Regulation of Labor Market Monopsony

John A. Litwinskit†

I. INTRODUCTION ................................................................................................. 50

II. THE EXEMPTION’S COMPONENTS AND THE PROBLEMS THESE
TRY TO ADDRESS .................................................................................................. 53

   A. Rationale of the Labor Antitrust Exemption .................................................. 53
   B. Components of the Exemption ....................................................................... 54
   C. The Main Problems the Labor Exemption Attempts to
      Address and the Concept of Bargaining Power ............................................ 56
         1. What Determines How Much Workers are Paid? .................................... 56
         2. The Unfairness of “Fair” Wages ............................................................... 58
   D. The Monopsony Problem ................................................................................ 58
      1. When Does Firm Monopsony Power “Exploit”
         Workers? ........................................................................................................ 61
   E. Giving the Labor Exemption Its “Best Reading” ............................................ 63

III. CURRENTLY FLAWED LEGAL APPROACHES ................................................. 64

   A. The Myth of Bargaining Power ...................................................................... 65
      1. The Last Wedge of the Depression Era Corporatist
         Triangle .......................................................................................................... 65
      2. Competitive Labor Market “Offers” ............................................................ 66
      3. Some Harmful Effects of Labor Market Monopsony .................................. 67
   B. How Unions Differ from Product Monopolies ................................................. 69
      1. Posner and “Bilateral Monopoly” ............................................................... 70
      2. Campbell on Unions as “Legal Monopolists” ............................................. 73
   C. Why Unions Usually Cannot Transfer Profits from Owners
      to Workers ....................................................................................................... 73
      1. Higher Union Wages are Paid for Through Increased
         Product Prices ............................................................................................... 75

† B.A., Johns Hopkins; M.Sc., London School of Economics; J.D., Georgetown. Thanks to
Professors Steven Salop and Mark Popofsky, formerly of the Department of Justice, Antitrust Division
and now with Kaye, Scholer, for extensive and helpful comments. Thanks also to my family and to
Jessica. All errors and omissions, of course, remain my own.
I. INTRODUCTION

Although labor relations are generally exempt from antitrust scrutiny, the distinction between antitrust law and labor law is completely artificial. From an economic point of view, antitrust law and labor law are somewhat like Siamese twins unhappily separated at birth. The natural affinity between their subject matter and concern was recognized by the early cases and statutes. In some spectacularly controversial decisions, the Sherman


Act was applied to labor unions. No less than the Clayton Act, so central to antitrust law, is the same legislation that enshrines the work of the laborer as a "non-commodity" and hammers out a partial exemption for labor unions from antitrust prosecution. It is not surprising to find early labor legislation embedded in antitrust law since labor and antitrust issues are so similar. Labor law empowers unions to fight the monopsony power of firms, while antitrust law regulates the monopoly power of firms. A firm's monopsonistic power to set wages without regard to workers' productivity mirrors its monopolistic power to fix product prices without regard to cost.

It may seem unusual to think of labor unions as creating the same problems as monopolistic companies. Certainly the men who created the statutory and non-statutory labor exemptions to antitrust law thought the comparison odd. But labor is not, to use a tendentious phrase, a holy thing made by holy men. It is a commodity, like any other, and is created, bought, and sold in the marketplace subject to market laws and rewards. In a capitalist system, the relationship between selling labor and buying labor is identical to selling goods and buying goods. Buying labor can be

(1921), the Supreme Court enjoined workers from collectively boycotting their employers' goods. In Bedford Cut Stone Co. v. Journeyman Stone Cutters' Ass'n, 274 U.S. 37, 50 (1927), the Supreme Court held that the Clayton Act did not permit unions to engage in secondary boycotts of firms' products. See also Gompers v. Bucks Stove & Range Co., 221 U.S. 418 (1911) (applying Sherman Act). Until the 1930's, employers could enjoin much union activity on antitrust grounds. The 1914 Clayton Act did not change this very much. It was only during the Great Depression that pro-labor legislation removed most union activity from judicial antitrust scrutiny. See Richard A. Epstein, A Common Law for Labor Relations: A Critique of the New Deal Labor Legislation, 92 YALE L.J. 1357 (1983).


4. See, e.g., Loewe v. Lawlor, 208 U.S. 274 (1908) (holding for the first time that antitrust laws applied to labor unions). Some of the most heated criticism of decisions like this one came from pro-union lawyers like future Justice Felix Frankfurter. See FELIX FRANKFURTER & NATHAN GREENE, THE LABOR INJUNCTION 139-42 (1930).


8. Certainly the drafters of most labor legislation did not think of labor unions in this light. But many academics—not just those clustered around the critical Chicago-Columbia labor economic approach—have come around to this viewpoint in the last 20 years. Although Posner, Epstein, and Campbell are among the main skeptics, there are others skeptical of parts of the union program. See Daralyn J. Durie & Mark A. Lemley, The Antitrust Liability of Labor Unions for Anticompetitive Litigation, 80 CALIF. L. REV. 757, 761-62 (1992) (discussing union litigation activity against non-union builders and the economic costs that litigation creates).


10. From a competition perspective, the only issue is whether buyers and sellers are competing in
thought of as the “back end” of a productive process whose “front end” is selling goods. Often even the parties are the same. The same worker who cries out for union representation has no trouble purchasing food (without the help of any union) from his local grocer, though surely the market power of grocers in the food business is often as great as that of employers in the labor market, and though workers certainly need to eat just as much as they need to work. The issue is whether the separation of product from labor markets, and antitrust from labor law is intellectually sustainable, or whether it is irrational and should be replaced.

This Article argues that (1) labor unions should be prohibited under the antitrust laws from collectively bargaining for wages and striking, and that concurrently (2) antitrust law should be extended to outlaw or regulate firms’ abilities to exercise labor market monopsony power. What the first entails is obvious. The second requires that both single firms and cartels of firms be prohibited from using their market power to buy labor below the price which would otherwise exist in a competitive labor buying market. Just as firms are prohibited from exercising monopoly power in the goods selling markets, so firms should also be prohibited from exercising monopsony power in the labor buying market. This Article will present the economic case in support of these propositions. In doing so, the Article will attempt to take the law of worker-employer relations beyond its most stale arguments and self-destructive practices by reconciling antitrust and labor law.

This Article will first discuss the antitrust exemption’s components and the problems they try to address. It will next evaluate currently flawed legal and economic approaches to labor unions, namely the often confused ways that labor unions are conceived of in most of the legal literature. There are some surprising culprits here, not just pro-union lawyers and public officials, but even a few otherwise economically sophisticated commentators. The third part of the Article examines efficiency defenses of labor unions. The Article analyzes whether defenses of union activity, for a discussion of the history and an interesting analysis of the problem—and how we got here—see HERBERT HOVENKAMP, ENTERPRISE AND AMERICAN LAW 1836-1937 211-35 (1991).

But see Daniel J. Chepaitis, The National Labor Relations Act, Non-Paralleled Competition, and Market Power, 85 CALIF. L. REV. 769 (1997) (arguing that “employing firms likely exercise a degree of market power—the power to set terms unconstrained by competition—that would be unacceptable if exercised by producers in consumer markets”). One reads this article in vain for any understanding of when or why a labor market is competitive. For instance, there is not a single mention of the marginal product wage in this article.

An exception is the RICO statute, which can be applied to criminal racketeering in either context. See 18 U.S.C. § 1961.

For an introduction to the concept monopsony (though not labor market monopsony), see generally ROGER D. BLAIR & JEFFREY L. HARRISON, MONOPSONY: ANTITRUST LAW AND ECONOMICS (1993); JOAN ROBINSON, THE ECONOMICS OF IMPERFECT COMPETITION (1933) (Robinson’s book is the classic study).
both the more sophisticated and more sophisticated of them, make sense, or whether they are, as some economists suspect, too often just smoke and mirrors for bad economic policy. The fourth part sets forth some ideas for what an optimal antitrust-labor regime should look like.

II. THE EXEMPTION’S COMPONENTS AND THE PROBLEMS THEY TRY TO ADDRESS

A. Rationale of the Labor Antitrust Exemption

Nineteenth century common law judges often viewed labor unions as unlawful conspiracies to prevent trade. Union activities were therefore often banned, though there certainly was some inconsistency in the law. The Sherman Act expanded judicial scrutiny of labor unions. Beginning with the Clayton Act, however, Congress began to limit judicial scrutiny of labor activity under both antitrust and common law grounds. Because congressional activity exempting unions from such scrutiny reached its height during the Great Depression, the Progressive and New Deal eras are sometimes thought to represent a complete break with classical liberal thinking about labor markets.

This story, however, forgets that the late 19th century was itself a break from an earlier set of employer-worker relations. Certain older combinations between working men, for instance the medieval system of Old World guilds, were often permitted and even granted royal charter. The fact that these were both labor and product cartels does not erase their historical relevancy. Other examples include the medieval law of master and servant, and the apprentice system. The point is that the notion of "fair" wages and prices is ancient. Legislation creating the labor antitrust exemption did not mark a radical break from all older European and perhaps even American thinking, even if it submerged most of the 19th century Anglo-American common law design by removing many labor activities from traditional judicial scrutiny.

14. The main conflict among economists is between the Chicago-Columbia approach (e.g., Sherwin Rosen), which is quite critical of unions and skeptical that many labor markets are monopsonized, and the more traditional approach predominant at schools like Yale and Harvard (e.g., Richard Freeman).
15. See Epstein, supra note 2 at 1368.
16. See id. at 1360-62.
18. Epstein seems to regard the New Deal as some sort of epoch-making tragedy, but in my view the New Deal, and its labor legislation, merely reshifts older balances. See Epstein, supra note 2, at

2001]
The older thinking, which cannot be adequately described here, still reflects how most ordinary people think about labor-employer relations. The maxims that workers should receive a "just" wage, employers should only make only a "fair" profit, and greed and profit should be subordinated to human values like stability and community probably date to the Middle Ages, if not earlier. This is the thinking that underlies the antitrust labor exemption and probably the antitrust laws more generally. While such language may sound radically imprecise to an economist, it is impossible to understand the thinking behind the antitrust labor exemption without acknowledging that labor markets have been and continue to be perceived in this way, rather than in the economist's way.

B. Components of the Exemption

The labor exemption has two parts, the first statutory and the second based in constitutional law. The statutory exemption arose after pleas from labor unions to exempt their organizing, collective bargaining, and striking activities from the then-young Sherman Act. In several important cases, the Lochner-era Supreme Court had applied the Sherman Act to labor unions, severely limiting their ability to organize to raise their workers' wages. The first labor union exemption was granted by Congress in the late 19th century.


20. See Charles Mulvey, The Economic Analysis of Trade Unions 148 (1978) ("Almost all of the statutory wage provisions are based on the notion that there exists, independent of economic criteria, some 'fair wage'. There is no such thing as a 'fair wage' . . . . The idea of a 'fair wage' is normally confused with the idea of a socially acceptable income—a quite different concept.").


23. Early issues of the American Federationist, the AFL's official magazine, have many editorials by labor leaders on the problems the Sherman Act posed to unions. See, e.g., Samuel Gompers, The Hatters' Case. The Sherman Law—Amend It or End It, 17 AM. FEDERATIONIST 197, 199 (1910) (arguing that "[a] labor organization is not a trust; none of its attributes, methods, or achievements in (sic) behalf of its members and society at large can properly be confounded with the pernicious and selfish activities of the illegal trust."). Gompers's argument surely does not lack its contemporary believers.

24. See supra note 2.
1914 Clayton Act.\textsuperscript{25} In the 1930's, the Norris-LaGuardia\textsuperscript{26} and National Labor Relations Acts (NLRA) further removed union activity from antitrust scrutiny.\textsuperscript{27} After World War II, the statutory exemption was narrowed somewhat through the Taft-Hartley\textsuperscript{28} amendments to the NLRA.\textsuperscript{29}

Although the effects of these acts and the scope of union power is beyond the scope of this Article, the economic structure of the statutory exemption is easy to explain.\textsuperscript{30} In general, the exemption provides unions with the power to create cartels in specific labor markets with the goal of raising workers' wages.\textsuperscript{31} It is an open question whether raising workers' wages in this manner is efficient. In some cases, unionized workers may push their wages above their marginal product, and thus be "overpaid." This is a common criticism of unions.\textsuperscript{32} There are, however, circumstances in which workers are paid below their marginal product such as when they are locked in to jobs at salaries below the marginal product wage because of firm-specific training.\textsuperscript{33} In such cases, or in circumstances where a "company town" employer has sufficient labor monopsony power to underpay his workers, it is thought that unions are beneficial because they force monopsonies to more efficiently use labor\textsuperscript{34} and pay workers their productive value.\textsuperscript{35} This Article shall address whether unionism is the best means to address these real problems. This Article argues that, although problems of monopsony and exploitation are real, the current union-employer bargaining system is a poor solution.

C. The Main Problems the Labor Exemption Attempts to Address and the
Concept of Bargaining Power

The labor exemption primarily attempts to remedy the problem of unequal bargaining power between workers and employers and thereby to raise union workers’ wages and non-wage benefits. The concept of unequal bargaining power is deceptively simple to understand. The basic bargaining power argument is that workers need a union to bargain collectively with their employer to set wages at the correct level. Because the employer is powerful and has many resources, and a single worker has nothing to hold out against the employer except his labor, and because he must work or else watch his family starve, so the story goes, he has no real power to bargain alone against the employer. Such an employer can exploit and thus underpay its workers because they must accept lower wages than what is due them; the workers’ need is great, and their power is dispersed and weak. Accordingly, unions are necessary to counterbalance employing firms’ power to underpay.

1. What Determines How Much Workers are Paid?

Among bargaining power advocates, there is a split between those who believe in collective bargaining only up to the point at which workers receive the market value of what they produce, and those who want unions to secure for all their members a “fair” standard of living irrespective of productivity.

