

The Economics of Organised Labour : With some reference to Hong Kong
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THE ECONOMICS OF ORGANISED LABOUR :
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I. INTRODUCTION

Organised labour can be analyzed from both an economic and a political perspective. The purpose of this paper is to present a nontechnical account of how neoclassical economic theory can shed light on this institution. It deals not only with economic issues, but also with political ones. Research on labour unions have been advancing very rapidly since the 1970s. Prior to which there were very few economic articles dealing with unionism in the major journals of the United States and the United Kingdom. The reemergence of interest in unions is significant, from the academic point of view, in that it achieves a synthesis of choice-theoretic microeconomic analysis, traditional institutional approaches, and the use of sophisticated econometric techniques. It is also noteworthy from a practical point of view in that this increased output of research has taken place when the number of organized workers is declining in the economy. Indeed further declines is considered likely in most advanced economies, although truly reliable estimates are not available at present.

The following section begins with some recent methodological developments in the study of social science to demonstrate the increasing acceptance of the economist's rational choice approach. This methodological convergence is taken as a useful step in focusing our future research on substantive empirical questions. Section III discusses union goals and union power. Although unions seek to improve the welfare of their members, the precise content of those goals is poorly understood. Economic and econometric analyses have not been able to identify a systematic and universal set of goals so far. However, considerable success have been obtained in identifying those factors which contribute to union power. These factors include those which operate mainly through market forces and those which work their way through the political system. These factors are then used to explain why strong unionism is not typical of many sectors of the private economy in Hong Kong.

The effects of union activity is examined in detail in section IV. Both the orthodox monopolistic view and the recently developed competitive view are presented. Evidence which bear upon the validity of each of these views are discussed. The relevance of these views for Hong Kong are briefly explored. The effect of unionism on wages and nonwage benefits in the union and nonunion sector and on economic efficiency, productivity, and profitability in the firm are analyzed with reference to empirical evidence.

Section V considers the political economy aspects of unionism. It discusses the conditions that allow rent-seeking coalitions and political entrepreneurs to succeed in securing organizational gain. The formation and maintenance of coalitions which compete in the political arena for economic benefits for its members and the consequences for public welfare is examined both theoretically and empirically. The final section summarizes the most important results.

Since this paper is only a partial survey that pulls together diverse materials it is not meant to be comprehensive. The choice as to what to include and what to leave out will inevitably be somewhat idiosyncratic. I hope that nothing of significance which bears upon unionism in Hong Kong has been omitted and that through examining these recent developments in the economic analysis of unionism will enhance our understanding of organized labour and the role of unions in Hong Kong.

II. ON METHODOLOGY

Eight years after publishing Sociologists, Economists, and Democracy, a slim volume which summarized the two major intellectual influences on the study of politics in the postwar period, Brian Barry (1970) wrote in the preface to the reprinted edition:

It is always risky to pronounce a verdict of death on ideas, even after an extended period of apparent lifelessness, but I predict that we have seen the last of the "sociologists" in political science The story of the "economic" approach is quite different. It has flourished quantitatively and qualitatively.

The growing influence of the economic approach is a result of a common phenomenon: the way in which methods and concepts are successful in one area tend to be applied in other areas in the hope that they will give results there, too. To most people the most noticeable feature of economics as a discipline is its subject matter: economists deal with the production, distribution, and consumption of goods and services, with money, and so on. But this is not the economic approach. Rather, it is a certain characteristic way of tackling problems that for a long time have been found especially among economists. When an economist wants to estimate what is likely to happen in a situation of a certain kind, his first step will often be to construct a model, which is a deliberate simplification of the kind of situation he wants to think about. He will postulate the existence of a number of individual actors, with certain ends, and will then try to work out deductively how they will act in a situation of a kind which presents certain alternatives to them, on the assumption that they pursue their goals rationally. It is this characteristic method of analysis that has led economists to believe that their discipline should be defined not in terms of subject matter, but as the logic of choice. Economics is more nearly a theory of rational behaviour than a theory of material goods.

The sociological approach is quite distinct. Taking Talcott Parsons as the representative figure, the entire approach considers society a quasi-organism and looks for mechanisms which maintain the system in spite of threats from the environment. The enormous influence such a holistic approach had on social science in the period following the Second World War and the reasons for its subsequent demise in the post-Vietnam War era are elucidated in Barry (1970).

Of even greater interest is the recent emergence among Marxist scholars of the view that social science needs a microfoundation. These scholars have proceeded to reconstruct Marx's entire corpus of work on precisely such a basis. I refer to the important works of Elster (1985, 1986), and others. The influence of the economic approach is clearly evident and is explicitly acknowledged. These authors reject functional explanation as a viable methodology in favour of intentional explanation. Intentional explanation cites the intended consequences of behaviour in order to account for it. Functional explanation cites the actual consequences.

Intentional explanations operate on two levels. First, there is the notion that individuals, acting for some goal of their own, bring about something that was not part of their intention. The unintended consequences of human actions is central to the making of modern social science (see Boudon 1982), for example, "private vices, public virtues" (Mandeville), "the invisible hand" (Adam Smith), "the ruse of reason" (Hegel), and "latent functions" (Merton). Modern economics have introduced the "Prisoner's Dilemma" and "Arrow's Impossibility Theorem". In this paper we shall explore at considerable length the intended and actual consequences of unionism.

