Using the Market to Find Common Ground

Rights in the Workplace

Richard Edwards

American industrial relations are at a crossroads. The old system—which was based on unions, collective bargaining, and oversight by the National Labor Relations Board (NLRB)—has clearly declined, yet what will replace it is still not clear. Will federal regulation, the courts, or markets play the lead role in shaping future employment relations?

This crossroads holds promise for establishing a market-driven system of employment relations that will serve well the interests of both employers and employees. Achieving that outcome, however, will require both employers' groups and workers' advocates to depart from what they have traditionally considered sacred ideological ground. Failing that, both sides are likely to find employment relations bogged down by increased government intervention, which will both limit workers' ability to get the protections they desire and create a growing drag on domestic employers' international competitiveness.

How We Got Here

For much of the post-World War II period, the dominant model of industrial relations was codified in the National Labor Relations Act (NLRA). The NLRA cemented unions and collective bargaining at the center of relations between employers and workers. Although unions never organized more than about one-third of the labor force, their industrial and political influence extended far beyond their membership. In the industrial arena, for example, nonunion employers clearly responded to what has sometimes been referred to as the "union threat effect" by preemptively providing their workers with many union-like benefits and thereby reducing the incentive for employees to unionize. In the political arena, unions were accepted as one of the three players (with business leaders and "the public") in a tripartite model of society; that view dominated in the 1960s and 1970s, reaching a peak in the famous (or infamous) anti-inflation and price control commissions of the Nixon-Ford years.

The union-based, NLRA-centered model of labor relations was severely stressed in the late 1970s and broke down completely in the 1980s. While scholars and others debate the causes of the breakdown—suggested culprits include industrial restructuring, employer hostility, union deficiencies, the undermining of labor law, and global competition—the results are quite clear: unions today represent only about one of every eight private-sector workers, and

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their share of the workforce continues to decline. Moreover, rather than organizing workers in the most technically dynamic areas of the economy, as they did during the 1950s and 1960s, today private-sector unions tend to represent stagnant, relatively outmoded sectors (or relatively stagnant companies within those industries, as in steel and autos).

It might be assumed that the demise of the NLRA model meant the triumph of the unrestricted operation of the market in labor relations. No such lazy assumption is warranted. The 1980s and early 1990s witnessed an explosion of employment-related regulatory legislation. At the federal level, the Worker Adjustment and Retraining Notification Act became law under President Reagan, and President Bush signed the massive Americans with Disabilities Act in 1990. Age discrimination laws were strengthened, and federal pension regulations proliferated during the 1980s. The first bill signed into law by President Clinton was the Family and Medical Leave Act.

Currently under discussion within the Clinton administration, Congress, and elsewhere in Washington's policy circles are other measures to regulate employment relations and the workplace. A bill to ban permanent replacement of strikers is working its way through Congress. Other possible legislation is intended to prohibit unjust dismissals, to mandate worker training, to slow the introduction of new technology, to institute comparable worth pay, to limit worktime on video display terminals, and to regulate employment in various other ways. Secretary of Labor Robert Reich's Commission on the Future of Worker-Management Relations is likely to propose other measures to alter the laws regulating union organizing and relations between unionized workers and their employers.

Action at the state level has been even more dramatic as legislatures have approved many new worker-protection statutes. Those new laws ranged from Massachusetts' Right to Know statute (concerning toxic substances in the workplace) to Florida's Whistleblower's Act to Montana's Remedy for Unjust Dismissal law to South Carolina's statute protecting workers who file for worker's compensation. While most labor advocates found Washington a hostile environment during the Reagan-Bush years, state capitals were much friendlier.

The decline of the NLRA model has produced a growing dependence on regulation, not on the market.

The Problems of Workplace Regulation

The United States has over 5 million workplaces, and a regulatory approach is likely to be grossly inefficient in governing them. A case in point is the Occupational Safety and Health Administration (OSHA). Most evaluations of OSHA suggest that while the agency has been quite successful in its information-disseminating role, as a regulator it has not done so well.

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For example, Duke University's Kip Viscusi, studying OSHA's effectiveness during the period 1973-83, found very meager benefits. On the most direct measure, the overall worker injury rate, he was not able to detect any OSHA effect; and on another measure, the risk to employees of losing workdays due to injury, Viscusi found OSHA reduced lost workdays by only 1.5 to 3.6 percent. Despite its limited effectiveness, OSHA's reporting and other costs are great.