Those in the first camp believe that an acceptable wage level is reached where workers are paid their marginal revenue product (MRP), that is, wages that are equal to what they produce. A worker’s pay is equal to what she produces when her wage is the net of the revenue produced by her labor minus the cost of other inputs into the production process and minus

37. I say ‘deceptively’ because it is really often a trap for the economically unsophisticated; see discussion at Part II-A infra.
39. See id. at 11-22 (putting forth a milder version of this common “bargaining power” argument).
40. For a contemporary though naive view when read in light of modern economic thought, see E. BERMAN, LABOR AND THE SHERMAN ACT, 19-30 (1930).
41. Most union officials and organizers, and most sympathetic lawyers like Weiler fall into the first camp (see WEILER, supra note 38), and in the other go most labor economists, except perhaps Pencavel, Freeman, and Medoff (see JOHN PENCAVEL, LABOR MARKETS UNDER TRADE UNIONISM (1991); RICHARD B. FREEMAN & JANICE L. MEDOFF, WHAT DO UNIONS DO? (1984)).
42. The marginal product wage is a simplifying assumption since even in a competitive labor market, workers may take part of their wage in fringe benefits or in general on-the-job training. See S.W. POLACHEK & W.S. SIEBERT, THE ECONOMICS OF EARNINGS 8-12 (1993).
the normal rate of return (profit) for the employer. Most simply, \( MRP = MR \times MP \), where MR is marginal revenue and MP is marginal product. Marginal revenue is the increased net revenue from one additional unit of output, while marginal product is the net increase in output created by the worker.

Those in the second camp believe that unions should seek a particular standard of living irrespective of productivity. What that standard of living entails is disputed because there are different measures of well-being. However, all supporters of the “fair” living standard believe that unions, employers and government should guarantee income above the poverty level irrespective of work output.

An important question is whether profit means exploitation. It may seem that even employers who make normal rates of profit must be exploiting their workers or customers to do so, but this is not necessarily the case. There is a much more benign explanation for the necessity of profits in a competitive economy. The normal rate of profit is the amount of income a particular investment in a competitive industry must pay, determined primarily by multiplying that investment’s risk by the duration of that risk, in order to induce investors to finance it. Without profits there would not be enough private capital investment to sustain economic growth or even employment, since there would be no incentive for anyone to invest or to take risks with his money. Without profits, investors would not invest but instead would shift their spending toward consumption. Profits create the incentive to invest. To put the normal rate of profit in perspective, in 1999 the average rate of profit for Fortune 500 companies, most of which operate in normally competitive industries, was approximately 6.5 percent.

43. There are many complications to this, most of which concern market rigidity, job search costs, and asymmetrical information. See Christain Belzil, Relative Efficiencies and Comparative Advantages in Job Search, 14 J. OF LAB. ECON. 154 (1996) (creating a model of job search strategies).

44. One such measure is the living wage. See generally LAWRENCE B. GLICKMAN, A LIVING WAGE (1997). For a good discussion of moral and economic issues of well-being in an international perspective, see AMARTYA SEN, Capability and Well-Being, in THE QUALITY OF LIFE 30-53 (Martha Nussbaum & Amartya Sen eds., 1993).


46. This is really an obvious point but an important one. See JOHN M. LEVY, ESSENTIAL MICROECONOMICS FOR PUBLIC POLICY ANALYSTS, ch. 4 (1995).

47. See id. at ch. 1.

48. On total revenues of $6.3 trillion dollars, these firms made $410 billion in profits (a 6.5 percent rate of profit, which constituted 47 percent of the total profits made by all American businesses in 1999). See Nicholas Stein, The Measure of American Business, FORTUNE 500, available at http://www.fortune.com/fortune/fortune500/giants.html (visited Feb. 8, 2000). For obvious reasons, one expects this rate of profit to be somewhat above lower-risk investments like bank CD's. But the rate of interest and the profit rate of competitive firms should not greatly diverge, assuming similar risk levels.
In a perfectly competitive labor buying market, where employers compete such that none can capriciously lower her offered wage without losing her workers to a competitor, workers are already paid their marginal product. This does not happen because the employer loves her employees and wants to pay them well, but rather because she is self-interested, rational, and must pay them equal to what they produce in order to not lose them to her competitors. In perfectly competitive labor markets firms are unable to increase their profits above the “normal” level by artificially keeping wages low. In competitive labor and product markets, employers do not earn any profit beyond that amount required to induce them to invest in the first place. The rest of their firms’ revenue goes to wages and other inputs such as capital.

2. The Unfairness of “Fair” Wages

The common rationale used to justify unions in competitive labor markets where no monopsony exists is that they secure fair wages for employees. “Fair wage” refers to income above the marginal product level. In other words, unions may force the employer to pay the worker more than the value of what he produces.

Where unions operate in competitive labor buying markets, they will almost certainly secure wages for their workers higher than those workers’ marginal products. Those who pay for higher union wages are not the ones that most people imagine. Often it is not capitalists who pay the

50. This goes back to Adam Smith, supra note 9. I should note that academic economists supporting unions, such as Richard Freeman, are not big fans of this ‘exit’ option. See Freeman, The Exit-Voice Tradeoff in the Labor Market: Unionism, Job Tenure, Quits, and Separations, 94 Q.J. OF ECON. 643 (1980).
52. This is true in the ‘tight,’ simple theory of how a particular set of employment transactions work, in which there is no ‘leakage.’ See Polacheck & Seibert, supra note 42, at 1-15.
55. This is unfair when one considers that wage differences accounted for by differential productivity may result from varying tastes and preferences for work and ambition, some of which are stifled when particular workers receive below their marginal product so that others may have more. An interesting article on this is Sherwin Rosen’s Manufactured Inequality, 15 J. OF LAB. ECON. 189 (1997).
56. The union wage premium is consistently 15-20 percent above the non-union rate; see Freeman & Medoff, supra note 53 at 150.
57. Neither Posner nor Campbell spend time on this question; see discussion on Posner and Campbell at infra notes 108-115 and accompanying text.
price, but consumers. What is troubling is that often these consumers are not better off than the union workers they are forced to subsidize. As discussed at Part II-C infra, unions are rarely able to transfer income from capital owners to themselves. Most often they only raise final product prices and thus transfer income from consumers to themselves. Privileging unions makes little sense if most consumers earn incomes similar to those of union workers. In general, antitrust law frowns upon allowing one class of people to expropriate income from society at large to itself. The patent and intellectual property laws are an exception, but only because it is thought necessary to give creators of ideas incentives to keep creating.58 Union workers do not need any special incentive to keep working when they are paid their marginal product.59 Part IV will discuss less costly means of achieving income transfers in genuine cases of worker exploitation.

D. The Monopsony Problem

There is no question that some labor markets suffer from monopsony.60 A monopsonistic firm has the power to set wages by fiat. There being no substantial competitors to push up wages or unions to bargain with the monopsonist, he will rationally maximize his profit by paying the lowest wage possible. If the monopsonist competes with other firms who face competitive labor markets, he will be more profitable than they are. Although he may be more internally inefficient than his competitors who face competitive labor buying markets, the capital markets will reward his greater profitability by increasing the value of his firm, thus lowering his borrowing costs relative to his non-monopsonist competitors. In effect, capital markets may subsidize his internal inefficiency.61

If the monopsonist competes against other monopsonistic employers, he will not necessarily be more profitable than them, but his wages and his competitors' wages will remain lower than if his competitors were forced to


59. There are also models of monopolist behavior wherein the monopolist perfectly price discriminates all along the demand curve for his good, thereby extracting all the consumer surplus through giving individual consumers take-it-or-leave-it offers. This outcome is efficient, and is possible in theory, but is unrealistic. Analogizing to unions, a union would be able to do some of the same things (i.e., perfect price discrimination against the employer) if it were a monopolist. But as shown in Part II-B, unions are not monopolists. Unions cannot perfectly price discriminate against employers and hence achieve an efficient extraction because the firm can substitute cheaper labor inputs.

60. A company town, the monopsonistic equivalent of a natural monopoly, or natural monopoony, is the classic example. The Article discusses other cases in which firms have monopoony at Part II-A-4 supra.

compete with him for the same pool of workers. The effect here will be a transfer of real income from workers to consumers, precisely the opposite of what occurs when a union pushes wages above the competitive level. Here there will be inefficient substitution away from goods produced by competitors lacking monopsony and towards goods produced by firms in the monopsonized industry. In one sense, all consumption of such goods is inefficient because their real social cost of production, their opportunity cost, is greater than their nominal price.

It may seem odd to think of underpricing as bad since we are accustomed to condemning only overpricing and the resultant substitution away from monopoly goods. Substitution toward nominally underpriced monopsony goods is a different story. However, there are good economic reasons for being as concerned with inefficient substitution toward artificially cheaper monopsonistic goods as with substitution away from more expensive monopoly goods. A monopsonist will be forced to pass on to consumers the rents he extracts from his workers if he competes with other monopsonists. When a monopsonist exploits his workers by paying them less than their marginal product, consumers will tend to buy more of his good because it appears cheaper in nominal terms. But the real social cost (the opportunity cost) of producing this monopsonist’s good is higher than its nominal price.

Where a monopsonist competes with firms facing competitive labor markets, he will be able to keep those rents in the form of higher profits. There will be no consumption side distortion if he sells his products at the competitive level set by other firms, but there will continue to be a production side distortion. This distortion will make him more profitable than his competitors. The monopsonist’s greater profitability also imposes costs beyond mere redistribution, for it is very likely that the market value of a monopsonist’s firm will rise if he is more profitable than his non-monopsonist competitors. As a consequence, a single monopsonist’s real cost of borrowing and raising capital through financial markets will be lower than that of his competitors, and he gains a further competitive advantage.

This argument presents the economic case against labor market monopsony. The split between nominal and real product prices caused by

62. See Campbell, supra note 51.
63. See id.
64. See id.
65. Say, if ten company town coal mines produce all the coal in America, and are located in different towns sufficiently far apart such that commuting is impractical (i.e., there is no competition for workers between them).
66. See supra note 62.
67. See id.
labor market monopsony imposes real economic costs through imperfect substitution, as well as exploits workers in the more classical sense.

1. When Does Firm Monopsony Power “Exploit” Workers?

As supporters of labor unions are quick to point out, many labor buying markets are substantially uncompetitive.\(^\text{68}\) In imperfect labor buying markets, workers may be paid below their marginal product because some employers have the power to arbitrarily set wages.\(^\text{69}\) Unions are thought to be necessary to balance out this power of monopsonistic employers.\(^\text{70}\) Monopsony in the labor market is similar to monopoly in the product market, except that the former concerns buying power and the latter concerns selling power. A labor market monopsonist has the power to set wages somewhat arbitrarily; he is a “price maker” in the labor market. He does not (proportionally) lose workers equal to his wage cuts because those workers have nowhere else to go. Even under labor market conditions that are tight overall, there are not enough competing nearby employers to absorb those workers.\(^\text{71}\) Although a company town is the classic case of firm labor market monopsony, firm exploitation of workers is thought to occur more frequently.\(^\text{72}\) Exploitation is used here in a technical, not pejorative, sense to refer to firms’ use of their labor market monopsony power to pay workers less than the value of what those workers produce. This is separate from other arguments about exploitation.\(^\text{73}\) In the economic literature, there are two well-understood reasons why workers are paid below their marginal products.\(^\text{74}\) One involves monopsony power, which is exploitation in the technical sense, while the other is innocuous and is natural to the structure of vertically-integrated firms.

---

\(^{68}.\) See Weiler, supra note 38, at ch. 1-2.

\(^{69}.\) For an example of an economist who, though critical of labor laws himself, still admits that this practice occurs, see Thomas J. Campbell, Labor Law and Economics, 38 STAN. L. REV. 991, 998-1000 (1986).

\(^{70}.\) But see Henry Simons, Some Reflections on Syndicalism, 52 J. OF POL. ECON. 1, 2-9 (1944).

\(^{71}.\) This is true by definition if the labor market looks as I have described it.

\(^{72}.\) Although ‘exploitation’ goes hand in hand with the labor laws’ desire to help workers, unions appear independently of any showing of monopsony employer power. This confusing mix is described in Bernard Meltzer, Labor Unions, Collective Bargaining, and the Antitrust Laws, 32 U. CHI. L. REV. 659, 706-710 (1965).

\(^{73}.\) One such argument is that workers are underpaid relative to bosses, who often make fifty or one hundred times the salary of some employees. The fact that CEOs earn high salaries or that some firms are very profitable does not at all prove that firms’ lower-wage workers are exploited. See Kevin J. Murphy, Corporate Performance and Managerial Renumeration, 7 J. OF ACCT. AND ECON. 11 (1985) (finding that executive compensation is strongly correlated to firms’ growth in sales and shareholder return).

First, firms may exercise monopsony labor power to underpay workers, the technical exploitation, whenever a worker receives what is called "firm-specific" training. Firm-specific training occurs when a worker is taught a skill or procedure which can only be used (or which is most efficiently used) at the firm providing the training. This may be as simple as learning to run the firm's proprietary machine. Because firm-specific training is, by definition, useless at competing firms, the firm must pay the initial cost of this training. This cost does not come out of the worker's wage, but rather is properly treated by the firm as a capital cost. This differs from general training, which is transferable by workers to other firms and is "paid" for by the workers by receiving lower wages.

Suppose a worker's new firm-specific training increases the value of his marginal product from 10 to 17 dollars per hour. The firm will continue to pay the worker at his old marginal wage level, or perhaps offer him a minor wage premium to induce him to stay. Such a worker will have little success in obtaining a higher wage since he is already being paid at or slightly above what he could receive at another firm for his old skills. In this example, it is irrational for him to quit since he cannot earn more at another firm. Additionally, he may be unaware to what extent his new skills have raised his marginal product. Because his new skills are by definition useless to competing firms, he will therefore be unable to advertise his new skills to the highest bidder. Unless there is a union or some other mechanism to push his wage up to his marginal product, the firm will rationally and systematically pay him below his marginal product. Although this outcome depends entirely upon the extent to which training is really firm-specific, one can see how the inability of workers with firm-specific training to organize will, in many cases, prevent their wages from rising to the marginal product level. Such workers are exploited to the extent that specific training creates economic rents for their firms.