Second, there is the causal analysis involving the determination of preferences and other mental states, such as beliefs, emotions etc. These in turn guide individual action. Economists have generally had very little to say about this since they typically take them as givens. Indeed Stigler and Becker (1977) argue that preferences should be taken as identical among individuals and stable overtime, appearances to the contrary notwithstanding. The variance in behaviour is to be explained exclusively by the variance in opportunities. Two developments have, however, allowed a more explicit treatment of preferences: the emergence of rational expectations as a major force in explaining economic processes (Lucas, 1981) and the recognition of ideology as a constraint on maximizing behaviour and as a device that economizes on the amount of information that people must have to make choices (North, 1981). These ideas open the way to endogenous preference formation, however, it is still at a very preliminary stage. It may seem odd that a paper on the economics of organized labour should begin with some methodological notes on the study of social science. My purpose is to give the reader an appreciation of the fact that at the methodological level there is significant convergence of ideas among various schools of thought and that the economic approach is not only well established in neoclassical economics but is being adopted as an important mode of analysis in political science and Marxist analysis. The recent ascendance of the rational choice approach and methodological individualism is particularly significant because it combines the study of economics with politics and bridges neoclassical and Marxist approaches. This holds out the promise that different schools of thought will be talking with and not at each other. In so doing it helps focus research on substantive empirical issues. This exciting development promises to further enrich our understanding of many issues, including that of organized labour.

III. UNION GOALS AND UNION POWER

An union is an association of workers whose fundamental goal is to improve the welfare of its members. The union pursues its objectives by acting as their exclusive agent in collective bargaining and via the political process. Unions attempt to affect both wages and nonwage benefits, for example, seniority systems, structured work rules and schedules, fringe benefits, and other aspects of the employment condition. Attempts to model union goals have not yielded any universally accepted model. There are broadly speaking two classes of models. The first type of model assumes that the union first sets the wage rate, and the firm then adjusts employment to the profit maximizing level on the demand curve. The compensation-employment outcome denotes a tangency point between the union's indifference curve and the labour demand schedule. Inference is then made about union objectives from the curvature of the indifference curve (see Pencavel 1984). Empirical analyses, however, have not established a commonly accepted set of union objectives. Neither the Dunlop (1944) wage bill maximization nor the Rosen (1970) rent maximization views have been substantiated empirically. In part, this is because detailed information is not available for most unions so that empirical work is restricted to a few well known cases which may not be typical or representative.

The second type of model is due to the recent works by Hall and Lilien (1979) and McDonald and Solow (1981), where it is argued that in general a wage-employment outcome on the demand curve is suboptimal for the two bargaining parties. Since both firm and union are not constrained to be on the demand curve, the model yields predictions that can differ significantly from those obtained from the on-the-demand-curve model. Nevertheless attempts to verify the model have not yielded conclusive results (see MaCurdy and Pencavel 1986). Since the off-the-demand-curve model is relatively new and is unlikely to be true of all or even most cases because moving off the demand curve requires competitive market forces to be nonbinding, our analysis will focus only on the on-the-demand-curve model.

To the extent that wage-employment outcomes occur on the demand curve then much of union behaviour can be understood as attempts to alter demand and supply conditions in a way that improves the wage-employment constraint faced by the union. Union policies are aimed to increase or maintain demand for union labour, to make labour demand in the union sector more inelastic, or to restrict factor supplies.

Variations in the extent of unionization across industries and occupations is in part associated with the level of skills, and is not unrelated to the elasticity of labour supply. In the short run, it is more difficult to replace highly skilled workers and it is therefore easier to unionize such workers. In the long run new workers can acquire such skills and the staying power of the unions depend on their ability to prevent employers from hiring the newcomers.

Historically, strong unions have largely been concentrated in the skilled occupations. The medieval guilds with long apprenticeship systems reflected successful restriction of the supply of skilled workers by institutionalizing effective control over the training process. In modern times many professions have sought to restrict entry through various licensing mechanisms and the control of institutions that train these professionals. This is of course true of

quite a few professions in Hong Kong and is evident in recurrent attempts to defend these restrictions where they already exist and to establish new ones where they are absent.

The tradeoff between compensation gains and employment losses are more favourable the more inelastic is the demand for union labour. According to the Marshall-Hicks rules of derived demand, demand for union labour will be more inelastic when (1) the share of labour costs in total production costs is small, so that the latter is not significantly raised when wages are bid up and the impact on employment is minimized, (2) labour is an essential factor of production in the sense that there are poor substitutes for it, (3) the supply of other factors of production are inelastic so that attempts to use other substitutable factors will significantly bid up costs, and (4) the demand for final product is inelastic so that increases in wages and, hence, of product prices will not reduce significantly the amount demanded of the product and, therefore, of the level of employment. These implications have been tested and substantiated in the study by Oswald (1982).

On the basis of such reasoning one would expect that workers in export oriented industries in small open economies, like Hong Kong, are seldom well organized, because as a small member of a large international trading community they face keen competition from others and so have highly elastic demand for their product. The fact that Hong Kong's manufacturing sector is both export oriented (rule 4) and labour intensive (rule 1) explains why its labour force has not had a strong union movement.

Other authors who have studied Hong Kong's labour movement, for example, England and Rear (1975) and Turner (1980), have identified numerous other reasons for the "underdevelopment" of industrial and labour relations. They may well be correct and is as informative as can be about numerous events and various institutional detail, however, the economic analysis developed here is more powerful and appealing because it is simple and does not have to evoke unique circumstances as explanatory factors, and it is consequently more general in application. Indeed one could predict that so long as the manufacturing sector in Hong Kong remains export oriented then union power in the manufacturing sector is unlikely to become significant. This is of course a falsifiable proposition which events in the future would either uphold or discredit.

