WORKING PAPER SERIES - 83

Concession Bargaining and Wage Determination

by

Daniel J.B. Mitchell*

California. University.

*Daniel J.B. Mitchell
Director
UCLA Institute of Industrial Relations (Los Angeles)

and

Professor
Graduate School of Management
UCLA

Paper for "Business Economics"

Draft: March 1985

L.A. (1) (2)

CONCESSION BARGAINING AND WAGE DETERMINATION

DANIEL J.B. MITCHELL*
DIRECTOR, INSTITUTE OF INDUSTRIAL RELATIONS, UCLA,
AND
PROFESSOR, UCLA GRADUATE SCHOOL OF MANAGEMENT

*ADDRESS: INSTITUTE OF INDUSTRIAL RELATIONS, U.C.L.A.,
9339 BUNCHE HALL, LOS ANGELES, CALIFORNIA 90024
(213) 825-4339

PAPER FOR "BUSINESS ECONOMICS"

DRAFT: MARCH 1985

CONTENTS

TABLES

Concession Bargaining
Daniel J.B. Mitchell

The 1980s have produced a wave of union wage concessions which has captured newspaper headlines and media interest. Experts in industrial relations differ in their interpretation of this phenomenon. Some see it as heralding a new age in collective bargaining while others are more restrained in their assessment. For the economic forecaster, the concession movement has also raised the question of whether wage pressures seen in the 1970s have been "permanently" reduced, or whether a wage catch-up bubble will burst in the late 1980s.

Four key points emerge from the discussion below:

1) The initial cause of the wage concession movement was the economic slump of 1979-82 and its aftermath, combined -- in some industries -- with economic pressures from de-regulation and import competition.

2) The hardline management position that appeared in several prominent negotiations was primarily a response to economic pressures. As prominent firms were able to obtain concessions from their unions, a demonstration effect prompted others to pursue similar bargains.

3) The primary impact of the economic adversity of the early 1980s was to reduce the size of the unionized workforce rather than to change fundamental institutions of collective bargaining.

4) The second half of the 1980s is likely to be a period of reduced wage pressures characterized by a downward shift in the "norms" of the labor market.

I. The Scope of Union Wage Concessions.

Defining a concession in a collective bargaining setting is like defining pornography; there is no precise definition but you know it when you see it. The imprecision is the result of the bargaining process itself; a certain amount of give and take is expected in any negotiation. However, as an empirical matter, a reasonable proxy for concession bargaining is the frequency of first-year wage freezes and wage cuts in union agreements. By that measure, there have been previous episodes of union concessions -- notably in the early 1960s -- but the scope of the phenomenon in the 1980s was unprecedented in magnitude.

Table 1 illustrates this point clearly. U.S. Bureau of Labor Statistics (BLS) data on workers covered by "major" private settlements show no significant wage cutting until the early 1980s, even during periods when price inflation was very low. Wage freezes occurred in the early 1960s, after two back-to-back recessions had weakened union bargaining power, but were less extensive than in the 1980s. Independent data based on contracts negotiated -- rather than number of workers -- from the Bureau of National Affairs, Inc. (BNA) confirm the BLS figures. Although it is impossible to make a precise estimate, as many as 47% of the workers covered by major private agreements may have experienced at least one episode of a wage freeze or cut during 1979-84. Somewhat less than one third of all private contract situations probably featured at least one concession over the same period.

II. The Concession Sectors.

Concessions bargains have not occurred evenly across all sectors; certain industries have been more prone to concessions. The industry composition, in turn, has dictated which unions have

Table 1

Proportion of Union Workers and Settlements With First-Year Wage Freezes and Cuts, 1959-1984

Year	Workers Under Major Private Settlements (BLS): Freezes and Cuts (1)	Workers Under Major Private Settlements (BLS): Cuts (2)	Private Settlements (BNA): Freezes and Cuts (3)
1959	3%	0%	3%
1960	4	0	3
1961	7	0	7
1962	22	0	10
1963	25	0	10
1964	5	0	8
1965	4	0	5
1966	1	0	2
1967	1	0	1
1968	0	0	*
1969	1	0	*
1970	0	0	*
1971	1	0	*
1972	3	0	*
1973	1	0	*
1974	1	0	*
1975	4	0	*
1976	4	0	*
1977	2	0	*
1978	2	0	*
1979	4	0	*
1980	0	0	*
1981	8	5	3
1982	44	2	12
1983	37	15	28
1984	23	5	27

* = not available.