The second case in which workers may be paid below their marginal

---

75. See, e.g., Steven C. Salop, A Model of the Natural Rate of Unemployment, 69 AM. ECON. REV. 117, 124-25 (1979). See also Shaviro, supra note 7, at 450-51.
76. See Salop, supra note 75 at 117-18.
77. This is a postulate of the theory. See id.
78. See GARY S. BECKER, HUMAN CAPITAL 21 (2d ed. 1975).
79. This is perfectly rational since to do so will maximize the firm's profits. For insight into why a firm would act this way, see LEVY, supra note 46, at ch. 1.
80. This is a more proximate case of firm monopsony power than the traditional "company town" envisaged by Becker, supra note 79.
81. If he was able to hold out against the firm without being undercut by his fellow workers (and while being able to keep bread on his table), a standard model might predict that he would get all of the difference from the firm, up to the last penny or the replacement training cost (which often are the same number). See Salop, supra note 75.
82. This argument is probably strongest where a firm controls trade secrets or other intellectual property from which it extracts monopoly and monopsony rents. See Shaviro, supra note 7, at 450.
product occurs when a firm must spend part of the workers’ wages on monitoring to ensure that the workers are not slacking on the job, or “shirking.” ³³ There may be a tradeoff between worker wages and monitoring of workers to prevent shirking. ³⁴ In some cases, firms will find it more efficient to pay higher wages and spend little on monitoring because workers know that if they are caught shirking they will be fired and face unemployment.³⁵ The flip side of this argument is that under some circumstances, firms may elect to pay their workers less and spend more on monitoring their workers to prevent shirking.³⁶

It makes no sense, however, to say that workers are underpaid because their firm spent some part of their salaries making sure that they actually did the work they were paid to perform.³⁷ Because virtually all vertically-organized firms, both monopsonistic and those facing competitive labor buying markets, must engage in some monitoring, this cost is properly taken out of workers’ salaries. Monitoring is another cost of doing business[CS2].³⁸ In circumstances where it is cheaper for firms to pay higher wages and rely upon the threat of unemployment to prevent workers from shirking, wages will be higher and monitoring costs lower.³⁹ This wage versus monitoring tradeoff is not the result of firm exploitation. Rather, it is a natural condition that market participants face and may be considered an input cost.⁰⁰

E. Giving the Labor Exemption Its “Best Reading”

The labor antitrust exemption was primarily designed to help unions fight firm monopsony power and thus help push worker wages up to a competitive level.⁰¹ While monopsony is not the only cause of labor market imperfection, for imperfect labor markets have many causes, it is probably the only one antitrust law is capable of resolving.⁰² Because government or

---

³³. See Polachek & Siebert, supra note 42, at 261-63.
³⁵. See id. at 435, 438.
³⁶. See id. at 437. This occurs where there are high wages with downward wage rigidity ab initio, and low levels of employment.
³⁷. This issue is not, to my knowledge, addressed in the caselaw. But it is a common discussion among labor economists. See Tapio Palokangas, Labor Unions, Public Policy, and Economic Growth, ch. 2-3 (2000).
³⁸. See Polachek & Siebert, supra note 42, at 255.
³⁹. See Shapiro and Stiglitz, supra note 84, at 435.
⁰⁰. The input that monitoring provides is production information. This problem is discussed in greater detail in G.A. Alerkof & L.F. Katz, Workers’ Trust Funds and the Logic of Wage Profiles, 104 Q. J. OF ECON. 525 (1989) (discussing the costs a worker faces if fired for shirking).
⁰². Another source of labor market rigidity is the government creation of franchise or monopoly.
quasi-government bodies may create barriers to entry into labor markets or labor buying markets, and because those barriers to entry are ordinarily not actionable under antitrust law, antitrust law is only equipped to remedy private firm labor market monopsony.93 One might expect that antitrust law would therefore be used to its comparative advantage to fight firm monopsony as well as monopoly. Instead, the antitrust labor exemption cuts in the opposite direction and contemplates that unions will remedy labor market imperfections.

To conclude this discussion on the exemption's background, we can see that the labor exemption's main effect is to increase the wages of workers. The exemption achieves this effect by giving collective bargaining power to unions.

III.

CURRENTLY FLAWED LEGAL APPROACHES

Most current legal literature on unions suffers from serious deficiencies.94 One cannot begin to understand the problems caused by the labor exemption without first seeing why most people think about the issue incorrectly.95 There are four main arguments which are fallacious or often misused. The first of these erroneous arguments, building on the discussion above, is that wages are (or must be) primarily set through bargaining power and that workers need more bargaining power.96 The second idea is that union behavior can be readily analogized to that of product monopolists or that unions are indeed themselves monopolists.97 The third argument is

---

93. Nor would it make sense for one branch of government to attack the other over antitrust issues, Constitutional and separation of powers questions aside. It would be ideal from an efficiency perspective to use the antitrust laws to dismantle inefficient government monopolies such as the Post Office, but that is unlikely to ever occur since the law provides for the opposite.

94. Meltzer, supra note 73 (arguing that labor law, seen from an economic perspective, is a complete mess.)

95. See id.

96. See, e.g., WEILER supra note 38, and FREEMAN & MEDOFF, supra note 53.

that unions transfer wealth from capital owners or investors to workers. The last argument is that unions' wealth redistribution activities are merely redistributive and do not create deadweight social costs. By discussing why these arguments are wrong, we can better understand why the present legal regime is unsupportable.

A. The Myth of Bargaining Power

It is true that effective unions can set wages through bargaining. A powerful union can surely sit across a table from an employer and hammer out particular terms of employment. The great economic hurdle that the bargaining power theory must overcome is not the fact that bargaining can achieve some kind of result, but rather showing why the ordinary means of price-setting in the economy, the interplay of supply and demand, do not work in the context of normal employment.

1. The Last Wedge of the Depression Era Corporatist Triangle

When the New Deal era labor legislation was passed (e.g., the Norris-LaGuardia and National Labor Relations Acts), the country was experimenting with a particular system of economic production, which at least with respect to large industries might be called corporatist or even mercantilist. During the Depression, legislation and great urgency forced industries, the government, and workers (unions) to form a close triangle of interests, under the theory that excessively zealous competition was the

98. See, e.g., FREEMAN & MEDOFF, supra note 53.
99. See id.
101. And legally so. See Apex Hosiery Company v. Leader, 310 U.S. 469 (1940).
102. This dilemma is at the root of Professor Campbell's analysis, but, alas, it is one to which he gives no final answer. See Campbell, supra note 69, at 1015-16. One might ask, when most prices and wages are set through 'take it or leave it' offers, why should union bargaining be privileged? Union proponents must overcome a rhetorical burden to show why those same unionized employees, when they take off their work hats and become consumers, do not (for instance) need 'consumer unions' to bargain against equally large or larger product sellers. For if bargaining power is important, then surely it is important both when selling one's labor and buying products; the possibility of exploitation is great at both ends. It is not enough to say that antitrust law suffices to deal with product monopoly—why should antitrust law not also deal with labor monopsony? Finally, union supporters must also show why, when most private sector employees do not belong to unions or collectively bargain, unions remain necessary for a small number.
103. Much of this history is discussed in Richard Epstein, A Defense of the Contract At Will, 51 U. CHI. L. REV. 947, 948-52 (1984), and in Epstein supra note 2.
cause of the calamity.\textsuperscript{107} During the New Deal and into the Second World War, many wage and production schedules were set by agencies and committees, and both workers and employers had to negotiate nominal prices for inputs and outputs.\textsuperscript{108} Unions were thought necessary to bargain with employers and government planners, just as progressives forty years earlier thought them necessary to negotiate against the titans of industry.\textsuperscript{109}

After the Second World War, when the government again\textsuperscript{110} got out of the business of fixing most price and output tariffs, the only prong of the New Deal corporatist triangle to remain was the union bargaining privilege.\textsuperscript{111} Unions' bargaining powers with respect to wages were only somewhat weakened by the Taft-Hartley amendments to the NLRA.\textsuperscript{112} Unions today maintain the power to collectively bargain for wages and other benefits and to create union shops.\textsuperscript{113} The concept of bargaining power, which is seen as a great anachronism in other areas of economic life, remains the benchmark for understanding what unions do and why unions are thought necessary.\textsuperscript{114} The widely held belief has been that without unions, individual workers who lack bargaining power will be paid less than their marginal product and thus exploited by vastly more powerful employers.\textsuperscript{115}

2. \textit{Competitive Labor Market “Offers”}

In labor markets as in product markets, buyers and sellers rarely bargain. This is not because employers are powerful and workers are weak, but because it is usually too costly to bargain. It is usually cheaper to offer a wage or price, and if no suitable candidate accepts it, to change that price or eliminate that offer.\textsuperscript{116} The same occurs in product markets when sellers refuse to bargain.\textsuperscript{117}

In a competitive market, wages are created when a worker accepts an

\textsuperscript{107} See id.
\textsuperscript{109} See Epstein, \textit{supra} note 2, at 1368-72.
\textsuperscript{110} The federal government had never been “in” the business of regulating much peacetime economic activity until the Depression.
\textsuperscript{111} See Epstein, \textit{supra} note 2, at 1365-70.
\textsuperscript{112} See Campbell, \textit{supra} note 69, at 995 (arguing that “the legacy of the unmistakably pro-union Wagner Act was not completely undone by the Taft-Hartley Act”).
\textsuperscript{113} See generally FREEMAN & MEDOFF, \textit{supra} note 53.
\textsuperscript{114} See Richard Freeman, \textit{Two Faces of Unionism}, 57 PUB. INT. 69, 70-73 (1974).
\textsuperscript{115} See id.
\textsuperscript{116} See POLACHEK & SIEBERT, \textit{supra} note 42, at 1-5.
\textsuperscript{117} Many consumers also prefer not to bargain—hence the recent success of automobile dealerships with non-negotiable pricing.
employer’s job offer at a particular wage. Wages are substantially set through “take it or leave it” offers. If no suitable worker accepts a particular wage offer, that position will go unfilled until the cost of having an unfilled job opening exceeds the cost of raising that wage or eliminating that position. When a suitable worker accepts a particular wage offer, just as when he purchases a certain good, a price is created in the relevant economic sense, and that price ripples through the economy like the rings a pebble makes when dropped into a pond. It is these ripples, along with real wage and price information, that create the system of real cost information vital to an efficient economy.

3. Some Harmful Effects of Labor Market Monopsony

Monopsonistic labor markets may appear identical to competitive labor buying markets in terms of the mechanics of offer and acceptance. In truth, however, labor monopsony distorts the system of accurate wage and price information because under monopsony, nominal wages diverge from real labor costs. If an employer is able to artificially reduce the nominal cost of some input, either labor or another input, then one of two things will happen. If the monopsonist competes with other companies who make the same product but cannot lower their input prices, she will rationally keep that extra amount as profit and charge the same price as her competitors. This is the normal behavior of a labor monopsonist. This creates problems which shall be discussed below.

If, for some reason, the monopsonist instead passes some of her monopsony rent on to consumers in the form of lower product prices, perhaps to damage her non-monopsonistic competitors by undercutting them and to increase her own market share, then consumers will inefficiently substitute away from her competitors’ goods and toward her product. Customers will buy more of her good at the lower price and buy

118. See Polacheck & Siebert, supra note 42, at 5-6.
119. See id.
120. See id.
121. See id.
123. See id. at 84, 89.
124. There are efficiencies from doing this if he faces a declining average cost curve. See Steven C. Salop & R. Craig Romaine, Preserving Monopoly: Economic Analysis, Legal Standards, and Microsoft, 7 Geo. Mason L. Rev. 617, 618 (1999) (noting the durability of monopoly in “a market subject to scale economies”).
125. This is the opposite from the traditional fear from monopolies—inefficient substitution away from monopoly-priced products to inferior substitutes. See K. Poole & H. Rosenthal, The Enduring Nineteenth Century Battle for Economic Regulation, 36 J. L. & Econ. 837, 838-40 (1993).
less of her competitors’ good. Customers will therefore substitute away from competitively priced goods and toward goods which nominally appear to have cost less to produce, but which actually have cost society more to produce than their price indicates. In economists’ terms, such products have a high opportunity cost. Under this type of monopsony outcome, society will therefore devote too many resources to producing the monopsonist’s good because the nominal price for that good falls below its social cost of production. While this may appear good for the consumer, it is in fact bad from an economic point of view if one believes that nominal and real goods prices should be, for the most part, identical in order to facilitate efficient resource allocation.

The other pernicious effect that may come from a single labor market monopsonist’s practices, assuming now that he maintains his product prices at his competitors’ level and makes higher profits instead of passing on his cost savings, is that rational capital markets will reward his use of monopsony power by pouring more investment money into his company. This outcome is doubly perverse. First, it gives the monopsonist an advantage vis-à-vis his non-monopsonistic competitors with respect to borrowing and financing capital. Second, because the total amount of investment capital is scarce, at least with respect to particular industries and levels of risk, it may also raise his rivals’ costs of borrowing, thus further harming them.

Since he pays less for labor inputs than his non-monopsony competitors, the monopsonist faces less external price competition and his firm may also be less internally efficient than it would otherwise be. Economists call this $x$-inefficiency, or internal inefficiency. As the monopsonist has more room for slack and error, he can be more slack and commit more errors and yet not suffer as much because of his cushion in

---

126. Recent work by Salop and others has shown the opposite under more relaxed assumptions. See Thomas G. Krattenmaker & Steven C. Salop, Anticompetitive Exclusion: Raising Rivals' Costs to Achieve Power over Price, 96 YALE L.J. 209 (1986).

127. See id. This short-term harm is not what Krattenmaker and Salop have in mind; they are more concerned with the typical long-run monopoly overcharge that a successful monopolizer will have to make in order to recoup his short-term losses.

128. See id.

129. This practice has received far too little attention from both economists and lawyers working in competition law. For some background on why this can happen, see Frank J. Fabozzi, Capital Markets: Institutions and Instruments, ch. 8-9 (1996).


labor costs. Since he remains more profitable than his competitors who face competitive labor buying markets, capital markets will react to the monopsonist's higher profits by funding him instead of his leaner competitors. In effect, the capital markets may subsidize his internal inefficiency because the profits from monopsony x-inefficiency sometimes "look" more like competitive x-efficiency than the real thing.