Another application of this approach is to the growth of the public sector relative to the economy in many countries. The conventional wisdom is that because many forms of public service are both "essential" and monopolized, the demand for public employees is wage inelastic. This implies that market forces will not constrain the wage demands of public sector employees, which is in sharp contrast to the situation in the private sector.

A variety of union policies which aim at improving the welfare of union workers can be understood by examining their effect on product and labour demand. Union negotiated contract provisions, such as work rules specifying minimum labour inputs for given jobs or capital inputs, limitations on tasks performed by union workers, restrictions on substitution of nonunion for union labour, and effort level or output limits for workers, act either to increase demand for union labour or to decrease its elasticity by making substitution in production more difficult. Such

provisions are in general inefficient because the potential output obtained from given amounts of capital and labour is reduced.

Lobbying by unions can also be explained in terms of this framework. Organised labour have in general tended to support restrictions on many foreign imports, oppose limitations on exports, oppose the building of plants in foreign countries which substitute foreign for domestic labour, support strict restrictions on immigration, oppose relaxation of child labour and work-in-home laws, and strongly support high minimum wage laws while opposing a lower youth differential. Although all these policies tend to reduce society's total output, they benefit identifiable groups of union workers through their effects on the demand for union labour.

Of particular interest is the case of minimum wage laws. They tend to lead to a reduction in the amount of labour demanded, which creates an excess supply of workers and so allow employers to select from the job queue only the more skilled workers. As a result union workers tend to gain most from minimum wage laws, whereas unskilled and casual workers, like women, children, and discriminated minorities, tend to suffer most from such laws (see Linneman 1982). It has been argued that the introduction of minimum wage laws in a monopsonistic labour market is justified on social efficiency grounds because it increases wages to the workers and at the same time raise employment levels. The case is defensible, but unfortunately few markets are in fact monopsonistic and the purpose of minimum wage legislation is often aimed at a much broader coverage rather than targeting it at specific monopsonistic markets.

The simple economic ideas which have been introduced explains why organized labour has not been active in most of the sectors of the Hong Kong economy. Active unions are concentrated in the public sector. Specialized occupation groups have also been somewhat successful in advancing their interests, especially when they are facilitated by favourable protective legislation. These successes demonstrate that unionism is weak in Hong Kong because it has been constrained institutionally, ideologically, and by divisiveness as is often alleged. What is lacking is an economic environment conducive to such activity in the private industrial and commercial sectors. Instead a considerable amount of labour activism has been directed at getting legislative and governmental support for their causes, rather than at employers. This has been emphasized by Ng (1984) and can be easily understood in our framework. The politicization of organized labour, in the sense of participation in the political process rather than in the sense of ideological contests, and the interactions of organized labour groups with other interest groups in society is likely to be the most interesting feature of labour activism in Hong Kong and will be explored later.

IV. UNIONS AND THEIR EFFECTS

Union effects on the workplace can be broadly divided into the monopolistic view or the competitive view. Although these terms are not mutually exclusive, they characterize those aspects of unionism that, respectively, decrease or increase economic efficiency. In this section we shall explain these two views and present empirical evidence that test their implications. In particular, we examine the effects of unionism on economic efficiency, wages, firm productivity and profitability.

Monopoly unionism is the orthodox view firmly held by most economists. It believes that unions raise wage rates above competitive levels in the union sector through restricting the supply of labour, primarily but not only through the threat of strikes. The opportunity to raise wages assumes the presence of monopoly or Ricardian rents in the product market, or that unions are organized across most firms in an industry. If unions successfully increase the wage of workers in some but not most of the firms in a competitive industry, those firms are unlikely to survive if they continue to bear higher cost than their competitors. Unions therefore thrive in monopolistic settings created either through government regulation or through collusion among private agents. The colluders may include only firms or both firms and unions. In the latter case, emphasis is placed on the fact that keeping the firm profitable is in the interest of both labour and management. As a result unionism may be a means of capturing cartel profits for the industry. The key mechanism is the union's right to strike, which makes possible a reduction in industry output so that monopoly price and profits can be obtained.

In response to union induced wage increases, firms would substitute towards using more capital intensive methods of production. Furthermore union wage gains will create an excess supply of workers to covered jobs. Profit maximizing firms will select only the relatively more productive workers from this queue, thus leading to an upgrading of labour quality. The consequent inefficient factor mix and the misallocation of resources between union and nonunion sectors generates a net welfare loss for society. Standard estimates of these losses are, however, quite small ranging from .02 to .2 percent of gross national product (see DeFina 1983). Such calculations, however, ignore wasted resources due to unemployment and job queue effects. They also fail to take into account the negative effect of unions on profitability, investment, and growth (see subsequent discussion). Finally, they do not include the cost of resources spent in establishing and maintaining the union.

In addition, losses may also be incurred as a result of strikes, inefficient work rules, decreases in managerial discretion, and a standardized compensation structure that fails to provide optimal work incentives. Economy wide estimates of these effects are in general not available, with the exception of the study by Neumann and Reder (1984), where they found that strikes have a relatively small effect on loss of output. This is not surprising since struck firms can substitute production over time and for strike-free employers to increase their output and so offset some of the losses. In summary, although estimates of the impact of unions on welfare or output may be quite small for each effect, the sum total of these effects may be nonnegligible. Some of these losses are not merely static ones, but are also dynamic in the sense that they affect future growth and productivity.

