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Working for the economy: The economic case for trade unions

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No. PB05-2015



UNIVERSITY
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GREENWICH



FOUNDATION FOR EUROPEAN
PROGRESSIVE STUDIES
FONDATION EUROPÉENNE
D'ÉTUDES PROGRESSISTES



Working for the economy:

The economic case for trade unions¹

Looking at the relationship between two major economic trends since the 1970s – declining union membership and a shrinking share of wages and salaries in national income – it becomes clear that the UK has paid a heavy economic price for years of labour market deregulation and anti-union policies.

- Over the last four decades, the decline of trade unions and weakened collective voice of the UK workforce have slowed the motor of the economy - reducing national income by £27.2bn.¹ This can be explained in seven steps:

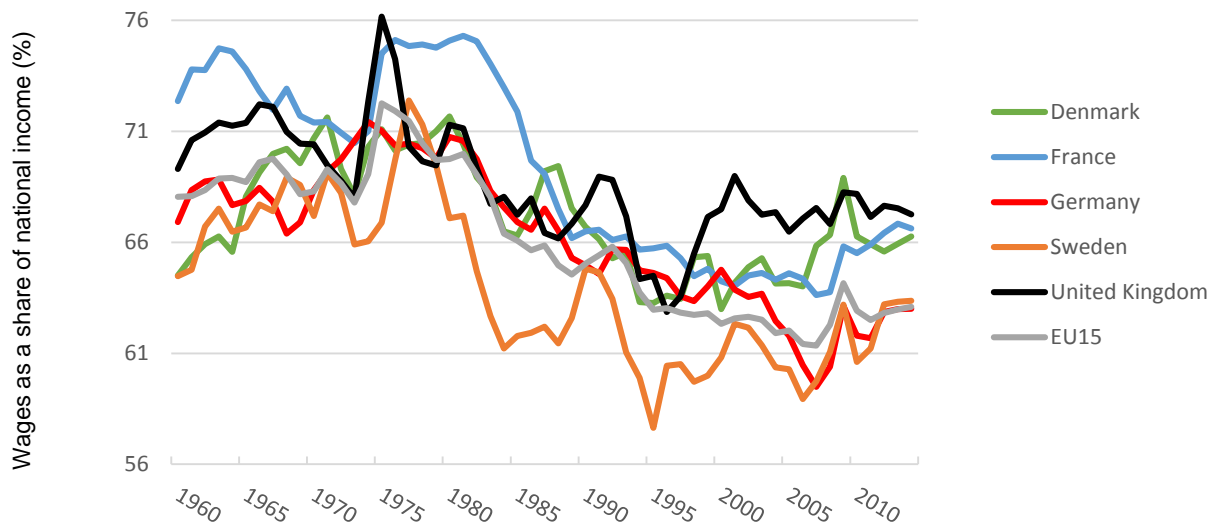
A lower share of national income has been going to wages

There has been a significant shift in the distribution of the national incomes of developed economies since the 1970s. National income is the total amount produced by an economy in a single year, and is usually measured by Gross Domestic Product (GDP).

Regardless of their individual histories and institutions, European countries have seen a pronounced decline in the share of national income received by labour – the wage share – and an increase in the share going to capital in the form of profits for private business owners, shareholders and financial investors – the profit share. As shown in the graph, wage share in the UK reached its peak in 1975 at 76.2% and had decreased by 8.9% in 2014, to 67.3%.

¹ This paper is a joint project of Greenwich Political Economy Research Centre (GPERC) and the New Economics Foundation (NEF) sponsored by the following unions: Community, FDA, Nationwide Group Staff Union, Nautilus International, Prospect, Royal College of Nursing, Society of Radiographers, USDAW.

