

Backgroundunder

No. 2270
June 4, 2009



Published by The Heritage Foundation

RAISE Act Lifts Pay Cap on 8 Million American Workers

James Sherk and Ryan O'Donnell

Federal law caps the wages of over 8 million middle class workers. Union contracts set both a wage floor and a wage ceiling—unionized employers may not give productive workers pay raises outside the collectively bargained contract. Unions usually insist on seniority-based pay and rarely allow employers to reward hard-working individuals. No matter how hard most union members work, they cannot earn higher wages than specified by their contracts.

The RAISE (Rewarding Achievement and Incentivizing Successful Employees) Act, introduced by Senator David Vitter (R-LA) and Representative Tom McClintock (R-CA), would lift the “seniority ceiling” on workers’ wages by allowing employers to pay individual workers more—but not less—than the union contract specifies. By offering workers the opportunity to earn higher wages, the RAISE Act provides an incentive for increased productivity. Should Congress pass the RAISE Act, the typical union member could earn between \$2,600 and \$4,300 more a year. RAISE restores union members’ freedom to earn individual raises through their own efforts—a freedom that federal labor law currently denies. With many American families struggling to get ahead financially in the recession, Congress should lift the seniority ceiling on workers’ wages.

Unions Impose Pay Caps

In December 2007, the economy slid into a deep recession and, consequently, many American workers are having difficulty getting ahead. Concerns that government-imposed pay caps on executives at firms

Talking Points

- Unions cap the pay of their members. Employers may not pay productive workers more than a collective bargaining agreement allows without negotiating with the union.
- However, unions usually insist on seniority-based promotions that ignore individual effort.
- This “seniority ceiling” holds back productive union members. They cannot get ahead no matter how hard they work.
- The RAISE Act allows companies to pay individual workers more than the union-negotiated rates. This allows businesses to encourage productivity and hard work.
- With RAISE, workers would take advantage of the opportunity to prosper by becoming more productive. The typical union member would earn between \$2,600 and \$4,300 per year more if RAISE became law.
- RAISE restores individual workers’ freedom to contract freely for the highest possible wages without being held back by collective bargaining requirements. The law should not force exceptional employees to accept an average pay increase.

This paper, in its entirety, can be found at:
www.heritage.org/Research/Labor/bg2270.cfm

Produced by the Center for Data Analysis

Published by The Heritage Foundation
214 Massachusetts Avenue, NE
Washington, DC 20002-4999
(202) 546-4400 • heritage.org

Nothing written here is to be construed as necessarily reflecting the views of The Heritage Foundation or as an attempt to aid or hinder the passage of any bill before Congress.

receiving TARP financing would harm the economy created controversy, but these pay caps affected at most a few thousand employees. Far more destructive is the legislative pay cap on the earnings of over 8 million middle class workers.

Most Americans know that unions set a floor on workers' wages: An employer may not pay individual union members less than the amount bargained for by the union. Few Americans know that unions also set a ceiling on workers' wages: Businesses effectively may not pay individual workers more than the amount bargained for by the union.

Unions are exclusive bargaining representatives. They represent all the employees in a bargaining unit as a group and they negotiate a collective contract that applies to all workers. Employers may not pay hard-working individuals more than the contract allows without first negotiating such an increase with the union.

Individual Work Unrewarded

As a practical matter, union officials cannot assess the productivity of hundreds of workers at a company and negotiate appropriate individual merit raises. Unions also want their members to view the union—not their own hard work—as the source of any wage gains. Therefore, individual performance reviews are the exception in collective bargaining agreements (CBA). Most union contracts base pay on seniority systems and job classifications that apply to all workers.¹

As a result the individual efforts of union members go unrewarded: The diligent union member putting in an honest eight-hour day and the slacker putting in half that both receive the same seniority-based raise. No matter how productive an individual union member is or how hard he works he cannot

earn more than the amount specified by the CBA. Unions do not only raise wages—they also impose a “seniority ceiling” on productive workers' wages.

Paying Higher Wages Legally Barred

It is against the law for employers to pay productive individual workers more than provided for in the union contract without bargaining over it with the union. The National Labor Relations Board (NLRB) and the courts have repeatedly struck down attempts to raise wages above union levels. A merit raise or a bonus not negotiated with the union constitutes “direct dealing.” That violates sections 8(a)(1) and 8(a)(5) of the National Labor Relations Act which requires employers to collectively bargain with the union—not individual employees. Thus the National Labor Relations Board upheld the decision of an administrative law judge in *James Heavy Equipment Specialists* that struck down bonuses paid to individual workers:

[The owner] told the employees that he was instituting a bonus plan but did not give details of how the plan would be applied. Subsequently certain employees were paid bonuses. I find that the Respondent's announcement of the bonus program was direct dealing with the employees in violation of Section 8(a)(1) and (5) of the Act.²

In another case the NLRB struck down a \$10,000 bonus paid to a pair of workers who completed an urgent task on their own time.³ Many other NLRB decisions have similarly rejected individual pay increases.⁴

Implementing at Impasse

The NLRA requires an employer to bargain with the relevant union with respect to “wages, hours,