Since unions exist to advance the welfare of members, their effect on relative wages have been most extensively studied by economists. The path breaking book by H. Gregg Lewis in 1963 and his more recent survey of the evidence in 1986 are clearly the most authoritative statements of the subject for the United States. The theoretical underpinnings of these and other studies can be briefly restated here. In the long run, competitive market forces make it unlikely for unions to markedly increase the wages of union members relative to otherwise similar nonunion members, unless there are persistent monopolistic elements in the market. To the extent that unions are successful, such wage increases will create an excess supply of workers to covered jobs. Firms will choose to hire only the more productive workers from the queue. Over time the union-nonunion wage differential between similar workers may be small. Most of the wage gain will accrue to inframarginal workers.

Nevertheless complete elimination of union-nonunion wage differentials at any point in time is unlikely because firms usually have substantial fixed costs and the replacement of union workers who usually have seniority provisions can be quite lengthy. Significant wage differentials can be maintained for a long time in industries where most firms have been unionized, especially in those that are publicly regulated, face little foreign competition, or have an inelastic product demand. In such situations the movement and selection of higher skilled workers into union jobs alone cannot mitigate the wage differentials.

Union effects on wages are not restricted to the union sector alone. The labour spillover, threat, and demand effects of unionism affects specifically the nonunion sector. The labour spillover effect shows up when a higher union wage pushes workers into the nonunion sector and depresses its equilibrium wage. If labour shifts from the union to the nonunion sector costlessly and completely, then there will be no unemployment. It will be rational, however, for some workers to queue for union jobs so long as it is profitable for them to wait. This accounts for the observation that the unemployment rate is often higher in the unionized sectors.

The presence of unionism can encourage firms to raise the wages and other nonwage benefits of nonunion labour to discourage unionism. Both firms and workers may prefer a nonunion environment with equivalent remuneration packages because it economizes on certain costs like union dues, strikes, and bargaining. Such threat effects are more likely to be credible in industries where unions are prevalent or most likely to organize and in potentially organizable jobs where similarly skilled workers in the same labour market are highly organized.

Demand effects are present when there is a shift away from more costly products made in the union sector to the relatively less costly products from the nonunion sector. So long as labour supply in the nonunion sector is not perfectly elastic, demand effects will tend to pull up wages in the nonunion sector. In principle, the effect of unionism on wages in the nonunion sector can be either positive or negative, most empirical estimates obtained suggest that the overall effect is positive (see Mellow 1983).

The point to be stressed is that although unionism can change the relative wages among workers of different skills types, the impact on the wage differential for workers of similar skill

type is small. That is, while unionism may significantly alter the structure of wages in an economy, yet in the long run have little observable effect on union- nonunion wage differentials. In other words, a distinction should be made between the observed "wage gap" between union and nonunion workers of similar skills and the hypothetical "wage gain" obtained in a regime under unionism as compared to one without unionism.

An extensive literature exists on measuring the union-nonunion "wage gap". The "wage gain" is, however, unmeasurable. Much of the evidence tell us that union wage effects are not uniform over time, across industries, occupations, age groups, race, and sex or with respect to other personal or job characteristics. Most economists tend to believe that an average differential of 10-15 percent is probably correct for the United States. A figure quite similar to that suggested by Lewis (1963) in his early study. This estimate is large enough to support the view that union effects are in fact substantial, yet not so large as to conflict with the view that, in the long run, competitive forces limit the extent to which similar workers can be paid differently. To the extent that Hong Kong is at least as competitive as the United States, if not more, it is highly unlikely that the discounted life time advantages of unionism to a worker can be more attractive than adding another quarter percent to the growth rate of the economy.

Competitive unionism is a relatively new alternative view developed by Richard Freeman and James Medoff (1979, 1984), using the exit-voice framework formulated by Hirschman (1970). They stress that union collective voice, combined with firm's response to unionism, helps to improve productivity and the functioning of internal labour markets. These positive aspects of unionism should be weighed against the monopoly effects stressed traditionally by economists.

Freeman and Medoff argue that the presence of firm-specific human capital makes layoff and quit behaviour more costly to both firms and workers. Firm-specific human capital is a concept introduced by Becker (1964) and describes those investments which enhances a worker's productivity only in the firm in which he is employed and not elsewhere. The cost of such investments are typically shared by both the firm and the worker as a hedge against quits or layoffs initiated by the other party. Once these investments are made both parties have an interest in maintaining regularity of employment. A long term relationship between the firm and its workforce will emerge and the terms of employment, embracing both remuneration and allocation aspects, are negotiated under conditions that are somewhat shielded from the external (or market) price mechanism.

All this is important because the characteristics of labour services are not only heterogeneous in nature about which information is scarce, but that labour also cares about how that unit of labour service is utilized. As workers have some control over their own activities and can affect the productivity of others, especially in team settings where there are high monitoring costs, their attitudes and morale may have significant efficiency implications. Freeman and Medoff argue that the productivity enhancing potential of unionism arise from the public goods nature of the workplace.