Figure 1: Adjusted wage share, %ⁱⁱ



Source: AMECOⁱⁱⁱ

Note: 'EU15' shows an average of wage share decline in 15 European Union Member States: Austria, Belgium, Denmark, Finland, France, Germany, Greece, Ireland, Italy, Luxembourg, Netherlands, Portugal, Spain, Sweden and the United Kingdom.^{iv}

The reduced ability of the workforce to negotiate collectively on wage levels is a major cause of this decline

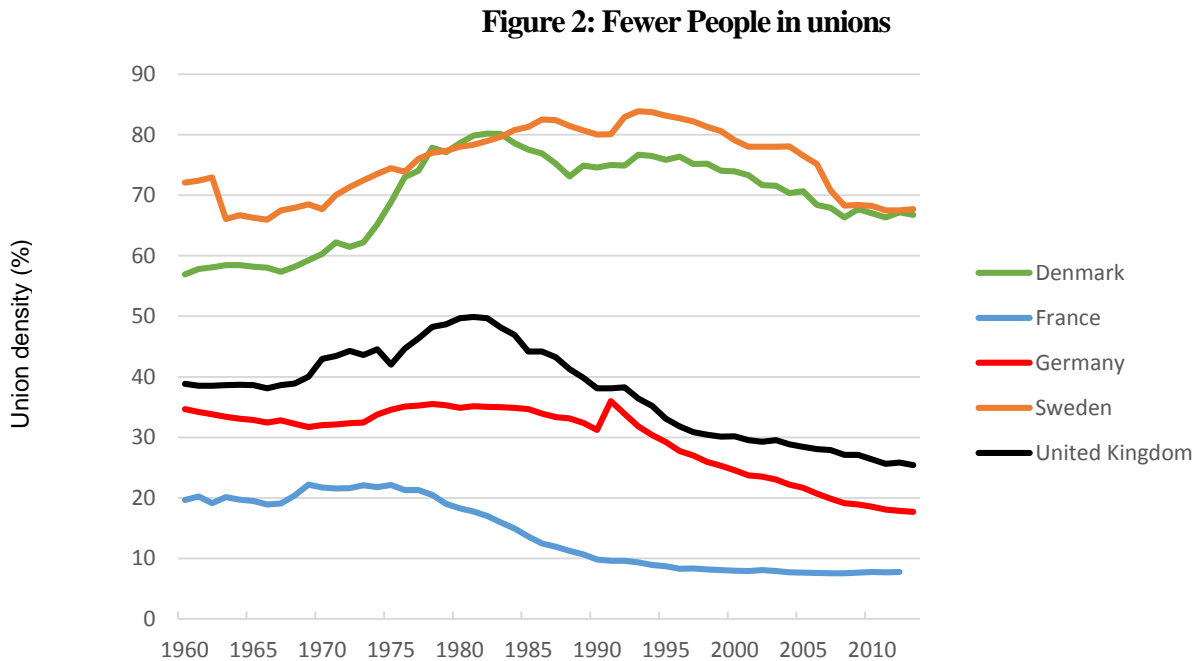
Trade unions are the collective voice of the UK labour force. They play a critical role in determining what portion of national income goes to wages. This bargaining takes place mostly at the level of individual workplaces, where trade unions bring together the voices of employees to negotiate on wages and conditions.

The aggregate effect of these individual negotiations, only some of which are coordinated across different workplaces in a sector, is a measurable impact on the share of national income going to wages overall.

Over the past three decades there has been a pronounced decline in membership of unions, in the level of industrial action and in the share of the workforce covered by collective bargaining. It is the decline in density – the percentage of the workforce which is in a union – that gives the most accurate picture of the reduced powers of unions in many countries in Europe, but most dramatically in the UK.

As shown in Figure 2, the UK has experienced one of the sharpest declines in union density in Europe, behind only three countries – Portugal, Ireland and Austria.^v

Union density in the UK fell from a high of 49.9% in 1981 to a record low of 25.4% in 2013. This decrease – union density has halved in 30 years – significantly exceeds the rate of decline in Germany (18.3%) and France (14.4%).^{vi}