1. David Metcalf, Kirstine Hansen, and Andy Charlwood, “Unions and the Sword of Justice: Unions and Pay Systems, Pay Inequality, Pay Discrimination and Low Pay,” *National Institute Economic Review*, Vol. 176, No. 1 (2001), pp. 61–75; Richard B. Freeman, “Union Wage Practices and Wage Dispersion Within Establishments,” *Industrial and Labor Relations Review*, Vol. 36, No. 1 (October 1982), pp. 3–21; and Assar Lindbeck and Dennis Snower, “Centralized Bargaining and Reorganized Work: Are They Compatible?” *European Economic Review*, Vol. 45, No. 10 (December 2001), pp. 1851–1875(25).
2. *James Heavy Equipment Specialists, Inc. and International Union of Operating Engineers, Local No. 9*, 327 NLRB 910, 915 (1999).
3. *American Standard Companies, Inc.*, 352 NLRB No. 80 (2008).
4. *SPE Utility Contractors, LLC.*, 352 NLRB No. 97 (2008); *Register-Guard Co.*, 339 NLRB 353 (2003); *KSM Indus., Inc.*, 336 N.L.R.B. 133, 135 (2001); *Anderson Enters.*, 329 N.L.R.B. 760 (1999); and *McClatchy Newspapers, Inc., v. NLRB*, 131 F.3d 1026 (D.C.Cir.1997).

and other terms and conditions of employment”⁵—a requirement that covers situations where an employer wants to provide diligent, deserving employees with a merit-based raise.

Failure to negotiate with the union before unilaterally changing the system of compensation specified by the collective bargaining agreement is a clear, well-established violation of the NLRA.⁶ During such negotiations, unions will usually propose seniority systems that prohibit merit raises and impose pay caps on hard workers.

Yet, because this duty to bargain does not “compel either party to agree to a proposal or require the making of a concession,”⁷ such negotiations can reach an impasse. Once bargaining reaches an impasse an employer may—with some exceptions—unilaterally implement its final offer, thereby changing the current conditions of employment.

The necessity to bargain to impasse before giving any individual raises effectively prevents most employers from awarding merit-based wage increases. Bargaining to impasse and imposing a merit pay system is expensive and time consuming. Therefore, most employers do not insist on implementing a merit pay system during negotiations, particularly when such a proposal meets strong union resistance.

Yet, even if an employer is determined to raise hard-working employees’ wages by implementing its last offer upon reaching impasse, such employers must still contend with applicable NLRB restrictions.

As the D.C. Circuit Court of Appeals ruled in *McClatchy Newspapers, Inc.*, an employer cannot “unilaterally implement a final offer...if the implemented provision gives the employer unlimited discretion, thereby affecting wages and hours...”⁸ When implementing a merit-based wage increase at impasse, employers must present a system with clear, non-discretionary standards for giving these raises.⁹

In some industries this requirement presents no difficulties because employers can easily observe workers’ productivity and provide the union with a detailed scale for merit-based wage increases. However, many industries have necessarily subjective measures of productivity. In hospitals, for example, supervisors would have difficulty setting a standard means of measuring how well individual nurses perceive patients’ needs. While a supervisor might recognize that a nurse deserves a raise, providing a standard detailed enough to satisfy the *McClatchy* doctrine may prove difficult in practice.

Even in instances where the employer is able to meet the *McClatchy* standard, strong barriers to implementing a merit-based wage increase at impasse persist: The cost of litigation usually far exceeds any productivity gains. It is far less expensive for an employer to forgo giving \$4,000 annual raises to motivate productive employees than to spend tens of thousands of dollars on legal fees defending its merit system in court. As a result, the law effectively prevents most unionized employers from rewarding individual employees’ hard work.

RAISE Act Lifts Wage Cap

Legislation before Congress eliminates this wage ceiling. The RAISE Act amends the National Labor Relations Act so that employers may pay individual workers more than specified by their respective CBA. The act changes the law so that a union’s status as the workers’ sole representative and the terms of a CBA do not prevent employers from paying individual workers higher wages.

Union contracts would still set the minimum that workers would earn, but workers could earn more through their own hard work. Employers could not selectively give raises to anti-union workers to undermine the union, however. Under the RAISE Act it would remain illegal to discriminate against workers on the basis of their union membership.

5. 29 United States Code §158(a),(d).

6. *NLRB v. Katz*, 369 U.S. 736, 745 (1962).

7. *Ibid.*, § 158(d).

8. *Mail Contractors of America v. NLRB*, 514 F.3d 27 (D.C. Cir. 2008).

9. See *Detroit Typographical Union No. 18 v. NLRB*, 216 F.3d 109 (D.C. Cir. 2000).

Workers Earn Raises Through Productivity

Many employers would pay higher wages to productive individual employees if the law permitted it. Workers respond to incentives: Unsurprisingly, employees who cannot earn more when they work harder put in less effort than those who are rewarded for high productivity. If employers were allowed to pay wages in excess of the seniority ceiling, enterprising employees would take the opportunity to get ahead and become more productive. Productivity, profits, and pay would rise.

