

## SELECTIVE INCENTIVES AND TRADE UNION DENSITY

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**Abstract:** *Trade unions often emphasise their objective of protecting and representing workers' common interest. They provide not only a means of achieving common goals but many other services as well. It is a hallmark how are these large organizations able to fulfil this important mission. At present, however, there is a declining trend in trade union densities. We can ask why do workers think that the unions' performance has deteriorated? What is the difference between the past and the present? The key question of the theory is related to employees' willingness to join a large organization. If the most important trade union services are collective goods which are obtainable without costly membership, then why would a rational individual become a union member? The most widespread response among economists comes from the logic of collective action which is used, in general, as a starting point in studies for explaining trade union membership or density growth. According to this theory, there must be some form of pressure or positive incentives, i.e. union excludable incentive goods such as legal aid or strike pay, which can reward contributors and punish free-riders. This article would like to highlight the relevance of positive and negative selective incentives in connection with trade unions. Therefore, it conducts a survey of theoretical and empirical studies. The paper focuses on economic approaches, thus it devotes a relatively little attention to theories of social sciences, for example the social custom theory. Instead of this it emphasizes union security methods (e.g. obligatory union membership) and presents union-run, government subsidised unemployment insurance, the so-called Ghent-system in detail, because these seemed to be the most important factors which influence trade union density. More accurate identification of union security practices and data collection of pure private goods provided by the union would be needed to allow for analysing the effects of unions' selective incentives.*

**Keywords:** trade union density; union excludable incentive goods; closed shop; Ghent-system.

**JEL classification:** J51.

### 1. Introduction

Trade unions have a significant impact on the economy, therefore these organisations are important and interesting subjects of the economic analysis. Nowadays, the most striking observation regarding trade unions is the worldwide declining trends in union density. Many economists have attempted to explain the union membership or density growth over time.

Examination of the short and long term trends is not only the one at the centre of attention. In Estonia trade union density is less than 6%, while in Finland or in Sweden it is almost 70%. Thus, exploring the factors that cause differences across countries may also be important.

Institutional approaches can help to explain both the evolution of the trends and cross-country differences. The purpose of this paper is to survey empirical studies analysing European countries in order to provide an overview of the negative and positive selective incentives that can motivate the individual to join to a union.

Therefore, the structure of the paper is as follows. Section 2 reviews the related literature on institutional factors which can influence union density. Section 3 describes union services, while in Section 4 trade union trends and incentives are presented in the selected European countries. Section 5 concludes general remarks.

## **2. Literature review**

Various theoretical and empirical approaches to union membership and union density can be found in surveys (e.g. Riley, 1997; Schnabel, 2002) or at the beginning of empirical studies (see for example Ebbinghaus – Visser, 1999; Schnabel – Wagner, 2007; Fitzenberger – Kohn – Wang, 2006; Ebbinghaus – Göbel – Koos, 2011). As Schnabel (2002) remarks, theory and empirical research have developed together in this field and in many cases empirical findings have provided new perspectives and ideas for theorists.

There are economic and sociological theoretical approaches. The basis of economic thinking is the cost-benefit framework. In this rational-choice explanation an individual's union membership decision depends on membership fees (costs) and the collective and private goods provided (pecuniary and non-pecuniary benefits), as well as external factors like individuals' income and enthusiasm for unions. Individuals maximise their utility, and the equilibrium level of unionism is determined by demand for union representation and services and the supply of these benefits by trade unions (Schnabel, 2002). The main question of the theory is that if key benefits (such as higher wages or better working conditions) are public goods that are non-rival and non-excludable, then why would a rational individual join a union instead of being a free-rider? The starting point of economic thinking about overcoming the free rider problem is Olson's (1965) by-product theory. According to this theory, large organizations need to offer negative and positive selective incentives to mobilize the latent group, and lobbying activity is a by-product of this. Negative incentives include sanctions such as social pressure or a closed shop. Positive incentives should be available only for members: - these include union-provided club goods such as legal support or social insurance (Ebbinghaus – Göbel – Koos, 2011). According to Moreton (1999), union members enjoy greater job security via a reduced probability of dismissal, and this private good can be interpreted as a selective incentive. Some social scientists have emphasized the importance of union monopoly on the supply of excludable incentive goods because the attractiveness of a union declines as these goods become available at lower cost elsewhere (Neumann and Rissman, 1984; Booth

1985; Hechter, 2004). In addition to material incentives, Booth (1985) – following Akerlof (1980) – suggests an important factor is reputation derived from complying with social norms.

