



# LABOR UNIONS



# INTRODUCTION

- ❖ Unions attempt to maximize the well-being of their members
- ❖ Unions can flourish only when firms earn above-normal profits
- ❖ Unions influence practically all aspects of the employment contract

# LABOR UNION AND WAGE DETERMINATION

- ❖ Increase demand
- ❖ Decrease supply
- ❖ Wage bargaining to be higher than equilibrium wage

## OBJECTIVE OF LABOR UNION

- ❖ Freely decision (to join union) → how to make a decision
- ❖ Trade off between working hour and the wage rate
- ❖ Cost of joining the union
- ❖ Create productivity → pay high → efficiency
- ❖ Exit-voice hypothesis

# DETERMINANTS OF UNION MEMBERSHIP

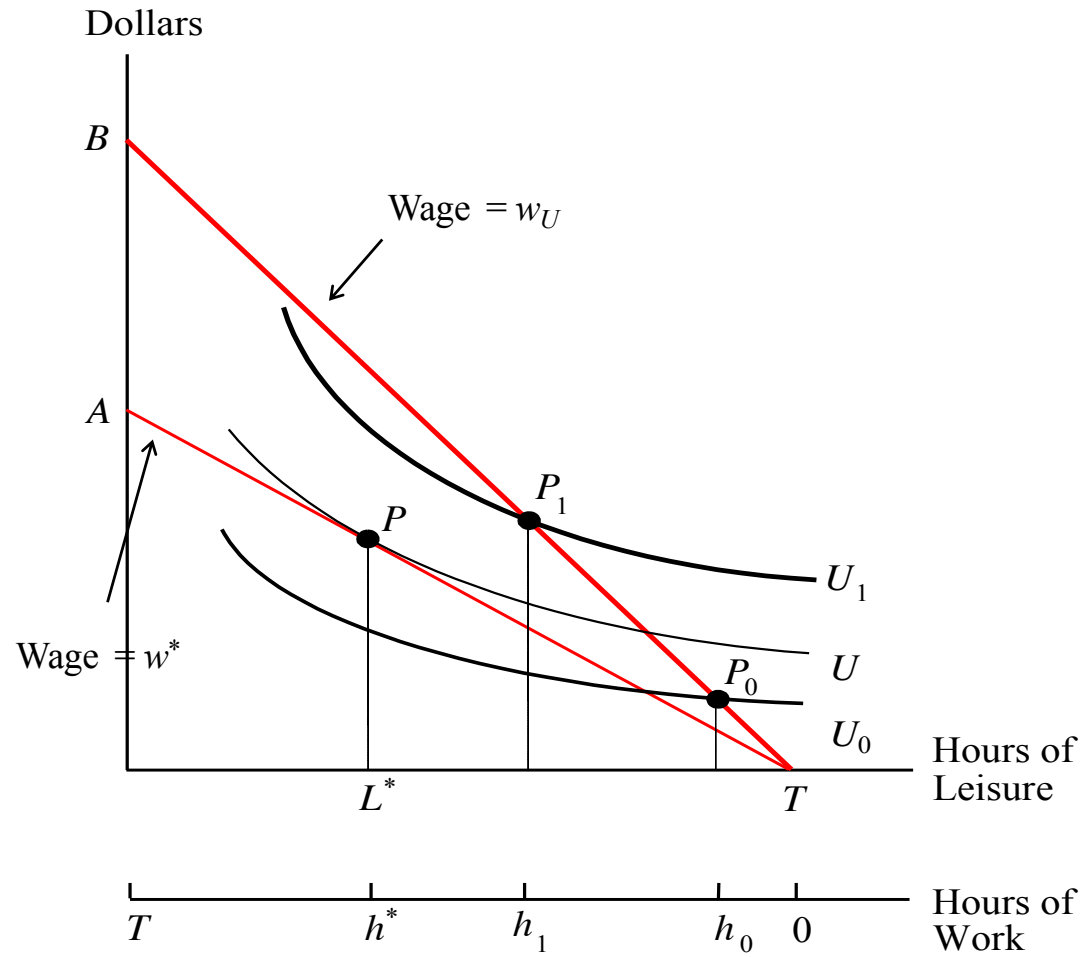
- ❖ A worker joins a union if the union offers him or her a wage-employment (benefit) package that provides more utility net of union dues than the wage-employment package offered by a nonunion employer
- ❖ Higher wages increase firm costs, so there could be employment cutbacks
- ❖ If a firm's demand curve for labor is inelastic the employment reduction is small (and vice versa)



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the union offers him a wage employment package that provides more utility than the wage-employment package offered by a nonunion employer

# THE DECISION TO JOIN A UNION





The budget line is given by AT, and the worker maximizes utility at point P by working  $h^*$  hours

The proposed union wage increase shifts the budget line to BT

If the employer cuts back hours of work to  $h_0$ , the worker is worse off

If the employer cuts back hours to  $h_1$ , the worker is better off

## THE DEMAND FOR AND SUPPLY OF UNION JOBS

- ❖ The demand for union jobs depends on the size of the wage increase, the amount of employment loss, and the costs of union membership.
- ❖ The supply of union jobs depends on the ability to organize a workforce, the legal environment affecting union activities, the resistance of management, and whether a firm is making excess rents.