First, shared working conditions like the level of job safety can be provided more optimally through a collective voice mechanism than by exit and entry alone. This is because the entry and exit mechanism tend to emphasize the preferences of the marginal worker, whereas that of the average or median worker is better served by a collective voice mechanism, especially in circumstances involving significant public goods. Second, in the presence of strong input complementarities there may be spillover effects associated with work effort which generates considerable externalities in the workplace. These have to be internalized by resorting to internal labour market governance structures to which unions can make a positive contribution.

The public goods argument is valid to the extent that there are significant costs to using the exit and entry mechanism, for otherwise, the worker can select the employer whose working conditions most closely mirror his own. This is of course the famous Tiebout (1956) mechanism of local public goods provision, whereby workers sort themselves into homogeneous groups and locate themselves in different communities which provide different amounts or mixes of public goods. In addition, the workplace must also be subjected to continuous unforeseen shocks, for otherwise, there will be no need for a permanent union role to perform the demand revelation mechanism after the initial match. Given such conditions, collective organization provides a means of expressing discontent other than through quits, collective voice is said to reduce exit behaviour, lower hiring and training costs, and increase firm- specific investments. Union collective voice also serve as a mechanism for aggregating worker preferences in collective bargaining and allowing the firm to adopt more informed and efficient practices. It should be noted, however, that the prospect for raising firm productivity is potential and not guaranteed. Whether unions enhance or lower productivity is an empirical question.

Brown and Medoff (1978) estimated the productivity gain due to unionism to be around 20 percent for manufacturing industries in the United States and is similar in magnitude to the estimated union- nonunion wage differential. The finding is considered to be totally implausible and would imply both significant increases in profitability and substantial reductions of employment in unionized firms (see Clark 1984 and Wessels 1985). Both implications are contradicted by evidence. The production function studies of Gollop (1976) and Warren (1985) using economy wide and time series data have concluded that union labour is less productive than nonunion labour.

The effect of unions on profitability have been found to be uniformly negative. Freeman (1983), Karier (1985), and Salinger (1984) argued that unions primarily capture monopoly profits associated with industry concentration. In contrast, Hirsch and Connolly (1985) and Connolly, Hirsch, and Hirschey (1985) showed that unions capture rents associated with intangible capital investments in R&D. In the former view, monopoly rents are transferred to unions in a neutral fashion, while in the latter view, unions act as a distortionary tax that may impact negatively on long run growth. Evidence in Hirsch and Link (1984) and Maki (1983) of the negative effects of unionism on productivity growth over time tend to support the latter view.

At the more micro level the evidence is also mixed. Lower quit rates found in unionized firms support the collective voice view, but a 30 percent higher rate of absenteeism among union workers and a lower level of job satisfaction are much more difficult to reconcile. Clark (1980)

pointed out that union productivity effects appear to be restricted to the private sector and are largest where competitive pressures are most intense and where union-nonunion wage differentials are most pronounced. This suggests that the argument that unions raise productivity is more a result of shock or X-efficiency effects (see Leibenstein 1966). Union productivity gains appear to be generated by management responses to unionism not so much because of improved voice as in response to situations in the private sector where there are large wage gain increases, significant nonunion competition, and deteriorating profit expectations. In other words, management is pressured into exerting more effort in a worsened situation.

In summary, the evidence for the collective voice view is quite underwhelming. Its major contribution is to emphasize rightly that unionism does not necessarily detract from productivity, and this is an important finding in itself. Given the low labour mobility cost, high turnover rates, and small firm sizes in Hong Kong, the applicability of the collective voice approach to the local scene is quite limited. The effectiveness of the exit mechanism has rendered voice largely irrelevant. It should be noted that Freeman and Medoff themselves have not tried to extend their model beyond the United States experience.

An important but not sufficiently researched implication of the Freeman and Medoff approach is that by focusing attention on the exit versus voice mechanism, it brings attention to the distribution of power among workers in influencing the workplace. In particular, reliance on the exit mechanism tend to shift power in favour of the more mobile workers at the expense of less mobile workers, i.e., from the marginal worker to the median worker. In Hong Kong's highly competitive markets, the lack of strong unionism shifts power towards more mobile workers, like young workers and women workers. The union inability to promote the collective interests of less mobile workers through localized collective bargaining with firms, have prompted them to seek labour legislation that regulate employment and workplace conditions as a whole. These political economy considerations are the subject of the next section.

V. POLITICAL ECONOMY OF THE UNION

We have discussed how supply and demand conditions can influence the development of organized labour. These conditions are necessary but not sufficient ones. The actual process of organizing labour and the articulation and implementation of labour demands is a complex institutional problem. Here we present a set of economic ideas may shed light on this problem. These ideas like others in the area of economics are of a general nature and are not addressed specifically to labour organizations. For this reason, it is useful to present the general arguments first, and then to apply it to the labour area. Traditional neoclassical general equilibrium theory has focused on the invisible hand aspect of competition and has elegantly explained the conditions under which self-seeking individuals unwittingly serve society's goals. This famous theorem originated in Adam Smith's classic work on the Wealth of Nations. But Smith also wrote:

People of the same trade seldom meet together, even for amusement and diversion, but that the conversation ends in a conspiracy against the public, or in some contrivance to raise price.

This quotation shows another side of the economic process, one in which the invisible hand does not seem to be working. Individuals left to their own devices continually try to escape competition in a process that has been called rent-seeking, but that also goes by a variety of other names -- cartelization, monopolization, etc. Not only does the invisible hand guide people toward activities beneficial to society, it also has an underside; individuals following their own self-interest continually attempt to see that the invisible hand does not work. Magee (1985) call this aspect of human behaviour the invisible foot. Real life competition is often a game in which invisible feet are stomping on invisible hands.

