# The Future of Unions.

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Some institutions die. Some keep being reborn. What will happen to unions?

The question is an important one. It is also a tough one. Economists (and others) have a hard time understanding why countries have different institutions, let alone predicting how these institutions are likely to change. We heard plenty of examples at this conference of how difficult the task is. Nevertheless, with the help of the two papers and the discussions that followed, I believe we have made some progress. Let me share my thoughts at the end of the day. Take them for what they are: Thoughts at the end of a day. There is much in what follows which is speculative, if not simply wrong.

A useful starting point is to think about what unions have done in the past. There are many ways of drawing up such a list. With an eye to what may happen in the future, let me organize mine around four functions.

- First—and first historically—to provide insurance and help to their members, were the need to arise.

- Second, to protect workers against rent extraction by firms, in other words to fight exploitation.

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- Third, to extract rents from firms and from the state. Clearly, the high unionization rates in sheltered sectors—including the public sector—does not stem from an unusual risk of exploitation in those sectors, but rather from the presence of rents to be extracted.
- Fourth, to represent the interests of workers at the national level, either directly in consultation with business and government, or indirectly through political parties.

For each of these functions, it is useful to ask: Which of these functions can/will/should unions continue to perform in the future? Let me take each one in turn. (Some of my arguments will have to do with "can", some with "should", some with "will".)

**Insurance.**

It is fairly clear, both theoretically and empirically, that the state has a comparative advantage in providing unemployment insurance to workers. The state has the administration, the statistical records, the economies of scale that unions just do not have. This was indeed the main motivation for the development of state–provided insurance, which is now the rule in most countries. It was a major accomplishment. But, in a way, it was a Pyrrhic victory for unions. The workers are better off, but the unions have lost one of their main functions.

The discussion of the so-called "Ghent" system of unemployment insurance in one of the papers presented at this conference is interesting in this respect. In its pure form, the Ghent system is a system of co-provision of unemployment insurance by firms and workers. The unions like it, and the evidence is that it leads indeed to higher membership rates. The authors of the paper contend that there might be good economic arguments in favor of such co-provision. But the argument they develop should actually make unions think twice: It is that, by forcing unions to internalize the cost of unemployment insurance, such co-provision will lead to more wage moderation. If this is the case, this may well be a poisoned gift. If the co-insurance system comes with large subsidies from the state, this is clearly more attractive to unions. But, in this case, the economic argument disappears. And, as we are currently seeing in France, the state may not be eager in that case to transfer responsibility for running the system to unions and firms.

**Rent extraction by firms.**

The opportunities for exploitation of workers by firms (or, to use more neutral semantics, the degree of monopsony power of firms in the labor market) have substantially decreased since the 19th century. But they have not disappeared. The issue here is how best to limit them. How much should be done by the state, how much should be left to the unions?

The answer is that it should mostly be done by the state. What is needed here are clear, across the board, rules which limit abuse without interfering further with the decisions of most firms. This suggests the use of national laws and national minima, enforced by inspectors, rather than case by case bargaining.

And this is indeed what has happened over time. Working conditions are typically determined by national standards. In most countries, the minimum wage is determined by the state, rather than bargained sectorally.

Employment protection is a bit different. In many countries, the rules are complex, and the firms' decisions can be challenged by individual workers or by unions. But even there, there seems to be an increasing perception that the system is too complex, and that the costs are large, relative to the transfers to workers. The evolution—which, admittedly, is taking place only at glacial pace—seems to be towards simpler rules, more automatic payment of severance, and less room for recourse by either workers or unions.

All in all, the conclusion here seems to be the same as for insurance earlier. Limiting rent extraction by firms is probably better done through laws than by unions. And the role of unions in that dimension is indeed decreasing.

**Rent extraction from firms and from the state.**

We were warned in the first paper today that higher European integration does not necessarily imply a decrease in product market rents. The warning is important. But it is still the case that, in many sectors, increased competition, either at the national or international level, is leading to a decrease in rents. Even the state sector is under increasing pressure to keep public sector wages under tighter control.

What about the new economy? One might actually argue that, in much of the new economy—think of the Net, or genetic engineering— marginal cost is close to zero, generating enormous rents. This is certainly the conclusion one must draw from the stock market's assessment of high tech stocks. These rents may however be difficult for workers to appropriate. They come and go too fast, both in time and in space, and most workers do not have much bargaining power anyway.

So the news on this third front is also bad for unions. The smaller the rents generated by firms, the smaller the rents the unions can appropriate, the smaller the appeal of unions.

**National representation.**

With the increasing focus on reform of labor market institutions, unions clearly have an important political role to play in the redefinition of these institutions. But one of the lessons I draw from the unemployment experience in Europe is that their role should go beyond that.

For an economy to grow at a steady pace, many conditions must be satisfied. One of them is that real wage growth be consistent with the pace of total factor productivity (tfp). The lesson of the 1970s and early 1980s is that real wage growth in excess of tfp leads to lower employment, lower capital accumulation and increasing unemployment. The lesson from the Netherlands or Ireland over the last 15 years is that wage moderation, wage growth below tfp growth, leads to recovery and a decrease in unemployment.

Once upon a time, it was believed that active monetary policy could repair the damage created by inappropriate nominal wage growth. Whether or not this belief was right, it is no longer relevant. In the Euro environment of a common currency and inflation targeting, appropriate real wage growth means appropriate nominal wage growth. And there are two ways to achieve it. One is to leave it to the markets. If nominal wage growth is too high, then unemployment will increase, and sooner or later, pain will lead to wage moderation. The other is to try to avoid unemployment in the first place, and rely on coordination at the aggregate level to achieve the outcome. After all, the evolution of tfp, the appropriate nominal wage growth, are complex issues, and one may hope for a better outcome if these are discussed at the aggregate, coordinated, level.

This takes us to social pacts and the role of unions in that context. It is fashionable these days to hail the Wassenaar agreements, which led to wage moderation in the Netherlands from the early 1980s, as an example of what should be done. And, in this case, I agree with fashion. Maybe, given the state of the Dutch economy then, wage moderation would have come anyway. But the agreement almost surely helped show the way, and the results have been impressive.

Are social pacts the solution to all the problems of the labor market? Surely not. Wassenaar did not happen until unemployment was high in the Netherlands, and it may not have happened otherwise. And recent European history is full of failed social pacts, when circumstances were such that no trust existed, and no compromise could be achieved—such as in Spain in the early 1980s. But social pacts, or less formal coordination at the national level, can help. And, with the loss of national monetary policy, there are not many alternatives.

**Conclusions.**

Suppose my conclusions are right. What is going to happen to unions?

On the one hand, they have less and less to offer to individual workers: Unemployment insurance, basic protection are increasingly provided by the state; and rents are getting smaller, leading to less room for rent extraction. As we saw in the papers today, this decreased attractiveness is reflected, in nearly all countries, by decreased membership and support.

On the other hand, they have an increasingly important role to play at the national level. But they can only do this if they can claim to represent the workers. This question of legitimacy strikes me as the main challenge facing European unions today. Absent strong grass root support, there is clear danger of a "squeeze play," in which either the government or the business organizations point to dwindling membership, and decide to ignore the unions.

The experience of France is interesting here. This is a country where membership numbers are between 5 and 10%, but where unions still play an important role at the national level. Will this remain the case? One of the exchanges in this morning's discussion suggests that the answer may be yes. When they are formally represented at the firm level (as is the case in France), unions can help workers in making sure that existing laws are enforced, that workers are aware of their rights, as well as provide other services. Whether such a limited "service" function at the firm level is enough for them to retain their legitimacy at the national level remains to be seen.