"Why Are Wage Settlements So Low?"

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Labor unions have accepted wage cuts, and upward wage adjustments for most workers have been low over the past few years — lower than economic circumstances would indicate. Discussing these wage concessions is Dr. Daniel J. B. Mitchell, an economist by training who is a Professor, Graduate School of Management, UCLA. He also heads a UCLA think-tank on industrial relations. Previously he served as Chief Economist of the Pay Board under President Nixon's wage/price controls program. He has performed research work as Senior Fellow in the Economics Studies Program of the Brookings Institution and he is a well-published scholar in the field of wage determination.

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Over the first nine months of 1985, the index of hourly earnings for the nonfarm sector rose at an annualized rate of about 2%. This was a modest rate compared with the peak of over 9% in calendar year 1980. Total private compensation in the same period (including fringe benefits) rose at an annualized rate of approximately 4%, down from its 1980-1981 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% last year, down from 10.4% in 1980. An alternative survey 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 last couple years union wages have been rising more slowly than nonunion, a dramatic reversal of the pattern in the 70s.

In analyzing why wages are rising so slowly, the first issue to investigate is whether there is 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 wages and prices. Prices are important for two reasons. First, they represent the workers' cost of living. Second, they reflect, in part, the employers' ability to pay and the 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. 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 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 aggregate wage indexes, such as hourly earnings, are rising *more slowly* than can be explained by prices and unemployment. Moreover, the evidence indicates that especially low rates of wage increase are concentrated in the union sector of the economy.

Despite the well-publicized shrinkage in union membership, the union sector is still large enough to be a powerful force in wage determinations. Roughly one-third of the private compensation dollar in the United States goes to the union sector. The key to understanding slow wage increases lies in the union sector.

WAGE CONCESSIONS

From the end of World War II to the 80s, cuts and freezes in union wages were rare. But in the early 80s wage concessions became quite common. Somewhere between one-third and one-half of union workers have experienced a wage cut or freeze since 1979. Most of the action took place in 1981 when concessions began to occur in meatpacking and other industries. In 1982 there were notable wage concessions in automobiles and trucking. Then more and more industries started to negotiate concessions.

The standard explanations for these concessions have been economic distress, import competition, and deregulation. These are certainly valid explanations for many of the concessions. But they do not explain the concessions at Disneyland, the Las Vegas hotels, the retail supermarket industry, and the airline industry.

Almost one-fourth of newly negotiated union contracts during the first nine months of 1985 provided no basic first-year wage increase. Thus, even with the additional explanation of comparative union versus nonunion wages, the sticking power of the concession movement suggests a more complex mechanism.

Several years ago economist George L. Perry of Brookings Institution proposed the concept of shifts in "wage norms." According to Perry, the empirical evidence suggests that there are extended periods of wage "pushiness." The early 60s 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. There were some bitter strikes, but, overall, there was a reduction in strike frequency. An increased management "hard line" coexisted with labor-management cooperative schemes to raise productivity. Wage moderation was reinforced by government policy, namely the Kennedy Administration's "voluntary" 3.2% wage guidepost.

In contrast, in the late 60s 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 shifted up and remained high until the early 80s.

We are now once again in a lull period, much like the 60s, this time reinforced not by wage guideposts but by other administrative policies and court decisions that tend to weaken the union side. Management now has the upper hand. And a demonstration effect has set in. Demands for wage concessions initially came from economically distressed companies. The success of those firms in obtaining concessions has encouraged others, who are not so distressed, to try their hand.

ALTERNATIVE PLANS

From the period 1981 through 1985, a survey conducted by myself of union contracts shows that 7% of these contracts employ fixed bonus plans instead of guaranteed wage

increases. The arithmetic is obvious: a contract that provides for annual 3% increases raises the wage rate by 9% at the end of three years. In contrast, a three-year contract with only 3% annual bonuses and no increase leaves the annual compensation 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 pay plans is misleading since the use of these plans has been quickly accelerating. During the first half of 1985 about 30% of contracts in my survey sample had such plans, up from 8% in 1984.

Under two-tier plans the pay for new hires is lower relative to that of existing workers. These plans fall into two basic categories: permanent and temporary. Permanent plans do not allow the new hires ever to catch up with incumbent workers; temporary plans allow for an eventual catch up. About 8% of my concession contract sample includes some type of two-tier plan. For contracts reported during the first half of 1985 the figure is 12%.

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 plans. There are several advantages to be had from gain sharing. Union members are entitled to some recoupment of their sacrifice when granted in times of economic stress, if and when their concession leads to renewed profitability. Management gains a more flexible compensation system that affords automatic relief on labor costs during hard times.

So far, however, union profit sharing is largely concentrated in a few settlements. Over 8 out of 10 workers under concession agreements that contined profit sharing were at Ford and General Motors. Only 4% of the contracts in my concession sample include profit sharing provisions. My personal hope is that the gain sharing approach will develop in the future, even in the absence of concessions.

During the 70s management felt burned by cost of living escalator clauses that provided wage increases geared to increases in the Consumer Price Index (CPI). At that time the CPI was heavily weighted by movements of housing costs and mortgage interest rates. As interest rates rose, there was an exaggeration of price inflation.

Despite management efforts to drop escalators, relatively few escalator abandonments have occurred. There have been exceptions, of course, the largest being the dropping of a CPI-linked escalator clause by the Teamsters from their master freight agreement. More frequently management's drive to remove escalator clauses has resulted in compromise. All manner of restrictions can now be found on escalators. 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 surveyed that negotiated escalators, about half adopted some form of restrictions, 7% abandoned the escalator entirely, and 8% "froze" the escalator for the contract's duration. If price inflation remains low, we may see many more unions agree to abandon escalators due to a feeling that their utility is diminished.

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 climates. It is true that the initial concessions did reflect market pressures, particularly those stemming from deep economic slumps in the early 80s caused by the Federal Reserve Bank's efforts to reduce the inflationary pressures that had developed. But, when the degree of momentum of the concession movement is considered — three years after the bottom of these slumps — 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 National Labor Relations Board, by administrative changes following 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 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 70s that collective bargainers were taking an excessively short-term view. Particularly on the union side, the membership erosion seemed to be of little concern. Recent research, however, suggests that union militancy that built up in the late 60s triggered a management counterreaction. This counterreaction took the form of more aggressive efforts to keep 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.

Some observers have argued that the 80s will be like the 20s — in other words, a period in which management will overreach itself followed eventually by a union renaissance. 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 *is*, inherently, an adversarial relationship. Indeed, any buyer/seller relationship involves a conflict of interest. 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 and should not preclude mature bargaining approaches and economic sophistication.

These issues raise broad societal questions beyond the scope of this speech. 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 60s when wage norms were also low.

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