Although monopolization and cartelization can occur as a private coalition among individuals, they are not free from competition. There is always the threat of new comers. In the time of Adam Smith and ever since, such private coalitions have sought state protection for their privileged positions through lobbying for franchises and other legal measures to keep out potential entrants. The theory of economic regulation expounded by Stigler (1971) developed the idea that government regulation of industries and markets should not always be considered as actions taken by a neutral actor to promote the public interest. Government regulation generally results in a redistribution of income that benefits certain groups often at the expense of others. If certain regulations have existed for long periods of time and systematically benefits well identified groups, then there is a likely case for believing that the regulations exist to benefit these groups and at their instigation. Special interest groups lobby for protection and governments or political parties "sell" protection in exchange for votes or political support. One should therefore analyze regulatory behaviour as the outcome of maximizing behaviour of political agents who seek the support of lobbyists and voters in order to get into political office or to remain in office.

The political process is somewhat analogous to the operation of an economic market in which there are demanders and suppliers, and where items are bought and sold. Unlike economic markets, however, most political markets are characterized by high transactions and organizational costs, and free-rider problems are much more pervasive. Downs (1957) and Buchanan and Tullock (1962) discussed the main characteristic of political markets. They put the issues in the context of voting behaviour but it can clearly have more general applications. The logic of collective action is: If I am narrowly self-interested, then I will not go to vote, since, the impact of my vote on the outcome is so slight and the consequences so minor, that it clearly cannot exceed the cost that I will incur by going to vote. Hence, voluntary individual actions by rational self-interested agents must imply that the vast majority will not vote. This is of course the free rider problem.

Much of political activity involves collective action. Individuals come together to lobby for a collective or public good, which if obtained benefits all in the coalition. The problem is what can prevent each individual member from cheating on the coalition by staying away and letting others pay the costs of lobbying if he can still collect the benefits due to the coalition's efforts. Of course if all members of the coalition think likewise, then the coalition will not be formed in the first place. It will exist as a latent group. Active coalitions are those who can successfully overcome the free rider problem, and latent groups are those who fail to do so.

Overtime active coalitions may become latent ones, and vice versa, as the conditions that determine the cost of overcoming free rider problems change.

Likewise, unionism can be treated as the outcome of both private and collective choices. Individuals choose their jobs and in turn their union status as well. Although each individual worker has little effect on union coverage, services, and outcomes with any given workplace, the extent and goals of unionism across labour markets are affected by the private decisions of mobile workers. The indicated mechanism is somewhat similar to that described by Tiebout (1956).

Olson (1957) argued that successful coalitions are those which have been able to develop selective incentives. Such an incentive is one which can be applied selectively to the individuals depending on whether they do or do not contribute to the provision of the collective good. The selective incentive can be negative punishment or positive reward. One of the best known organized interest groups in modern democratic societies is the labour union. It is also usually supported, in part, through negative selective incentives. Most of the dues in strong unions are obtained through union shop, closed shop, or agency shop arrangements which make dues paying essentially compulsory and automatic. The use of picketing during strikes is another negative selective incentive. The great amount of violence involved in the early history of unionization on the part of both unions and anti-union employers and scabs reveals the importance of using coercive force in maintaining effective coalitions.

Many professional associations also use negative selective incentives but often in more subtle and informal ways. Selective application of sanctions against fellow members because of unprofessional or uncooperative conduct is favourite gossip among members of all too many professional associations. The fact that so few medical doctors ever testify against fellow doctors in malpractice suits in so many countries is suggestive of the presence of an implicit negative selective incentive scheme which discourages them from testifying. Those who do testify tend not to be those who practice locally. Positive selective incentives are also common place. In urban settings these often take the form of insurance policies, cheap group travel fares, special discounts, social parties, and the like. Sometimes selective incentives are given by greater attention to grievances of active members.

The use of selective incentives will be facilitated when the cost of organizing effective coalitions are lower. Small homogeneous groups are generally easier to organize. Size is important because organization, negotiation, and enforcement costs tend to grow when the group get bigger. Homogeneity of membership also helps a group to maintain cohesiveness and discipline, and will be aided by the existence of ethnic, kinship, and other ties. Time is also important because organizations takes time to build. The sustainable modern trade unions did not emerge in great Britain until a full century after the start of the Industrial Revolution and was even later in other countries. Even today most unions tend to be small with relatively homogeneous members, which is true of Hong Kong as well. This is not inconsistent with the existence of much larger federations whose greater resources can be gainfully utilized by individual unions without sacrificing much individual autonomy. Sometimes groups with large numbers of members may have low organizational costs if a few members have a big stake in the

welfare of the group. In such situations free rider problems become less severe because these few members will be willing to bear most of the costs.

Size of the group is also important for a different reason. An organized group who seek to benefit members say through influencing government policy must persuade government or the public to transfer resources to them from those who do not belong to that group. This may be opposed by other groups or public opinion. To overcome opposition the interest group will have to spend resources to persuade, to bribe, to threaten, or to deceive the opposition and the public. Such expenses will tend to rise with the amount of the transfer that is being sought. These expenses reduce the net benefit that can be obtained through organized political action. With fewer members each will receive a higher sum from a given amount of transfer. The cost to be imposed on nonmembers will also be smaller on a per capita basis and will, hence, generate less opposition.

