6 What's Wrong with the Employee Free Choice Act?

Richard A. Epstein

The first one hundred days of the Obama administration have been marked by its determination to pass the revolutionary Employee Free Choice Act (EFCA), which was introduced in Congress on March 10, 2009. As of this writing, it looks as though the bill will not pass this year, given the unanimous Republican opposition to it in the Senate. But the issue is likely to be revived again during the Obama presidency, as it has been before, so it is important to examine its provisions because it raises important issues of principle. In addition, it has gathered an impressive level of political and intellectual support. In particular, the EFCA has received the endorsement of the Democratic National Convention Platform Committee of prominent economists, under the aegis of the Economic Policy Institute, and of President Obama and Vice President Biden. In a recent congressional hearing before the 110th Congress on February 8, the EFCA was defended as the means to return to the management-labor balance under the National Labor Relations Act of 1935 (the NLRA, in its original form is commonly referred to as the Wagner Act), said to be the surest way to revive the fortunes of a shrinking middle class.

The reality, however, is otherwise. The EFCA would hamper the efficiency of labor markets in ways that make the road to economic recovery far steeper than necessary. Generally, it will severely hurt the very persons whom it intends to help. Dire consequences of this sort do not occur by happenstance. They are driven by a misconceived vision that strengthening union monopolies will improve the overall operation of labor markets. But monopolies are as socially unwise in labor markets as they are everywhere else. Shrinking the size of the social pie hurts many in the short run and benefits no one in the long run. Wages and productivity are inextricably linked in the economy as a whole. The central mission of sound labor policy is to grow the economic pie to create greater opportunities for all. Employers should not be demonized; workers should not be canonized. We want firms and workers to make the best deals for themselves by playing within the rules of the game. The key task of labor policy is to determine how to best structure those rules.

Accordingly, part I of this chapter outlines the proper role for freedom of contract in organizing labor markets. Part II compares this vision with the modern collective bargaining regime under the NLRA as it is currently organized. Part III explains the overall decline in labor unions over the past fifty years. Part IV explores how the key provisions of the EFCA will further deteriorate our overall economic conditions, followed by a brief conclusion.

How Labor Markets Work

Labor contracts are governed by the same principles applicable to all exchange relationships. Any voluntary exchange (i.e., one not tainted with force or fraud) generates social improvement. First, the exchange produces mutual gain between the parties. Self-interested people make deals only when they value what they receive more than what they surrender and find their trading partners by voluntary choice, not by government decree. A strong legal system enforces each deal in accordance with its express provisions. Judges do not impose their own visions of a just contractual order on the parties, who are free to adopt whatever business arrangements they see fit. Keeping transaction costs low allows for the rapid deployment and redeployment of labor. Savvy contracting parties use the outputs from one agreement as inputs for the next. Over time, sophisticated parties build up complex supply and distribution chains, which bring more goods to market at lower prices.

These myriad developments also benefit outsiders by expanding their business opportunities. One vital exception, however, does not, properly speaking, involve an exchange of goods or service at all, but rather concerns "horizontal" agreements between individuals or firms on the *same* side of the market to restrict output and raise prices. These cartel-like arrangements, of course, reduce overall social welfare by cutting back output and raising prices. Their externalities are systematically *negative*.

Critics of labor markets claim that these arrangements aren't truly competitive because employers and employees don't routinely dicker over contract terms. They view take-it-or-leave-it offers as signs of private coercion. Unfortunately, this common claim ignores the insight that efficient markets increase the number of transactions completed relative to the transaction costs of completing them. Any dickering between two neighbors over the backyard fence is a sign of a "thin" market with only a few participants, slowing down deal creation. In contrast, "thick" markets, with lots of buyers and sellers, employers and employees, operate more quickly and quietly. Knowledgeable actors on both sides of the market gravitate quickly to a competitive price or wage that less-knowledgeable participants then use as guides for their own dealings. Speedy negotiations are a sign of active competition, not decrepit markets. With time, unregulated markets incorporate technological improvements, which in turn lead to a rise in real wages, a decline in child labor, a reduction in working hours, and an increase in life expectancy—largely without government intervention. This was the outcome during the relative open market policies of the first third of the twentieth century.

