

# BACKGROUND

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## RAISE Act Lifts Pay Cap on Millions of American Workers

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### Abstract

*Federal law allows unions to impose wage restrictions on nearly 8 million American middle-class workers. Union contracts set both a wage floor and a wage ceiling—barring unionized employers from offering pay raises as reward for exceptional work without negotiating with the union. No matter how hard most union members work, they cannot earn higher wages than specified by their contracts. The RAISE Act would lift the “seniority ceiling” on workers’ wages by allowing employers to pay individual workers more than the union contract specifies. Many unionized companies would offer merit raises if the RAISE Act were passed. Restoring workers’ freedom to contract for higher wages, and the higher earnings themselves, would create wealth and supply a much-needed boost to the economy. Congress should lift the pay cap on union members now.*

This paper, in its entirety, can be found at <http://report.heritage.org/bg2702>

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Federal law caps the wages of 7.6 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 employees on an individual basis. 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 this year by Senator Marco Rubio (R-FL) and Representative Todd Rokita (R-IN), 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 average union member’s salary could rise between \$2,700 and \$4,500 a year. The RAISE Act would restore union members’ freedom to earn individual merit-based raises—a freedom that federal labor law currently denies. With

### TALKING POINTS

- Unions cap the pay of their members—employers may not pay workers more than a collective bargaining agreement allows without negotiating with the union. Unions generally 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 could take advantage of the opportunity to prosper by becoming more productive. The typical union member would earn between \$2,700 and \$4,500 per year more if RAISE became law.
- RAISE restores individual workers’ freedom to contract for the highest possible wages without being restrained by collective-bargaining requirements. The law should not limit exceptional employees to average pay increases.

many American families struggling financially in the aftermath of 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 since then many American workers have struggled financially. While government-imposed pay caps for executives at firms that received funds from the Troubled Asset Relief Program (TARP) caused concern that the pay caps would harm the economy, these caps affected, at most, a few thousand employees. Far more destructive is the pay cap that the National Labor Relations Act (NLRA) places on almost 8 million middle-class workers.

Most Americans know that unions set a floor for 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 for workers' wages: Businesses may also not pay individual workers more than the amount for which their union bargained.

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

### Individual Work Unrewarded

As a mere practical matter, union officials do not have the ability to assess the productivity of, and negotiate appropriate individual merit raises for, hundreds of workers at a given company. Unions also want their members to view the union—not their individual accomplishments—as the source of any wage gains. Unions prefer, in the words of Teamster's President Jimmy Hoffa, "to create uniform standards for all employees."<sup>1</sup> Therefore, individual performance reviews are the exception in collective bargaining agreements (CBA). While some union contracts permit employers to pay individual workers higher wages, most base pay on seniority systems and job classifications that apply to all workers.<sup>2</sup> Table 1 shows the proportion of workers in several manufacturing sectors whose pay is at least partly based on their individual performance.

Union members are much less likely to be paid for individual performance than are non-union workers. About half of non-union employees work in jobs with some performance pay. Only about 20 percent of union employees do.<sup>3</sup>

As a result, the individual efforts of most union members go unrewarded: The worker who slacks off receives the same seniority-based raise as the stellar employee. 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 impose a "seniority ceiling" on wages.

### Paying Higher Wages Legally Barred

The NLRA requires an employer to bargain with the relevant union over "wages, hours, and other terms and conditions of employment"<sup>4</sup>—a requirement that covers situations where an employer wants to give diligent, deserving employees merit-based raises.

It is against the law for employers to pay individual workers more than stated in the union contract without bargaining with the union. The 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" and a "unilateral" change to working conditions. These violate sections 8(a)(1) and 8(a)(5) of the National Labor Relations Act, which requires employers to collectively bargain with the union—not with individual employees. Thus the NLRB has repeatedly struck down pay increases that have not been approved by union negotiators:

- The Brooklyn Hospital Center wanted to improve its services. As part of that initiative, the hospital wanted to recognize and reward its best nurses. The hospital directed supervisors to identify

1. Letter from James P. Hoffa, President, International Brotherhood of Teamsters, to the United States Senate, June 7, 2012, <http://capwiz.com/ibt/utr/1/NCXQRUZBOI/LJUBRUZBRN/8381113621> (accessed June 14, 2012).