Lifting the seniority ceiling will help both workers and the economy. Economic research shows that the average worker's earnings rise by 6 to 10 percent when the pay is performance-based.¹⁰ This is an average figure—industrious and enterprising workers earn larger raises while lazy employees earn less. The average worker, however, takes advantage of the opportunities presented by performance pay and works harder to prosper.

Improving the Economy

Economic research also shows that union members work just as hard to earn raises as non-union workers when unions permit performance-based pay.¹¹ Some 8.6 million workers are covered by collective bargaining agreements regulated by the National Labor Relations Act.¹² If

Congress passed the RAISE Act to amend the NLRA, many unionized employers would offer performance pay to inspire hard work. The workers at these companies would earn between \$2,600 and \$4,300 per year more than if Congress left the union wage ceiling in place.¹³

These higher earnings would provide the right type of stimulus to get the economy moving. Workers would earn more money by creating wealth through their own hard work, adding tens of billions of dollars to the economy. Their greater productivity would also improve business earnings. Instead of fighting over how to redistribute wealth, the RAISE Act encourages employers and employees to work together to create more wealth and spark economic renewal.

This is the type of policy that President Obama called for when criticizing the executive bonuses paid by AIG: “We believe in the free market, we believe in capitalism, we believe in people getting rich, but we believe in people getting rich based on performance and what they add in terms of value and the products and services that they create.”¹⁴ The RAISE Act enables enterprising workers to be rewarded for their own hard work.

Restoring the Freedom to Earn a Raise

The RAISE Act would restore workers' right to contract for higher wages. Labor law unilaterally

10. Alison L. Booth and Jeff Frank, “Earnings, Productivity, and Performance-Related Pay,” *Journal of Labor Economics*, Vol. 17, No. 3 (July 1999), pp. 447–63; Edward Lazear, “Performance Pay and Productivity,” *American Economic Review*, Vol. 90, No. 5 (December 2000), pp. 1346–1361; Tuomas Pekkarinen and Chris Riddell, “Performance Pay and Earnings: Evidence from Personnel Records,” *Industrial and Labor Relations Review*, Vol. 61, No. 3 (April 2008), pp. 297–319; Adam Copeland and Cyril Monnet, “The Welfare Effects of Incentive Schemes,” *Review of Economic Studies*, Vol. 76, No. 1 (2009), pp. 93–113, 01; Daniel Parent, “Methods of Pay and Earnings: A Longitudinal Analysis,” *Industrial and Labor Relations Review*, Vol. 53, No. 1 (October 1999), pp. 71–86.

11. Charles Brown, “Wage Levels and Methods of Pay,” *The Rand Journal of Economics*, Vol. 23, No. 3 (1992), pp. 366–375.

12. Heritage Foundation calculations based on data from Barry T. Hirsch and David A. Macpherson, “Union Membership and Coverage Database from the Current Population Survey,” Unionstats.com, at <http://www.unionstats.com> (May 4, 2009). The NLRA covers private sector employers outside the agricultural, railroad, and airline industries. This figure includes both union members and nonmembers covered by collective bargaining agreements.

13. Heritage Foundation calculations based on data from the Department of Labor's Bureau of Labor Statistics on the median earnings of private-sector workers covered by collective bargaining agreements in 2008 and assuming a 6 to 10 percent rise in median annual earnings due to merit raises.

14. President Barack Obama, “Obama's Remarks About A.I.G.,” remarks to reporters on the South Lawn, March 18, 2009, at <http://www.nytimes.com/2009/03/18/us/politics/18text-obama.html?pagewanted=all> (May 5, 2009).

cedes workers' *individual* contractual bargaining rights to the *collective* entity of the labor union. What is good for all is presumed to be good for each individual. Congress intended this provision to enable unions to collectively negotiate for higher wages. However this presumption in the law trumps the individual worker's unique qualities—qualities that may make him more valuable, and therefore more worthy of enhanced remuneration, than others in the union collective.

The RAISE Act redresses this governmentally-sanctioned intrusion into the individual worker's right to contract freely for the highest possible compensation package that the market will bear. The law should not hold hard-working employees back to the same raise that slacking employees get. The American Dream means working hard to get ahead, but federal labor forbids union members from doing this. Congress should not prevent workers and employers from contracting for higher wages.

Conclusion

Current law places a ceiling on the wages of over 8 million middle class workers. Union contracts dictate not only the minimum, but the maximum, that employers may pay their workers. The RAISE Act lifts this seniority ceiling, thereby allowing employers to encourage productivity and give workers the opportunity to prosper through their own efforts. Many unionized companies would offer merit pay raises if the RAISE Act passed. The earnings of the typical union member at these companies would rise between \$2,600 and \$4,300 per year. This restores workers' freedom to contract for higher wages and these higher earnings would create wealth and help get the economy moving again. Congress should lift the pay cap on union members.

—James Sherk is Bradley Fellow in Labor Policy in the Center for Data Analysis and Ryan O'Donnell, a former private-sector labor attorney, is a Web Editor at The Heritage Foundation.