Workplace regulation is complex. The millions of job sites all have different technologies, workforces, management philosophies, physical layouts, and workplace cultures. Writing rules in Washington to cover the myriad of workplaces is almost certain to be inefficient, except when directed at the simplest of regulatory targets. The rules can be made very complicated to fit the differences among those many workplaces, in which case they become extremely complex to administer and impose a correspondingly large regulatory burden. Alternatively, the regulations can be made simple enough to be easily administered but then are frustratingly inappropriate (and costly) when applied to different workplaces. Neither approach works well.

State Courts Enter the Scene

As significant as the turn to regulation has been, an even more ambitious governmental role has been carved out elsewhere. During the 1980s, state courts rewrote the basic common-law provision governing employment, the "at-will" doctrine, and the results have been startling.

State courts have final jurisdiction over all labor contracts, except for cases involving constitutional questions, aspects specifically preempted by federal statutes such as the NLRA or the Civil Rights Act, or suits between citizens of different states. The decline of the union sector has therefore greatly increased the importance of how state courts interpret employment contracts. Traditionally, the at-will doctrine has granted employers a free hand in dismissing employees; in the words of the 1884 precedent-setting case, *Payne v. Western Atlantic Railroad*, employers could fire workers "for good cause or for no cause, or even for bad cause without thereby being guilty of an unlawful act *per se*."

Starting in the 1980s, state courts dramatically changed their interpretation of the at-will doctrine in favor of workers, by holding employment contracts to several other standards derived from ordinary contract law. In effect,

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the courts have said that workers, even those whom prior courts would clearly have viewed as at-will employees, have certain employment rights not previously recognized. In particular, courts have recognized three exceptions to at-will:

•The public policy exception. Courts in most states have refused to sanction the dismissal of employees for actions that further important public policies. For example, they have protected employees who refused to commit an illegal act or who reported a workplace illegality to authorities or who missed work for jury duty or military service.

•The implied covenant of good faith and fair dealing. Courts in a few states have also vested employment contracts with a requirement that the employer exercise good faith and fair dealing toward the employee. For example, a Massachusetts court nullified the dismissal by National Cash Register of a long-time at-will employee when the employee showed that the company's main purpose was to avoid paying him a bonus.

•The implied contract exception. Courts in 41 states have interpreted employee handbooks, personnel manuals, and employers' oral promises as elements of an implied contract that can alter at-will status. For example, statements in an employee handbook that employees will be dismissed for poor job performance have sometimes been interpreted as excluding dismissal for other than "good cause."

The various exceptions to at-will have opened the courts to aggrieved workers and increasingly involved the courts in administering workplace relations. Although the data here are notoriously poor, various estimates suggest that currently before the courts are 20,000 to 25,000 cases involving unjust dismissal alone. And as one legal reporter rather delicately put it, as a result of the substantial awards won by employees, the "plaintiff's bar has become receptive to handling wrongful discharge cases on a contingency fee basis." That is, smelling blood, the sharks have arrived on the scene.

Little wonder. Several studies suggest that workers frequently win their cases and that they are obtaining substantial awards. Jury Verdict Research, in one nationwide study, found that plaintiffs (employees) recovered damages in 78.9 percent of defamation cases, 70.0 percent of sex discrimination and harassment cases, and 58.4 percent of wrongful discharge cases. The average jury award to the plaintiff was $602,302. In a separate study in California, workers in at-will trials were found to have won 73 percent of their cases, with an average award of $652,100. A study by James Dertouzos and colleagues at the RAND Corporation of 120 wrongful discharge jury trials in California between 1980 and 1986 concluded that the plaintiffs won 67.5 percent of those cases; the average award was $646,855, and the median award was $177,000. Another study in California found that in 1987 plaintiffs won 61 percent of the time and the average award was $596,340. Moreover, the Dertouzos et al. study found that, whether they won or lost, employers paid an average of $83,000 in legal fees to defend themselves.

The indirect costs to employers are, however, far more significant economically. In a second study by James Dertouzos with Lynn Karoly, the authors found that the indirect expenses to employers are "100 times more costly than the direct legal costs of jury award settlements and attorneys fees." They note that "the threat of wrongful termination suits changes firms' human resource practices in a manner that increases the cost of doing business. . . . In effect, firms have responded to increased wrongful termination liability by treating labor as more expensive." Dertouzos and Karoly estimate that the decline in employment resulting from these indirect costs is roughly equivalent to the effect of a 10 percent wage increase.

