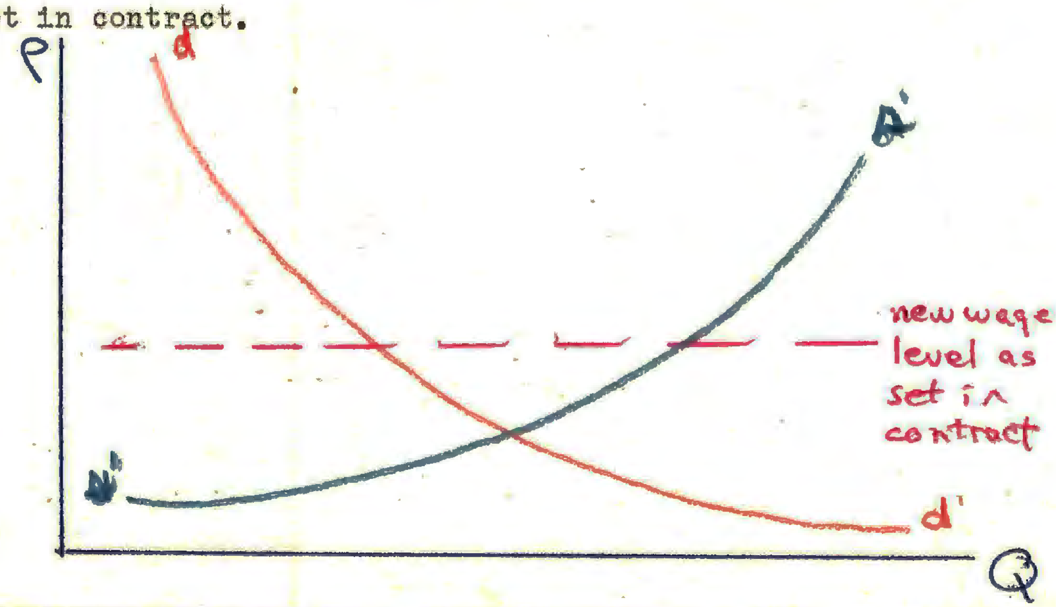
For it is the unions, as represenatives of the workingman that are more interested in increasing wages than anyone else, and through action for these interests the labor unions can cause price changes independent of market forces. The labor market is not a market in the ordinary sense, but it does follow the laws of supply and demand. In the example of Acme Steel, the demand for workers would be set accorking to the amount ot profits to be derived from production of steel. The demand for labor varies according to demand for product. If Acme Steel was in great demand, then the union would have gotten their 5% wage increase relatively easily. If steel was in little demand, the increase might not have been granted.

The supply of labor is the number of workers willing to work for Acme Steel at the prevailing wage. The supply and demand schedules can be graphed on the same graph with the point where they cross being the level of prevailing wages.

