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Are Trade Unions a Force for Greater Equality in Europe or the Champions of Privileged Insiders?

This short paper links two discussions that are usually discussed separately: the causes of inequality differentials between countries and over time, and the role of trade unions in the political economy of modern societies. It does so primarily with reference to Europe.

Prior to the economic crisis, the issue of growing inequalities in most advanced capitalist countries had moved back up the academic and policy agenda. Alongside some national studies, notably in the USA,[1] the leading international economic organisations examined growing inequalities from a comparative perspective.[2] In most cases the debate was couched in terms of the disproportionate gains accruing to capital owners and high (wage) income earners in the context of increased globalisation and technological changes (with skill-biased technological change increasing returns to higher-skill workers at the expense of the low-skilled). Institutional changes (including declining union influence) played a small role in this debate.

Most of the economic debate on the impact of unions on the economy has centred on claims that, by exerting monopoly power, they push up wages above "market" rates, either in the aggregate or for certain groups, and thus cause unemployment. Some participants in this debate acknowledge that unions, alongside other institutional features of labour markets and welfare states, often exert a wage-compression effect. Paul Krugman, for example, argued that, in the face of pressure for wider wage differentials, due to globalisation and skill-biased technical change, Europe had "chosen" to maintain greater equality than in the USA – and paid a price in terms of higher unemployment.[3] This hypothesis corresponds to what might be termed the "conventional wisdom" in Europe that unions stood up for the "little guy" (and increasingly little girl), while causing social costs in terms of lost employment. The debate has been on how to balance these two effects.

Increasingly, though, a more negative view of the impact of unions has gained currency. Put starkly, approaches such as the so-called "insider-outsider" theory[4] or rent-seeking approaches suggested that unions were bad on both counts: not only do they raise the unemployment rate, by privileging the interests of "insiders" and promoting the exclusion of "outsiders", strong trade unions exacerbate inequality, at least within wage income (and also more broadly with respect to the physical and contractual conditions of employment). They do this not only through their organisational power at the workplace, but also by championing broader institutional measures (notably dismissal protection) which strengthen their insider power.[5]

By emphasising the key importance of the division between insiders and outsiders, and claiming that this results from unionisation and other labour market institutions which are held to be closely correlated with union power, this approach strongly implies a belief that societies in which unions are strong are those in which insiders have an entrenched role and that these are likely to be more unequal. Indeed, in the light of this academic debate, many liberal-conservative, and increasingly also some social-democratic, policymakers came to see unions as representing "privileged" groups in society. This was used to justify measures to reduce the influence of unions with claims that in doing so they were championing the interests of the weak and the excluded, interests supposedly neglected by unions themselves.

This article first presents empirical evidence on the link between inequality and the power of national trade unions. This is followed by an interpretation of this evidence in the light of the predictions of insider-outsider

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[1] T. Piketty, E. Saez: Income Inequality in the United States, 1913-1998, in: Quarterly Journal of Economics, Vol. 118, No. 1, 2003, pp.1-39.

[2] OECD: Growing Unequal? Income Distribution and Poverty in OECD Countries, OECD, Paris 2008; IMF: Globalization and inequality, in: World Economic Outlook, October 2007, Ch. 4, pp. 31-65.

[3] P. Krugman: Past and prospective causes of high unemployment, in: Economic Review, Federal Reserve Bank of Kansas City, Vol. 79, No. 4, 1994, pp. 23-44.

[4] See for an overview: A. Lindbeck, D. Snower: The insider-outsider theory: a survey, IZA Discussion paper No. 534, http://www.iza.org/index_html?lang=en&mainframe=http%3A//www.iza.org/en/webcontent/publications/index_html%3FmenuTriggered%3Dtrue%26noPageLoaded%3Dtrue&topSelect=publications/.

[5] Ibid., pp. 26ff.

theories. The final part concludes. The key result is that overall no evidence was found for the claim that, in Europe, stronger trade unions lead to higher inequality or unemployment. It seems from this preliminary look at the data that trade unions do not simply champion the interests of privileged insiders.

