The headline on this lesson is “How Labor Unions Cause Unemployment.” But before we can talk about that, we really have to talk about what labor unions are, and why they do what they do. Suppose you live in a town where there’s one employer, and this employer is a monopoly supplier of jobs. This employer can choose what wage it wants to pay, and because all the workers in this town depend on this company for employment, they don’t have a lot of say. You either take the wage or you don’t get a job. But suppose the workers get fed up with this exploitation and decide to meet power with power. That is, they form a cartel of labor, and they say, as a group, “We will not supply any labor to this company unless it pays us a decent wage, and gives us decent working conditions.” This is the idea behind a labor union.

A labor union forms a monopoly of labor in some particular industry so that it can meet power with power; it can bargain with the more powerful employers. Since there are fewer employers and they are better organized into firms, the workers have to also get organized, or they’re going to be at the mercy of these monopoly suppliers of jobs. However, whenever workers form labor unions, one of the consequences may be unemployment.

Some quick terminology: First of all, a labor union is an organization of workers in a particular industry that bargains collectively with firms about wages and working conditions. Second definition, collective bargaining: Collective bargaining is when a representative of the labor union sits down with the representative of the firm or the management to negotiate about wages and working conditions. And the result is usually a contract that’s enforced for one, two, or three years. Collective bargaining recurs on a regular cycle. Finally, a strike is a stoppage of work. Workers go on strike whenever their terms are not met. This is part of their bargaining power; they can withdraw labor from the firms until the firm meets their demands for higher wages or better working conditions.

Now what do labor unions have to do with unemployment? In the free market, the supply of labor reflects the passive response of workers to higher or lower wages. The demand curve for labor reflects the firm’s profit-maximizing choices – At different wages, how much labor are we going to choose to hire? In a free market, the interplay of supply and demand determines an equilibrium wage in an equilibrium quantity of labor hired – say this is $10.00 an hour, and 100 workers hired in this industry. The labor union says to itself, “This total amount of wages that we’re receiving – $10.00 times 100 workers, or $1,000 an hour – that’s not good enough, we can do better.” So what they do is they hold out for a higher wage – and this is the union wage – that is, they say, “If you don’t pay us $12.00 an hour, we’re going to go on strike.” And the company is faced with a choice: Pay the higher wages, or don’t get any workers at all.

So at the higher wage, the company wants to employ fewer workers, say only 90 workers instead of 100. But all in all, the labor union is in better shape; $12.00 an hour times 90 workers is $1,080, and that’s an improvement over the original situation. So I can shade in this area, this rectangle, which is the total wages received by the union workers, and see that they’re better off.

But here’s where unemployment comes in, because at this higher union wage, there are a lot of people who would like to get a job. And the gap between the number of people who would seek work at the union wage, and the number of jobs that are offered by companies – well, that’s unemployment. So what do we do about that? Well, first of all, what does the union do about that? The union may require, as one of its terms of supplying labor, that the firm not only pay the high wage, but actually employ more workers. This is an outward shift in the demand curve for labor that’s imposed on the company as a term of the contract; it’s worked out in collective bargaining. So $12.00 an hour, and maybe you still have to hire all 100 workers, or maybe you have to hire more.

Well, an economist starts getting very uncomfortable at this point, because now the firm is not allowed to make a profit-maximizing choice. They’re saying to themselves, “Oh, man, we’ve got to hire all these workers, and it would be to our advantage to use machines instead, or even cut back our production at this higher wage. It’s just not working for our bottom line.” On the other hand, the economist can’t totally support the company in this bargain, because, after all, to begin with, the company may have had some monopoly power of its own. That is, it was throwing its weight around to force wagers lower, and impose terms of work on the employees that may not have been in their best interest.
So it's kind of hard to take sides in this dogfight. However, it is easy to say that once the union gains control in this bargaining power, once they can force the company to hire more workers, we may wind up with an inefficiency. However, the ironic flip side of that is, when you hire more workers, you've got less unemployment. So there's kind of a tradeoff here, the point being that, until the union requires the company to hire more workers – a practice that's sometimes called featherbedding, more workers being hired at the higher union wage – then we've got unemployment – a gap between the workers who want to work and the jobs the company wants to offer.

Unions have the right by law to form; workers can organize into unions, and their activity is overseen by the National Labor Relations Board, which guarantees that workers everywhere are allowed by their companies to organize. However, remember we've talked before about how unskilled workers may be at a disadvantage in this environment, because the unionized workers are usually the skilled workers. The unskilled workers then find themselves at a disadvantage when the unions get out and agitate for high minimum wages. These high minimum wages mean that you have to pay an unskilled worker a lot of money. That causes you to be less attracted to unskilled workers, and want to use skilled labor instead. The minimum wages make the unskilled workers uncompetitive and incline companies to hire the skilled unionized labor instead.

Sometimes unions go so far as to push companies to say that, “You must be a union member to work in this industry.” Some companies then have to accede to the demands of labor. But then unskilled workers who may choose not to join the labor union, because they're not skilled enough to be hired at this high wage, they then are at a disadvantage; they can't go out and offer to work at a lower wage and be competitive. That's why in many cases, states have right-to-work laws that protect unskilled workers. Right-to-work laws rule that it is illegal for companies to require union membership as a condition of employment. Unions don't like these laws, because they make unskilled workers more competitive. But unskilled workers appreciate them, because they allow them access to jobs and make them more competitive. So labor unions are kind of a cartel, and like a cartel, they have advantages and disadvantages. The advantage of a cartel is it gives you power to meet power with; workers get a better deal when they can organize and bargain collectively. The disadvantage is, at the higher wages that we have with the union, we get unemployment, and maybe inefficiency. Also, union activity puts unskilled workers at a disadvantage.