The Current Labor Law Synthesis

The rejection of competitive markets shaped the New Deal legislation of the 1930s. The progression from competition to state monopoly proceeded as follows. In 1914, section Six of the Clayton Act exempts voluntary agreements among workers from the operation of the antitrust laws:

> The labor of a human being is not a commodity or article of commerce. Nothing contained in the antitrust laws shall be construed to forbid the existence and operation of labor, agricultural, or horticultural organizations, instituted for the purposes of mutual help, and not having capital stock or conducted for profit, or to forbid or restrain individual members of such organizations from lawfully carrying out the legitimate objects thereof; nor shall such organizations, or the members thereof, be held or construed to be illegal combinations or conspiracies in restraint of trade, under the antitrust laws.

But, in and of itself, that statutory advantage could not guarantee the widespread penetration of labor unions into American industries. Employers could still reach out to third persons and refuse to bargain with any union.

The 1935 version of the NLRA plugged both these chinks in the union's armor. First, it allowed workers to decide by majority vote in secret-ballot elections whether or not to appoint a union representative as their exclusive bargaining agent. The act contemplated an extensive and vigorous democratic campaign that let all interested parties have their say before the vote was taken. Once the union prevailed by majority vote, however, it gained the exclusive statutory right to bargain for all workers. Employers were prohibited from having any direct contact with individual workers as long as the union was in place, and the collective bargaining agreement displaced all preexisting contracts.

Second, the NLRA has always required the parties to bargain in good faith with an eye to making an agreement; refusals to negotiate were branded unfair labor practices (ULPs). The statutory good-faith standard was meant to block the employer from stonewalling the union after its certification. But the meaning of good faith remains elusive more than seventy years after the passage of the statute. Good faith does not require either side to make concessions; good faith does not refer to honesty in business dealings. Rather, its key components are that the employer must disclose key information to enable the union to better formulate its demands and must not make offers directly to workers that undercut the role of the union as the designated bargaining agent.

The economic case made for the NLRA also rests on false premises. The first is that unequal bargaining positions between labor and employers preclude "actual liberty of contract," according to the NLRA statement of findings. But inequality of bargaining power is a phrase devoid of descriptive content. Any employer who possessed that advantage would drive its hapless workers, regardless of skill levels, down to the minimum wage. That doesn't happen because workers can sell their services to other firms that will bid wages up to a competitive level. The relative revenues or net worth of firms and workers do not set the equilibrium wage. The number of choices available to employers or employees does.

The NLRA is also defended on the ground that higher union wages increase the purchasing power of workers in ways that jump-start the overall economy—the precise argument that the Obama team uses to support the EFCA. But it does not work. The workers who receive higher wages do have greater purchasing power, but nonunion workers who are pushed aside have less purchasing power. Additionally, higher prices for consumer goods diminish purchasing power, even for union members. In short, overall social welfare is not improved by moving further away from a competitive equilibrium.

Most critically, in practice the effects of the NLRA are uniformly counterproductive. Its novel institutional arrangements invert the relationship between transaction costs and completed transactions. Its monopoly bargaining regime creates a wide range of possible outcomes for any negotiation, not only on wages but on all other mandatory terms of negotiation: pensions, benefits, grievances, promotions, and the like. Each party has an incentive to hold out for a large fraction of the gap between the competitive and the monopoly wage. Management and labor gird for titanic battles that may end in employer lockouts or worker strikes, both of which disrupt key relationships with customers and suppliers. Permanent replacements, even though available in some instances under current law, offer an imperfect mitigation device.

In the short run, this complex administrative structure can at times produce gains for some unionized workers. But, on a sustained basis, the NLRA's confrontational approach is incapable of developing a thriving middle class, as is commonly claimed by labor supporters. In fact, it is just as likely to take small employers out of the middle class as it is to push poorer workers into it. The current legal regime entrenches two key sources of social loss: monopolistic structures coupled with high administrative, compliance, and bargaining costs. Neither can we overlook the personal casualties under the NLRA. Currently, millions of individuals have lost their jobs because unions overplayed their hands in collective bargaining negotiations; the shuttered GM factories offer mute testimony to the risks of aggressive bargaining strategies.

The Decline of Unionization

Much of the push for the EFCA is a result of the decline in union membership over the years, notwithstanding the extraordinary protections that labor unions receive under the NLRA. For its first two decades, the NLRA generated a steep increase in unionization levels; the next half century, however, saw a slow and steady decline of private unions. From a peak of about 35 percent of workers in unions in1955, today unions only represent about 8 percent.