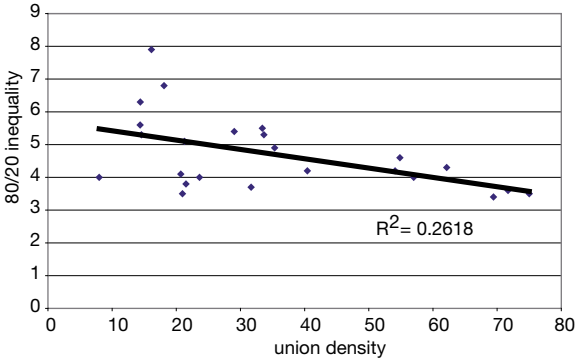
Data Used

This section offers a preliminary empirical description of the statistical links between inequality and the power of national trade unions. The main focus is cross-sectional, i.e. we look at the correlations between the strength of trade unions and inequality across European countries at a given point in time. To a lesser extent, because of data limitations, we also consider the longitudinal aspects, in other words the link between changes over time in measures of trade union power with those of inequality.

We consider two standard measures of the power of trade unions. The first is the percentage of workers organised within trade unions (union density). The second is the percentage of workers that are covered by collective agreements negotiated between unions and employers (collective bargaining coverage). Data are taken from the ICTWSS database.[6] The use of these two indicators is standard in the voluminous literature on the link between unemployment and labour market institutions.[7] The first measure indicates the quantitative importance of trade unionism within each national labour force. Collective bargaining coverage indicates the extent to which unions manage to set wages for all workers, whether by direct bargaining responsibility or by various national measures by means of which collectively agreed standards are extended to other workers.

Each measure has certain drawbacks. Cross-national differences in union density can be affected by institutional configurations, most notably union involvement in running unemployment and other social insurance funds, without this necessarily implying higher union power. Particularly with regard to inequality outcomes, collective bargaining coverage might be thought to be the more relevant. One drawback is that only rough estimates are available in some cases and data are missing for a number of European countries.

Figure 1
80/20 Inequality and Union Density, 2006



Three inequality measures are considered: the Gini coefficient, the ratio of the incomes of households at the 80th and the 20th percentile (80/20 ratio), and the proportion of households in which at least one person is in work and where household income is 60 per cent of the median ("working poor"[8]). The Gini coefficient indicates the overall extent of inequality across the entire income distribution. The 80/20 indicator can be considered particularly relevant as it ignores developments at the very top and bottom of the distribution, which are likely to be influenced more by capital and transfer income respectively. The working poor indicator only focuses on working households and provides a measure for the degree of (net) wage compression at the bottom of the distribution. A weakness of this latter data is that it is rounded so that only whole percentages are reported. The inequality data are taken from the Eurostat EU-SILC survey. For one longitudinal comparison (see Figures 9 and 10) OECD Gini coefficient data are used.

Empirical Findings

Figure 1 shows a negative correlation between inequality, as measured by the ratio of the 80th to the 20th income percentile, and trade union density for the 24 European countries for which both data points were available. The data suggest that, on average across Europe, in a country with a union density rate of a quarter, the income of those at the 80th percentile is five times higher than at the 20th; in countries where

[6] J. Visser: Institutional Characteristics of Trade Unions, Wage Setting, State Intervention and Social Pacts (ICTWSS), an international database, Amsterdam Institute for Advanced Labour Studies (AIAS), Amsterdam 2009.

[7] Such as L. Calmfors, J. Driffil: Bargaining Structure, Corporatism, and Macroeconomic Performance, in: Economic Policy, No. 6, 1988, pp. 14-61; S. Nickel, L. Nunziata, W. Ochel: Unemployment in the OECD since the 1960s. What do we know? in: The Economic Journal, Vol. 115, 2005, pp. 1-27; J. Driffil: The Centralisation of Wage Bargaining Revisited: What Have we Learnt? in: Journal of Common Market Studies, Vol. 44, No. 4, 2006, pp. 731-756; T. Iversen: Contested Economic Institutions: The Politics of Macroeconomics and Wage Bargaining in Advanced Democracies, Cambridge University Press, New York 1999; L. Calmfors: Wages and Wage-Bargaining Institutions in the EMU - A Survey of the Issues, in: Emprica, Vol. 28, No. 4, 2006, pp. 325-351.

[8] We use "working poor" as a more intuitive phrase in place of the official term "in work and at risk of poverty".