2. 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.

3. Thomas Lemieux, W. Bentley MacLeod, and Daniel Parent, "Performance Pay and Wage Inequality," *The Quarterly Journal of Economics*, Vol. 124, No.1 (2009), pp. 1-49, figure IV(b), <http://blogs.law.harvard.edu/corpgov/files/2008/11/Imp-qje1.pdf> (accessed June 11, 2012).

4. 29 USC §158(a), (d).

TABLE 1

**Percentage of Workers with Performance-Based Pay (Partly or Entirely)**

Manufacturing Sector	Union	Nonunion	Difference
Paints and Varnishes	19	81	62
Textile Dyeing and Finishing	8	31	23
Cotton, Manmade Fiber Textiles	6	9	3
Wool Textiles	9	17	8
Industrial Chemicals	10	52	42
Wood Household Furniture	38	79	41
Miscellaneous Plastic Products	26	82	56
Fabricated Structural Steel	29	71	42
Nonferrous Foundries	23	68	45

**Source:** Heritage Foundation calculations using data from Richard Freeman, "Union Wage Practices and Wage Dispersion within Establishments," *Industrial and Labor Relations Review*, Vol. 36, No. 1 (October 1982), figure 4, pp. 3-21. Performance-based compensation is the percentage of workers whose pay is based on an individual determination, a merit review, or merit review combined with automatic progression (a seniority system).

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the best 10 percent of their nurses. The hospital held a reward breakfast for these nurses and gave them each a \$100 gift card. Since the union had not approved these bonuses, the NLRB ordered the hospital to stop rewarding these nurses.<sup>5</sup>

- The Register Guard Publishing Company wanted to promote a new advertising contract. The company decided to reward employees who sold ads for that contract with a commission in

addition to their usual pay. The NLRB ordered the company to stop paying the commission.<sup>6</sup>

- After Hurricane Katrina hit the Gulf Coast, the Coastal Cargo Company—a firm that helped unload cargo ships in New Orleans—faced a labor shortage. Demand for labor, and thus wages, had increased, and several employees had threatened to quit and work for competitors. Negotiations with the union had bogged down, so the company

unilaterally raised wages from \$13.25 to \$14.50 an hour. The NLRB struck down this raise.<sup>7</sup>

Even when the union contract allows individual pay increases, the National Labor Relations Act does not permit companies to implement general performance raises that apply to multiple employees without the express permission of the union. In the 1967 landmark case *NLRB v. C. & C. Plywood Corp.*, the Supreme Court addressed this topic directly.<sup>8</sup> The case dealt with a manufacturer who had just reached an agreement with its union to pay workers between \$16.20 and \$17.00 an hour (in 2012 dollars). The contract expressly allowed the employer to reward good performance by paying individual employees higher wages. The company announced that if the unit met higher production goals, the company would pay every employee \$18.50 an hour.<sup>9</sup> The union sued, contending that an individual bonus clause did not allow the company to pay every employee higher wages. The Supreme Court agreed. The court found that the NLRA requires companies to bargain before giving company-wide wage increases, even if the increases reward performance and even if the contract allows higher individual pay. Companies may not give performance pay to all employees without union permission.