Why this decline? Union leaders adamantly insist that the current rules are stacked against their organization efforts, including bitter employer opposition to unionization efforts. Those campaigns are, however, a result of the complex NLRA bargaining framework, which substitutes divisive politics for unanimous agreement by firms and workers. To obtain the critical votes needed under a regime of majority rule, both sides work overtime to attract members to their side. Which side has the advantage under current rules is uncertain. Today, the NLRA allows employers to make statements that predict the economic dislocations that will ensue if the union prevails; it also bans both threats of retaliation and promises of benefits to workers who steer clear of union membership. But it does not prevent employers, at their own expense, from holding mandatory sessions to explain their views. The union, on the other hand, faces no such constraints on either promises or threats and can approach workers in unsupervised settings. The union can also decide when to launch its campaign and when to ask for an election. It is not uncommon for unions to delay an election to turn up the pressure with pickets and publicity campaigns, as was seen in the case between the Service Employees International Union (SEIU) and the MGM Grand Hotel (which may now file for bankruptcy). The SEIU's prolonged campaign relied on pickets and other public relations tools to organize the Las Vegas hotel. By refusing to ask for an immediate election, the union was able to force the management to accept a card-check determination, allowing it to gain recognition by getting cards from just over 52 percent of the unit members. And it actively sought so-called neutrality agreements that require the employer to stand silently aside while the union gathers cards that generate union recognition without a secret-ballot election.

However one weighs the pros and cons, the point is that these election rules have undergone no substantial changes during the past fifty years. Similarly, union claims of an increased rate of employer ULPs rest on shaky empirical data. The current number of employer ULP charges filed does not reflect any increase, given that these charges are often dismissed or abandoned, and more reliable evidence suggests fewer ULPs filed by employer. Today, most organization campaigns tend to be fought to a draw, with unions and employers having about equal fortunes in NLRB-supervised elections.

Thus, the explanation for union decline must lie elsewhere. One possibility is the increased sophistication of employers' defensive strategies, but these are matched by equally greater sophistication on the union side. In fact, the factors appear to be clearly structural. The assembly line of 1940 has given way to more-complex organizational arrangements in which workers assume more-specialized roles. No single union message can appeal to all workers; educated workers, for example, realize that the union cannot negotiate an overall agreement that will accurately reflect their diverse positions. Higher job turnover also makes it hard to persuade workers who may change jobs tomorrow to form a union today. In addition, in many manufacturing and service industries, the reduction of trade barriers reduces the monopoly rents that firms can extract in a given product market, which also makes it more difficult for unions to extract wage premiums in highly competitive markets. Finally, much of the decline in union membership is attributable not to sputtering organizational drives but to mass attrition in key industries, such as automobiles and steel, where declining market share has led to mass layoffs, in part because manifest wage rigidity in labor contracts prevents the needed downward adjustment in wages and benefits. Bilateral renegotiation, however, is both too little and too late.

The Employee Free Choice Act

The flawed economic analysis of the pro-union advocates undermines their case for the EFCA. Reduced output cannot jump-start production or propel more workers into the middle class; vague appeals to "balance" cannot remove the dysfunctional features of mandatory collective bargaining. Even an efficient monopolist reduces labor supply and increases costs, resulting in social losses. A recent study by Anne Layne-Farrar of LECG quantifies the relationship between increased union penetration into the workforce and increased levels of unemployment. Her study estimates that every 1.0 percent increase in unionization rates leads to a 0.30 to 0.35 percent increase in the level of unemployment. Union leaders boast that they can increase union membership in the private sector by more than one million a year. A 5 percent increase in union membership in a workforce of 150 million people, therefore, cashes out, over a five-year period, to a loss of about two and a quarter million jobs.

Indeed, the situation is even worse. Labor unions are inefficient monopolists that must insist on Byzantine work rules to share the wealth among union members so as to maintain their critical level of worker support. In looking out for their members (and for their leadership), unions have every incentive to ignore the opportunities for advancement lost by nonunion workers. The picture is not rosy. The EFCA's three key provisions, still very much on the table, give still more reason for pessimism:

1. *Extra Sanctions for Employers' Organizational Activities*. The first, and most modest, change in the EFCA toughens sanctions against employers that the National Labor Relations Board (NLRB) finds have committed ULPs during union organizational drives. Back-pay awards are trebled, and employers can be subject to fines of up to $20,000 per violation (the scope of such violations is left undefined). But multiple violations are likely in prolonged and bitter campaigns. In addition, investigating the ULPs takes priority over all other NLRB activities, with no corresponding priority for dealing with union ULPs or increases in penalties for unions. That provision makes it more costly for employers to mount a defense to a unionization campaign, which in turn emboldens union

organizational behavior. In the end, this provision will most likely modestly increase union membership and the consequent social dislocations.