Figure 2
Working Poor and Union Density, 2006

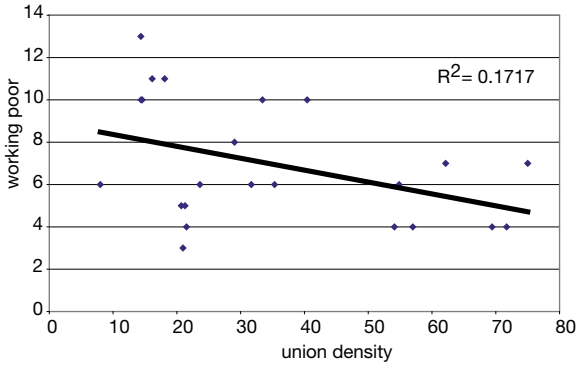
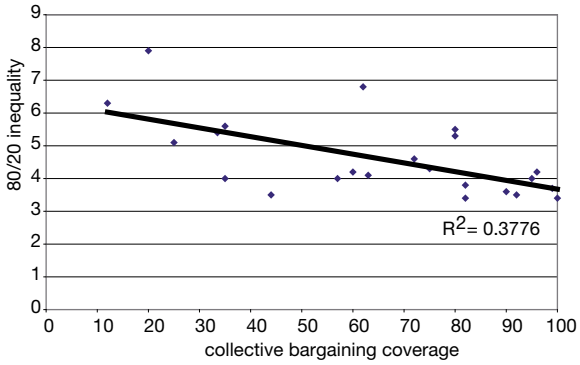


Figure 3
80/20 Inequality and Collective Bargaining Coverage, 2006



around two-thirds of workers are organised in unions, the income disparity is reduced to a factor of four.

The interpretation of the data will be postponed to the part "Interpreting the Empirical Findings", but some discussion of the value of R-squared – which indicates the amount of variation in inequality that can be statistically "explained" by variation in union density – is called for, as it pertains also to the following figures. This is not an econometric model seeking to "explain" the distribution of inequality, but a simple bivariate correlation. Clearly other factors are also important determinants of inequality. Still, an R-squared of 0.26, suggesting that union density helps to "explain" more than a quarter of the variation in inequality, is an important result.

It is noteworthy that the correlation is much stronger for the upper part of the distribution (from density rates of around 30%), than below. In particular a number of countries manage to have relatively low inequality scores on this measure, at low rates of union density. This is true of France, the Netherlands and Germany in western and the Czech and Slovak Republics in Eastern Europe.

The result from using the Gini coefficient (not shown) is almost exactly the same. This reflects the extremely high correlation between the two inequality measures (correlation coefficient: 0.98). For this reason no separate discussion of the Gini coefficient is given in what follows.

As can be seen from Figure 2 the result when using the working poor indicator of inequality is rather similar, although the goodness of fit is somewhat lower. On average in Europe 8% of households are "working poor" in countries with a union density around 15%. This falls to 6% where just over half of all workers are union members and below 5% for those with the highest unionisation rates. Once again there is greater variation in terms of inequality among countries with low levels of union density.

Figure 3 reports the results using collective bargaining coverage rather than union density. It suggests that bargaining coverage is an even better predictor of low inequality than the proportion of organised workers. The data (for 23 countries, as above except Romania) point to an even closer statistical relationship (the R-squared is a substantial 0.38) right across the distribution. On average in countries with the lowest coverage (around 20%) those on the 80th percentile earn 6 times those on the 20th; this is reduced to a factor of four in countries where more than four fifths of workers are covered by collective agreements.

With regard to the working poor, we see (Figure 4) once again a negative correlation with collective bargaining coverage. As was the case with union density, though, the statistical fit with this measure of inequality is rather weak. Notably Spain and Portugal have a large percentage of working poor despite a fairly high level of collective bargaining coverage. The reverse is true of the Czech Republic and Bulgaria.

But Do Trade Unions Cause Unemployment?

A prediction of insider-outsider theory is that in the presence of strong unions institutional configurations are such as to strengthen insiders which drives up the cost of labour and freeze out low productivity workers from employment.[9] As mentioned above, this view is widely accepted as "conventional wisdom". Of course a much more sophisticated analysis of this issue would be required, but it is worth noting briefly in the context of this article that the current distribution of unemployment in Europe does not support this view. Figures 5

[9] A. Lindbeck, D. Snower, op. cit., pp. 14ff.