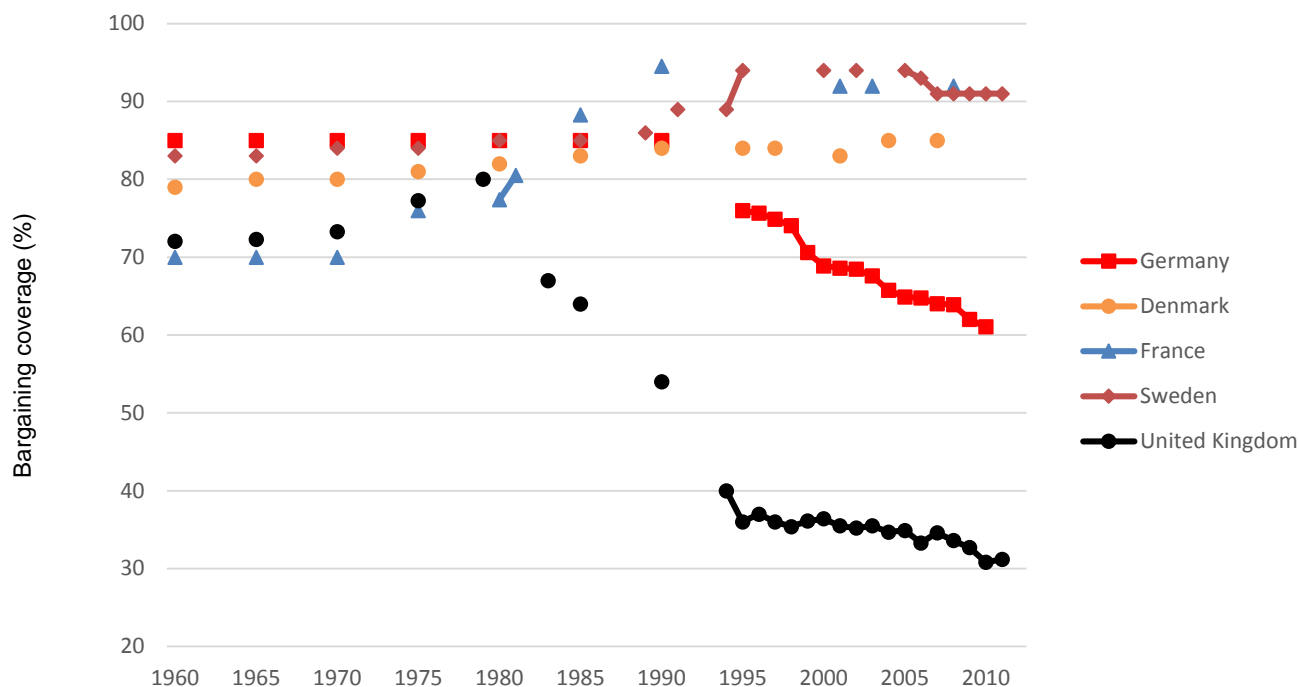
Source: OECD^{vii}

Note: Union density is calculated as union membership as a proportion of wage and salary earners in employment.

While membership levels measure the potential bargaining strength of unions, a fuller picture of their effectiveness and reach can be seen by looking at bargaining coverage – the level of the national workforce which is covered by collective agreements on pay and conditions.^{viii}

As Figure 3 shows, following the decline in membership, bargaining coverage in the UK has plummeted, from a peak of 80% in 1979 to 31.2% in 2011. Today, the vast majority of the British workforce has no say over their pay and conditions.

Figure 3: Decline in collective bargaining^{ix}



Source: Visser, J. (2013), ICTWSS.^x

Why the reach and influence of unions has declined

Several factors have contributed to the falling rate of union membership and reach in the UK. The government-led reforms of the 1980s and 1990s introduced onerous regulations for union activities and new laws were created imposing limits on employee protections.^{xi}

The labour market and workplace have also changed in ways that mean employees are now less able to speak collectively, weakening the labour force’s negotiating position on wages and conditions, even when collective bargaining and union activities take place.

These changes include:

- Deregulation of the labour market carried out between the 1970s and 1990s – including changes to unemployment insurance benefits, employment protection policies and payroll taxes. This reduced the bargaining power of the work force significantly by increasing the threat of dismissal.^{xii}
- Cuts to welfare, high unemployment levels, and austerity measures reduce the options available to employees, meaning that people are more likely to take on jobs with poor pay and conditions.