# EFFICIENT CONTRACTS

- ❖ The firm and the union could make a deal that makes at least one of them better off without making the other worse off
- ❖ The efficient contract curve lies to the right of the labor demand curve
- ❖ Efficient contracts imply that unions and employers bargain over wages and employment

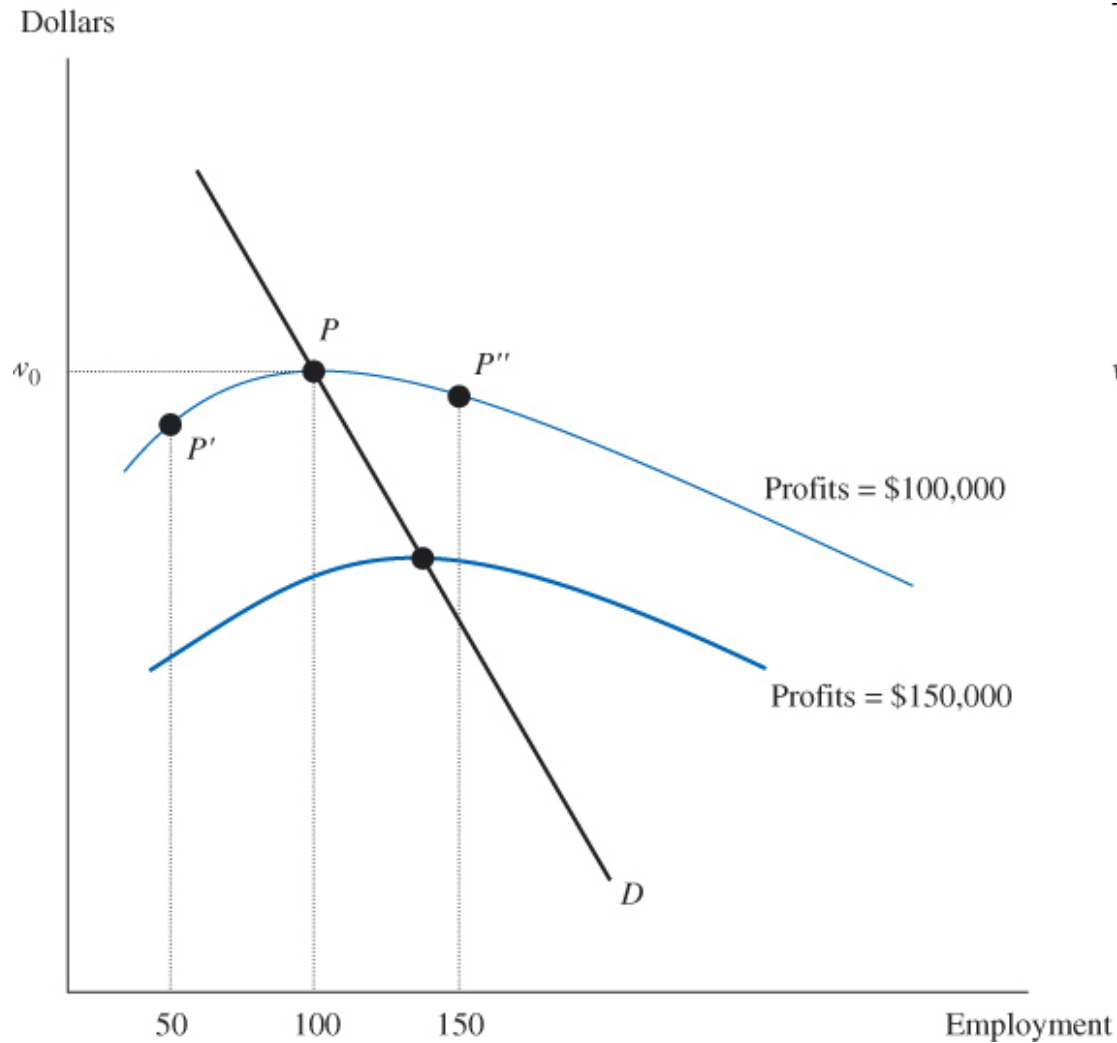
# EFFICIENT BARGAINING

- ❖ The Firm's Isoprofit Curves
- ❖ The Contract Curve
- ❖ Featherbedding
- ❖ Strongly Efficient Contracts

## THE FIRM'S ISOPROFIT CURVES

- ❖ An isoprofit curve gives the various wage-employment combinations that yield the same level of profits
- ❖ A profit maximizing firm is indifferent among the various wage-employment combinations that lie on a single isoprofit curve