Supplementary explanations in social and political sciences discuss other factors (class consciousness, values and composition of the workforce) and theories, e.g. frustration-aggression, rational choice and interactionist theory (Wallerstein 1989; Klandermans, 1986). Ebbinghaus – Göbel – Koos (2011) incorporate the concept of social capital into their analysis.

In empirical research three approaches have emerged: cyclical, structural and institutional (Schnabel, 2002). The short and long-term development of the trade union movement is explained by analyses that connect union membership or density growth to the business cycle. These studies use aggregate time series. The main cyclical factors are price inflation, changes in the nominal wage, employment growth, unemployment rate or its change, lagged density, labour friendly politics and labour force composition. Microeconomic determinants of structural approaches such as gender, age (work experience), nationality, education, white or blue collar workers, earnings, etc. help to explain differences in unionisation by cross sectional methods. Institutional factors may also have a significant impact on the level of unionization. Several studies have pointed out that institutions matter (Ebbinghaus – Visser, 1999; Holmlund – Lundborg, 1999; Ebbinghaus – Göbel – Koos, 2011). Findings suggest that union-run unemployment insurance (Ghent system) or unions' access to the workplace provide an important contribution to understanding the trade union movement.

### **3. Trade union's services**

Usually, membership fees finance trade union activities and services. Sometimes state subsidies or application funds may provide the amounts needed.

Many studies draw attention to the fact that there are two groups of services provided by a trade union: collective and private goods. Typical collective goods which unions fight for are higher wages, equal pay, reduced working time, better working environment, etc. These are available for all employees. If the main services are non-excludable and non-rivalry collective goods then how can we explain their success in overcoming free-riding?

Inter alia, Ebbinghaus – Göbel – Koos (2011) refers to Olson's (1965) selective incentives. The most obvious advantage would be the wage premium of union members but it is not typical in the OECD countries (Goerke and Pannenberg, 2011). A typical trade union provides several services that are obtainable only for members: legal aid, cultural and sport services, discount shopping (e.g. member cards), subsidised holidays, training and education, insurance, grievance and promotion procedure, fringe benefits, salary advances, journals and strike pay. Do any of these selective incentives play a role or a more important role than others in interpreting the employees' willingness to join a trade union, and correspondingly in understanding union density growth?

#### 4. Trends in union density in selected European countries

Studies confirm declining European and worldwide trends in unionization (e.g. Carley, 2009; Blanchflower, 2007). So trade unions have less and less members compared to the potential members.

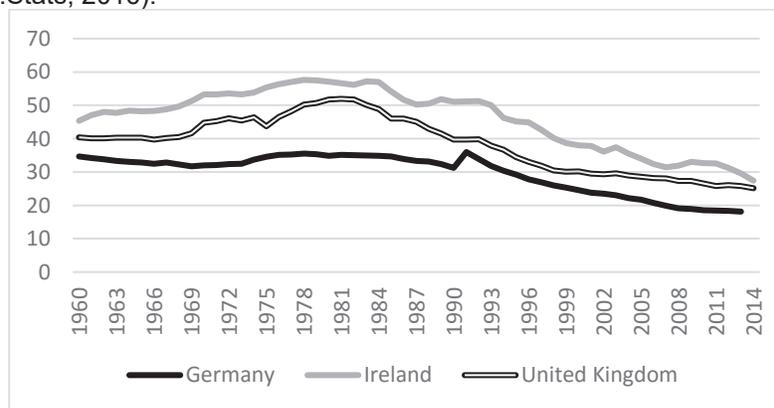
It appears to be obvious to identify a trade union member as ‘a member of a trade union’. However, databases can differ according to whether they consider pensioners and the unemployed. The International Labour Organisation does not calculate these two groups of people (Hayter – Stoevska, 2011: 2). The Organisation for Economic Co-operation and Development considers only active union members, with membership covering only wage and salary earners. On the basis of this definition, trade union density is the number of trade union members divided by the total number of wage and salary earners (OECD.Stat, 2016).

For analysing trends and presenting empirical findings in connection with the effects of selective incentives, we can distinguish two groups of countries according to their insurance systems: those with compulsory national insurance and those with state-subsidised voluntary unemployment insurance administered by trade unions (Dimick, 2012). The third group of countries involves post-socialist countries in which trade unions had transmission-belt function.