Indeed the growth of public sector unionism in Hong Kong has been facilitated by the fact that the sector is relatively small, so that for a given total transfer there is less opposition generated from the public. It also took place during a period of rapid economic growth which allowed the government to expand with relative ease. One of the limiting factors is that as the public sectors grows larger, the cost to further growth rises and this will put a dampening effect on public sector union activism. Demsetz (1982) investigated at considerable length the tolerable size of the public sector in democracies before negative feedback effects begin to emerge. But his conclusions are essentially conjectural.

Another area of possible union activity is in declining industries. The evidence here is somewhat mixed and there are opposing reasons for this. Leading an uphill fight in a declining industry is not conducive to success. Organised labour have usually been successful in boom years and not in recession years. On the other hand workers in declining industries facing imminent dismissal and who have little opportunities elsewhere may have considerable incentive to get organized and seek protection from market forces. The most dramatic example of this is the agricultural lobby in the advanced countries.

The agricultural sector shrank enormously with economic growth because of an inelastic income demand for agricultural products and rapid technological advances in agricultural production. With fewer agricultural workers they became easier to organize, especially when there is a great disparity of farm sizes. The per capita cost imposed on the rest of the population to finance the transfer became smaller. An inelastic demand for agricultural products also ensured that the gain from organizing the agricultural labour force will be rewarding. It is therefore interesting to observe peasants and farmers who were always the oppressed and exploited groups in poor countries manage a turnaround in the rich countries. The agricultural lobbies in the Common Market, Japan, U.S.A., and Canada are without doubt one of the most powerful interest groups in their countries. Johnson (1973) provides considerable evidence of their activities and the negative impact it has on agricultural resource allocation and poverty on a global scale. In an overwhelmingly urban city like Hong Kong, the power wielded by the rural interests is quite disproportionate relative to their numbers. One cannot cease to be amazed at the

aggressiveness of vegetable farmers in rural Hong Kong who petitioned the Premier of China in protest against cheap imported vegetables from China that were damaging their interests.

Successfully organized coalitions are generally small and they seek gain often at the expense of the unorganized public. The implication is that small groups representing narrow interests tend to be more successful at political competition. Government regulations and public policies, therefore, often end up protecting minority interests rather than public ones. The homogeneity of the highly skilled professions and their small numbers have helped them to organize. They have also been able to convince the public, by virtue of their specialized knowledge and often with the support of the government, that they ought to be able to determine who is "qualified" to practice in that profession and thereby to control a decisive selective incentive. Often times the professions have been able to impose their interests on the public in the name of public interest. Thus New York city implemented free and compulsory education at the instigation of teachers and not parents. The American Medicaid and Medicare health insurance programmes designed to benefit the low income groups was not opposed by doctors because most could derive significant benefits from it. The legal profession have usually supported the enactment of complex regulations which inevitably results in greater demand for their services.

Political entrepreneurs who for their own career reasons, may find it in their private interest to work to provide collective benefits to interest groups, including latent ones. In an open society even latent groups may exert some influence. First, candidates for elective office recognize that, even though a group may not be organized, it may nevertheless exist as a latent group and that its members might be more inclined to vote for candidates who seek to provide the group with some collective benefit. Wallis (1969) have discussed the effects of political entrepreneurship on the explosion of welfare programs in England and the United States. Second, political entrepreneurs work, just as entrepreneurial business leaders do, to find and expand organizations and to seek collective benefits for organization members, in part because their own careers will be enhanced by the size and prosperity of their organizations. Nathan Smith Davis, an early and energetic organizer of the American medical profession was in part motivated by his own career interests (see Berlant 1975), and so were other early union leaders.

Sometimes a combination of political entrepreneurship and effective use of selective incentives can institute and maintain highly elaborate systems whose sole purpose is to protect minority interests. The British Factory Acts which placed restrictions of increasing severity on the employment of children, adolescents, and adult women was not necessarily an enlightened act of humanity, but a successful attempt by skilled male operatives to restrict competition. Women repeatedly fought against these supposedly enlightened legislation without success for more than half a century.

One of the most infamous of all selective incentive schemes ever concocted is the system of apartheid in South Africa. Until relatively recently, intermarriage between races was not uncommon. Early in the century, white workers fearing the competition of cheaper African and Asian labour began instituting employment ratios between African labourers and white foremen. The labour unions supported by conservative Afrikaaners and socialist and communist leaders

succeeded in instituting increasingly restrictive practices that denied skilled and semi-skilled jobs and various civil rights to Africans. To preserve this system sexual relations, in marriage or otherwise, between races were forbidden. The use of coercive police and military power became an essential instrument to enforce these oppressive rules.

Turning to Hong Kong, given the export oriented and labour intensive nature of Hong Kong's industries, organized labour did not succeed in building powerful unions in the manufacturing sector despite the use of selective incentives. The use of violence is, however, extremely rare. The only success stories are in the highly skilled professional occupations and the civil service. In Hong Kong, the weakness of the unions have prevented them from emerging as a major political force. The labour federations are furthermore split along leftist and rightist ideological lines, which makes it difficult for them to work together. To be sure there are also labour activists, who are essentially political entrepreneurs and not unionists, who have sought to represent labour interests, perhaps partly as a reaction to weak unions. They seek to minimize organizational costs by appealing directly to the average labourer. They lobby for labour legislation which appeals to broader labour interests than specific narrow ones. Their mode of operation is characterized by organizing mass rallies, signature campaigns and petitions and appeals through the media. On occasion they have worked together with political entrepreneurs representing other interests. But, their influence remains limited in the highly centralized politico-administrative structure of Hong Kong. Their presence, however, have prompted the labour federations into greater activism in the political arena.