Note: Columns (1) and (2) are drawn from U.S. Bureau of Labor Statistics surveys of major agreements (agreements involving 1,000 or more workers. Column (3) is drawn from surveys of the Bureau of National Affairs, Inc. of settlements involving 50 or more workers. Figures rounded to nearest whole number.

Sources: MONTHLY LABOR REVIEW, CURRENT WAGE DEVELOPMENTS, DAILY LABOR REPORT, various issues.

been most involved in freezing or cutting wages. Table 2 shows the top ten industries and unions involved in contracts freezing or cutting wages during 1981-84. Over 1,000 contracts are represented on the table._1_/

i. Construction.

Heading the "hit parade" is the construction industry, a fact which may be surprising to some readers due to the lack of media attention devoted to construction negotiations. Construction bargains tend to be local and are conducted on a craft-by-craft basis. Strikes in construction rarely cause public inconvenience. Thus, wage developments in that sector escape newspaper headlines.

During the late 1960s, a wage explosion substantially boosted union wages in construction relative to those in other sectors. The explosion was eventually quelled by the imposition of special wage controls in 1971 (several months before wage controls were imposed on the rest of the economy). A second explosion occurred when controls expired in 1974. The two wage explosions triggered substantial growth of nonunion construction contractors. This competition, combined with the special cyclical and interest rate sensitivity of construction, led to a construction wage correction which is still underway.

Construction unions attribute some of their difficulties to a 1976 Supreme Court decision which made it easier for unionized contractors to set up nonunion ("double breasted") subsidiaries. In addition, the Reagan administration modified the operating procedures of the Davis-Bacon Act, a law which tends to raise wages of nonunion contractors on federally-funded projects. These changes

Table 2

Union Settlements Including First-Year Wage Freezes and Cuts, 1981-84

Industry ↓ / Union →	Food and Commercial workers	Steelworkers	Carpenters	Teamsters	Auto workers	Laborers	Plumbers	Operating Engineers	Machinists	Plasterers and Cement Masons	All others	Percent of all wage freezes and cuts	Wage cuts as percent of wage freezes and cuts
construction			X	X		X	X	X		X	X	40%	28%
metals		X	X	X	X				X		X	10	22
retail food-stores[a/]	X			X							X	9	33
machinery		X			X				X		X	6	11
airlines				X							X	4	43
lumber and paper			X						X		X	3	3
meatpacking	X											3	61
printing and publicity											X	3	6
aerospace					X				X		X	2	4
motor vehicles[b/]					X				X		X	2	4
all others	X	X	X	X	X				X		X	16	11
Percent of all wage freezes and cuts	10%	8%	7%	7%	5%	5%	5%	5%	4%	4%	38%	100%	23%

X = At least one contract in row and column marked.

Note: Details need not sum to totals due to rounding. Table based on 1046 contracts.

a/ Includes related wholesale operations.

b/ Includes motor vehicle parts.

went into effect, however, well after the concession movement had snowballed in construction, although they will have the effect of heightening union/nonunion competition in the future.

ii. Trade-Sensitive Industries.

The other industries featured on Table 2 each have their special stories. But several can be grouped. Metals, machinery, motor vehicles, the commercial side of aerospace, and lumber and paper are all subject to international competition on either the import of export side. Marked appreciation of the dollar in the early 1980s made international markets far more difficult for American employers.

iii. Other Industries.

Airlines and -- indirectly -- its supplier, the commercial side of aerospace, were buffeted by de-regulation in the 1980s, a policy with its roots in the Carter administration. De-regulation also affected trucking and intercity bus operations, two industries which while not on the top ten concession list, featured some notable concession bargains.