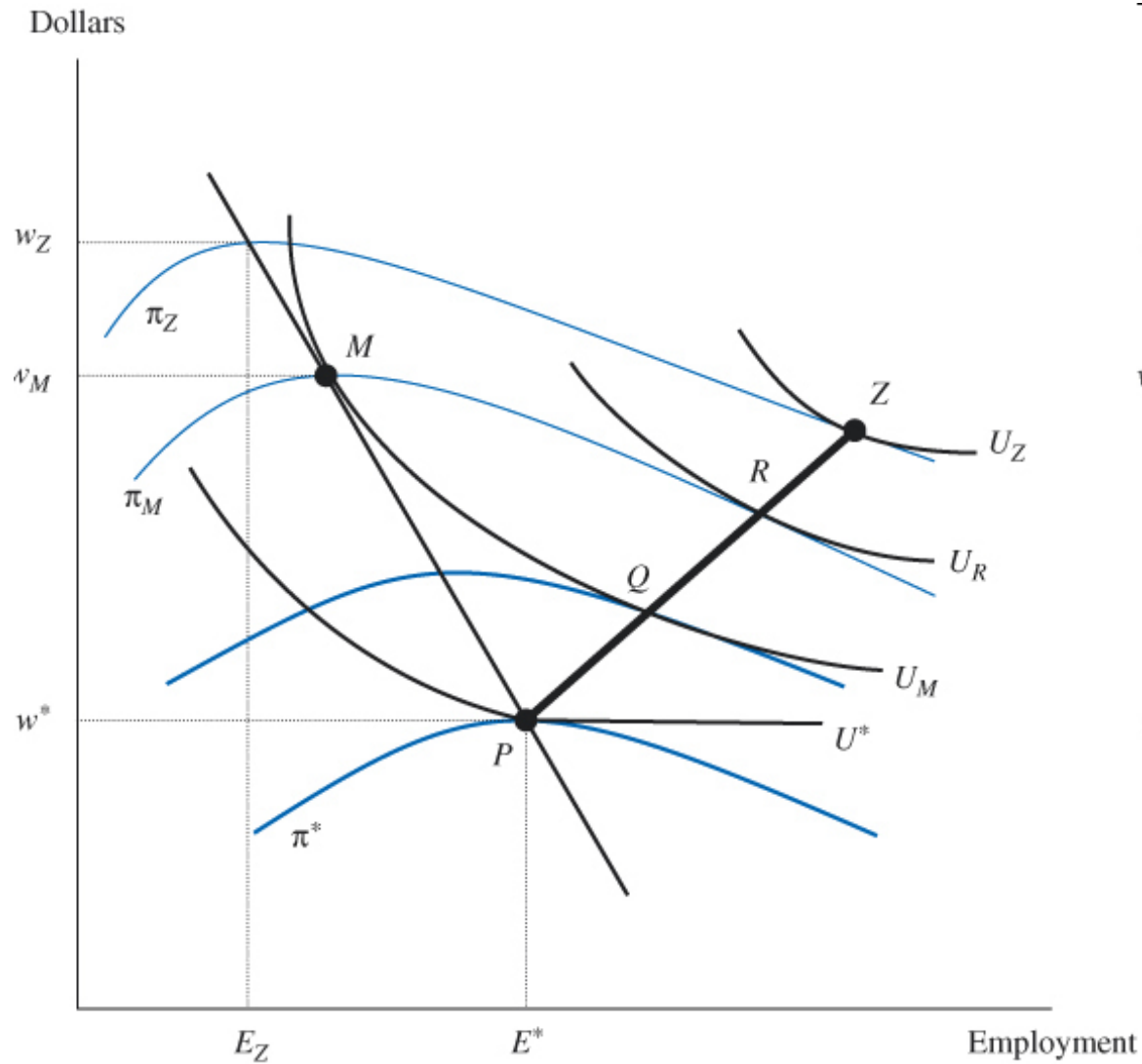
# THE DEMAND CURVE AND THE FIRM'S ISOPROFIT CURVES



## THE CONTRACT CURVE

- ❖ The curve PZ gives all the points where the union's indifference curves are tangent to the firm's isoprofit curves- these wage employment combinations are **Pareto optimal**
- ❖ The curve PZ is called **the contract curve**
- ❖ If the union and the firm agree to a wage-employment combination on the contract curve, the resulting contract is called an **efficient contract**

# EFFICIENT CONTRACTS AND THE CONTRACT CURVE





# FEATHERBEDDING

Featherbedding occurs when labor contracts require overstaffing


Featherbedding practices are negotiated to “make work” for the extra staff

# FEATHERBEDDING

- ❖ The contract curve is **upward sloping** – the unionized firm hires more workers than the competitive level  $E^*$
- ❖ The firm is overstaffed
- ❖ The firm and the union will then have to negotiate “make work” or **featherbedding practices** to share the available tasks among the many workers

# STRONGLY EFFICIENT CONTRACTS

- ❖ The shape of the union's indifference curves generates a vertical contract curve PZ
- ❖ The firm hires the same number of workers  $E^*$ , regardless of whether it is unionized or not
- ❖ If the contract curve is vertical, the deal struck between the union and the worker is called a **strongly efficient contract** because the unionized firm is hiring the competitive level of employment



Wage employment combinations on an upward-sloping contract curve are **efficient only** in the sense that they exhaust all bargaining opportunities between the employer and the union

# STRONGLY EFFICIENT CONTRACTS: A VERTICAL CONTRACT CURVE