Figure 4
Working Poor and Collective Bargaining Coverage, 2006

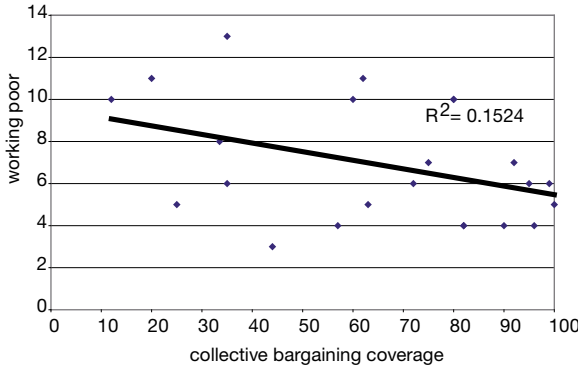
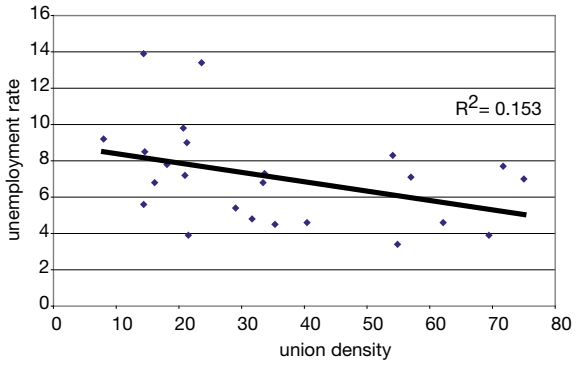


Figure 5
Unemployment Rates and Union Density, 2006



and 6 graph unemployment rates against union density and bargaining coverage respectively. The two measures of union power are negatively correlated with unemployment, although the correlations are statistically weak. On average the European countries with high density or coverage have an unemployment rate more than 2 pp lower than those with low density or coverage, although the weak fit suggests that unionisation is not particularly important. This finding is in line with earlier work[10] which showed that employment rates were higher and unemployment lower in European countries with a set of welfare and labour market institutions, including strong unions, that offer economic security to workers.

A Longitudinal Perspective

It is also possible to examine whether changes in inequality measures over time are correlated with changes in unionisation and collective bargaining coverage. Unfortunately, Eurostat data are not available for the enlarged European Union over a sufficiently long period. Even among the 15 pre-2004 EU countries, missing data points restrict the number of countries which can be compared. Going back to 1995 permits a comparison over just over a decade for eleven countries (EU15 minus Finland, Greece, Luxembourg and Sweden), with respect to union density and only nine countries (Portugal and Ireland are also missing) for collective bargaining coverage. While such a restriction will tend to reduce confidence levels in a statistical sense, it has the advantage of forming a more homogenous group of countries in terms of economic structures and other institutions than the wider EU27. An important drawback of these numbers is that in 1995 Europe was just emerging from recession and unemployment was very high, whereas in 2006 the Continent was just before a business-cycle peak. Largely for this reason 80/20 inequality actually declined somewhat in most countries over the period.

The results are presented in Figures 7 and 8.

Compared with the cross-sectional data the findings are almost totally insignificant. There does not seem to be a meaningful link between changes in union power and changes in inequality over the period considered, although the correlation with density is negative. The same is true, with respect to bargaining coverage, of the cluster of countries close to the y-axis in Figure 8. In this case, however, there is one extreme outlier (Denmark) in the top right corner.

If we use, instead, OECD data, we can examine the same relationships for a larger set of countries and over a longer time period. Comparing the mid-1980s with the mid-2000s means that business cycle conditions are more readily comparable in the two periods. The disadvantage of this approach is that a more heterogeneous set of countries is considered. These data are presented in Figures 9 and 10. They refer to the 16 and 18 OECD countries respectively for which the data was available.[11]

Once again we see that the statistical fit is extremely weak. There is not a meaningful link between changes in inequality and in unionisation.

Interpreting the Empirical Findings

The correlations do not, of course, in themselves, tell us about causal relations. However, at least in the case of the cross-sectional comparison, it does seem plausible to posit a chain of causality running

[10] A. Watt: Economic security and employment: trade-off or synergy?, in: Transfer, Vol. 10, No. 4, 2004, pp. 630-640.

[11] The non-European countries included are Canada, Japan, New Zealand (only density) and the United States.