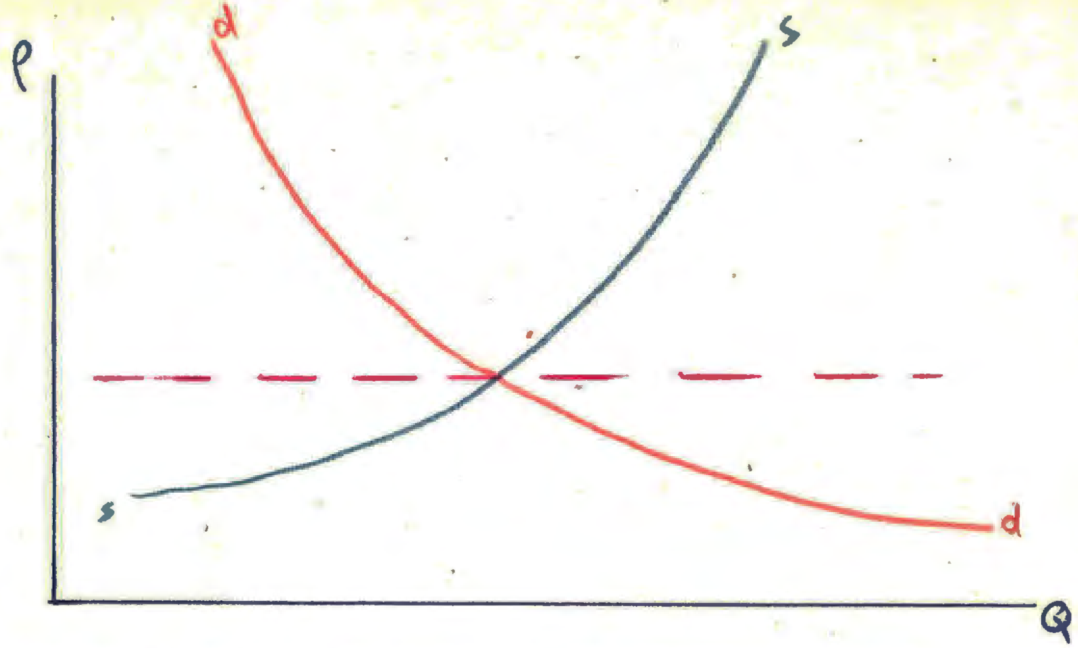


In a purely competitive situation, the wage rates would be affected by only market forces, such as increase in number of workers in market, greater sale of products, etc. However, unions are able to operate outside of market forces. "The reason unions can sometimes affect wages where an individual worker cannot is that it confronts an employer with an 'all or nothing' offer; that is, 'either you meet our terms, or none of your employers will work.' What an employer is prepared to pay to avert such action depends, given demand conditions for his output, upon how easily he can replace his strikers." [16]

It is through unions that increases in wages not likely to be brought about by market forces can be obtained. This means that an arbitrary, higher price level will be set by the meeting of union demands. If this level is above the equilibrium point, then the wages must be brought up to level set in contract.



16 Melvin W. Reder, Labor in a Growing Economy, John Wiley and Sons, Inc., New York (1957), p. 333-4



As can be seen from the graphs, this situation would involve an upward shift of the supply and demand curves. That is, the normal process of market determination of wages would be distorted, for instead of the normal process of supply setting the wage rate, the union and the new contracts set it. This causes a rise in labor costs that the market is not ready for, and therefore there will be effedts elsewhere, probably in the price structure.

As we have seen in the example concerning Acme Steel, if the labor cost is any sizable percentage of total cost, and there is no offsetting ways management can reduce costs, they are forced to pass on costs to consumers. If the producers' elascitity of demand for his product is high, he will of necessity be very resistant to union demands. "As a result, unions have come to realize that there are great advantages in reducing the elasticity of demand for the employer's products.

"One important reason why the elasticity of demand for a firm's output is high is that the union in question has organized only part of an industry and (wage and) price increased in organized segments are not followed in unorganized parts. Consequently, t ere would be considerable switching of purchases from union to nonunion employers in the event of a unilateral price advance by the former group. For this reason, among others, unions are very anxious to organize all employers whose products are close substitutes for the output of employers already unionized. ...

"A union may attempt to reduce the elasticity of product demand by extending its organization to encompass the producerssof substitutes; it may also attempt to get government contracts for 'its' employers.....Unions have also helped to enhance the demand for their employer's output by lobbying for protective tariffs, by boycotting nonunion firms, by campaigns to purchase only products bearing a union la bel, and by helping industry-wide marketing campaigns........These are all cases where union activities in the product market raise the price at which union employers can sell a given volume of output, and these employers can therefore be forced to bear higher labor costs per unit of output."[17]