Retail foodstores have a history which partially parallels construction. Wage pressures prior to wage controls ultimately led to specialized controls for the food sector under the overall Nixon controls program. Competition from nonunion supermarkets, convenience stores, and drugstores took business at the margin from the major chains. After wage concessions occurred in meatpacking, supermarket employers began to assess the costs of their in-house meat processing operations compared with the costs of external suppliers. Certain of the major chains -- notably A&P -- were in the process of re-structuring when the economic slump arrived, intensifying their difficulties. Finally, the 1982 wage concessions made by the Teamsters to major trucking firms had a tendency to spill over to drivers employed by foodstores.

In meatpacking, a general de-concentration of the industry away from a few urban areas toward a broader regional distribution had been underway for many years. Meatpacking became one of the earliest major concession industries; a wage freeze at Armour in late 1981 quickly spread to other firms. In early 1983, Wilson Foods used the new bankruptcy code as a mechanism for cutting wages, cuts which spread quickly to other producers.

Finally, in printing and publishing, the retrenchment of daily newspapers was underway prior to the economic slump. Related services such as United Press International were also in a precarious financial situation. Computerization also was rapidly eroding the level of skills needed on the production side. These trends interacted with the economic slump to produce the concessions listed on Table 2.

III. The Demonstration Effect.

Although the initial impetus for the concession movement was clearly economic distress, the persistence of concession agreements well into the economic recovery was surprising and unanticipated by most observers. It appears that the success of employers in obtaining concessions in the distressed sectors encouraged other employers to attempt to obtain similar agreements. In addition, high unemployment made finding replacements for strikers who resisted concessions a more credible threat. The option of going nonunion was exercised or threatened in several prominent negotiations in sectors ranging from retailing, hotels, recreation, mining, meatpacking, and airlines.

In short, the concession movement acquired a momentum of its own by 1983. It became part of the mechanism producing a downward shift in wage expectations.

IV. New Features of Collective Bargaining.

There were certainly some novel developments accompanying the concession movement. Some of these were not directly related to wage determination and included improved mechanisms of labor-management cooperation, union representation on corporate boards, and job security arrangements. Industrial relations experts are unsure of the staying power of this reduction in the adversary relationship. Historical evidence suggests that such reductions occur during periods of economic distress but tend to erode after a sustained recovery.

From the applied economist's viewpoint, the key question is how the concession movement will change the process of wage determination. This question can be decomposed into three parts. First, it can be asked whether the past sensitivity of wage determination to price inflation will persist. Second, it can be asked whether the sensitivity of wage determination to the ups and downs of the business cycle will be altered. Third, it can be asked whether -- given the level of price inflation and the state of the real economy -- there will be more or less "push" behind wage setting than was the case in the past.

i. Prices and Wages.

Union workers' wages are often adjusted for price inflation by means of escalator or cost-of-living adjustment (COLA) clauses. During the 1970s, contracts with COLA clauses tended to produce higher wage increases than contracts without them. Employers came to believe that they were being "burned" by COLAs. The problem was twofold. First, the housing component of the CPI involved a peculiar treatment of mortgage interest rates (now eliminated from the index). Rising mortgage interest rates exaggerated the pace of CPI-measured price inflation. Second, much inflation in the 1970s reflected world market conditions rather than increased domestic "ability to pay." Oil price inflation was the prime example.

Despite these employer concerns, the COLA principle was not eliminated during the concession era. Only about 7% of the concession agreements which had COLA clauses actually eliminated them during 1981-84. Another 8% "froze" the COLA clause, i.e., left the COLA language in the contract but prevented the clause from operating. Thus, about 85% retained active COLA clauses.

BLS figures for "major" private agreements confirm these trends for all union contracts, not just the concessions. Although the proportion of workers covered by COLA clauses in major agreements dropped slightly (from 59% to 57%) during 1979-84, most of this drop resulted from changed industry composition. That is, COLA-prone industries shrunk relative to others. Indeed, given the marked drop in inflation over this period, the sticking power of COLA clauses is remarkable.

The big news for COLA clauses was the tendency to constrain them in the concession contracts rather than eliminate them altogether. COLAs were limited by imposing "caps" on the maximum adjustment that could be paid, requiring "corridors" of minimum inflation to occur before the COLA clause would kick in, diverting COLA money to pay for fringes, eliminating some normally scheduled COLA payments, and other creative devices. The net effect is that over the next few years, a 1% increase in the CPI will trigger a smaller net wage increase than was the case in the 1970s.