For workers, the entry of the courts is a mixed blessing at best. The courts are a poor mechanism for administering industrial relations: they are costly, have long delays, require lawyers and other expensive legal personnel, produce capricious awards, and, perhaps most unfortunately, create winners and losers rather than mediating disputes in a way that allows the parties to go back to working together.

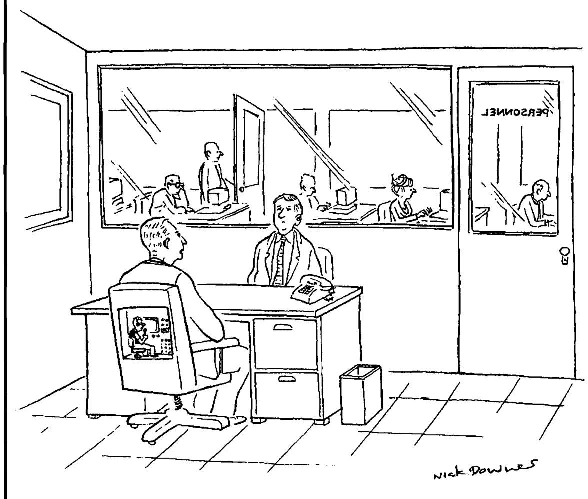
Thus, industrial relations have come to a crossroads. Although the union-centered, NLRA-based system of the early postwar period has greatly declined and is unlikely to be revived, a new system has yet to replace it. Unless some new common ground is discovered, it is likely that future industrial relations will be characterized by some market elements, significant and growing intervention by statutory regulation and by the courts, increasing costs on employers, and decreasingly effective protection for workers. That is an exact description of what economists describe as a "dead-weight" loss; fortunately, the situation also has the classic conditions under which to construct a "win-win" solution.

Toward Common Ground

A whole new approach to workplace protections is needed, one rooted in the forces of market competition.

The first element in finding common ground must be the recognition that employees need and deserve some special workplace protections. Individual workers have difficulty bargaining for enterprise rights under current market rules.

One reason is asymmetric information. A substantial scholarly literature now argues that bargaining is likely to be inefficient when one party to a transaction has information unavailable to



"Yes, as a matter of fact, we are under micro-management."

the other. In the case of enterprise rights, the employer has nearly complete information about what enterprise rights its own employees enjoy, and with what degree of effectiveness and certainty, whereas the jobseeker has almost none.

A second market defect is an unusually serious issue of contract enforceability for employees. Enterprise rights are typically company

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policies rather than specific and explicit clauses in individual employment contracts. Under the traditional at-will doctrine, courts consistently ruled that employers had a unilateral prerogative to change or ignore such rights. State courts in the 1980s significantly reversed that precedent by incorporating such polices as part of an "implied contract." Nonetheless, enforceability remains a great uncertainty, and individual bargaining is ineffective when the contract being bargained over is of uncertain enforceability.

A third issue involves the inherent (local) public goods aspects of enterprise rights. Most rights are extended to all of an enterprise's employees, or at least all of those in the same category. Making rights an individualized benefit, applicable to one employee but not others, may be technically infeasible (as in the case of layoff protections based on seniority) or prohibitively costly (workplace safety); in other cases (protection against racial discrimination), individualizing rights may simply be impractical because doing so would be too great a violation of workers', employers', or society's sense of justice. Rights that are local public goods create a classic "free rider" problem; despite valuing those rights highly, an individual jobseeker will not want to "waste" his or her bargaining power to attain them, correctly assuming that if other employees of the enterprise gain such rights they will probably be available to the jobseeker as well.

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Finally, there are significant economies of scale in the provision of enterprise rights. For example, establishing a grievance and appeal mechanism may involve substantial fixed costs, such that grievance rights could be provided to many workers at significantly lower per-unit (per-worker) cost than they can to one worker. If the decision about how much is provided were to be left for individual bargaining to determine, the market would fail to provide the optimal level and mix of rights.

Those various features produce one common result: while individual job applicants can and commonly do bargain effectively for wages, they cannot or do not bargain effectively for most job rights.

Thus, great demand is generated for achieving workplace protections in nonmarket ways—that is, through regulation or the courts. That is why there is such a pervasive, continuing, and apparently successful appeal to legislatures, Congress, and the courts for workplace protections. (In contrast, the same petitioners are quite unsuccessful when asking for intervention in wage bargaining.)