The view that government acts as an impartial authority to protect the interest of the public is limited. The economic view of government, both that of Adam Smith and Karl Marx has been that governments are influenced or even controlled by interest groups who seek to advance their own interests. Our analysis here summarizes some of the recent developments of the latter view to shed light on the political and organizational aspects of labour in Hong Kong society. The significance of this analysis is not only in understanding what exists, but also of its implications for the prosperity of Hong Kong.

The welfare implications of these economic theories of political competition among interest groups differ significantly from standard welfare economics. Traditional measures of welfare loss due to monopoly, cartels, regulation, and market intervention have generally concentrated on measuring Harberger (1954) triangles. The estimated welfare losses from deviations from competition proved to be so small that a cynic might ask: If the losses are so small why bother with the analysis? Unless a thorough re-examination of the validity of this traditional conception is made, the inevitable conclusion is that economics has ceased to be important. The answer provided by the new analysis demonstrates that the welfare loss should not be merely the Harberger triangles, but also the entire amount of the tax, tariff, monopoly profit, or regulatory transfer. The reason is as follows: Individuals will compete for the rents or lobby for the revenues and (assuming competition in rent-seeking) it is worthwhile for each person to spend up to the amount times the probability that he will receive the transfer. Although such rent-seeking activities absorb resources, they merely result in transfers from one group to another. They are directly-unproductive-profit-seeking activities and are losses to society. The public choice theory of rent seeking developed in Buchanan, Tollison, and Tullock (1980)

focuses on an interest-group modeling of the political system in which groups compete for artificially contrived transfers. The resources devoted to such dissipation of contrived rents are wasted. Since these resources are considerably greater than welfare triangle losses, they can no longer be dismissed as trivial.

In the recent work by Olson (1982), the rise and decline of nations is traced to the formation of distributional coalitions. His key explanation for why growth rates differ among societies is that the process of rent-seeking places increasing restrictions and constraints on society and reduces the rate of growth. He argues that unless a country experiences a sudden institutional change, such as war, that breaks up these groups, "institutional sclerosis" will set in: the economy's growth will become more and more sluggish and will eventually stop. Although Olson's work remains controversial, it explains why the American South grew faster than the North in the post civil war period, or why Britain with its long history of political stability averaged a lower growth rate than France which is known for its turbulent political history, or why many of the newly industrialized countries in the Pacific rim can grow rapidly without having democratic regimes. Even a superficial knowledge of Chinese history is sufficient to lead one to associate the rise and decline of the dynasties with the process of institutional sclerosis and devastating civil war.

The message in the economic literature about behaviour in the political sphere and on the relationship between the economy and the state is by and large not very complementary about nonmarket measures in solving society's problems. The application of this body of analysis to union activity and its effects also leads to a similar conclusion. One exception is Hirschman (1970), who bridged an important gap between economists and political scientists. Economists have typically assumed that dissatisfaction with a product or service is met by withdrawal of demand, while the political scientist thinks rather of the protests possible within the organization. This is the exit versus voice option. Both processes are at work and their interaction can explain a wide variety of political and economic phenomenon. It explains why the two options may sometimes complement each other and why one may sometimes substitute for the other in providing a signalling mechanism to alert firms, nations, and other organizations of a decline in performance. The emergence of a positive role is thus made possible. We have seen in the previous section how Freeman and Medoff (1984) applied the exit and voice approach to the study of labour unions in the United States with highly original and controversial results.

VI. A FEW FINAL WORDS

It is always difficult to summarize a paper, especially when it is itself a summary of many works. The impressions I wish to leave the reader with are, however, quite simple and straightforward.

First, methodological individualism in general and neoclassical economics in particular is an useful approach to the study of organized labour.

Second, on theoretical grounds unionism can have both a positive and a negative impact on economic efficiency, productivity and profitability in the firm, and long run economic growth.

Most, but not all, economists believe that the arguments for a negative impact are more persuasive and the overwhelming amount of evidence seems to support this view. Nevertheless, the other view should not be discarded and further empirical studies may help us to understand its relevance more clearly.

Third, unions tend to be more successful in noncompetitive environments and when the demand for union labour is inelastic. This explains why union activity and policy have tended to promote less competition and more protection in many instances.

Fourth, while unions may distort the wage structure and redistribute various benefits from more mobile workers to less mobile workers, the long run compensating wage differentials between union and nonunion labour is not very substantial. For the United States it is probably between 10-15 percent.

Fifth, the political economy of unions suggests that those unions which are successful are usually those who promote more narrowly based interests. Power is often negatively related to numbers. For this reason, unionism as rent-seeking activity is likely to be detrimental to economic growth. At a time when organized labour is declining in numbers, one should not necessarily expect that its political power will also decline. Indeed if the political economy arguments are to be believed, then its power may actually rise.

Since the 1970s significant progress has been made in research on organized labour, at a time when the number of unionized workers are declining in most countries. I believe there is no causality between these two phenomena. The increasing interest economists have in this area is much more an effect of developments within the discipline; a result of the availability of better tools, more data, and relevant theoretical advances. The declining number of unionized workers stems from changes which have taken place in the economy.

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