During the 1970s, a 1% increase in the CPI produced approximately a 0.6% wage increase. Available estimates for 1983-84 suggest a ratio closer to 0.5%. Thus, while some reduction in wage sensitivity to price inflation has occurred, the overall impact is quite modest.

ii. Wages and the Business Cycle.

Long-term contracts have been a special feature of the unionized sector of the economy. Typically, a union agreement will be two to three years in duration, with those having COLAs tending to be longer than those without. Since there has not been much elimination of COLAs, it is not surprising to find that contract duration among concession contracts has remained in the 2-3 year range. The mean duration during 1981-84 for contracts freezing or cutting wages was just under two and a half years.

While some contract shortening occurred during the concession era -- notably in the hard-hit construction industry -- the principle of a multiyear contract clearly remained intact. To the extent that long-term contracts reduce the sensitivity of union wage change to the business cycle, that tendency will persist. Short term contracts MIGHT show more wage sensitivity over the business cycle, simply because wage decisions would be made in reference to short run considerations. However, the management community strongly prefers long-duration agreements to limit exposure to strikes.

Even in a long-duration contract, a contingency clause could in theory gear wages to real economic conditions. Some contracts do contain gain-sharing pay systems such as profit sharing. Since employer profits are likely to be reflective of general economic trends, these contracts do have a built-in sensitivity of pay to the business cycle. Until the concession era, such clauses were extremely rare in union agreements, however.

The concession contracts produced a noteworthy expansion of profit sharing. However, most of the expansion was concentrated in a handful of contracts. Eight out of ten union workers who were covered by profit sharing under concession agreements were located at General Motors and Ford. Some of the airline agreements also provided for profit sharing. But in all, only 4% of the 1981-84 concession contracts included profit sharing.

It is unfortunate that profit sharing has not become more widespread and that the plans that have been negotiated tend to be limited. Profit sharing has important, desirable macroeconomic properties which could improve overall national economic performance._2_/ As yet, however, it is uncertain that profit sharing in the union sector will expand much beyond its current boundaries.

Two factors may encourage more profit sharing. The already-noted interest in job-security arrangements can be related to gain sharing. In the past, an employer who needed to reduce payroll costs by, say, 10% would do so by layoffs rather than wage adjustments. But if layoffs are to be inhibited in the name of job security, more flexibility must be allowed in compensation. Thus, gain sharing can be viewed as the safety valve needed for job security.

In addition, the budding experiments with union and worker participation in management suggest a need to share gains and losses. Those who participate in decisions -- it can be argued -- ought to participate in the fruits of those decisions. Thus, the current mood in some industries of labor-management cooperation could lead to more profit sharing. More profit sharing, in turn, would increase the sensitivity of wage adjustments to the business cycle.

iii. Shifting Wage Norms.

George L. Perry of the Brookings Institution has argued that there are discreet shifts in the "norms" of wage setting apart from the business cycle and price-inflation influences._3_/ These norm shifts show up as serially correlated error terms in econometric wage-change forecasting equations. Effectively, norm shifts can be viewed as adjustments in the constant terms of those equations. In some periods, notions of what should be the going rate of wage adjustment are higher than others, even after accounting for other influences.

The early 1960s were years in which the norm seemed to shift down. At the time, some observers attributed this shift to the Kennedy/Johnson administration's 3.2% guideline for wage increases. But -- as already noted -- the early 1960s also witnessed a limited wage concession movement, a smaller-scale version of the events of the early 1980s. Thus, concessions and (downward) norm shifts may occur in concert.

One index of the state of wage expectations is the level of wage adjustments negotiated for the second and third years of union contracts. Thus, in contracts negotiated in 1981 wage adjustments specified for the second and third years (1982 and 1983) fell in the 7-8% range. Presumably, negotiators back in 1981 expected wage changes bargained in 1982-83 to fall in that range. (They guessed too high). By 1984, second and third year adjustments (for 1985 and 1986) had fallen to the 4-5% range. Lowered expectations are apparent from these data.