##### 4.1. Western Europe

Unemployment insurance has been controlled and administered by the state from the beginning in the United Kingdom (1911), Ireland (1923), Austria (1920), Germany (1927) and Italy (1919) (Dimick, 2012). This means that trade unions do not have unemployment insurance administered by them to attract and retain members.

Concerning trade union density trends in the United Kingdom and Ireland the continuous decline started around 1980, preceded by an increase. In Germany a slow decrease of union density was observed (from around 35% to 31.2%) at the beginning of the 1980s. After reunification in 1990 the participation rate grew back to 36% but since then union density has decreased constantly (it is now 17.7%) (OECD.Stats, 2016).



**Figure 1:** Trade union densities in selected Western European countries  
Source: Compiled by the author, according to OECD.Stat (2016)

Practices of enforced membership as negative selective incentives – e. g. closed-shop agreements – may positively affect trade union density by helping to overcome the free-rider problem.

Closed shop means that the precondition of employment is to be a member of a certain trade union. Actually, in Europe, closed shop practice was legal only in the United Kingdom till 1990 (IER, 2012) and in Ireland, where it operates even nowadays, however, it is less prevalence (ILO, 2016). The empirical evidence on the effect of compulsory membership is controversial. Ebbinghaus and Visser (1999) showed that closed shop practice in combination with union's workplace access was a necessary condition for a medium level of unionization but it could not stop decline. Blaschke (2002) found that in the United Kingdom closed shop exerted a positive influence on union density, while in Ireland it did not necessarily stimulate union growth. According to Bryson (2008: 6) there is a strong relationship between closed shop practice and high union density in the United Kingdom. Windolf and Haas (1989) analysed the workers' willingness to join a union in West Germany and found that there was a quasi-compulsory membership enforced by works councils. The employees were motivated to join because works councils had a great impact on promotion, requalification and redundancy programs. Thus, trade unions could attract and retain their members.

If there is no possibility for any forms of union security (for example the above mentioned one) and discriminatory wage policy, other incentives must be needed (Beck and Fitzenberger, 2004). Such incentives may include greater job security or legal aid. In general, empirical studies have not directly tested for the selective incentives. Moreover, investigations usually refer to a certain point of time. Beck and Fitzenberger (2004) and Fitzenberger et al. (2011) identified age and job satisfaction as determinants of the trade union membership. The age variable can show higher demand for job security, while low job satisfaction can indicate that legal aid and financial support provided by a union are more important services for a worker. According to the above mentioned two articles related to Germany, age had a concave impact on union membership decision with the maximum at about 50 years, while job satisfaction was negatively correlated with the joining propensity (Beck and Fitzenberger 2004) or had no considerable effect on willingness to join a union (Fitzenberger et al, 2011).

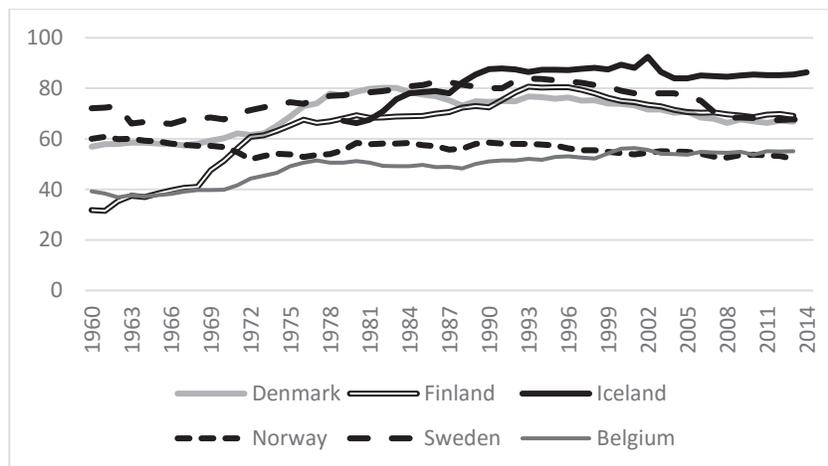
Booth and Chatterji (1995) examined directly the influence of excludable incentive goods and found that these selective incentives (grievance procedures, bargaining over physical conditions and redeployment, managers limited by formal union agreement) significantly and positively correlated with British manual workers' union density. In addition, Moreton (1999) used British establishment-level data and showed that higher union effectiveness (i.e. higher job security via the lower achieved dismissal rate) and pseudo closed shop (in which management strongly recommends union membership) could raise union density.