Figure 6
Unemployment Rates and Collective Bargaining Coverage, 2006

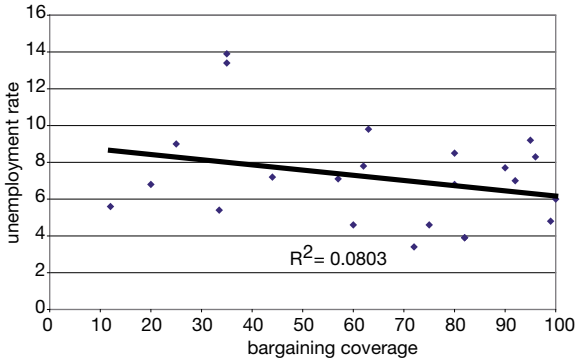


Figure 7
Change in 80/20 Inequality and in Union Density, 1995-2006

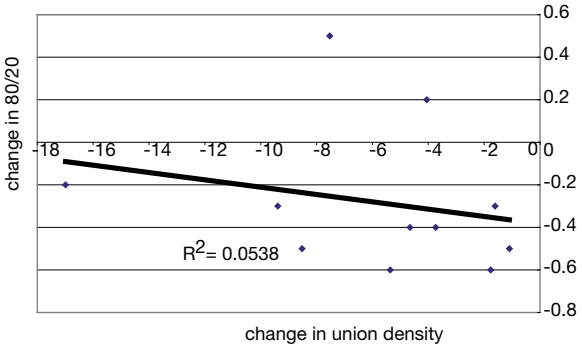
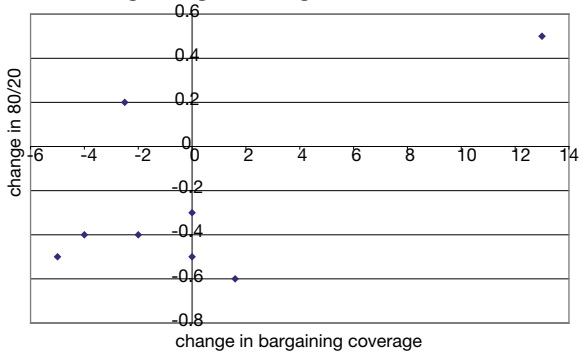


Figure 8
Change in 80/20 Inequality and in Collective Bargaining Coverage, 1995-2006



from trade union power to inequality outcomes, rather than the two logically possible alternative hypotheses: greater inequality causing lower unionisation or some third factor driving differences across countries in both unionisation and inequality in opposite directions. The latter hypothesis may, on the other hand, seem plausible in the case of changes over time where the correlations are in any case insignificant. More importantly, it seems likely that certain explanatory factors (such as globalisation, individualisation, tertiarisation) are driving the indicators of union power down while increasing measured inequality. To take the example of tertiarisation, a greater role for services in the economy may increase the extent of both high-skill and low-skill employment, at the expense of medium-skill jobs more typical of manufacturing. The same process may also drive down unionisation and bargaining coverage rates because of the historical importance of manufacturing to trade unionism, the difficulties of organising workers in small enterprises, rather than large (industrial) firms, and so on. Econometric studies, particularly of the USA have sought to disentangle these effects.[12] The findings of different studies vary quite considerably. It seems clear from the literature that the joint causation phenomenon is strong. Nevertheless, most studies find at least some specific causal effect from the decline in unionisation on rising inequality.

Some important channels by which strong unions (as measured by density or bargaining coverage) can be expected to exert a casual influence in the direction of lower inequality include:

- Sectoral bargaining and/or the extension of collective agreements to non-unionised firms in a sector may compress wage differentials between firms of different productivity levels.
- Unions may strengthen the bargaining position of the lower-skilled, thus flattening the overall income distribution.[13]
- Unions may negotiate wage agreements at various levels that achieve higher wages for the lower skilled at the expense of wage moderation by higher-skilled workers, compared with employer preferences.
- Powerful unions may influence government wage setting policy, particularly with regard to minimum wages and also public sector pay
- Unions may exert greater influence over the political process and achieve more redistributive tax and

[12] See the discussions and literature reviewed in D. Card, T. Lemieux, W. Riddell: Unionization and Wage Inequality: A Comparative Study of the U.S, the U.K., and Canada, NBER Working Papers 9473, 2003, National Bureau of Economic Research, http://papers.nber.org/papers/w9473.pdf/.