Thus far we have seen that bargaining power in competitive markets is often a dangerous and unproductive myth. We have seen that uncompetitive labor markets left to their own devices, where monopsonists unchecked by unions can underpay employees, create their own perversities. The latter is true although it is surely significant that firm labor monopsony is checked by labor mobility.

We have seen that some labor markets are competitive, and some are not, and that bargaining power may on occasion reduce both worker exploitation and the types of perverse market responses discussed above. Union bargaining power does play some role in mitigating the effects of some monopsonistic labor markets and has other effects in competitive labor markets, as discussed below. But as discussed at Part III-A infra, even if one believes that some or many labor markets are monopsonistic, one should not be seduced into thinking union bargaining power is the solution.

B. How Unions Differ from Product Monopolies

Although unions differ from product monopolies in some important respects, critics of unionism often make careless use of monopoly language. Some otherwise very intelligent critics of labor unions make the significant analytical mistake of analogizing labor unions to product monopolists or even call unions monopolies. Although unions may sell a product (labor) they are not monopolists in any relevant sense of the word. The analogy to product monopolists, though not misleading in a broad overview, would prove fatal for an economist trying to construct a formal model of union-employer behavior.

---

132. See id.
133. See FABOZZI, supra note 129, at ch. 8.
134. But see W.H. HUNT, THE THEORY OF COLLECTIVE BARGAINING 1930-1975, at 63-64 (1980). This important proviso shall be discussed in Part IV infra.
136. For an early example, see Archibald Cox, Labor and the Antitrust Laws—A Preliminary Analysis, 104 U. PA. L. REV. 252-55 (1955) (arguing that the purpose of federal labor law is to promote union attempts at creating monopolies and cartels in relevant labor markets).
137. I will analyze two such commentators, Richard A. Posner and Thomas J. Campbell.
138. But see Fischel, supra note 1, at 1072 (discussing unions and monopoly wages).
139. See id.
Unions are often bad, but not for all the same reasons that a product monopoly like Standard Oil was bad. Unions differ from product monopolies and are best analogized to large (in number of members, not necessarily in size) product market cartels. However, even this analogy must be conditioned.

1. Posner and “Bilateral Monopoly”

Contrary to Judge Richard Posner’s assertions, there are a number of reasons why firm-union negotiations are not “a situation of classic bilateral monopoly.” He argues that when a firm and a union reach a negotiating impasse, for example when bargaining for a new labor contract breaks down, “we have a classic example of bilateral monopoly: the union and employer can deal only with each other and a refusal to deal, by imposing costs on the other party, makes him more likely to come to terms.”

Posner is incorrect in asserting that when unions and firms bargain, their negotiations are a form of bilateral monopoly. Classic bilateral monopoly negotiation is easily modeled as a simple two-party, single good relationship, where two sides who must bargain will fight over the distribution of some amount of economic rent. In the real world, however, unions bargain for wages, particular wage distributions, employment goals, work rules, etc., some of which are not even economic rents in any relevant sense of the word. Unions will bargain to get the most they can, but if they exchange wage goals for something like particular work rules (whose benefit to the union will rationally equal the benefit in wages given up, but whose cost to the firm may be less than the wage costs it would have otherwise had to pay since those rules may create firm intra-firm efficiencies), then it is not true that union-firm negotiation is a simple bilateral monopoly.

Union-firm negotiation is instead a case of a multi-interest cartel bargaining with a profit-maximizing firm under conditions of uncertainty.

140. See Standard Oil Co. v. United States, 221 U.S. 1 (1911).
144. This points up the intriguing, though perhaps unrealistic possibility that unions 'pay' for more efficient work rules by reducing their wage demands. For a discussion of the effect of rules on union-firm bargaining, see generally Stewart J. Schwab, Collective Bargaining and the Coase Theorem, 72 CORNELL L. REV. 245 (1987).
which is not the classical bilateral monopoly negotiation. For instance, if the union cannot determine either the costs of work rules to the firm or the efficiencies they create for the firm, the union will be unable to extract those efficiencies as profits. Such a union may give up more in pecuniary demands than it receives in benefit, or it may even unwittingly "pay" the firm to create efficiencies for itself. Although this surprising outcome may not occur often in the real world, its existence makes parts of Posner's argument misleading.

While there are a number of reasons why firm-union negotiations are not a case of bilateral monopoly, two are worth discussing. The first concerns a labor union's structure and the second concerns its goals, both of which make the predictions of classic bilateral monopoly negotiation theory implausible in cases of union-firm negotiation.

The first reason is that because of its structure, a cartel's behavior and interests, referring for the moment to a normal product market cartel like a cartel of countries selling oil, are different in at least one important respect from a single monopolist's. A product monopolist is willing to cut production to maximize profit regardless of which part of his firm or which factory location cuts production the most. Indeed, if there are efficiencies to be gained from cutting in one place instead of another, he will cut accordingly. On the other hand, a multi-producer cartel will be unable to effectively cut production unless the distribution of those cuts is acceptable to all producers involved, barring some mechanism for shifting income to one member of the cartel forced to cut its production disproportionately. This point is of more than passing interest for the science of modeling cartels. The internal structure of a union or other cartel, meaning its leaders and often large democratic membership, is considerably different from that of a monopolist. This has obvious implications for union-firm negotiation.

The second point is that although product market monopolists and

146. The same is true, of course, for the firm positions are reversed. For a discussion of union-firm bargaining under uncertainty, see Schwab, supra note 144, at 278.
147. For a discussion of bilateral monopoly, see BLAIR & HARRISON, supra note 13, at 109-129 (particularly 113-116).
148. My criticism of Posner's argument is complicated by the fact that he refers to unions interchangeably as 'cartels' and 'monopolists'; as far one ascertains from reading his article, he does not use the terms to mean different things.
149. See JANUSZ ORDOVER, OBSTACLES TO TRADE AND COMPETITION 34-51 (1993).
150. See id.
153. See SPAR, supra note 151, at ch. 6.
cartels both have only one goal, profit maximization, labor unions have multiple goals.\textsuperscript{154} While a monopolist will cut production to maximize profit, unions are often and quite understandably unwilling to cut union jobs to achieve higher wages for their remaining members.\textsuperscript{155} To give a stark analogy, if unions' only goal was to maximize wages and fringe benefits comparable to the monopolists' goal of maximizing profits, unions would pursue that strategy up to the point at which only one worker remained, earning an enormous salary.\textsuperscript{156} This is also true for a union's other primary goal—employment maintenance. Unions do not singularly pursue ever-increased employment. Indeed, if it is true that unions cause unemployment among non-members, which is a common criticism, then this suggests that unions are quite happy to pursue policies which unemploy others, so long as their existing members are not harmed. The ability of unions to compensate or force the government or firms to compensate members who have been unemployed as a result of some bargaining agreement, of course, makes unions less averse to job losses.\textsuperscript{157}

There is no way to reconcile unions' multi-member, multi-interest character with the classic single-interest monopolist model.\textsuperscript{158} In fact, it is impossible to construct a model of union interests which includes only some weighted bundle of wage and employment goals even if these are a union's primary goals because unions pursue other interests as well.\textsuperscript{159} Union leaders may have their own institutional interests, and unions may also wish to distribute income in a particular pattern, such as seniority, to account for the demands of their members.\textsuperscript{160} Fulfilling these demands, except for the leaders' institutional interest, certainly requires obtaining economic rents or employment for their membership.\textsuperscript{161} Although most unions primarily bargain for economic rents, unions often push employers to create things like particular work or grievance rules. These rules' cost and benefit to the union may be greater than their cost to the employer, which further complicates the story. Unions must give up other demands like slightly higher wages to obtain such procedures.\textsuperscript{162}

\textsuperscript{154} See Reynolds at 473-79.
\textsuperscript{155} See id at 475.
\textsuperscript{157} See Reynolds at 136-37.
\textsuperscript{158} Although "[u]nder classical trade union theory, [because] the goal of unions is to eliminate wage competition...[u]nions are thus inherently monopolistic." Theodore J. St. Antoine, Integrity and Circumspection: The Labor Law Vision of Bernard D. Meltzer, 53 U. Chi. L. Rev. 78, 89 (1986).
\textsuperscript{159} See generally Freeman & Medoff supra note 54.
\textsuperscript{160} See id.
\textsuperscript{162} See Part III-B infra.
2. Campbell on Unions as "Legal Monopolists"

Another Chicago School critic has made similar mistakes in his analysis of the effect of unions. In an otherwise fine piece, Thomas Campbell argues that "it has long been recognized that labor unions act as legal monopolists, and that their influence spills over into the product market."\(^{163}\) Campbell's use of the term is only half troubling because he is certainly well aware that some legally sanctioned monopolies (e.g., government enterprises) do not have a single profit-maximizing motive, unlike private monopolists.\(^{164}\)

Campbell's assertion that unions are legal monopolists is wrong for two reasons. The first, that unions are most properly described as multi-interest, multi-member cartels, was discussed above.\(^{165}\) The second and more interesting reason is that it is possible, with some exceptions, for employers to substitute lower priced workers for union employees during a strike, whereas it is true by definition that no firm or consumer dealing with a monopoly can substitute lower priced, non-inferior goods for the monopolist's goods, otherwise he would already have done so and there would be no monopoly.\(^{166}\) This distinction is critical, for it shows that while unions are legal, they are not monopolists in a strictly economic sense.\(^{167}\) While it may be true that unions will attempt to raise the price of non-union substitute labor, either by legislating for a high social reservation wage (unemployment benefits), or by beating up "scab" workers during a strike,\(^{168}\) the option of lower priced, non-inferior labor substitution is available at least in theory.\(^{169}\)

While the criticisms of Posner and Campbell are narrow in focus, it is important for analytical reasons to understand that unions differ substantially from monopolists.

C. Why Unions Usually Cannot Transfer Profits from Owners to Workers

The great myth of labor law is that unions transfer wealth from capital


\(^{164}\) There is a good deal of work in the political science literature about the institutional interests of government monopolies, and in the public choice literature there is some work on how government monopolies respond to interest group pressure. As Campbell's language suggests, it is clear that multi-interest monopolies exist, though they are limited to government subsidized- and run- monopolies.

\(^{165}\) See MULVEY, supra note 20, at 36-37.

\(^{166}\) See id.

\(^{167}\) Unless Campbell simply means 'monopoly' as genus and 'cartel' as species in some sort of antitrust taxonomy, but he never indicates that this is his meaning.


\(^{169}\) Whether it is so in practice is another question, if it were so, we would not see many successful strikes.
to labor or from wealthy managers and owners to poorer, exploited workers. This is usually incorrect. What ordinarily happens is that unions force firms to raise product prices to pay higher union wages, thus transferring income from consumers to union workers. This section discusses why firm profits are usually unaffected by unionism.

Unions are often quite successful at raising worker wages above the competitive level, that is, above the level that would exist in a non-cartelized labor market. This is more true when the employer is a labor monopsonist than when he is a price taker in the labor buying market. This is because a firm with labor monopsony will rationally exploit that power over an unorganized labor force to extract rents from workers by paying lower wages. This is less often true when the final product market is competitive and when competing producers all have labor monopsony power. In such an instance, producers will compete with one another to drive prices down in the final product market, thus cutting out the surplus initially extracted from the workers through firms' labor monopsony power. The result will be a normal profit, low-wage industry with little chance for a union to raise wages at one firm without doing so at every firm.

Unions can also extract rents from a non-price regulated final product market monopolist by forcing the monopolist to share some of his economic rent. If the unions' activities have no effect on the slope of the demand curve facing the monopolist, which is the usual assumption, then the monopolist will be unable to change his production pattern and will be forced to share some of his economic rent with the unions. If he does not, he will miss his production target, and thereby fail to profit maximize.

The problem with this story is that, except for one special case of a firm with sunk costs surprised by unionization, it is generally impossible for a union to extract profits from unionized firms. It is not for lack of trying


171. Union supporters like Professor St. Antoine believe that unions' effects upon product markets should be ignored, though this is puzzling, as virtually all workers are also consumers. See Theodore J. St. Antoine Connell: Antitrust Law at the Expense of Labor Law, 62 VA. L. REV. 603, 604-608 (1976).


173. See Freeman & Medoff, supra note 54.


175. See id.

176. Such an effect is possible where a firm acquires a reputation for poor product quality as a result of unionization. See George R. Barker, An Economic Analysis of Trade Unions and the Common Law 107 (1997).

177. See generally Cameron W. Odgers & Julian R. Betts, Do Unions Reduce Investment? Evidence from Canada, 51 IND. & LAB. REL. REV. 18, 19-21 (1997) (discussing the literature). There is
that unions are unable to extract income from capital; it is simply that competing firms and efficient capital markets make this impossible.\footnote{178}

1. Higher Union Wages are Paid for Through Increased Product Prices

When unions successfully unionize a firm, part of their demands will likely include higher wages.\footnote{179} Union supporters believe that these higher wages will be paid out of the firm’s profits and that union wage increases will therefore come at the expense of capital.\footnote{180} This view is incorrect and naïve when considered in light of profits’ important economic role.\footnote{181} The function of profits in a competitive industry is to induce investors, by offering higher rates of future return, to invest their money instead of spending it or holding it.\footnote{182} The rate of profit demanded by rational evidence that unionization decreases new sunk investment by unionized firms by up to 20 percent. See Barry T. Hirsch, *Innovative Activity, Productivity Growth, and Firm Performance: Are Labor Unions a Spur or Deterrent?*, ADVANCES IN APPLIED MICROECONOMICS 69 (Jai Press, Vol. 5, 1990). Some of the labor laws in question were designed with the thought that such an income transfer would occur. See Daniel J. Gifford, *Labor Policy in Late Twentieth Century Capitalism: New Paradoxes for the Democratic State*, 26 HOFSTRA L. REV. 85, 88-90 (1997). Although there is evidence that unions are able to capture rents on sunk capital, see, e.g., Vincent Crawford, *Long-Term Relationships Governed by Short-Term Contracts*, 78 AM. ECON. REV. 485-99 (1988), it is unclear whether the return on this capital was adjusted \textit{ex ante} to account for the threat of unionization.