- Many jobs, particularly those associated with the rise of the service industry, have become increasingly characterised by multi-skilling, flexible and casual employment contracts, and self-employed work. Individuals in this growing portion of the labour force find themselves more isolated and the transient nature of their positions provides less opportunity to coordinate with colleagues.
- The growing prominence of globalised firms has transformed the negotiation process; firms increasingly coordinate their activities in complex and dispersed ways involving outsourcing and relocation.
- Changes to incentive regimes have seen pay being increasingly linked to performance, reducing commonality among workers. When wages and terms of employment *are* negotiated collectively, this takes place at lower levels of administration.

Economic growth has slowed but the share of national income going to the profits of firms has risen

The decline in the wage share and increase in the profit share has happened at the same time as a weaker growth performance over the last three decades in the UK and other European countries, the US, Japan, and several major developing countries.^{xiii}

In the UK the seemingly higher growth rates of 2000–07 appear, with hindsight, as something of an illusion: in the absence of strong productivity-oriented wage increases, it was rising household debt that fuelled consumption.^{xiv} This proved to be a fragile growth model that collapsed in the Great Recession. Average annual growth in the 2000s (2000–13) in the UK, including the years of the recession, is considerably low at 1.7%.

Company profits are accounting for an increasingly large slice of the UK economic pie, but the pie itself is growing more slowly. Why?

This general drop in growth levels poses a significant puzzle for proponents of economic policies that are intended to ensure profitability, such as labour market deregulation, but that have failed to restore economic activity to previous levels.

Mainstream economic policy in recent years has been based on the belief that if wages are kept low relative to company returns, investment by firms, encouraged by greater profits, will pick up. In addition, if labour costs are falling, exports will become more competitive, stimulating more overseas sales.

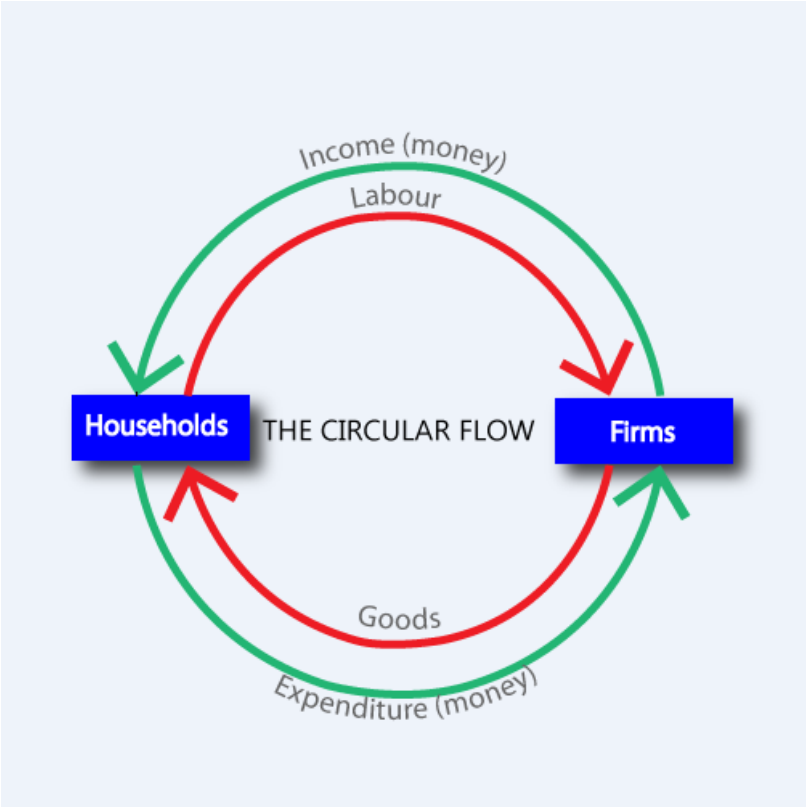
But it is evident that enacting economic policies on the basis of these assumptions – for example limiting wages, curtailing trade union activities and reducing collective bargaining coverage – has not had the desired effect of boosting national income.