2. *The Card Check*. The ECFA's first major innovation authorizes the use of a card check as a substitute for secret-ballot elections. Although some union supporters note that the secret-ballot election is still "available" under the new statute, that is only a play on words. The relevant statutory provision, in the proposed *Employee Free Choice Act of 2009*, reads in full:

> [W]henever a petition shall have been filed by an employee or group of employees or any individual or labor organization acting in their behalf alleging that a majority of employees in a unit appropriate for the purposes of collective bargaining wish to be represented by an individual or labor organization for such purposes, the Board shall investigate the petition.

Essentially, then, it takes only one employee, represented by any union, to initiate the card-check process. The secret-ballot option, however, remains available only when the union wants it, which is basically never.

This provision quoted above transforms the process of unionization. The current rules let unions use cards signed by 30 percent of the workers to trigger a secret-ballot election. In practice, most unions only move forward if they collect signed cards from a clear majority of workers, knowing that some workers sign cards to fend off pressure and others change their minds after they hear both sides. The secret-ballot election, then, allows all workers to voice their preferences without being under the watchful eye of *either* side.

The EFCA removes the secret-ballot buffer that now stands between the union and the worker by allowing unions to collect cards *in secret* so as to get a leg up in the card-check derby before either the employer or the dissident workers can respond. In some small businesses, employers may not learn of the campaign until the union has been certified by the NLRB. The cards need not be notarized to be valid nor must the union return the cards to any worker who requests them. Challenges to the signed cards are allowed on only the narrowest of grounds (forgery) but not on grounds of union coercion or misrepresentation. Indeed, every Republican proposal to limit union discretion in running card checks was uniformly rejected by Democrats in committee during the 110th Congress.

This loaded procedure is not just a departure from the ordinary rules of voluntary agreement but also a stunning repudiation of the central premise of the NLRA: that a democratic process should decide whether or not a union will represent workers. The EFCA undermines the right of all workers to participate in a deliberative process concerning the decision of whether or not to accept a union. Imagine Congress enacting laws when half of its members had signed a bill but before there was any opportunity for debate! I believe that this truncation of the deliberative process violates constitutional guarantees associated with free speech and due process of law, as I wrote in an article entitled "The Ominous Employee Free Choice Act" (Regulation, spring 2009). In any event, these rules represent horrible policy. Unions have long supported the aptly named Worker Adjustment and Retraining Notification Act (WARN), which, roughly speaking, requires employers to give sixty days notice before closing any plant or facility with more than one hundred workers. If unions believe notice is justified here, why do they oppose a simple limitation that would make cards valid only if they are signed and notarized after a public announcement is made that the campaign has begun?

3. *Compulsory Interest Arbitration.* Arbitration has had a long and honorable place in helping resolve grievances that arise under preexisting collective bargaining agreements. But grievance arbitration only works because the NLRA requires the parties to bargain in good faith to reach an agreement. In its most radical provision,

however, the EFCA introduces a regime of mandatory interest arbitration that has never been used before in the private sector. Under the EFCA, an arbitration board would be charged with designing the basic contract from top to bottom, starting with a blank piece of paper. Although public unions often arbitrate under similar schemes, which are also imposed on local governments by state legislatures, the EFCA proposes extending this practice into the private sector. Compulsory interest arbitrations can help avoid strikes that might otherwise disrupt vital services. But as the years pass, these agreements will introduce a degree of structural rigidity that will make it impossible to reorganize any unionized activity. The longer the basic template remains in place, the less well it works. Unions can also use their political clout with legislators to increase pension obligations whose cumulative impact has led to large budgets deficits in such key states as California and New York.

Mandatory interest arbitration will work far worse under the EFCA, which offers zero guidance on how its ambitious arbitration system will operate. It does, however, set up an impossible timetable that requires negotiations to start within ten days of union recognition, even for employers who have received no prior notice. Next, it allows only ninety days for unaided negotiations to run their course; thereafter, a mediator has thirty days to help the parties reach an agreement before the case is designated for compulsory interest arbitration. Beyond this bare timetable, the EFCA offers no hint as to what adjustments should be made in the schedule if the process is derailed. If the mediator is not available on the ninety-first day, no one knows whether the thirty-day period is suspended or continues to run. And although the supposed timetables are strict up to the arbitral phase, the EFCA does not specify how long it will take to convene an arbitration panel, how that will be done, how long the panel will gather evidence, or when it will issue a so-called first contract, which then lasts two years. The original mandated arrangement could easily run hundreds of pages of text and appendixes addressing the full range of mandatory bargaining topics, which include wages, pensions, fringe benefits, absences, overtime, demotions, grievances, contracting out, and countless more. Neither is it clear whether that decree takes effect only when issued or whether it relates back to the time of union recognition or just to the start of arbitration. How businesses are supposed to fly blind in the transitional period is never explained.