\footnote{178} But see \textsl{Freeman & Medoff, supra} note 53, at 181-90 (1984). Freeman and Medoff argue that unions do transfer profits from firms to workers, but as I have shown in this section, they are wrong. In the simplest model, a particular investment (e.g., a share of stock) is priced on the basis of its expected return. Insofar as investors fear that a firm may unionize and face higher wages, hence lowering profits (versus in the absence of a union), the “price” of that investment will fall. Those investors who buy into such a company at a discount accept that risk, and when such a firm unionizes, the firm’s profits will be in line with the cost of their investment. There is no transfer of profits from the firm to its workers (rather, the higher wages are just another input cost), and the firm’s investors are receiving precisely what they bargained for. (This assumes no change of legal rules, and does not apply where investors did not demand a union-fearing premium.)


\footnote{180} See, e.g., Daniel J. Gifford, *Redefining the Antitrust Labor Exemption*, 72 MINN. L. REV. 1379, 1428 (1988) (arguing that “[i]n the United States, part of General Motors’s profits, for example, are captured in the wage bargain and thereafter become part of that company’s labor costs.”). This is technically correct but does not get at whether unions are really expropriating income that investors demanded, and paid for, \textit{ex ante}. Labor costs are subtracted prior to the calculation of profits. Higher union labor costs may raise overall costs at General Motors (GM) but this is irrelevant for determining whether the union is successfully extracting income from GM’s investors. Since GM was unionized many decades ago, there is probably no “special case” here of investors not knowing about the union before sinking their money into the firm. Whatever extra labor costs come from the union were already accounted for in the price of GM stock \textit{ex ante} in the level of risk assigned to GM stock. Assuming no change in the GM-union position (and Gifford does not tell us of any), all GM investors post-unionization are not getting less than they thought they would because of higher labor costs; they are getting precisely what they bought into.

\footnote{181} See generally \textsl{Lloyd G. Reynolds et al., Labor Economics and Labor Relations} 480-81 (11th ed. 1998).

\footnote{182} See \textsl{id.}. 
investors, the expected return, depends primarily upon an investment’s risk and that risk’s duration. A unionized firm will be unable to lower its profits to pay workers more because those profits are the only thing keeping its investors on board. The firm will therefore need to raise its prices to pay for the workers’ higher union wages, which is in fact what happens. Unionized firms usually raise their prices in order to pay their workers more.

It might be asked, if the firm is in a competitive industry, would not its price increase cause it to get slaughtered by its non-union competitors? In theory, this is what would happen if just one firm in a competitive market was unionized. It is impossible for one firm in a competitive industry to be unionized and survive by raising prices. That firm would go out of business or if it cut profits to pay for higher wages, its investors would sell out, the stock price would fall, it might be bought by another firm or group of investors, and be shut down or sold off. The unionized workers would therefore lose their jobs, and the great paradox of unions would be that any union that is even a little bit successful would strangle its employer and eventually asphyxiate itself.

There are two reasons why this does not happen. The first is that unions either unionize or attempt to unionize whole industries, not just single firms. If a whole industry is unionized, then the firms’ relative competitive positions will not change and hence their profits will remain relatively stable in the long run, assuming similar use of labor inputs and costs. In a sense, unions harmonize production costs, or at least labor costs, across competitors and so may also facilitate the cartelization of product markets. Facing higher wage costs from unions may have no more effect on an industry’s long-run profits than experiencing an across-the-board

183. See id.
184. I am assuming easy investment diversification.
185. See LLOYD G. REYNOLDS ET AL., LABOR ECONOMICS AND LABOR RELATIONS 408 (11th ed. 1998) (Under a certain set of competitive conditions, “unions can improve the wages an working conditions of their members but only at the expense of other workers as well as employers and consumers”) (emphasis added). Unions become better off at the expense of consumers only by raising product prices.
187. See MULVEY, supra note 20, at 60-63.
189. See MULVEY, supra note 20, at 62-63.
190. See id.
191. See id. at 160-177.
increase in the price of some other input, such as steel in the car industry, which is used by each firm in that industry. Instead, higher union wages are often passed on as increased product costs to consumers.\(^\text{192}\)

Once an industry is unionized, the costs of entry into the industry will increase.\(^\text{193}\) Efficient capital markets will necessarily assign more risk to firms seeking entry into unionized markets.\(^\text{194}\) Some investments simply cannot pay the higher rates of return demanded by union-fearing investors, and so new competitors do not enter.\(^\text{195}\) Investors will rationally fear that any sunk costs may not be fully recoverable without a risk premium.\(^\text{196}\) The mere chance that a firm may be unionized and suffer short-term losses from strikes, etc., will make rational investors require a premium for investing their money.\(^\text{197}\) This points out one of the paradoxes of unionism—the very same unionization which raises prices and should in theory impel new entry, instead raises entry costs to new entrants and so preserves the status of both unionized firms and unions.

There is a final reason why higher union wages are passed through to consumers in the form of higher product prices. Unions are unlikely to be able to redistribute wages within firms, except to the extent that they can contract to do this between their own members.\(^\text{198}\) Many non-unionized firm employees, such as managers, may have transferable skills and it will be difficult for a firm to underpay them in order to overpay the union employees. If it does, the firm will lose its management to other firms. This circumstance is mitigated by the degree to which management skills are firm or industry specific.\(^\text{199}\) Managers with highly specialized skills may be unable to leave their firm or industry if it is fully unionized, but intra-firm wage redistribution is unlikely under unionization since a rational firm will already have an incentive to exploit locked-in managers.

\(^\text{192.}\) See Daniel J. B. Mitchell, supra note 186, at 1083-85.

\(^\text{193.}\) See Part III, infra.

\(^\text{194.}\) For a discussion of the effect that unexpected changes in collectively-bargained labor costs have upon firms' stock market values, see John M. Abowd, The Effect of Wage Bargains on the Stock Market Value of the Firm, 79 AM. ECON. REV. 774 (1989).

\(^\text{195.}\) See Campbell, supra note 70, at 1032. Labor can do this by shaping the demand curve the firm faces—for instance by shaping public opinion against the firm.

\(^\text{196.}\) Firms either demand greater returns on their investments or invest less at a lower rate of return. From an economic perspective, the two amount to the same thing. See William N. Cooke, The Influence of Industrial Relations Factors on U.S. Foreign Direct Investment Abroad, 51 IND. & LAB. REL. REV. 3, 5 (1997). There is unfortunately shockingly little empirical work on the magnitude of union-fearing premium. An analogy is rent control laws, whereby new builders would not build in rent controlled areas unless they can command a risk premium. See Edward L. Glaeser & Erzo F. P. Luttmer, The Misallocation of Housing Under Rent Control, NBER Working Paper No. W6220 (National Bureau of Economic Research, October 1997).

\(^\text{197.}\) The analogy is the government imposing rent control laws and thus ‘taking’ away the property’s investment return and returning it back to the renters.


\(^\text{199.}\) See Salop, supra note 76.
2. **A Special Case Where Unions Extract Profits from Owners**

The special case where unions extract profits from owners is a firm in a competitive industry with sunk costs whose investors did not anticipate being unionized and hence did not demand a compensating investment premium *ex ante*.\(^{200}\) It may be impossible for this firm to move its sunk plant to escape the union, and so it will be forced to deal with the union on unfavorable terms.\(^{201}\) In that case, the union will be able to extract rents from the firm by forcing it to pay lower investment returns on its sunk capital than those anticipated when the investment was made.\(^{202}\) If the firm is in a competitive industry whose other members are not unionized, it will also be unable to raise its prices. In that case, there will be a transfer of income from capital to labor and at least one of the deadweight losses associated with unions, lower firm output at a higher price (the same problem as with monopoly) will be absent.\(^{203}\)

In such a case, the firm will continue to produce at the socially optimal level, except that its owners will receive a lower rate of return on their investment than they anticipated\(^{204}\) and the unionized workers will receive wages above the competitive level. If the firm once had labor market monopsony power, then it is possible that an optimal Coasian bargain may be reached wherein wage, price, and output schedules are all set at the efficient level.\(^{205}\) The only loser in that case will be the investor who *paid* a premium instead of demanding a risk discount, thinking the firm would be able to exploit its labor monopsony position to pay higher returns.\(^{206}\) This is unlikely to happen, however, for the union must both surprise the investor and cease\(^{207}\) its wage demands at the marginal product level. The latter condition suggests why firm-union bargaining only rarely achieves an optimal Coasian outcome, since a monopsonistic firm has no desire to pay its workers their marginal product and a union has no incentive to stop its wage demands at that level.\(^{208}\)

---

200. This is the only case in which unions can disgorge expected profits from firms.

201. *See Freeman & Medoff, supra* note 53. This is the circumstance they (and others) seem to have in mind when discussing wealth redistribution from owners to workers.


203. *See id.*

204. *See id.*

205. *See Schwab, supra* note 144, at 245.


207. If the union pushes for a wage above the marginal revenue product level, the firm will inefficiently capital for labor or else will pass higher labor costs on as higher product costs, thus decreasing social welfare. *See* David D. Friedman, *An Economic Analysis of Alternative Damage Rules for Breach of Contract*, 32 J. L. & Econ. 280, 285 (1989) (discussing why consumer welfare suffers when the price of a good is greater than its true social cost of production; a worker’s marginal revenue product is his true cost of producing a good).

208. *See Campbell, supra* note 69, at 1005-06 (discussing unions as monopolizing input price and
Even in this special case, the typical deadweight cost of unions, the rent-seeking required to create and maintain a union will still be present.\textsuperscript{209} If a firm with sunk costs is also a monopoly, the case is somewhat different. There the union may well extract all of the monopolistic firm’s rents, but depending upon the union’s power, it is less likely to extract the normal income on those sunk costs.

Even where unions ambush a single firm in a mixed industry by unionizing it unexpectedly and extracting the investment returns on its sunk costs, only the ambushed part of the sunk costs is subject to expropriation. None of the new sunk capital investment, including all new investment made in already-unionized firms, will be expropriated by the union since all new investment will already be discounted for that possibility. If it is not, the investment will simply not be made.\textsuperscript{210}

Except where unionization comes as a surprise to investors, unions are unable to extract income from capital. What unions ordinarily do is empower themselves \textit{vis-à-vis} consumers and extract cartel rents from consumers. In this manner, a union’s effect is similar to a product cartel’s. It imposes social costs through higher wages that usually transform into higher prices and hence lower net output. Part III-C \textit{infra} discusses why unions do not increase, or cause firms to efficiently increase, worker productivity sufficiently to compensate for higher union wages.

\textbf{D. Why Consumer-to-Union Income Transfer is Socially Wasteful}

Part III-C \textit{supra} mentioned briefly some of the costs of union price hikes.\textsuperscript{211} This section examines those costs in greater detail to demonstrate that such income redistribution is socially quite expensive. Wealth transfers are socially expensive when they cause substantial deadweight losses, meaning that overall social wealth is decreased by such transfers.\textsuperscript{212} This Article will also examine whether there are less socially costly ways of achieving the same ends.

\textbf{1. Deadweight Losses and Rent-Seeking}

The first cost is the straightforward consumer surplus loss that comes from raising the price of labor inputs in the productive process, thereby

\textsuperscript{209} See Posner, \textit{supra} note 141.

\textsuperscript{210} This assumes several things, including primarily no (unanticipated) change in relevant labor laws or rules. \textit{See} Hirsch, \textit{supra} note 172, at 180.

\textsuperscript{211} \textit{See} Freeman & Medoff \textit{supra} note 53 (discussing the union wage premium).

\textsuperscript{212} It is analytically identical to product monopolist overcharge. \textit{See} Friedman, \textit{supra} note 207, at 285.
raising final costs and decreasing overall production. Less is produced, but each unit costs consumers more, causing many consumers to pay more than they otherwise would and making other people who would like to buy unable to do so. The other loss arises from the rent-seeking expenditures the union makes to keep its cartel, such as lobbying legislatures for favorable laws, organizing activities, and administrative expenses. Although the first of these is only a transfer of income from unions to legislators, it is considered socially wasteful rent-seeking behavior because unions expend productive social resources in finding ways to divide up a small pie instead of trying to make the pie bigger.

2. Raising Non-Union Rival Firms' Costs Through “Salting”

There are at least two additional deadweight losses caused by unions. Both losses are unique to unionized labor markets and are not caused by other types of cartels. The first cost is created through the union strategy of “salting.” The purpose of salting is to raise non-union firms' costs to the extent that those firms either agree to unionize or else to neutralize such firms by destroying their comparative advantage in labor costs. Unions salt when they have been previously unsuccessful in organizing workers from the bottom up, when the workforce has high levels of turnover, or is located in a region like the American South where worker attitudes toward unions have historically been ambivalent or even hostile. To prevent non-union firms from utilizing their comparative advantage in labor costs, salting unions resort to both bottom-up and top-down strategies to pressure non-union firms to sign union recognition agreements.

Salting takes two forms. In the first, unions secretly send their organizers to seek ordinary employment at non-union firms. Such organizers have two goals: to raise the non-union firm's costs and to convince workers to organize. Once hired, the unions' organizers disrupt the non-union firm's work process to raise its costs. They also engage in

214. See id.
215. See Polachek & Siebert, supra note 42 at 312.
218. See Robert Bussell, Southern Organizing in the Post Civil Rights Era: The Case of S. Lichtenberg, 52 Ind. & Lab. Rel. Rev. 528, 536 (1999) (discussing the South's “anti-union tradition” and arguing that “the inability to organize in the South has been one of the labor movement's historic albatrosses”).
220. See id. at 48.
workplace organizing activity. Under a free market system, a rational non-union firm would engage in self-help and simply fire such salts. Modern labor law makes it difficult, however, for employers to fire employees for poor performance if those employees are also engaged in organizing since dismissal on the latter ground can result in costly litigation. This is especially true after the Supreme Court decision in National Labor Relations Board v. Town & Country Electric Inc. There, the Supreme Court unanimously held that union organizers are considered employees or applicants under the National Labor Relations Act. Even if a salt is unsuccessful in organizing workers, she may still be able to raise the non-union firm’s costs. Success in either goal helps the union decrease the non-union firm’s comparative advantage in labor costs.

