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World of Labor
Evidence-based policy making

Employment and wage effects of extending collective bargaining agreements

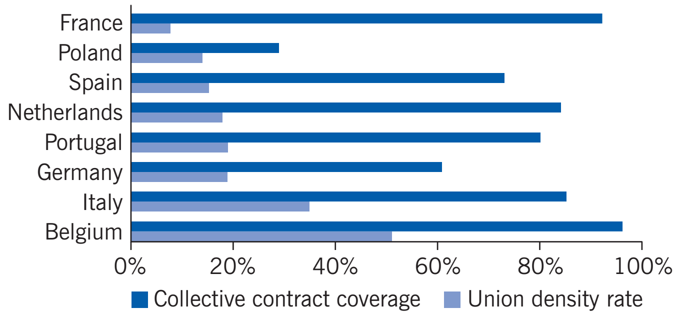
Extending provisions of collective contracts to all workers in an industry or region may lead to employment losses

Keywords: collective contracts, wage inequality, employment losses

ELEVATOR PITCH

In many countries, the minimum wages and working conditions set in collective bargaining contracts negotiated by a limited set of employers and unions are subsequently extended to all the employees in an industry. Those extensions ensure common working conditions within the industry, limit wage inequality, and reduce gender wage gaps. However, several studies suggest that those benefits come at the cost of reduced employment levels, especially during recessions. The income losses of workers who are displaced because of a collective contract extension can offset the wage gains among workers who keep their jobs.

Even countries with low unionization rates can have high worker coverage through collective contract extensions, 2010



Source: Based on Figure 1.

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KEY FINDINGS

Pros

- Extensions of collective contracts reduce wage inequality by setting occupation-specific minimum wages within an industry.
- Extensions reduce gender wage gaps, mainly at the bottom of the wage distribution.
- Extensions provide job stayers with insurance against transitory productivity fluctuations or economy-wide fluctuations associated with the business cycle.
- In the absence of full mobility across jobs, extensions avoid opportunistic cuts in job quality and wages.

Cons

- Sector-wide minimum wages increase labor costs to all covered firms, inhibiting employment growth.
- Extensions impose working conditions on employers and employees who did not participate in the bargaining process; not all countries require bargaining parties to be representative of the entire industry.
- Extensions reduce competition by deterring entry and small business creation.
- Extensions introduce wage rigidities that limit the ability of firms to adapt to economic shocks.

AUTHOR'S MAIN MESSAGE

The overall impact of extending a collective contract to all firms in an industry depends on how much employment is destroyed as a result of the contract's provisions concerning minimum wages and other working conditions. Assessing the benefits and costs of extensions requires comparing the increase in earnings among job stayers with the loss in earnings among job losers. New evidence suggests that earnings forgone due to extensions can offset wage gains among job stayers. Allowing firms to opt-out and requiring bargaining parties to represent a majority of employers and employees in the industry may reduce the costs of extensions.

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