More frighteningly, the EFCA gives neither the union nor the employer any say as of right in the choice of the members of the arbitration board. The entire provision reads:

> The [Federal Mediation and Conciliation] Service shall refer the dispute to an arbitration board established in accordance with such regulations as may be prescribed by the Service. The arbitration panel shall render a decision settling the dispute and such decision shall be binding upon the parties for a period of 2 years, unless amended during such period by written consent of the parties.

As a matter of principle, this provision of the EFCA wholly repudiates the central premise of the original NLRA as stated by the Senate Committee on Education and Labor:

> The committee wishes to dispel any possible false impression that this bill is designed to compel the making of agreements or to permit governmental supervision of their terms. It must be stressed that the duty to bargain collectively does not carry with it the duty to reach an agreement, because the essence of collective bargaining is that either party shall be free to decide whether proposals made to it are satisfactory.

The EFCA then goes on to implement its novel program in the worst possible way. The statute supplies no blueprint for the selection of arbitrators but entrusts that decision to a partisan political figure, the chair of the Federal Mediation and Conciliation Service

(FMCS), appointed by the secretary of labor. In the Obama administration, in that cabinet office is Hilda Solis, meaning that the appointed FMCS chair is certain to be sympathetic to the union side. Also, nothing prevents the FMCS from making all arbitrators full-time employees of the FMCS or limits the ability of the FMCS to designate its own list of arbitrators from whom the parties must choose. No substantive standards limit the discretion of the arbitration board, whose determinations could destroy the business model of many firms, impair their profitability, or force them to slash workforces or close divisions. And if these are forbidden under the initial arbitration decree, nothing can forestall the inevitable plunge into bankruptcy.

The burdens on the nascent arbitration system are extraordinary because large retailers and chains could face many simultaneous arbitrations. Yet nothing in the EFCA coordinates the decisions of the multiple arbitration boards that might have to deal with separate units within a large integrated firm. Indeed, one likely shortcut is that arbitration boards will take existing union contracts and impose them by decree on formerly nonunion businesses, which could help cartelize labor markets through government intervention. Furthermore, nothing in the EFCA ensures that these numerous decrees will not be riddled with inconsistencies and ambiguities that could take weeks or months to iron out. The EFCA also makes the arbitration decision "final," which precludes the possibility of any judicial appeal. Throughout it all, the represented workers have no collective say in the selection of the union or in the ratification of the supposed contract. The entire process reads like a partial nationalization of every firm subject to the EFCA's reach. And if today the EFCA governs for two years, a stroke of the congressional pen could extend it time and again—to give the scheme time to prove itself, of course. How this ill-conceived system of state coercion and expropriation is supposed to create jobs is a mystery. How this system could survive a constitutional challenge is every bit as mysterious when biased arbitration panels can force parties to enter into losing deals. If the government cannot force me to pay $250,000 for a house that is worth $100,000, how can it force me to hire labor for what I think is worth one hundred dollars an hour for only forty dollars? The NLRA lets an employer walk away from a losing deal; the EFCA forces the firm to eat its losses.

A Grim Conclusion

It is a sad sign of the temper of the times that so destructive a statute attracted so much political support before faltering. I do not wish to defend the current system from its critics (of whom I am one) who prefer a competitive employment market. Any process whereby unions are selected by majority vote comes out a distinct second to market institutions that operate under a principle of unanimous consent. It is therefore no surprise that no one is happy with the current configuration of the NLRA. But for all its manifest flaws, the current system is light years ahead of the EFCA. The central choice that faces any political system is whether it wants its productive processes to be organized by state coercion or voluntary association. State coercion is vulnerable to massive interference by public officials and outright capture by well-situated interest groups. Voluntary association allows parties to harness their private knowledge to improve their market positions through gains from trade. The current system lies midway between the two poles. The EFCA pushes the system decidedly to the authoritarian pole and, in so doing, mocks the principle of free choice that it claims to embrace. It denies choices to dissident workers when unions are formed and union contracts ratified. It puts employers, without their consent, under the thumb of government administrators. Beyond their posturing, the EFCA's advocates have offered no explanation of how the heavy hand of government can increase productivity or improve labor relations. Union bosses and government bureaucrats gain from this system. Everyone else loses.

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