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WHY ARE WAGE
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by

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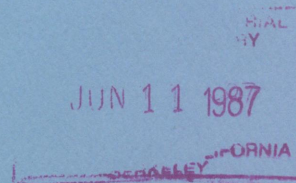
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Over the first 9 months of this year, the index of hourly earnings for the nonfarm sector has risen at an annualized rate of about 2%. This is a modest rate compared with the peak of over 9% reached in calendar 1980. Total private compensation for the same period (including fringe benefits) has risen at an annualized rate of approximately 4%, down from its 1980-81 peak of close to 10%. The U.S. Bureau of Labor Statistics reports that first-year wage rate adjustments under newly negotiated major union contracts in the private sector averaged 2.3% so far this year, down from 10.4% in 1980. An alternative survey of first-year union wage adjustments by the Bureau of National Affairs, Inc. indicates a median for the same period of 3.9%, down from a peak of 9.6% in 1981. Finally, for the past couple of years, union wages have been rising more slowly than nonunion, a dramatic reversal of the pattern found in the 1970s.

Why have these changes taken place? Why are wage rates rising so slowly compared with the not-so-distant past? What devices are being used to produce this change in wage determination? What significance does the current moderate wage trend have for the U.S. economy? Let's look at these questions in order.

I. Some Obvious Explanations.

The first issue to investigate is whether recent wage developments have a relatively simple economic explanation. An obvious consideration, for example, in wage setting is price trends. Studies of wage determination almost always find a high correlation between wage and price developments. Prices are important to wages for two reasons. First, they represent the workers' cost of living. Second, they reflect in part the employers' ability to pay and demand for labor. Thus, we can ask whether wage disinflation is merely a reflection of price disinflation.

Another potential explanation is the comparatively high rate of unemployment experienced in the U.S. since 1979. The unemployment rate peaked at over 10% at the bottom of the economic slump in 1982. Since that time it has remained at about 7% despite three years of economic recovery. There is no doubt that both price disinflation and soft labor markets are important causes of recent low wage settlements.

But while these two factors are important, they do not tell the whole story. The evidence suggests that the aggregate wage indexes, such as hourly earnings, are rising MORE SLOWLY than can be explained by prices and unemployment. Moreover, the evidence suggests that the especially low rates of wage increase are concentrated in the union sector of the economy.

Despite the well-publicized shrinkage in union

membership, which became a hemorrhage after 1979, the union sector is still of large enough weight in the major wage indexes to affect overall performance. Roughly one third of the private compensation dollar in the U.S. goes to the union sector. Unions are far more important to American wage setting than their membership figures suggest. The key to the story of abnormally low wage growth ultimately is to be found in the union sector, and particularly in the dramatic wage concession negotiations of recent years.

II. Union Wage Concessions.

For convenience, I will define a wage concession as any agreement providing a basic first-year wage adjustment of zero or less, i.e., a freeze or a cut. During the postwar period and up to the economic slump of the early 1980s, such contracts were rare, but not unknown. But in the early 1980s, freezes and cuts became quite common. Somewhere between one third and one half of workers under private, major union contracts (those covering 1,000 or more workers) have experienced a freeze or cut at least once since 1979. Most of the action took place beginning in 1981, when concessions began to occur in meatpacking and other industries. In 1982, there were notable wage concessions in automobiles and trucking. Construction began to become a major center of the concession movement. More and more industries started to negotiate concessions.

The standard explanations of these unusual negotiations have been economic distress, import competition (due, in part, to dollar appreciation relative to other currencies), and de-regulation. These are certainly good explanations of many of the concessions. But, they don't tell the whole story. Do they really explain developments at Disneyland and Las Vegas Hotels convincingly, for example? And why is the retail supermarket industry so concession-prone? After all, American consumers don't have the option of buying their groceries in Hong Kong or Taiwan. Nor was the supermarket industry de-regulated as was, say, the airline industry.

To some extent, the extension and depth of the concession movement reflects the widening of union versus nonunion wage differentials in the 1970s. The threat or actuality of nonunion competition taking business from unionized firms, or of a union employer itself substituting lower-cost, nonunion labor, has sparked concessions. Moreover, despite the recent concessions, the statistical evidence indicates that not all of the earlier widening of the union/nonunion wage gap has yet been worked off.

Almost one fourth of newly negotiated unions contracts during the first 9 months of this year provided no basic first year wage increase. Thus, even with the additional explanation of comparative union vs. nonunion wages the

sticking power of the concession movement suggests a more complex mechanism. Several years ago, economist George L. Perry of the Brookings Institution proposed the concept of a shift in "wage norms." According to Perry, the empirical evidence suggests that there are extended periods of more or less wage "pushiness". The early 1960s were years of a downward shift. During that period, a wage freeze was negotiated in steel, escalator clauses were dropped, and workers became jittery over job security. ("Automation" became a buzzword then, just as "robotics" has become more recently). There were some bitter strikes in the early 1960s, but mainly there was a general reduction in strike frequency. An increased management "hard line" co-existed with notable labor-management cooperative schemes to raise and share productivity, such as the Mechanization and Modernization agreement on the West Coast docks. Wage moderation was reinforced by government policy, namely the Kennedy administration's "voluntary" 3.2% wage guidepost.