Wages play a vital role in the economy and if they are restricted, spending can slow

In the economic theory and related policies outlined above, which focus on the supply side of economic relations, wages are treated first and foremost as costs to a business. As such, wages must be moderated to ensure the share of income going to company profits remains high.

But there is another side to this coin: the demand side. As shown in figure 4, wages are not merely a cost detracting from company profits, but the source of demand in the economy through spending, and as such play an essential role in generating company revenues. They are the means by which consumers buy products and therefore drive the economy.

Figure 4: The circular flow of income in the economy



Employees have a higher propensity to spend than those who own the companies which pay their wages and, therefore, less spending happens in the economy if the wage share is squeezed.^{xv}

If spending power is reduced, firms, facing smaller markets, will choose to hold back on investment and production. Growth overall is then likely to fall, unless the spending squeeze is outweighed by increased activity elsewhere in the economy, such as through increasing income from net exports.

Measuring the interplay of these factors over time determines whether the economy of any particular country is driven more by wages, or by profits.

The UK is wage-led – what this means and why it matters

Findings show that, alongside Germany, France and Italy, the UK economy is in fact wage-led.^{xvi} This means that it is wages, not profits, that drive growth in the economy.

Contrary to assumptions that have led to a policy-driven reduction in the wage share, growth in the UK is driven by healthy wages – more so than by increasing company profits. In fact, if profit share goes up, as has been the case for the past four decades, demand actually decreases. A 1% increase in the profit share leads to a 0.13% decrease in demand – which is a loss of £2.21bn to the economy at today's levels.

One reason for this is that profitability has not had a significant enough impact on investment. We can assume then that investment spending in the UK has largely been determined by companies' expectations of future sales, rather than immediate profits.

The evidence points to the fact that it is wages, not profit, that form the backbone of the UK economy. Policies aimed at keeping labour costs down in the interests of competitiveness have not only failed to generate the economic activity they were intended to generate: they have actively hampered growth.

Wage-led economies need a strong collective voice for the workforce

Trade unions have been vital for building trust and cohesion across workforces, establishing strong social networks, reducing inequality in organisations and sectors, and achieving workplace democracy. But their role does not end there.

Unions influence what portion of profits should be passed on to employees at individual workplaces, and this has an impact on activity in the economy overall. The aggregate effect of bargaining for adequate wages and conditions carried out in workplaces affects how national

income is shared between wages and profits – and this affect is measurable. The dramatic fall in union density in recent decades has had a negative effect on the UK economy: on new estimates, wage share is 9.3% lower than it would have been if this fall had not taken place.

Conclusion

As the UK is a wage-led economy, economic prosperity requires a boost to the share of national income going to wages. The past four decades have demonstrated that when left to their own devices, employers share less with their employees, even in times of growing corporate profits.

It is the workforce that must lead bargaining for a fair share of the revenue it generates. This is not solely for the benefit to living standards of individual employees, but for the healthy functioning of the national economy as a whole.

A summary in numbers:

- The wage share would be 9.3% higher if union density had not declined
- For every 1% reduction in the wage share, UK national income is reduced by £2.21bn, at current values
- This means that the decline in union density, from its peak to today, has reduced UK GDP by up to 1.6%
- Restoring union density to the levels seen in the early 1980s would add up to £27.2bn to current UK GDP. This would be a significant, and permanent, net gain.^{xvii}

The role of trade unions in ensuring a successful economy must be recognised if the damaging decline in the portion of national income going to wages is to be reversed.