[13] This is logically compatible with a belief that unions worsen the relative position of those at the bottom.

Figure 9
Change in the Gini Coefficient and in Union Density, OECD Countries, mid-1980s to mid-2000s

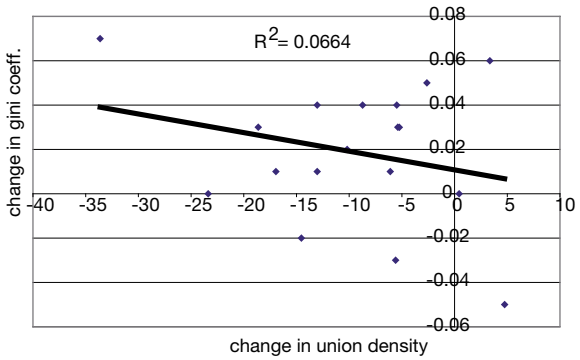
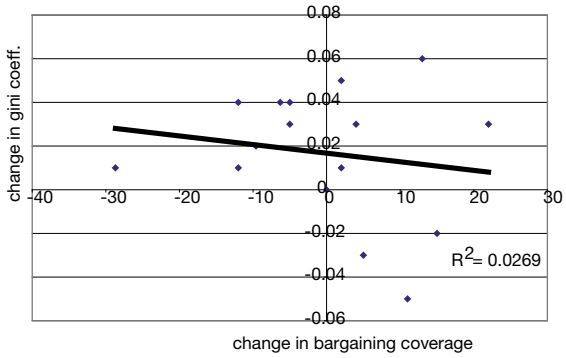


Figure 10
Change in the Gini Coefficient and in Bargaining Coverage, OECD Countries, mid-1980s to mid-2000s



benefit systems as a means to increase their members' net earnings.

- Even in the logic of insider-outsider approaches, unions have incentives to improve the situation of outsiders as this reduces the likelihood that the employer will resort to an "outside option" and the costs to (former) insiders if this occurs.

An alternative, but by no means mutually exclusive, view would be that high unionisation and low inequality have a common "cause", presumably in some social consensus about the need for cohesion and solidarity. This gives rise to a broad set of inequality-reducing institutions, including a strong role for trade unions.

This is not the place for the historical-sociological discussion to shed light on these issues. The point is rather to suggest that an influential strand of mainstream economic thinking, insider-outsider and related theories, has, perhaps unintentionally, led policymakers astray. The findings presented here certainly pose a challenge to received wisdom, at least within Europe, and especially to insider-outsider theories. For if unions' key function, as posited, is to exert some degree of monopoly power on behalf of a sub-set of core workers, and freeze out a smaller subset of marginalised outsiders either into unemployment or into precarious and ill-paid jobs, then this would *raise* the level of inequality. The effect on the distribution of wage income is direct, and via exclusion effects from the labour market a more general albeit indirect effect raising income disparities would be expected on the basis of these approaches. To illustrate by way of an extreme example: ignoring capital and transfer income, and assuming that the insider-outsider demarcation is one-fifth and four-fifths of the workforce, then the 80/20 inequality measure would be expected to vary precisely proportionately to the strength of insider power. While the literature also suggests numerous other sources of insider power (such as dismissal protection legislation) alongside unionisation, it is usually argued[14] that these are closely correlated with membership in unions, for in the absence of legal measures ensuring insider power, the rationale for joining a union falls away.

Of course broader issues of taxation, capital revenues and others complicate the picture. It might logically be the case that unionisation does create greater inequalities at the level of, say, the bargained wage (and other conditions of employment), but that this effect is overwhelmed by other, positive effects on equality of union power. We can to some extent examine this hypothesis by differentiating between income distributions before and after taxes and benefits. Using Eurostat data this is possible for one indicator namely the "at risk of poverty" measure, that is the proportion of households with an income of 60% below the median or less.

Figures 11 and 12 present the correlations between these measures and collective bargaining coverage for 23 European countries for which both data are available in 2006. (The same calculations were performed for union density – not shown – with qualitatively similar results.)

Comparing the two graphs it is evident that there is a negative correlation between bargaining coverage and the risk of poverty and thus inequality at the bottom of the distribution of *before-transfer* incomes. Statistically an increase from the lowest to the highest level of bargaining coverage implies on average a

[14] A. Lindbeck, D. Snower, op. cit., p. 27.