In contrast, in the late 1960s, demand pressures stemming from the general economic expansion and the Vietnam War reversed the climate. Union wages began to rise faster than nonunion. Strike frequency increased markedly. Militant workers rejected contracts negotiated by their union leaders. The wage norm, in short, shifted up and remained high until the early 1980s. We are now again in a lull period, much like the early 1960s, this time reinforced not by wage guideposts, but by other administrative policies and court decisions which tend to weaken or demoralize the union side. Management, once fearful of the strike threat, now has the upper hand. And a demonstration effect has set in. Initially, demands for concessions came from economically-distressed companies. But the success of those firms in obtaining concessions has encouraged others -- who are not so distressed -- to try their hand.

III. Special Concession Developments.

I have maintained a computerized file of concession contracts (wage freezes and cuts) culled from the Bureau of National Affairs biweekly listings covering the period 1981 to the present. In terms of the frequency of concession settlements, the top five unions (through June 1985) have been the Food and Commercial Workers, the Steelworkers, the Carpenters, and the Teamsters. It is not the case that these unions are inherently concession prone. Rather they happen to represent workers in industries which have been centers of concession bargaining: for example, construction, retail foodstores, metal manufacturing, and machinery. These and other unions have been negotiating contracts with a variety of unusual, concession-oriented feature.

i. Lump-Sum Pay Plans.

Seven percent of the contracts in my sample contain fixed bonus plans instead of guaranteed wage increases. These have been found in such industries as lumber and paper, aerospace, and retail foodstores. The arithmetic is obvious; a contract which provides for annual 3% wage increases in each of three years raises the basic wage by 9%. In contrast, a 3-year contract with no increase and only annual three percent bonuses does not raise the basic wage and leaves the annual payroll just 3% higher in the last year of the contract than it was prior to negotiations.

It is important to note that the 7% figure for lump-sum frequency is actually misleading, since the use of lump-sum plans has been accelerating. During the first half of 1985, 30% of the contracts in my files had such plans, up from 8% in 1984. Lump-sum plans have spread to nonconcession contracts which provide first-year increases in wages, as in the auto industry. The lump sum acts as a substitute for larger wage increases that might otherwise have been negotiated.

ii. Two-Tier Pay Plans.

Under two-tier plans, the pay of new hires is lowered relative to that of existing workers. These plans fall into two basic categories: permanent and temporary. Permanent plans do not permit the new hires ever to catch up with incumbent workers; temporary plans do provide for an eventual catch up. However, the line between permanent and temporary can be blurred. Some two-tier plans provide for catch up periods of ten or more years. As a practical matter, it is hard to distinguish such very long-term plans from the permanent variety. At the other end of the spectrum, some plans provide very short catch up periods; they are not much different from the common practice of having a lower wage for learners and apprentices than for experienced workers.

Last winter, a colleague of mine -- Sanford Jacoby -- and I surveyed managers in the Los Angeles area concerning attitudes toward two-tier plans. In summary, we found general management enthusiasm for such plans, with some minority dissents. Those managers whose firms actually had two-tier plans were MORE enthusiastic than other managers. While there was an acknowledgment that such plans might cause industrial relations frictions, internal political problems for unions, and possibly morale and productivity difficulties, managers seemed willing to accept those drawbacks in exchange for lower labor costs.

Of course, union spokespersons have not shared management's enthusiasm for the two-tier approach. And, there have been some scattered examples of unions

successfully demanding abolition of two-tier arrangements or, at least, a narrowing of the wage gap between the tiers. However, 8% of my concession contract sample includes some type of two-tier plan. For contracts reported during the first half of 1985, the figure was 12%. Thus, new two-tier plans are clearly exceeding abandonments.

iii. Gain Sharing.

In some cases, notably in airlines and autos, unions have accepted profit-sharing or other forms of gain sharing. This approach marks a departure from traditional union aversion to such compensation programs. There are several advantages to be had from gain sharing. To the extent the union has made a concession due to poor economic performance, its members are automatically assured of some recoupment of their sacrifice if and when their concession leads to renewed profitability. Management gains a more flexible compensation system which affords automatic relief on labor costs during hard times.