To read the full report on our findings go to:

<http://www.neweconomics.org/publications/entry/working-for-the-economy>

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Endnotes

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- ⁱ This figure is calculated using ONS figures for GDP in 2013. ONS(2015, 28 August). Gross Domestic Product Second Estimate of GDP, Quarter 2 (Apr to June) 2015. Retrieved from: http://www.ons.gov.uk/ons/dcp171778_414601.pdf
- ⁱⁱ Adjusted wage share is labour compensation adjusted for self-employed income calculated as a ratio to GDP at factor cost; see Box 1 for more information.
- ⁱⁱⁱ Annual macro-economic database of the European Commission's Directorate General for Economic and Financial Affairs (DG ECFIN) (2015, 10 June) [webpage]. Retrieved from http://ec.europa.eu/economy_finance/db_indicators/ameco/index_en.htm
- ^{iv} EU15 refers to the 15 member countries in the European Union prior to the accession of ten candidate countries on 1 May 2004. <https://stats.oecd.org/glossary/detail.asp?ID=6805>
- ^v The decline in union density is calculated as the difference in union density between its peak and the latest available value (2013 or 2012).
- ^{vi} Onaran, Ö., Guschanski, A., Meadway, J. & Martin A. (2015). Working for the economy: the economic case for trade unions. London: NEF. Retrieved from: <http://www.neweconomics.org/publications/entry/working-for-the-economy>
- ^{vii} OECD (2015, 10 August). Trade union density. Retrieved from https://stats.oecd.org/Index.aspx?DataSetCode=UN_DEN
- ^{viii} Bargaining coverage is defined as the number of employees covered by collective wage bargaining agreements as a proportion of all wage and salary earners in employment that have the right to bargaining. Visser, J. (2006). Union membership statistics in 24 countries. *Monthly Labor Review*, 129 (1), pp. 38–49, at p. 39.
- ^{ix} Collective bargaining coverage is adjusted for the possibility that some sectors or occupations are excluded from the right to bargain by removing such groups from the employment count before dividing the number of covered employees by the total number of dependent workers in employment.
- ^x Visser, J. (2013). ICTWSS: Database on institutional characteristics of trade unions, wage setting, state intervention and social pacts [webpage]. AIAS. Retrieved from <http://www.uva-aias.net/208>
- ^{xi} Ebbinghaus, B. & Visser, J. (2000). *The Societies of Europe - trade unions in Western Europe since 1945*. London: Macmillan Reference Ltd, p. 104.
- ^{xii} Baker, D., Glyn, A., Howell, D. & Schmitt, J. (2004). Unemployment and labour market institutions: The failure of the empirical case for deregulation. Working paper no. 43. Geneva: International Labour Officer. http://natlex.ilo.ch/wcmsp5/groups/public/-dgreports/--integration/documents/publication/wcms_079135.pdf
- ^{xiii} IMF (2014, October). World economic outlook: Legacies, clouds, uncertainties. World Economic and Financial Surveys. <http://www.imf.org/external/pubs/ft/weo/2014/02/pdf/text.pdf>; Antolin-Diaz, J., Drechsel, T. & Petrella, I. (2014). Following the trend: Tracking GDP when long-run growth is uncertain. Fulcrum Research Papers. Fulcrum Asset Management. https://www.fulcrumasset.com/assets/3/2586_document.pdf?1414159955
- ^{xiv} Meadway, J. (2013). Why we need a new macroeconomic strategy. London: NEF. http://b.3cdn.net/nefoundation/66609d0bb3c446660a_z6m6b6zxt.pdf
- ^{xv} This is a measure of how an additional £1 of income received by an individual (either a wage earner or a capital owner) will be spent and is referred to in technical terms as the 'marginal propensity to consume' (MPC).
- ^{xvi} Onaran, Ö., Guschanski, A., Meadway, J. & Martin A. (2015). Working for the economy: the economic case for trade unions. London: NEF. Retrieved from: <http://www.neweconomics.org/publications/entry/working-for-the-economy>
- ^{xvii} GDP is a crude account of how much is bought and sold in an economy. As a measure of growth alone, it tells us little about economic progress in terms of how living standards are changing or how income is being distributed. For more on alternative measures of economic progress see: NEF (2013, April). Beyond GDP: Valuing what matters and measuring natural capital (Economics in policy-making briefing 7). London: NEF. http://b.3cdn.net/nefoundation/800a24dd60a18be7ea_vem6bnetw.pdf; and regular publications at: <http://www.neweconomics.org/issues/entry/well-being>