Certain contractual features began to develop, especially during 1983-84, which should contribute to lower wage adjustments. In 1984, about 8% of the concession contracts negotiated provided for fixed, lump-sum bonuses as replacements for guaranteed wage increases. Such arrangements developed in aerospace, lumber and paper, and retail foodstore bargaining. The main advantage from the employer viewpoint of fixed bonuses is that they reduce overall labor costs over a multiyear horizon. Consider a three year contract with annual 3% wage increases. At the end of three years, wages will be 9% higher than at the beginning of the contract. In contrast a three year contract with annual 3% bonuses does not raise the basic hourly wage. Even considering the bonus, the annual compensation payout in the third year is only 3% higher than before the contract began.

Another contractual arrangement which tilted toward lower labor costs was the two-tier wage plan. About 10% of the 1984 concession agreements had some type of two-tier component. They became particularly common in retail foodstores and aerospace.

Under a two-tier plan, new hires are paid lower wages than existing workers. In some cases, new hires eventually can catch up with the existing workforce; in other cases new hires remain on a permanently lower pay scale. Interesting industrial relations questions are raised by these plans. For example, will morale and productivity suffer if new hires work side by side with higher paid individuals doing the same job? However, the wage implication is obvious. As the proportion of new hires increases, the average wage will tend to be pulled down toward the entry scale.

Apart from specific contractual changes, the general climate surrounding collective bargaining has tilted toward the employer. The tendency to threaten credibly to replace striking workers, or workers who refuse concessions, has increased. Administrative changes in labor law -- and certain court decisions -- have been unfavorable to unions. These circumstances are unlikely to change in the next few years, dampening the prospect of hefty wage increases.

V. The Shrinking Union Sector.

Probably the most dramatic long-range effect of the hard times experienced by organized labor in the early 1980s has been its absolute decline in membership and representation. BLS data indicate that the number of wage and salary earners represented by labor organizations in the private sector dropped by 2.5 million between 1980 and 1984. Over 400,000 workers were lost to unions during 1983-84, a period when employment was generally rising. Thus, it is not possible to attribute the losses to general employment trends.

Indeed, data on workers covered by major private union agreements suggest that only about one fourth of the loss in worker representation by unions can be explained by changes in employment patterns of production and nonsupervisory workers on a detailed industry basis. Unions still represented about 18% of private wage and salary earners in 1984. But this was down from 22% only four years before. Preventing further slippage, let alone recouping some of the loss, is the major challenge facing unions today.

Significantly, unions maintained their level of representation among government employees. Government is the sector most insulated from competition; a city cannot import its fire department from Taiwan. And the potential for contracting out public services to the private sector has its limits. But if unions are to survive as a major force in the private sector, they must find new methods of bargaining which permit recognition of changing product market conditions.

VI. Final Thoughts.

Despite their losses in bargaining and representation, unions still are an important factor in U.S. wage determination. Because of the high level of union wages, unionized workers account for a much larger fraction of payrolls than of total employment. In 1980, for example, it is estimated that union workers received 48% of production worker wages in the private, nonfarm sector._4_/ Thus, indexes such as average hourly earnings are very much affected by union-sector developments. Economic forecasters must continue to be concerned with collective bargaining developments. It is unlikely, however, that strong wage pressures will develop in the union sector over the next few years.

FOOTNOTES

1. Table 2 is based on a computerized file of union agreements drawn from the biweekly survey of settlements reported in the DAILY LABOR REPORT. To be included in the file, a contract must report a settlement of zero or less in the basic wage during the first year. The word "concession" is used interchangeably with first-year wage freezes and cuts in this article.

2. See Martin L. Weitzman, THE SHARE ECONOMY: CONQUERING STAGFLATION (Cambridge, Mass.: Harvard University Press, 1984).

3. George L. Perry, "Inflation in Theory and Practice," BROOKINGS PAPERS ON ECONOMIC ACTIVITY (1:1980), pp. 207-241.

4. Wayne Vroman, "Cost-of-Living Escalators and Price-Wage Linkages in the U.S. Economy, 1968-1980," INDUSTRIAL AND LABOR RELATIONS REVIEW, vol. 38 (January 1985), p. 227.