A second form of salting, closely related to the first, involves the filing of multiple grievances by union salts against non-union employers at the National Labor Relations Board. Such complaints may be related to the treatment the worker received at the non-union firm. Although many such claims may be frivolous, the cost of defending against them will increase a non-union firm’s costs and may wipe out the gain recognized by its comparative advantage in labor costs. Thus, whether a salt succeeds in increasing costs directly, through poor work performance or disruptive on-site activity, or indirectly, through filing spurious grievances at the NLRB, salting is an effective strategy for raising non-union firms’ costs.

3. The Union Threat Causing Self-Induced Firm Inefficiency

The second type of deadweight cost created by unions is indirect and involves non-union firms’ responses to the threat of unionization. Sometimes rational firms will act preemptively to avoid confrontation with a union. One category of avoidance, called induced inefficiency, helps to

---

221. See id. at 47.
223. Some academic observers have argued that salts “are not interested in securing employment or even in persuading non-unionized construction workers to organize, but rather are engaging in economic sabotage by driving up the costs of business for non-union contractors.” Note, Organizing Worth Its Salt: The Protected Status of Paid Union Organizers, 108 HARV. L. REV. 1341, 1346 (1995) (summarizing Professor Herbert Northrup’s argument to that effect).
224. This point has received some attention, see, e.g., Durie & Lemley, supra note 8, at 757-59.
225. Traditionally it has been difficult to limit such suits. See California Motor Transport Co. v. Trucking Unlimited, 404 U.S. 508 (1972). In California Motor Transport Co. the Court held that litigants must show some pattern of suits without basis by the other side in order to receive antitrust remedy. See id. at 515.
226. Cf. Krattenmaker & Salop, supra note 27, at 223-27 (discussing efforts by output producers to raise rivals’ costs through contractual arrangements with input suppliers).
227. See E. Parker & J. Wenzel, Induced Inefficiency as a Response to the Union Threat, 19 J. OF LAB. RES. 629, 643-44 (1998) (finding evidence that non-union sawmills in the Pacific Northwest utilize...
explain a great puzzle of labor economics: how union and non-union firms can compete in a single market without the latter driving out the former.\textsuperscript{228}

Unions operating in only partially unionized industries have a substantial incentive to unionize all the firms in their industry.\textsuperscript{229} This is because the wages and employment of union members depend directly upon the ability of unionized firms to maintain higher prices to pay union wage premiums.\textsuperscript{230} Where non-union firms are able to pay their workers less, they will be able to undersell unionized firms; and insofar as other costs of entry are held constant, unionized firms will be unable to profit or even survive.\textsuperscript{231}

It is therefore likely that non-unionized firms in an industry with a mix of unionized and non-unionized firms will face tremendous pressure from rival firms' unions.\textsuperscript{232} Although there may be typical free rider problems, the union will have an easier time persuading its workers to put pressure on the non-union competitor, through protests, sabotage, or boycotts, than if the non-union firm was in a different, unrelated industry.\textsuperscript{233} Unions will have more success in rallying their members where the costs of inaction are greater to each individual worker in the affected union.

The non-union firm will rationally wish to avoid attention from the union since such attention leads to higher costs and therefore can erase its comparative advantage.\textsuperscript{234} A rational firm in a mixed industry may respond to threats of unionization by reducing the size of its workforce and its level of output below what appears to be the price-efficient level.\textsuperscript{235} A firm will adopt such a strategy if the perceived costs from union attention are greater than the costs of voluntarily induced inefficiency. Even facing higher output costs per unit, such a firm will remain profitable since its unionized competitors still face higher union labor costs. However, a non-union firm adopting such a strategy will consequently pose a lesser threat to the

\textsuperscript{228} This thesis was first advanced by Sherwin Rosen and has since been called the Rosen "Threat-Effect Hypothesis". See Rosen, Trade Union Power, Threat Effects, and the Extent of Organization, 36 REv. OfECON. Stud. 185 (1969).

\textsuperscript{229} See id.

\textsuperscript{230} See id.

\textsuperscript{231} See id.

\textsuperscript{232} See id.

\textsuperscript{233} See id.

\textsuperscript{234} If the opposite were true, namely, that attention from the union led to lower costs, say through productivity increases which offset higher union wages (see Part III-A infra), one would expect rational employers to seek out unions and indeed even create unions for their workers. But in the real world this rarely happens; employers almost never want their workers to unionize.

union. By adopting this strategy, a non-union firm will both make it relatively more costly for the union to organize its workers and decrease whatever benefit the union derives from doing so. The union’s gains from organizing decrease when the non-union firm both increases its production costs and decreases its workforce, thus making it less of a target.

4. How Unions Lower the Wages of Non-Union Workers

Turning from the preceding discussions of the effects of union activity on prices and output and the strategies employed by unions to raise non-union rival firms’ costs, the next issue of significance is unions’ effect on non-union workers’ wages. Much of the literature supporting labor unions, particularly the political and historical arguments, asserts that labor unions somehow make non-union workers better off. One reason often given is that the threat of unionization forces non-union employers to pay higher wages and provide other non-wage benefits.

Unions’ effects on the wages of non-union workers are sometimes complicated. It is true that some firms may wish to avoid unionization and hence will pay higher wages. This might explain why non-union firms do not simply put unionized competitors out of business. Higher wages may be a good thing from the point of view of one worker or a group of workers. From the point of view of an economist, however, artificially higher wages translated into lower production at a higher price are undesirable. Social wealth transfers of this sort are damaging because they make the world materially poorer.

236. See id. at 320-21.
237. See id. at 319. See also Polachek & Siebert, supra note 42 at 316.
238. See Milkman & Merwin, supra note 235, at 319.
239. See, e.g., Freeman & Medoff, supra note 53.
240. See Polachek & Siebert, supra note 42, at 312. There is some interesting literature on whether unions increase workplace safety. See, e.g., J. Reardon, The Effect of the United Mine Workers of America on the Probability of Severe Injury in Underground Coal Mines, 17 J. of Lab. Res. 239 (1996) (finding that although the United Mine Workers of America installed safety committees and inspectors in unionized mines, there was no evidence that such mines had lower rates of injury or accident than non-union mines). Anyone familiar with how labor and capital markets operate should be suspicious of the notion that workers enjoy costless workplace safety improvements after unionization. It may well be true that workers today enjoy more safety than their predecessors, and unions certainly pushed for this. But to a great extent, the cost of increased safety has come at the cost of higher product prices and hence lower real wages for workers. It has not come out of long-run company profits; indeed, average company profits have not declined at all. Workplace safety enhancements are paid for in the same way as union wage increases are paid for—generally, through higher long-run product prices. Since workers are also consumers when they take their work hats off, it is really workers who pay for these changes. The laws of economic dictate that it must be this way—after all, where else would such extra ‘income’ (in the form of more work safety, for instance) come from?
241. See Freeman & Medoff, supra note 53, at 152-53.
242. See id. Indeed, they are often the ‘moral’ rationale for unions.
When unionized firms must pay higher wages they will generally pass those costs onto consumers. Unions thereby redistribute income from consumers to themselves. If the same amount of net social wealth existed after such a transfer as would exist in a free market, making that redistribution socially costless, then from an economic point of view one would be unconcerned. Morally one might object to such a transfer since some consumers are poor and most union workers are not, but an economist would remain ambivalent.

What unions do, however, is lower the real wage of non-union workers, even assuming the nominal wage of such workers remains unchanged and there is no inflation. The distinction between nominal and real wages is critical for understanding why unions make non-union workers worse off. A nominal wage is the number of dollars a worker earns, for example $30 for some amount of work. A real wage is what that nominal wage of $30 buys him, for example a tank of gas for his car.

In artificially raising the price of their labor over the market price, unions ordinarily force unionized firms to raise the price of their products. But since only some workers belong to unions, only some prices will rise. Other prices will remain the same or will rise less than those of union-made goods. Unionized firms produce many different things and it is not always feasible for consumers to substitute away from union-made goods. At best, any substitution will be an imperfect second-best. Since non-union workers must spend part of their income on artificially more expensive union-made goods, they will transfer part of their real income to union workers. The effect is no different than when a cartel such as OPEC raises oil prices. A worker may still earn $30 for his work, but since his $30 buys him less gas after the price increase, he is worse off than before. His nominal wage remains unchanged, but his real wage has declined.

243. For a discussion of the one exception to this practice, see Part II-C, infra.


246. This follows upon three earlier arguments: first, that union wages are passed through as higher prices, second, that non-union workers cannot efficiently substitute away from union-made goods, and last that non-union workers’ wages are not raised sufficiently by the threat to unionism to overcome this cost.

247. For a discussion of this in the context of the 1930’s, see Ben S. Bernanke & Kevin Carey, Nominal Wage Stickiness and Aggregate Supply in the Great Depression, 111 Q.J. OF ECON. 853-883 (1996).


249. For a brief discussion of nominal and real wages followed by an analysis of unionism’s effect,
There are dynamic effects from union price increases as well.\textsuperscript{250} Price changes have real effects on levels of output beyond merely altering patterns of income. Because prices rise, consumers buy less.\textsuperscript{251} Consequently, more union labor is used to produce fewer goods at a higher price than if there was no union. It is not simply that unions redistribute wealth to themselves through higher final product prices; such price increases also have the real effect of lowering overall output.\textsuperscript{252}

It is not true that creating more unions, or having every worker belong to a union, is the solution to this problem. It is true that if all workers unionized today, they would expropriate their employers' sunk costs in the short run by decreasing the return to capital.\textsuperscript{253} This is the special case discussed earlier, and it could occur economy-wide. However, such a shock would have dire consequences. Most importantly, it would decrease the aggregate amount of new investment in the economy in the long run.\textsuperscript{254} The result would be less productivity growth, fewer good new jobs, and considerably slower wage growth in the long run. It is surely true that today's workers would be better off if they unionized every firm in the economy.\textsuperscript{255} But they would probably regret doing so in the future and if they did not, surely their children would\textsuperscript{[B5]}.\textsuperscript{256}

As Professor Mulvey has lucidly argued, under an all-union system "the wage level and wage structure would be determined by union fiat and the labour market would be constrained to function by a system of non-price rationing which could have potentially disastrous consequences for the economy."\textsuperscript{257} One can imagine few more effective ways in which cartels could wreck an economy. By depriving the economy of accurate price information, an all-union system would prevent the efficient

\textsuperscript{250} I am assuming unrealistically that such price increases are not inflationary. The addition of an inflation analysis of union activity is beyond the scope of this paper. See Erikson & Ichino, supra note 249.

\textsuperscript{251} Assuming demand is not perfectly inelastic. But even under conditions of perfect demand elasticity, a price rise in one area necessarily means less to spend in another. See Friedman, supra note 208, at 285.

\textsuperscript{252} A point neglected by Freeman & Medoff, supra note 53.

\textsuperscript{253} This assumes that those firms' investors did not demand and receive a union-fearing premium before sinking their money. This is a reasonable assumption here.

\textsuperscript{254} See Hirsch, supra note 173, at 180. Money earmarked for investment would be invested elsewhere or diverted to consumption.

\textsuperscript{255} Although much of the increase in wages would be passed onto consumers through higher product prices (thus causing inflation), some of it would be appropriated from capital. The latter amount is non-inflationary and would generate a real, albeit short-term increase in unionized workers' wages.

\textsuperscript{256} Much as the children and grandchildren of socialists might regret that their forebears advocated the nationalization of private property and industry.

\textsuperscript{257} Mulvey, supra note 20, at 144.
allocation of resources, thus harming both employment and production.\textsuperscript{258}

Unions therefore do not generally raise the real wages of non-union workers. To the contrary, they often lower them. Even seemingly benevolent union activities such as lobbying for safer workplaces impose costs upon non-union workers.\textsuperscript{259} Those costs take the form of lower wages, higher prices, or both. In the case of workplace safety, it may be that there is some pressing reason to circumvent labor markets if many workers overly discount workplace danger due to an information problem. Legislation may be helpful under such circumstances. It is important, however, to acknowledge that workers, who are also consumers, ultimately pay most, if not all, of the costs of such legislation.\textsuperscript{260}

Unions’ detrimental effects on non-union workers’ real wages are often substantial.\textsuperscript{261} Progressives should be concerned when union workers gain higher wages mainly at the expense of similarly-situated or poorer consumers. While it might be possible to turn a blind eye to such distortions when they involve luxury goods sold only to wealthy consumers, it is much more difficult to come up with a plausible rationale for labor unions in the case of most products bought by ordinary consumers.

IV.
SOME FLAWED EFFICIENCY DEFENSES OF LABOR UNIONS

The preceding critique of unions would be moot, or at least mitigated, if union workers offset their above-competitive level wages with proportionally increased work productivity, or if unions created other efficiencies which counterbalanced their pernicious effects.\textsuperscript{262} There are some economists who believe that although unions cause many of the pernicious effects described above, unions sometimes create offsetting efficiencies that justify their existence.\textsuperscript{263} This section shall examine three such arguments in favor of unions. The first is that unions efficiently counteract monopsony in labor markets, and therefore in some cases, union wage increases force monopsonistic firms to produce at a socially efficient

\textsuperscript{258} For an excellent discussion of the importance of accurate price information in economic processes, see generally GEORGE STIGLER, THE THEORY OF PRICE (4th ed. 1987).

\textsuperscript{259} But see Susan Rose-Ackerman, Comment: Progressive Law and Economics—And the New Administrative Law, 98 YALE L.J. 341, 355-60 (1988) (arguing that the benefits might outweigh the costs).

\textsuperscript{260} It is possible that many of those workers, if offered the choice, would choose a marginally higher wage over a slightly safer workplace. Workplace safety legislation rarely gives workers such unbounded choice, however. For a discussion of these issues, see Cass R. Sunstein, The APA at Fifty: Health-Health Tradeoffs, 53 U. CHI. L. REV. 1533, 1539-42, 1551-52 (1996).

