Quadrant II - Notes

Paper Code : COS102

Module Name : Theories of Collective Bargaining- Hick's Analysis of Wage Setting

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The historical and analytical study of collective bargaining and of trade unions provided the earliest theories in academic industrial relations. As mentioned earlier, it was Sidney and Beatrice Webb who coined the term "collective bargaining" in 1891. The Webbs were an important influence on public policy formation with respect to trade unions and collective bargaining. They argued that collective bargaining is the essence of trade unionism" and regarded it as an economic process. Samuel Gompers, later enhanced the usage of the term in USA

Subsequently, Neil Chamberlain proposed three successive stages in the collective bargaining process. John T. Dunlop developed the system of industrial relations, and understood collective bargaining as a process of compromise and assessment of priorities within both union and management Allan Flanders viewed collective bargaining as a rule-making process. Over time, collective bargaining has evolved into a complex, multi-dimensional institution of industrial relations. A variety of collective bargaining theories have been offered by scholars to explain and predict negotiation process and

outcomes. Three major theories of collective bargaining are discussed in this chapter, in the order they were propounded:

1. Hicks' Analysis of Wages Setting Under Collective Bargaining (1932)
2. Conflict Choice Model of Negotiation (1958)

3. A Behavioural Theory of Labour Negotiation (1965)

HICKS' ANALYSIS OF WAGES SETTING

As part of his general theory of wages, John R. Hicks developed a theory of strike bargaining in his book titled "The Theory of Wages in 1932. Hicks provided a precise solution to the bargaining process. Given the strike costs for labour and management and their initial wage demands, the theory predicts a wage settlement.

Hicks attempts to answer the question: "To what extent can trade union pressure compel employers to pay higher wages (or to grant more favourable terms to their employees in other respect) than they would have done if no such pressure had been exercised?"

Hicks' answer for the question is that the "excess" wage is determined by cost of the strike, which is a function of length of the strike. Therefore the maximum concession that management is willing to make depends on its estimate of the expected length of a strike. This relationship between wage

concession and strike length is represented as "Employer's Concession Curve."

On the other hand, a strike is costly for the union as well. "Union's Resistance Curve" represents management's estimate of how long the union will resist before it concedes to a lower wage rate. The intersection of the two curves is the highest wage that the employer accepts in order to prevent a strike. At that solution point, the wage increase equals the cost of a strike.

Hicks' model is based on two important asymmetries. First, the firm knows the union's curve, while the union does not know firm's curve. Second, the wage rate is made exclusively by the union, while the firm never makes a counter-offer. Therefore, the employer is in a position to make a decision whether to accept or reject the offer based on the position of the wage offer on the curves.

Hicks employed the traditional economic assumption that the parties are rational decision-makers, and both have accurate information about the other side. He argued that a strike can occur because of miscalculations, unrealistic expectations, or political reasons.

The Hicksian Model

The Hicksian model is based on cost and benefit to the negotiating parties. Each party has two costs which determine their strategy. The employer calculates the cost **C1**, of a strike of duration t, and the cost **W1**, of agreeing to a wage of **w**. **C1** is the sum of lost profits and other costs associated with a strike, and **W1** is the cost over the duration of the wage contract of the wage w when compared to an ideal wage rate **wo**.

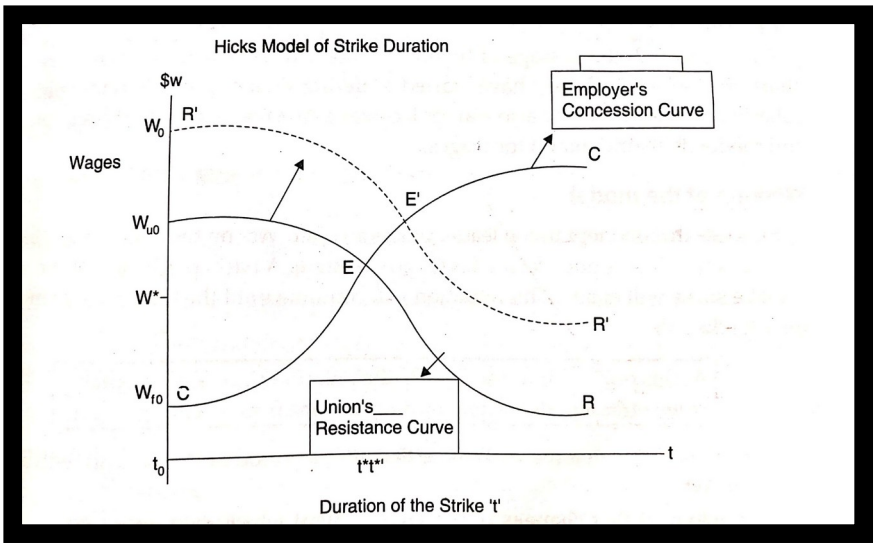
The wage rate is depicted on the vertical axis and the duration of the strike on the horizontal axis The curve **CC**, is the employer's concession curve, which is its offer at each point during the strike. At the start of the dispute, at time **t = 0**, the firm is willing to agree to only the low wage $\mathbf{w_{fo}}$. It might have plenty of unsold inventories that it can use to satisfy its customers) demands. Yet, when these inventories are exhausted, delays will occur and some of its customers may permanently switch to other suppliers. As this occurs, the costs of the strike gradually rise, the firm begins to soften its bargaining stance, and it raises its acceptable wage offer accordingly.

The schedule **RR** is the union's **resistance curve**. It depicts the lowest wage that is acceptable to the union. Initially, at time **t = 0**, the union may be rather aggressive in its wage demands, calling for the high wage $\mathbf{W_{uo}}$. However, as the strike progresses, the union slowly moderates its wage demands. One reason of course, is that, deprived of their earnings, individual union members begin to suffer financially, which lowers their esprit de corps and undermines the cohesion of the group

Another is that the union may fear that the firm will hire permanent replacement workers. This could not cnly jeopardize the existence of the union itself but also lead to the loss of everyone's job.

Suppose that a union leader places an offer $\mathbf{W_o}$ on the bargaining table and threatens a strike if it is not accepted. The basic prediction of the model is that a strike will ensue. Furthermore, it will continue until the **CC** schedule intersects the **RR** schedule. At this point the union's minimally acceptable wage offer equals the maximum wage the firm is willing to pay. As shown. this occurs at **point E,** indicating that the strike is settled after a period of t* days and with a wage agreement of w*.

HICK’S MODEL OF STRIKE DURATION



Source: Anand K.B., Paswan, A.K. (2017). Collective Bargaining and Negotiation Skills. Galgotia Publishing House

Shifts in Curves

The framework predicts that changes in the environment that shift either the **resistance curve, RR**, or the **concession curve, CC**, will affect both the wage agreement and the duration of the strike. For example, the payment of unemployment benefits to strikers reduces the costs to individual union members of the strike. As a result, the **RR schedule** shifts upward to **R ^{1} R^{1}** (dotted curve). In turn, the duration of the strike and the final wage offer increase (see **point E^{1}**). In contrast, any change that strengthens the hand of the employer shifts the CC curve down (not illustrated), leading to a lower wage and shorter strike duration.