5. The Brooklyn Hospital Center and New York State Nurses Association, NLRB Division of Judges, Case No. 29-CA-29323, May 27, 2009, <http://mynlrb.nlr.gov/link/document.aspx/09031d458029b9d0> (accessed June 13, 2012).  
 6. *In re Guard Publishing Co.*, 339 NLRB No. 47, June 20, 2003.  
 7. Coastal Cargo Company, Inc. and International Brotherhood of Teamsters, Local Union No. 270, 353 NLRB No. 86, January 30, 2009. Note: The 5th Circuit Court of Appeals vacated this case because the NLRB lacked the minimum three members at the time it issued the decision. The NLRB subsequently reissued its decision in August 2010 after establishing a quorum.  
 8. *NLRB v. C. & C. Plywood Corp.*, 385 U.S. 421 (1967).  
 9. The employer agreed to pay between \$2.19 and \$2.29 an hour in 1964, with a raise of up to \$2.50 an hour if the production targets were met. Inflation adjusted using the consumer price index for urban consumers (CPI-U).

## Implementation at Impasse Difficult

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.<sup>10</sup> 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,”<sup>11</sup> such negotiations can reach an impasse. Once bargaining reaches an impasse an employer will generally implement his final offer unilaterally, 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 raises. 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 NLRB restrictions.

Employers may not unilaterally implement a final offer that gives it unlimited discretion over pay, even if it wants to raise wages. As the D.C. Circuit Court of Appeals has ruled in *McClatchy Newspapers Inc. v. NLRB* and other cases, when implementing a merit-based raise at impasse, employers must present a system with clear, nondiscretionary standards for giving these raises.<sup>12</sup>

In some industries, this requirement presents no difficulties, and employers can easily observe workers’ productivity and provide the union with a detailed scale for merit-based wage increases. Many industries, however, 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 that is detailed enough to satisfy the *McClatchy* doctrine may prove impossible 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 it is to spend tens of thousands

of dollars on legal fees defending the company’s merit system in court. As a result, the law effectively prevents most unionized employers from rewarding individual employees’ work.

## Out of Step with the Modern Economy

The inability of CBAs to reflect individual effort is out of step with the modern economy. A one-size-fits-all approach was workable when all employees brought essentially the same skills to the bargaining table; individual skills and effort do little to distinguish workers on the assembly line. But the nature of work is changing. Employers are automating many rote repetitive tasks. The fastest-growing jobs are those that require individual skills: professional specialties (engineering, computer science, and nursing), executive and managerial jobs (such as in marketing and human resource management), as well as technical and sales jobs.<sup>13</sup>

At the same time, employers are also flattening the job hierarchy. The line between management and workers is blurring. Employers increasingly expect workers to exercise independent judgment and take initiative on the job.<sup>14</sup> The unique skills of individual financial planners, web developers, or medical specialists do not lend themselves to general representation. Employers want to reward—and employees want to be

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

11. *Ibid.*, § 158(d).

12. *Detroit Typographical Union No. 18 v. NLRB*, 216 F.3d 109 (D.C. Cir. 2000), and *McClatchy Newspapers, Inc., v. NLRB*, 131 F.3d 1026 (D.C. Cir. 1997).

13. James Sherk, “A Good Job Is Not So Hard to Find,” Heritage Foundation Center for Data Analysis Report No. 08-04, June 17, 2008, <http://www.heritage.org/research/Labor/cda08-04.cfm>.

14. Lindbeck and Snower, “Centralized Bargaining and Reorganized Work: Are They Compatible?”

rewarded for—individual contributions that no collective contract can reflect. Private-sector union membership has fallen sharply because workers’ demand for union representation has decreased.<sup>15</sup> America’s outdated labor laws, which ignore individual effort, do not appeal to workers in the modern economy.

### **RAISE Act Lifts Wage Cap**

Legislation currently before Congress eliminates this wage ceiling. The RAISE Act amends the National Labor Relations Act so that employers may pay individual workers more for their work 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 would not be able to 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.<sup>16</sup>

**Workers Earn Raises Through Productivity.** Many employers would pay higher wages to productive individual employees if the law permitted it. Employees respond to incentives: Unsurprisingly, employees who cannot earn more when they work harder make less of an 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 be rewarded for becoming more productive. Productivity, profits, and pay would rise.