\textsuperscript{261} See MULVEY supra note 20.


\textsuperscript{263} See generally FREEMAN & MEDOFF, supra note 53, at 162-80.
level. The second is that unions help create work rules which provide better communication between workers and management, and therefore create more efficient production processes.264 The last is that unions force firms to utilize their workers more efficiently and to invest optimally in labor saving capital equipment.

A. Why Unions Fail to Efficiently Counteract Monopsony in Labor Markets

Unions often do not efficiently counteract monopsony power in labor markets. Although it is possible in theory that a union’s countervailing power may raise wages to their efficiency level and no more, this is unlikely to actually occur.265 The deadweight costs of union-employer bargaining are the first reason why such Coasian bargaining is unlikely to create the optimal level of production.266 In order for a union’s countervailing power to completely offset the firm’s monopsony power and achieve an efficient bargaining outcome (such that competitive market wages are paid and goods are produced at socially-optimal levels and sold at competitive prices), the following conditions must be met:

The union and firm must both have perfect information on the workers’ competitive market wage and the extent to which current wages deviate from that wage.267 This requires knowing the net value that those workers produce.268

The union must be willing to “stop” its wage demands once its workers receive their (adjusted) marginal product wage and the firm must be willing to pay its workers that amount, without regard to the perceived strength of the other side.

Bargaining must be costless—e.g., no strikes, no lockouts, and no delays.269

These conditions, and especially the last one, are probably never met in the real world.270 There are many reasons for this. Bargaining power requires more bite than merely placing three union negotiators across a table from three company negotiators and asking for more money. To be

264. See PENC AVEL, supra note 198, at 93.
265. The concept of countervailing power is attributed to Galbraith. See John K. Galbraith, Countervailing Power: Memoir and Modern Reality, in LABOR ECONOMICS AND INDUSTRIAL RELATIONS: MARKETS AND INSTITUTIONS, (Clark Kerr & Paul D. Staudohar, eds., 1994) 431-34 (discussing the history of the concept, which postulates “bilateral and socially self-neutralizing monopoly” power between firms and unions).
267. Other things held constant, it is unimportant whether the unions has this information for each worker/job position or for all its workers together.
268. As I noted earlier, this must be controlled for the value of general training, etc., which is properly subtracted from worker wages.
269. Ironically, this may well mean “no bargaining,” since all bargaining is costly.
seen as legitimate, a union’s bargaining effort often must manifest, prior to or during bargaining, in socially costly practices such as strikes, work slowdowns, labor riots, and so on. The need to prove bargaining power may explain the apparent puzzle of why unions strike when the strike costs for both workers and employer are high. Firms, on the other hand, will expend money to prevent unionization and to subvert existing unions, though the latter is unlawful. Both types of posturing are wasteful.

Unions have a great incentive to cheat and to demand more than the marginal product wage for their workers. Monopsonistic firms also have no incentive to pay their affected workers their marginal product, unless that incentive is imposed on them by the union. Whatever compromise is reached is often messy, costly, and economically incorrect.

Moreover, it is difficult for a union to know whether its workers are being paid their value. Proof of wages below the marginal product level is not proof of monopsony exploitation. It has long been known that evidence of wages below a worker’s marginal product does not necessarily indicate worker exploitation or labor market monopsony. That is why condition two, above, requires that the marginal product wage be adjusted. Firms must fund general worker training out of wages and take-home wages therefore will be below the strict marginal product level even in competitive industries. Clearly, the simplifying device of “wage equals marginal product in competitive markets” is only that. Any determination of when a particular market suffers from monopsony requires a more rigorous analysis. This is a problem for any adjudicative system that tries to determine whether workers are being under or overpaid.

Further, unions may be too strong and push wages above the competitive level, in which case prices will rise and consumers will be harmed. Alternatively, unions may be too weak to sufficiently raise the price of labor against a powerful monopsonist. The costs of overshooting or undershooting are substantial. For these reasons, the optimal Coasian bargaining solution is probably never achieved in the real world.

272. Hylton makes the interesting point that “the fact that the union sector has declined significantly over the past three decades and continues to shrink is itself sturdy evidence against the hypothesis that unions enhance efficiency.” After all, if unions were efficient and their activity not wasteful, employers would surely embrace them. See Hylton, supra note 270, at 472.
273. See id. at 481, fn. 33.
274. But see id. at 498-508 (discussing instances of efficient unionism).
275. See id. at 481, fn. 33 (noting measurement problems).
276. See Becker, supra note 78, at 21.
277. And is made more difficult by the fact that “there seem to be few monopsonists in today’s labor market.” Hylton, supra note 270, at 485. It is unclear whether Hylton’s appraisal is correct.
278. See proposal in Part IV, infra.
279. See Hylton, supra note 270, at 477-78.
B. A Mixed Bag of Union Work Rules

Unions are more complicated than simple monopolies, in part, because they seek particular work rules and practices in addition to other benefits. Like wages and non-wage benefits, union seek work rules that benefit their members. Unlike other benefits which impose only costs on firms, such rules may create offsetting efficiencies which also benefit firms. If such work rules create efficiencies of which unions are unaware, it may be true that unions in effect doubly pay for efficient work rules by reducing other demands. This occurs if (1) union-proposed work rules are efficient, (2) unions moderate other demands in exchange for such rules, and (3) unions are unaware of the extent to which their work rules create efficiencies.

1. Do Unions “Buy” Work Rules from Firms?

In addition to bargaining for wages and employment, unions also try to create particular types of work rules and grievance procedures. For example, a rational union will be willing at the margin to trade some increment of wage increases in order to secure rules of equal perceived value. It is possible that implementing such rules and procedures may cost a firm less than the firm would have had to otherwise pay in wages. If the union is unable to ascertain the exact cost of those rules to the employer (a realistic scenario since unions and firms bargain under conditions of uncertainty), the resulting information asymmetry may permit the firm to sell such rules for more than their substitute wage cost. The union will therefore be unable to bargain away the firm’s rent in promulgating such rules and the ultimate harm to prices and output from excessive union wage demands may be lessened.

2. Do Firms Benefit from Union Work Rules?

This is not the only sense in which particular work rules are thought to redound to a firm’s benefit. It is sometimes argued that unions seek to create efficient work rules that promote optimal production practices.

---

281. See id.
283. This depends on the union’s strength. See Francis Green & Steven McIntosh, Union Power, Cost of Job Loss, and Workers’ Effort, 51 IND. & LAB. REL. REV. 363, 365 (1998) (discussing union power in bargaining).
284. See MULVEY, supra note 20, at 70-73
Even if the rules themselves are not more efficient than previous work rules or no work rules in benefiting production, workers may perceive them as such. If workers believe that particular work rules and practices benefit them, they may well enjoy higher morale and be more willing to work hard, whether those rules actually provide the perceived benefit. Being happier with their jobs, such workers may quit at lower rates, thus lowering firm quit costs. Additionally, if the rules are efficient, the firm will benefit from the greater efficiencies such rules create. If the union is unaware of the extent to which the firm has benefited, it will be unable to extract those benefits in the form of rents. Of course, if the union discovers that its work rules create efficiencies, it will rationally attempt to extract that increased productivity through higher wages.

3. Union Work Rules as Another Form of Economic Rent

Much of the foregoing is moot because there is very little evidence that unions seek to create efficient work rules as opposed to merely worker-favorable work rules, which are just a form of non-pecuniary income. Unions indeed bargain for particular work rules and grievance procedures but have only a secondary interest in ensuring that such rules are efficient. Unions often seek inefficient rules, that is, rules that provide workers with a form of non-pecuniary income but either harm or have no effect upon productivity. A union bargains for inefficient rules when it is unable to recoup its share of the firm's rent in efficient rules, which is an information or bargaining power asymmetry problem, or when following efficient work rules imposes non-pecuniary costs on union members.

Unions seek efficient work rules when it is costless to do so. Sometimes workers' interests may coincide with firms' efficiency interests, but there is no guarantee that this will happen. It is just as likely that unions will seek to featherbed or otherwise make it difficult for a firm to fire incompetent or unmotivated workers as it is that unions will seek to streamline production processes and lower costs. Unions already must

285. See Pencavel, supra note 198, at 10.
286. See Mulvey, supra note 20, at 75.
287. See Polachek & Siebert, supra note 42, at 279-329.
288. See id.
289. This is similar to unions' often hostile attitude to labor-saving capital equipment, even equipment which may raise remaining workers' productivity. See S. Dowrick & B.J. Spencer, Union Attitudes to Labor-saving Innovation: When are Unions Luddites?, 12 J. Of Lab. Econ. 316, 337-39 (1994).
290. See Lande & Zerbe, supra note 285, at 223.
291. See id. At 217 (noting that "restrictive work practices and featherbedding are [often] associated with unions").
make some wage or employment tradeoff to obtain such rules. If unions were really interested in promoting efficiency, they could easily do so by moderating their wage demands.\textsuperscript{292} One should be skeptical of claims that union-imposed work rules are a special efficiency case.

Another problem with the efficient union work rules argument is that it assumes that rational firms would not create efficient work rules without union pressure.\textsuperscript{293} The assumption of firm incompetence in the face of efficiency gains is at odds with the most basic economic thought. Firms already have an interest in keeping their workers happy, in order to lower inefficient turnover costs and promote productive communication and morale.\textsuperscript{294} Rational firms create work rules and grievance procedures where the benefit of such rules equals the marginal cost of worker quits and low worker morale. Where firms do not create particular work rules absent unions, the presumption must be that such rules are inefficient because their cost outweighs their benefit.\textsuperscript{295}

C. Unions "Create" Labor-Use Incentives That Often Already Exist

It is true that a union successful in raising wage costs for one non-monopsonistic firm above the competitive level faced by its competitors will force that firm to find other ways to lower costs. However, the presumption in economics has long been that firms profit-maximize, and no firm can profit-maximize in a competitive industry without cutting inefficient costs.\textsuperscript{296} Such a firm already has the strongest incentive to cut non-labor costs wherever they exist, and the presence of a union cannot create a greater incentive than already exists. A profit-maximizing firm will attempt to pass on a union's higher labor costs through higher product prices and if it is unable to do so, it will take a loss.\textsuperscript{297}

The same is true with respect to firms' use of labor. A competitive firm already has external pressures, namely competitors, and internal incentives from stockholders, which push it to cut wage costs, utilize workers efficiently, and therefore maximize profits.\textsuperscript{298} The argument that a firm will be forced to use its workers more efficiently is an old one and is

\textsuperscript{292} See id. at 232.
\textsuperscript{293} See FREEMAN & MEDOFF, supra note 53, at 153-54 (arguing that non-union firms sometimes mimic union work rules).
\textsuperscript{294} See Posner, supra note 141, at 1001.
\textsuperscript{295} See id. at 1007 (discussing the efficiency consequences of union seniority rules).
\textsuperscript{297} Although this is an important point, most critics of unionism seem to have missed it. See, e.g., RICHARD A. EPSTEIN, FORBIDDEN GROUNDS: THE CASE AGAINST EMPLOYMENT DISCRIMINATION LAWS 118-119 (1992). This is surprising since these same scholars refer often to "the monopolistic position" of unions, and are surely well-aware of the monopoly overcharge problem. See id. at 119.
\textsuperscript{298} See Leslie, supra note 296, at 361.
made in other contexts (e.g., in support of the minimum wage). This argument does not make sense, however, at least under the assumptions specified above. A firm operating in a competitive industry already has an incentive to use its workers more efficiently than its competitors use their workers since doing so will increase the firm’s profits. If a firm has not done so, that is presumably because the cost of making its workers more productive outweighs the benefit.

The argument that union wage demands force employers to utilize their workers more efficiently is closely related to whether union workers are productive enough to offset their higher wages. Union wage demand pressure is thought to create two positive incentives. The first compels monopsonistic employers to substitute more optimally in labor saving capital equipment after unions raise wage costs to the efficiency level. The second forces employers to make their workers more productive to compensate for union wage increases. The following sections analyze and then refute these two contentions.

1. The Special Case of Monopsonists’ Inefficient Use of Labor

A monopsonistic firm competing against firms who are not labor monopsonists, i.e., one which faces competitive labor buying markets, may inefficiently utilize labor relative to capital. Under such circumstances, a firm exercising labor monopsony power will not face the same external cost-cutting pressures as its competitors. Such a firm may therefore be more e-inefficient (internally inefficient) than its competitors, yet be equally or more profitable since it faces a lower cost schedule. It may therefore be slower to substitute capital equipment for labor than are competing firms since the monopsonist has a comparative advantage over competing firms in labor costs but not capital equipment costs. In such cases, a monopsonist will overutilize labor relative to capital.