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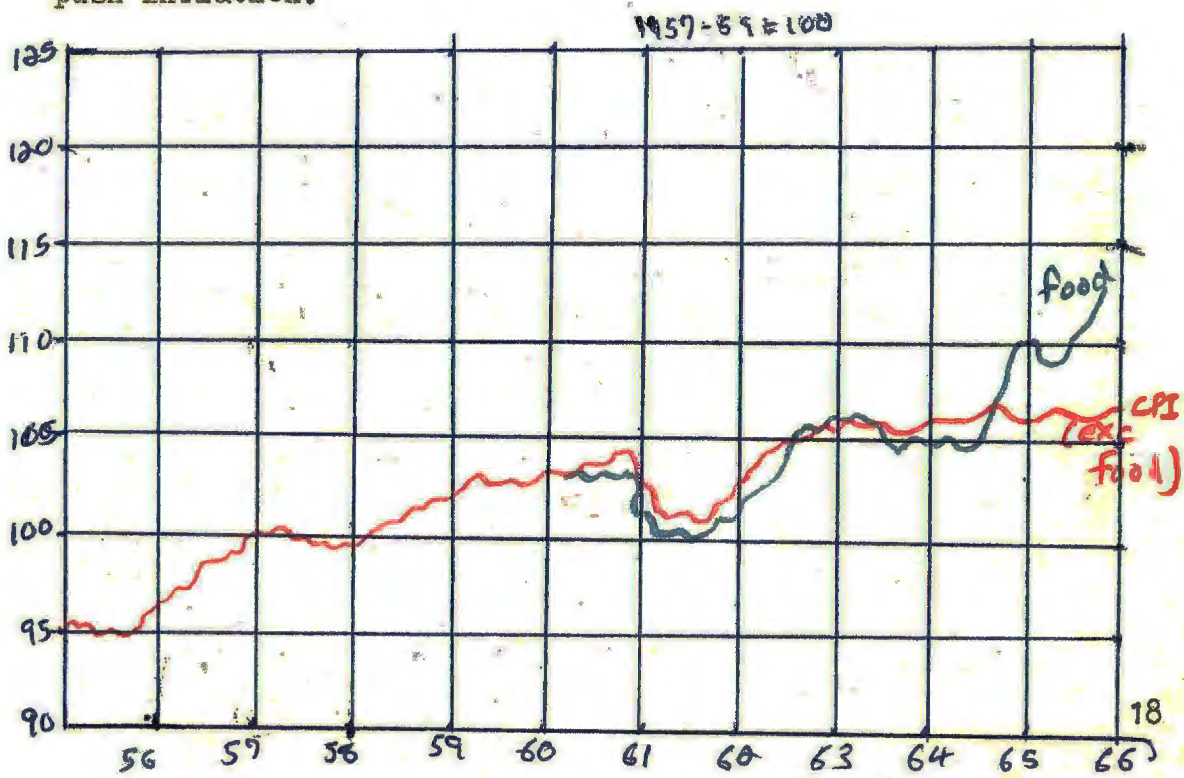
[17] Ibid, p.346-7

Efforts such as these, along with the fact that wages have steadily increased have a profound effect on prices in our economy. In fact, in many contracts today, wages have actually become tied to prices in what is called a 'cost-of-living' clause. This clause says that, based on data from the United States Governmently monthly consumer price index, adjuctments are made in wages. Since the raise in wages is going to push prices higher, the next CPI will be higher, and we have something of a cycle started.

Many economists of today feel that the entire rise in prices in the post war period has been the result of a cost-push inflation.



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[18] United States Department of Labor, Bulletin #1510, <u>Price Trends</u>, March, 1966, Washington, D. C., p. 3 & p. 6

It has been in the post-war period that unions have had the greatest effect on wages and henceforth prices. "In most industries, unions returned in 'round after round', to use the terminology of the period, to bargain for an increase ..., and for a noncontributory pension plan, for paid vacations and more paid holidays, and so on." [19]

As the prices moved upward, the business circles begin to complain of union induced inflation, and it must be agreed that we are in an inflationary period, for prices have risen over eleven percent in the last decade. Business is recently being joined by a number of a economists who are attributing the rise in prices to the increase in wages, for if man-hour productivity increases only three percent, and the union bargains for ten percent wage increases, then the only way the higher wage rates can be met is by increasing prices.

"But not only impose a burden on other income receivers; they also wipe out a great deal of the value of the wage increase which has been their cause (see pages 11 & 12). Money wages might go up ten percent, but if prices go up concurrently, real wages rise by no more than three percent (the amount of increase in industrial efficiency). Unions whose members are disappointed in the purchasing power of their added wages press for further increases, which can lead to further price indreases. The result can only be a

[19] Neil W. Chamberlain, The Labor Factor, McGraw-Hill Book Company, New York (1965), p. 670

'wage-price spiral'.

This was widely viewed as a 'new inflation', a different type from any which had previously been encountered. Classical inflation was something brought on by an excess of demand over supply at the prevailing prices. It was buyers who drove prices upward, in the face of limited supply. The 'new' inflation was looked upon as a 'cost-push' inflation, occuring even when supplies of goods were quite ample to take care of demand at current prices. It was the sellers of services - labor, especially the organized kind - who drove prices up, by monopoly pressures in the face of adequate supplies of goods." [20]

In closing, there are two points that stand out.

1. Unions have greatly helped the wage rates of its members.
2. Unions have been the primary cause of the cost-push inflation we have today.

And it is this inflation that causes one to wonder if perhaps unions should not be curbed, for as the inflation grows the good they do their members lessens, and there is always the danger of the inflation getting out of hand. So, at least for the present, the power of unions to obtain price increases should perhaps be lessened.

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[20] Ibid.

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