Economists have begun showing renewed interest in profit sharing as a device to improve macroeconomic performance. A recent book by Martin Weitzman of M.I.T., *THE SHARE ECONOMY*, convincingly argues that a move toward more profit sharing would lead to greater economic stability and reduced unemployment. Thus, the acceptance of profit sharing by unions could be a significant development. So far, however, union profit sharing is largely concentrated in a few settlements. Over 8 out of 10 workers under concession agreements which contained profit sharing were at Ford and General Motors. Only 4% of the contracts in my concession sample include profit sharing provisions. My personal hope, however, is that the gain sharing approach will develop in the future, even in the absence of concessions.

iv. Restriction of Escalator Clauses.

During the 1970s, the management side felt "burned" by cost of living escalator clauses -- which provide wage increases geared to movements in the Consumer Price Index (CPI). At that time, the CPI utilized a peculiar treatment of housing costs which gave heavy weight to movements in mortgage interest rates. Since interest rates generally rose in the 1970s, the rate of price inflation was exaggerated by the CPI. In addition, certain elements of the index, notably oil and food prices, rose in the seventies for reasons having nothing to do with the "ability to pay" of most employers.

Despite management pressure to drop escalators, relatively few escalator abandonments have occurred, particularly when one takes account of the tremendous drop in inflation since the 1970s. There have been some exceptions, of course, the largest being the dropping of a CPI-linked

clause by the Teamsters from their master freight agreement. But more generally, management's drive to remove escalators, and union resistance to that drive, has most often resulted in a compromise, namely keeping the escalator but placing restrictions on its operation. All manner of restrictions can now be found. Examples include diversion of escalator money to fringe benefits, caps on escalator payouts, and corridors requiring a minimum amount of inflation to occur before the escalator formula applies.

Of those concession situations which negotiated escalators or which had escalators prior to concession negotiations, about half adopted some form of restriction(s). Seven percent abandoned the escalator entirely and 8% "froze" the escalator for the contract's duration. The remainder retained an unlimited clause. Thus, despite the concession movement, the escalator idea is by no means dead; rather it is weakened. If price inflation remains low, however, historical evidence suggests that more negotiators will drop escalators, simply out of a feeling that their utility is diminished.

IV. The Outlook.

Economists tend to emphasize impersonal "market" forces in explaining economic developments. Yet, for those of us who follow the industrial relations scene, it is difficult to ignore the surrounding legal and political climate. It is true that the initial concessions did reflect market pressures, particularly those stemming from the deep economic slump of the early 1980s caused by the Federal Reserve's efforts to reduce the inflationary pressures which had developed. But when the degree of momentum of the concession movement is considered -- three years after the bottom of the slump -- noneconomic factors must be considered.

Organized labor clearly feels that it has been hurt (and the management side strengthened) by decisions of the Reagan appointees at the NLRB, by administrative changes (such as revisions in prevailing wage determinations under the Davis-Bacon Act), and by court decisions with regard to severing union contracts through bankruptcy and other matters. The Mondale electoral debacle had a further demoralizing effect on the union hierarchy. As a result, the AFL-CIO has been moved to consider alternatives to the NLRB representation election, and -- indeed -- alternatives to traditional collective bargaining itself as a union function. These may turn out to be healthy developments for unions in the long run. But in the short run, the atmosphere is no longer conducive to large wage settlements.

I felt in the 1970s that collective bargainers were taking an excessively short term view. Particularly on the union side, the membership erosion -- which was apparent even

then -- seemed to be of little concern. Recent research, however, suggests that union militancy which built up in the late 1960s triggered a management counterreaction. This counterreaction took the form of more aggressive efforts to keep new plants nonunion and to convince nonunion employees, sometimes through enlightened personnel practices and sometimes not, that their best interests would be served by remaining nonunion. By the 1980s, however, bargainers could not take a short view any more. The long run -- and its consequences -- had arrived.

Some observers have argued that the 1980s will be like the 1920s, i.e., a period in which management will overreach itself followed eventually by a union renaissance (as in the 1930s). This view has rather tragic overtones; it suggests that we are condemned to permanent cycles of excesses and reactions. I would prefer to think that out of trauma can come wisdom; that it is possible to learn from history and not endlessly repeat it.

Much -- too much -- has been written about the need to end the "adversary relationship" in collective bargaining. The difficulty with this view is that collective bargaining inherently IS an adversary relationship. Indeed, any buyer-seller relationship involves a conflict of interest between the parties as do many other human relationships. The two key questions are 1) whether the conflict can be handled maturely and 2) whether the parties can approach wage determination with a full understanding of its long-term economic consequences. Adversary relationships do not -- or at least should not -- preclude mature bargaining approaches and economic sophistication.

These issues raise broad societal questions beyond the scope of this paper. However, the current lull in wage setting does permit a short- to medium-term economic prediction. It is clear that the Federal Reserve regards wage trends as indicators of underlying inflationary pressures. As long as those trends remain as quiescent as they have been over the past few years, the Fed will feel freer to follow a policy of general economic expansion. Thus, the outlook for the next couple of years is for continued moderate growth of employment and output, an outcome reminiscent of the economic performance of the early 1960s when wage norms were also low.