Following Akerlof (1980) and Booth (1985), testing social custom theory is quite widespread. Goerke and Pannenberg (2004) confirmed that the presence of social customs might hinder free-riding behaviour. They noted that comparing the effects of excludable incentive goods with the influence of social customs would have been a valuable part of the literature.

#### 4.2. Nordic countries and the Ghent-system

Nordic countries chose another way to solve the problem of unemployment.

These countries have the highest union density rates compared to other European countries. In Iceland trade union density was 67.2 percent in 1979, after which it started to grow rapidly and in the last ten years it has been about 84-85 percent. Sweden and Finland had the highest level of union density around 1994 (above 80%), then membership rates decreased continuously and nowadays densities are slightly below 70 percent in both countries. After its peak of 80.2% in 1982, the Danish level of union organization fell steadily, but since the late 2000s it has been approximately 67%. Norway's union density is moderately high and stable at around 53-55%. Belgium, with density of around 55% is not a Nordic country but it is the birthplace of the Ghent system that characterises four out of five Scandinavian countries. Figure 2 shows the union density rates in these countries.



**Figure 2:** Trade union densities in Nordic countries and Belgium  
Source: Compiled by the author, according to OECD.Stat (2016)

Voluntary unemployment insurance subsidised by the state and administered by a trade union is referred to as the Ghent system (Vandaele, 2006: 647). The origin of this system was the need to deal with unemployment in the 19th century. To solve this previously unknown problem Belgian unions established unemployment funds. Due to their evolving financial difficulties unions turned to the city council in Ghent. A communal unemployment fund subsidised by the Ghent municipal authority was set up in 1901 (Vandaele, 2006). Soon, similar institutions emerged in many European cities. Later on, provincial governments started to subsidize unemployment funds and the system became more centralized. The first countries to introduce the Ghent system at a national level were France (1905) and few a years later, Norway and Denmark. In the next 30 years the Netherlands (1916), Finland (1917), Belgium (1920), Switzerland (1924) and Sweden (1934) launched national voluntary unemployment schemes as well. Subsequently, the role of

governments in the control and administration of unemployment insurance provision increased, at the expense of unions. Finally, the Ghent system is operational in only a few countries today (Dimick, 2011). Although there are important differences in current systems with regard to rules of membership, eligibility for unemployment benefits, administration of the system, financing and the level of unemployment benefit, similarities also can be found.

Workers are free to decide about taking out an unemployment insurance policy, but membership of an unemployment insurance fund is required to obtain unemployment insurance. These funds are usually established and administered with considerable trade union involvement. In 'Ghent countries', trade unions and the unemployment insurance funds established by these unions are often interwoven because trade unions establish and control these funds in the same occupational area in which workers are organised. Furthermore, these organisations often use common buildings and offices, therefore workers cannot really think of them as separate entities, even though they pay separate membership fees for trade unions and unemployment funds. Municipalities provide lower and means-tested social benefits for those who have no membership of an unemployment fund and no entitlement to unemployment benefits (Lind, 2009).

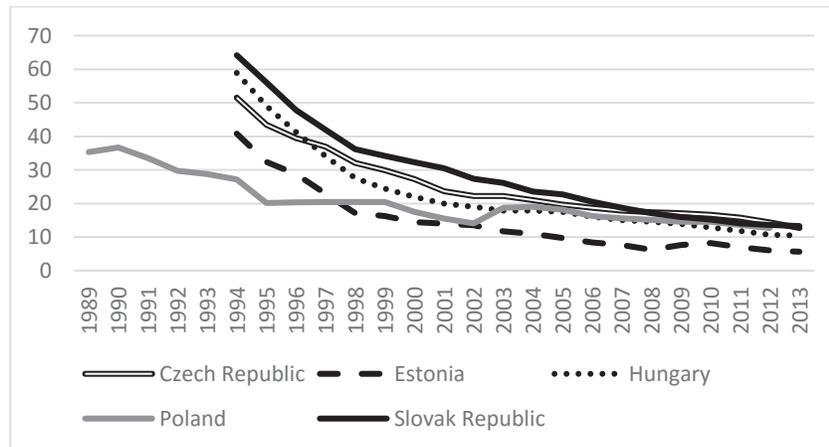
In addition, other articles emphasise that trade union membership is not a precondition for receiving earnings-related unemployment benefits via unemployment insurance funds (Scruggs, 2002; Böckerman – Uusitalo, 2006; Kjellberg, 2006; Lind, 2009) and that unemployment insurance funds are formally independent organisations. Nonetheless, there is a strong relationship between membership of a trade union and membership of an unemployment insurance fund. One reason for this is that the right to join an unemployment fund without union membership was not widely known (Kjellberg, 2006). Moreover, trade unions had the means to make it unprofitable to join unemployment funds directly. They have had the ability to reward union members and punish non-members through the discriminating allocation of benefits and the impact on individuals' prospects for re-employment (Scruggs, 2002).