---

299. In fact, a common criticism of unions is that by raising their wage rate they also increase unemployment by decreasing effective demand for labor. See, e.g., Oliver Williamson, Wage Rates as a Barrier to Entry, 82 Q. J. OFECON. 85 (1968).
300. See Posner, supra note 141, at 1001.
301. See POLACHEK & SIEBERT, supra note 42, at 288.
303. See id.
305. See id.
307. See Robert J. Gordon, Problems in the Measurement and Performance of Service Sector
utilization of labor and under-investment in capital equipment is a serious misallocation of productive resources.\(^{308}\)

If a union is successful in pushing up monopsony wages to the competitive market level but no further, the monopsonist will be forced to produce using a socially optimal mix of wage labor and capital equipment.\(^{309}\) In other words, the firm will use fewer workers and more machines. This is what critics of unions refer to when they talk about union-induced unemployment.\(^{310}\) However, this will not be an efficient outcome if the union pushes wages above the competitive level. In that case, the monopsonist will inefficiently substitute capital for labor.\(^{311}\)

2. Are Union Workers Productive Enough to Offset Their Higher Wages?

This naturally leads to whether union workers compensate for their higher wages (wages above the marginal product level) through higher productivity.\(^{312}\) In part, this was the theme of Part III-B supra. If union workers are able to deliver the goods more efficiently than non-union workers, then the union wage premium might be justified.\(^{313}\) But the operative phrase in the last sentence is might be, since the proportions must fit. A union wage premium of 20 percent cannot be justified with reference to 5 percent greater productivity.\(^{314}\) The answer to this question is in part empirical and in part theoretical.\(^{315}\) The empirical portion of the inquiry, although often difficult to measure since some industries are fully unionized, shows that union workers generally do not offset their higher wages with proportional increases in productivity.\(^{316}\)

Although unions may have better morale and have negotiated more efficient work rules than those used by non-union workers, union

---


308. See id.
309. See FREEMAN & MEDOFF, supra note 53, at 162-68.
310. See POLACHEK & SIEBERT, supra note 42, at 131.
311. Although the union may prevent him from doing this.
312. See FREEMAN & MEDOFF, supra note 53, at 162-80.
314. See POLACHEK & SIEBERT, supra note 42, at 313. (discussing studies which find that the union wage premium is between 14 and 17 percent in the US).
315. See generally Allen supra note 313, at 94-99.
316. See, e.g., Barry T. Hirsch, Trucking Deregulation and Labor Earnings: Is the Union Premium a Compensating Differential?, 11 J. OF LAB. Econ. 279, 296-98 (1993) (finding that unionized truckers' wage premiums fell after non-union competition became common, but that union truckers still received a minor wage premium over non-union truckers, indicating a compensating differential for union driver quality or experience).
employees generally are not sufficiently productive to offset their higher wages. In fact, many unions do not even come close.317 Because of featherbedding, union pressure on firms to hire or keep unproductive workers, some union workers are on average less productive than comparable non-union workers.318 Indeed, if union workers were sufficiently more productive to offset their higher wage demands, one would not see higher prices for union goods.319

Since most unionized firms must raise prices, unions do not as a rule generally raise worker productivity sufficiently to match their wage increases. This suggests more generally that if union workers really were efficient enough to offset their higher labor costs, then there would be no need for pro-union labor laws.320 Unions would survive because they were efficient, competitive firms would seek to create labor unions where they did not exist, would “buy” other firms’ unions, or at minimum would be neutral toward unions.321

V.
DISARMING BOTH UNIONS AND MONOPSONISTS: AN OPTIMAL ANTITRUST-LABOR REGIME

Most drafters of 20th century labor law probably thought that unions did little more than redistribute income from capitalist owners to workers.322 If anything, they probably thought that their laws would make labor markets more efficient by decreasing the incidence of wildcat strikes and labor strife. But as this Article has shown, those old views are naïve and incorrect.323 Advances in the economics of rent-seeking behavior and in

317. Admittedly, the empirical evidence on this question is mixed and often poor (although on my reading, it comes out against unions). Most labor economists, like Mulvey, Polachek, Rees, Mincer, Friedman, Simons, and Siebert, have been skeptical that unions generally raise productivity enough to offset their higher wages; some, like Pencavel, Freeman, and Medoff, seem to believe the opposite. See, e.g., Henry Simons, Some Reflections on Syndicalism, 52 J. Pol. Econ. 1 (1944) (giving the neoclassical case against unions); Polachek & Siebert, supra note 42 at 320-21 (discussing empirical evidence which shows that unions almost never raise productivity); see also M.M. Kleiner, J.S. Leonard, & A.M. Pilarski, Do Industrial Relations Affect Plant Performance?: The Case of Commercial Aircraft Manufacturing, NBER Working Paper No. W7414 (Nov. 1999) (finding that unions sometimes obstruct firm attempts at raising worker efficiency). But see S.M. Black, & L.M. Lynch, What’s Driving the New Economy: The Benefits of Workplace Innovation, NBER Working Paper No. W7479 (Jan. 2000) (finding that worker “voice” [a reference to A.O. Hirschman’s famous book Exit, Voice, and Loyalty] more effectively raises productivity in unionized than non-unionized firms).

318. Note that featherbedding is unlawful under the NLRA. See Posner, supra note 141, at 1001.

319. See Hylton, supra note 270, at 500.

320. See id. at 471-72.

321. See Campbell, supra note 69, at 997.

322. See Epstein, supra note 2, at 1366-68.

323. Many of the costs imposed by unions have been understood for decades. See Albert Rees, The Effects of Unions on Resource Allocation, 6 J. L. & Econ. 69 (1963).
consumer surplus analysis—advances that make the modern analysis possible—did not occur until at least the 1950's and 1960's.\textsuperscript{324} Today, we understand that both unions and monopsonists impose many social costs, and that the current firm-union bargaining system is poorly designed and too often creates sub-optimal outcomes.

In order to avoid the present distortions, the labor laws should be written and read to ensure that workers get paid their adjusted marginal product, which is the efficient market wage. Labor laws should fight labor market monopsony in the same way as antitrust laws regulate product market monopoly. Understood from an economic perspective, monopsony and monopoly together form the back end and front end of the productive process.\textsuperscript{325} It makes no sense to treat labor buying markets differently from product-selling markets if distortions at both ends harm the productive process or workers and consumers.

Labor markets do not operate in the manner contemplated by early labor legislation.\textsuperscript{326} No law can correctly predict which labor market will suffer from monopsony any more than it can predict which product market will suffer from monopoly.\textsuperscript{327} A rational labor policy should therefore, at minimum, repeal those laws that permit unions to collectively bargain or to strike.\textsuperscript{328} A rational labor policy must also prevent firms from exercising unregulated labor market monopsony power to pay wages below the efficiency level. Both are critical and both must be enacted in tandem.

Existing antitrust law prohibits input buyers from horizontally fixing input prices. The Supreme Court's decision in \textit{Mandeville Island Farms v. American Crystal Sugar Company} prohibits competing firms from conspiring to set the price at which each firm will buy inputs.\textsuperscript{329} In that case, a group of California sugar refiners agreed to fix the price at which

\begin{footnotes}
\item{324.} See Friedman, \textit{supra} note 207, at 285 (discussing consumer surplus loss from monopoly).
\item{325.} Campbell et al lean toward this conclusion. See Campbell, \textit{supra} note 69, at 1063-64.
\item{326.} See \textit{supra} notes 29-30.
\item{327.} Experience has shown this to be true even with natural monopoly markets (e.g., local telecommunications), some of which have been made competitive through regulatory ingenuity and technological change. This is discussed in David Gabel, \textit{Deregulation: Should the Local Telephone Market Be Next?}, 24 NEW ENG. L. REV. 39 (1989).
\item{328.} This holds aside constitutional problems.
\item{329.} 334 U.S. 219 (1948). There are several older cases in which the Supreme Court found that input buying power was unlawfully used to lower prices (or what is today called 'exercise of monopsony power'). See, e.g., Stafford v. Wallace, 258 U.S. 495, 514 (1922) (finding that input buying power of livestock packers was unlawfully used to "unduly and arbitrarily . . . lower prices" of input shippers); Swift and Co. v. United States, 196 U.S. 375 (1905) (holding unlawful the practice of livestock buyers to not bid against one another and hence to lower input buying prices). The Supreme Court has apparently only used the word 'monopsony' in three cases, though even in these it has never done an appropriate analysis of the term. See General Motors Corp. v. Tracy, 519 U.S. 278, 283 (1996); National Collegiate Athletic Association v. Board of Regent of Univ. of Okla., 468 U.S. 85, 93 (1984); In re. Permian Basin Area Rate Cases, 390 U.S. 747, 795 n.64 (1968).
\end{footnotes}
they would buy sugar beets from local producers. The Supreme Court held that it was *per se* unlawful for input buyers to use their combined monopsony power, or what is called oligopsony power, to fix input prices.\(^{330}\) Although the Supreme Court has never applied the *Mandeville Island Farms* precedent to a labor case, there is little question that employers conspiring to fix the price at which they buy labor inputs would be liable under that standard.

However, *Mandeville Island Farms* only stands for the proposition that it is unlawful for competing input buyers to conspire to lower an input price. At present, it is perfectly lawful for a single firm to use its labor market monopsony power, its 'natural monopsony power,' to underpay its workers. Labor monopsony power is not regulated or outlawed, except to the extent that the labor laws allow union labor cartels to fight such power.\(^{331}\) To be certain, there is no reason why existing monopolization doctrine could not be applied to firms attempting to *monopsonize*, that is trying to create or preserve labor market monopsony power. At present, however, a firm that merely has the good fortune to find itself in a position of labor market monopsony violates no law when it pays its workers below the competitive market level. This policy is clearly wrong.

One solution is to regulate natural monopsony in the same way as natural monopoly is regulated.\(^{332}\) Although labor markets differ in one critical respect from natural monopoly product markets in that workers are not “owned” by firms and can move, thus dissipating labor monopsony power, this objection is insufficient to defeat the comparison. Workers can certainly move their families to avoid labor market monopsony, but there is no necessary presumption that the costs of moving will be less than the costs of regulating monopsony. Moving to avoid monopsony is a second-best substitute for correcting monopsony distortions, for moving imposes real economic and non-economic costs upon affected workers.\(^{333}\)

The antitrust laws should therefore be amended to also prohibit the exercise of labor market monopsony power by firms. This should occur in

\(^{330}\) See 334 U.S. 219.

\(^{331}\) There may be some narrow exceptions, but these are insignificant to this discussion.

\(^{332}\) It is unclear whether this should involve rate-setting or merely antitrust regulation, the two traditional remedies. See generally Richard A. Posner, *Natural Monopoly and its Regulation*, 21 STAN. L. REV. 548 (1969). The author is skeptical of governments rate-setting the wages of natural monopsonists since experience has shown that governments often do so with little regard for efficiency concerns (preferring instead to set ‘fair’ prices, for instance in the regulation of local telephone utilities.) Put the third solution in the text? A third solution is to force monopsonists to return some of their rents to their workers by forcing them (perhaps at a discounted rate) to sell shares of stock in the monopsony firm to their workers. The effect would be to return the firms’ monopsony rents to the workers through dividends or higher stock prices. This strikes me as the most efficient method of regulating natural monopsony, though I leave the fuller analysis for another paper.

\(^{333}\) Something noted by many commentators, see, e.g., FREEMAN & MEDOFF, supra note 53; PENCANCEL supra note 198.
unison with a ban on union striking and collective bargaining.\textsuperscript{334} Cases of labor market monopsony should be dealt with in the same manner as monopoly cases are now dealt with. Both the government and private actors should be permitted to sue under this new doctrine.\textsuperscript{335} Alternatively, a commission might be created to arbitrate such claims. The premise behind such a doctrine is that determining whether a particular market is monopsonized is always a technical question and should be determined by experts, not through a socially costly power struggle between unions and employers.

None of this means that unions should necessarily be made unlawful. Unions should continue to play some of the mediating role between labor and management that they do today. Unions should be allowed to air workers’ grievances and to sue for enforcement under the new doctrine if they suspect that monopsony power is at work. They should not, however, be allowed to use their labor cartel power to bargain for higher wages, just as monopsonies should lose their legal right to underpay workers. The existence of active non-government litigants should ensure that labor market wage enforcement will not wax and wane depending upon the politics controlling the Department of Justice or Federal Trade Commission.

VI. CONCLUSION

It is clear that labor unions are cartels and as cartels, they impose some substantial deadweight losses upon the public.\textsuperscript{336} Unions are often quite effective in achieving their goals of increasing wages and maintaining employment for their workers. Yet it is difficult to defend labor unions on economic grounds. The deadweight costs associated with unions, such as lower overall output, costly rent-seeking, induced inefficiency among non-union rival firms, salting, etc., are all indefensible from an economic point of view. The costs of strikes, labor slowdowns, and labor strife are also significant and harmful.\textsuperscript{337} Labor unions’ wage demands often increase the prices of consumer goods while decreasing overall social output.\textsuperscript{338}

\textsuperscript{334}. This Article aside any discussion of the First Amendment problems caused by a ban on striking. I am not familiar enough with those issues to make an intelligent commentary on them.

\textsuperscript{335}. The elements of such a claim will be discussed in a future paper.

\textsuperscript{336}. Unfortunately it is difficult for states to create common law remedies for this problem, given the federal government’s broad preemption in labor matters. See Textile Workers Union v. Lincoln Mills, 353 U.S. 448, 457 (1957).

\textsuperscript{337}. For a model of union-firm bargaining, see Roberta Sestini, Union-Firm Bargaining as a Repeated Game and the Behaviour of Wages over the Business Cycle, 13 LABOUR: REV. OF LAB. ECON. & INDUS. REL. 821 (1999).

\textsuperscript{338}. See Campbell, supra note 70, at 997.
extent that unions harm consumers, many of whom are not better off than the union workers they are forced to subsidize, there may even be a strong moral case against unionism.

There is no reason to suppose that labor union members should enjoy an income transfer from consumers to themselves, since labor union members are, on the whole, probably not poorer and often are wealthier than many consumers. Since unions create deadweight social losses, the income transfer rationale is even less morally compelling. Most economists would agree that a monopoly is bad even if it is entirely owned in equal stock shares by 100,000 retired grandmothers. This is because income redistribution is unsupportable when it is so costly or wasteful. The case of unionism is not as stark and the analysis should be no different. Many other serious problems arise with respect to monopsony. Earlier, this Article discussed those distortive effects at length. Since the problem of unions is linked inextricably to the problem of firm monopsony, one can solve the labor market problems created by both only by disarming both unions and monopsonists.

This Article has analyzed the problems with the antitrust exemption for labor unions and found the current regime unsupportable. It has discussed the exemption's components and the problems the exemption tries to remedy. This Article has noted the reasons for treating many antitrust and labor problems similarly and criticized several current legal and economic approaches to labor unions and some efficiency defenses of labor unions. Finally, it has set out some ideas for what an optimal antitrust-labor regime should look like. This Article's argument is that labor unions should be prohibited under the antitrust laws from collectively bargaining and striking and that monopsonistic firms should be prohibited from exercising unregulated labor market monopsony power.

339. See POLACHEK & SIEBERT, supra note 42, at 131.
340. This is a policy preference, but one strongly held by most economists. See Campbell, supra note 69, at 996-97.