Lifting the seniority ceiling will help workers and the economy. Economic research shows that the average worker’s earnings rise by 6 percent to 10 percent when the pay is performance based.<sup>17</sup> This is an average figure—industrious and enterprising workers earn larger raises while less diligent employees benefit less. The average worker, however, does take advantage of the opportunities presented by performance pay, and works harder in order 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.<sup>18</sup> Some 7.6 million workers are covered by collective bargaining agreements regulated by the National Labor Relations Act. Table 2 shows the breakdown of workers under the NLRA by industry and sex.

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 \$2,700 and \$4,500 per year more than if Congress left the union wage ceiling in place.<sup>19</sup> That would enable 2.8 million women and 4.8 million men to earn higher wages through their individual effort.

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 Barack Obama called for when criticizing the executive

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15. Henry S. Farber and Alan B. Krueger, “Union Membership in the United States: The Decline Continues,” NBER *Working Paper* No. 4216, 1992.
  16. The RAISE Act states that Section 8(a)(1) and 8(a)(5) of the National Labor Relations Act may not prevent employers from paying an employee higher wages for his services as an employee. This permits employers to negotiate directly with an employee to give him an individual raise. It does not relax the 8(a)(3) proscription on discriminating against workers who support unions. Neither would it permit employers to pay higher wages for other discriminatory reasons—such as sexism or nepotism—unrelated to employee work.
  17. Alison L. Booth and Jeff Frank, “Earnings, Productivity, and Performance-Related Pay,” *Journal of Labor Economics*, Vol. 17, No. 3 (July 1999), pp. 447–463; 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; and Daniel Parent, “Methods of Pay and Earnings: A Longitudinal Analysis,” *Industrial and Labor Relations Review*, Vol. 53, No. 1 (October 1999), pp. 71–86.
  18. Charles Brown, “Wage Levels and Methods of Pay,” *The Rand Journal of Economics*, Vol. 23, No. 3 (1992), pp. 366–375.
  19. 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 2011, and assuming a 6 percent to 10 percent rise in median earnings due to merit raises.

TABLE 2

## Workers Covered by Collective Bargaining Agreements Regulated by the NLRA

Industry	Women	Men	Total
Mining	1,000	60,000	61,000
Construction	24,000	905,000	929,000
Manufacturing	286,000	1,235,000	1,521,000
Wholesale and Retail Trade	392,000	570,000	962,000
Transportation and Utilities	119,000	682,000	801,000
Information	83,000	214,000	297,000
Financial Activities	81,000	84,000	165,000
Professional and Business Services	98,000	224,000	322,000
Education and Healthcare	1,493,000	489,000	1,982,000
Leisure and Hospitality	163,000	181,000	344,000
Other Services	81,000	127,000	208,000
<b>Total</b>	<b>2,820,000</b>	<b>4,772,000</b>	<b>7,592,000</b>

**Note:** Figures have been rounded.

**Source:** Heritage Foundation calculations using data from the U.S. Census Bureau, 2011 Current Population Survey. Figures show the number of private-sector workers covered by a collective bargaining agreement, excluding workers in the agriculture, railway, and airline industries, and the self-employed. These workers are not covered by the National Labor Relations Act.

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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.”<sup>20</sup> 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 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 sustain. The law should not limit hard-working employees to the same raises that less productive employees receive. The American dream means working hard to get ahead, and current federal labor law forbids union members from doing so. Congress should not prevent individual workers and employers from contracting for higher wages.

### Conclusion

Current law places a ceiling on the wages of nearly 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. Restoring workers’ freedom to contract for higher wages, and these higher earnings themselves, would create wealth and supply a much-needed boost to the economy. Congress should lift the pay cap on union members.

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20. News release, “Remarks by the President upon Departure,” The White House, March 18, 2009, <http://www.whitehouse.gov/the-press-office/remarks-president-upon-departure> (accessed June 11, 2012).