Due to fundamental changes in the economic and political environment this connection has been weakened in recent years. However, it is still a substantial selective incentive that influences the decision to join or leave trade unions. At least – following Olson (1965) – several studies have identified union-run unemployment insurance – the Ghent system – as a selective incentive, some of them providing empirical evidence (e. g. Scruggs, 2002; Ebbinghaus – Visser, 1999; Ebbinghaus – Göbel – Koos, 2011). The selective benefits of being enrolled in a union-administered unemployment insurance system help overcome difficulties of collective action, namely the problem of free riding. Scruggs (2002) explains in detail how the Ghent system contributes to mobilize latent collective interests, i.e. how it operates as a selective incentive. He suggests three ways through which the Ghent system may work. The first is that a union-administered unemployment fund works largely on an actuarial basis. A trade union gains a surplus for providing collective benefits, and an individual can obtain benefits that are private because if there is no insurance then there is no unemployment benefit for them. The profit derived from the union's activity serves the collective goals of

the organisation. The second is that non-members pay higher prices for unemployment insurance, so the costs of union membership appear to be less. However, according to Scruggs (2002), the above mentioned mechanisms are not the most important ones. The main mechanism is the possibility of discriminating between members and non-members in the implementation of the insurance program. This does not occur by violating the general parameters of the rules of eligibility, but in the day-to-day operation of determining who is eligible for benefits and for more beneficial replacement jobs. This possibility creates a greater propensity for workers to join a union, in order to be in the 'insider job queue'. The declining tendencies in Nordic countries reported in studies are partly due to the weakening relationship between union membership and enrolling in unemployment insurance funds. The reason for this is that it has become very costly for employees to take part in both. The main contributing factor in Finland is the foundation of the independent unemployment insurance fund (YTK) in 1992. The situation in Sweden is similar, and the proportion of non-union members in unemployment funds is increasing. This process was furthered by the hollowing-out of the unemployment insurance with complementary insurance and unfavourable changes in the political environment. The same the case in Denmark where cross-industry unemployment funds have emerged and gained popularity. Certainly, there are many other factors that cause declining trends in various countries (risk of unemployment, composition of the workforce, younger workers' lower joining propensity, etc.).

#### 4.3. Post-socialist countries

Union density trends are quite similar and declining in the post-socialist countries. Now, the union membership rate is 13.3% in the Slovak Republic, 10.5% in Hungary, 12.7% in the Czech Republic, 5.65% in Estonia and 12.7% in Poland (Figure 3).



**Figure 3:** Trade union densities in post-socialist countries  
Source: Compiled by the author, according to OECD.Stat (2016)

Trade unions had similar structures and functions in the Central and Eastern European Countries under the influence of the Soviet Union. They were not for protection of workers' interest, but agents of the ruling party dealing with social matters, e.g. holidays or housing. Union membership was obligatory, but after 1989/1990, it has become a free choice (Kohl, 2008). The consequence is shown in Figure 3.

After collection of sufficient data it would be interesting to investigate the effects of negative and positive selective incentives in these countries.

## 5. Concluding Remarks

The effects of negative and positive selective incentives can probably be important mechanisms in investigating the trade union density trends. All empirical studies refer to Olson (1965) in the literature review part. Nonetheless, one can hardly find a study which examines the influence of other incentives than closed shop practice or the Ghent-system. A plausible explanation for this is that these are the most significant factors. In addition, there may be difficulties in collection and comparison of data or problems with the measurement of variables. As Goerke and Pannenberg (2004) suggest, it would be valuable to develop pure private goods model. Moreover, it may be worth considering union security methods. Perhaps, closed shops are mostly illegal, but certain forms of pressure can exist.

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