Figure 11
At Risk of Poverty Before Transfers and Collective Bargaining Coverage, 2006

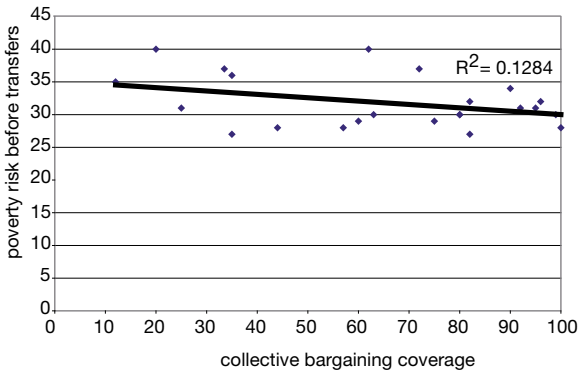
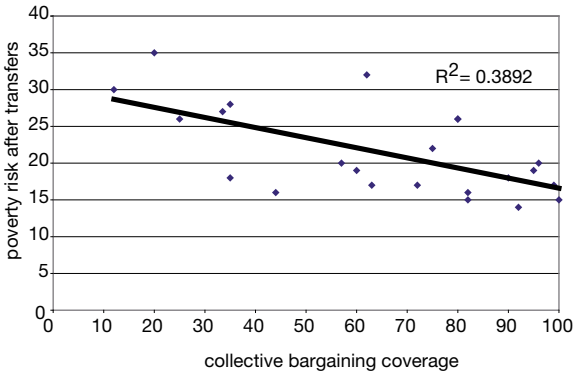


Figure 12
At Risk of Poverty After Transfers and Collective Bargaining Coverage, 2006



reduction of five percentage points in the proportion of the households below 60% of the median, considering only "market" incomes. The statistical link between unionisation and *after-transfer* incomes, i.e. allowing for taxes and benefits, is substantially greater though. Taking the two extremes of the distribution implies, statistically, almost a halving of the risk of poverty comparing minimum and maximum bargaining coverage rates (just under 30% to just above 15%).

Overall this suggests that the impact of unionisation is *both* on market incomes and on the redistributional power of the tax and benefit system. It does *not* seem to be the case that union influence via the welfare state compensates for an inequality-*increasing* effect of unionisation on market incomes. Even if the causal mechanisms described above are disputed it can certainly be concluded that factors that promote high rates of coverage and union density have inequality-reducing effects both on market incomes and on the redistributive social and taxation policy system.

Conclusion

The key result of this preliminary look at the data is that overall no evidence was found for the claim that, in Europe, stronger trade unions lead to higher inequality or unemployment. Comparing European countries, it seems that trade unions do not simply champion the interests of privileged insiders. Indeed, the empirical evidence presented in this paper suggests that, across Europe, a strong position of organised labour seems to be conducive to lower income inequality. Equally union power does not seem to be associated with higher unemployment in Europe. In fact the reverse currently seems to be true. In terms of changes over time, no meaningful relationships were found.

These findings pose a challenge to approaches such as insider-outsider theory which see trade unions as exerting a pernicious influence. This does not mean that insider-outsider mechanisms are not relevant or the theory contains no insights. Still, it seems from the various country comparisons presented here, with their consistent outcomes, that in those European countries in which unions are relatively strong, unions also serve the interests of "outsiders" (such as the predominantly non-unionised "working poor") and not just those of their own members. They do so both in terms of market (before tax and benefit) outcomes and because highly unionised societies have more strongly redistributive welfare systems. The ascription of simple "utility functions" to unions in models in this prevailing economic discourse would seem problematic. Rather than making assumptions, often driven by the need for modelling simplicity, researchers should attempt to determine union (leaders') preferences empirically. They should also look at the full range of channels by which unions influence economic outcomes, and not focus on a single mechanism.

Encompassing union movements, such as are found in the Nordic countries, can be expected to consider broader societal concerns when choosing their strategies. Often in such countries (in the so-called Ghent system) the unemployed remain members of unions. Such countries have among the best labour market performance in Europe. This is clearly an area worthy of much more detailed research, but the preliminary analysis presented here suggests that a reasonable working hypothesis would be that strengthening trade unions could be one way to reduce inequality in European countries.