The second element needed to find common ground is the understanding that while workers need and deserve certain job rights, the conservative approach is correct in emphasizing the superiority of market competition as a means of delivering them. The advantage of the market is that, in contrast to the clumsiness of workplace regulation, it promotes flexible and diverse accommodations, recognizing the manifest differences in individual workplaces. As Ronald Coase and others have convincingly argued, showing that the market fails is logically insufficient to justify regulation; it is also necessary to demonstrate that government intervention would be superior. Most workplace regulation manifestly fails that test.

A market-driven system could be implemented with some pro-competition rules, similar in nature to what we do in other situations to promote competition. For example, the Truth in Savings Act requires banks to state consumer interest rates clearly, using the annual percentage yield method, thereby facilitating comparison shopping by borrowers. Limited liability facilitates entrepreneurial activity. Food processors are required to list their ingredients, brokers to refrain from insider trading, and auto insurers to write their policies in understandable English. All of those policies promote more effective competition.

Using the Market Mechanism

Both employers and employees have an interest in having an effective market. Employees want fair treatment; their interest is evident in the thousands of lawsuits they file to obtain fair treatment. Moreover, most employers want to provide fair treatment, and in fact most employers already promise fair treatment in their employee handbooks. Those promises—what I call enterprise rights—are job rights unilaterally granted to workers by their employers, and they cover some of the most important due process issues.

Unfortunately, for the reasons noted, individual workers have trouble negotiating enterprise rights under present market rules.

At one time unions provided a means of internalizing plant-level or enterprise-specific externalities within the bargaining (unions also brought other consequences as well), but today they represent few workers. In the absence of unions, efficient bargaining could be created with the following rules:

•Employee handbooks could be mandatory and public. Effective competition would be enhanced if jobseekers had fuller information about job rights in prospective places of employment. That would solve the problem of jobseekers' lack of information. Lack of disclosure serves no compelling private or public interest and inhibits market functioning. The government could supply a prototype handbook, modeled on existing private-sector handbooks, so that employers currently without handbooks could, if they so chose, avoid the costs of developing their own. Employers, at least those with more than, say, 20 workers, could be required to provide an employee handbook to each jobseeker, and such handbooks should be public documents.

•The rights and obligations set forth in employee handbooks could be legally enforceable. Efficient market operation is hindered by having unresolved or ambiguous law regarding the enforceability of employment contracts. The very real cost of that ambiguity is apparent in the growing expenses associated with litigation to resolve employment disputes. When jobseekers are recruited by a company, perhaps in part on the basis of the job rights promised, both employer and employee should have clear assurances that the contract they are making is enforceable. That also would make competition work more effectively for the worker.

•An independent dispute-resolution service could be established. The government now provides a very high-cost service (the courts) for resolving disputes; all parties—employees, employers, and the public—bear some of the costs involved. Costs for all could be reduced if the government would expand its mediation and dispute resolution service, so that employee grievances or disputes—in nonunion cases—could be resolved in a mediation and arbitration setting that emphasized quick, simple, inexpensive, and legitimate resolutions. (A different model, used in a number of European countries, employs labor courts that specialize in industrial disputes.) Such a system could encourage and defer to private mechanisms of dispute resolution, such as private arbitration, rent-a-judge, mediation, and so on. Our increasing reliance on the civil courts clogs court dockets, puts substantial and unnecessary burdens on employers, denies most workers redress for unfair treatment, and creates a competitive disadvantage for domestic employers in world markets.

If a more directed scheme to guarantee workers' rights were desired, there would still be substantial benefits to relying on the market rather than bureaucratic regulation, because the market permits more efficient application of workplace protections to diverse circumstances. For example, I have elsewhere proposed a scheme called "Choosing Rights" that retains the crucial reliance on market forces. It would begin with the development, by a public-private commission, of 10 or more prototype employee handbooks; each handbook would contain a distinctive and diverse set of workplace rights.

Employers could either opt for one of the prototype handbooks or write their own. In the latter case, employers could tailor their rules and rights to exactly meet their own idiosyncratic workplace needs; the specially tailored handbook would be implemented so long as employers could convince workers that such rights were equivalent or superior to those given in at least one of the prototype plans. Worker sentiment on the issue could be determined through a simple NRLB-type election. Market forces—competition among employers in offering diverse workplace regimes and competition among workers in seeking out those workplace regimes they most desire—would retain the leading role in this system, thereby facilitating private, decentralized, and efficient arrangements.

A market-oriented system of workplace protections would offer workers more effective assurances of fair dealing at the workplace than they are likely to receive as a result of regulation or litigation. Such a system offers employers reduced litigation costs and flexibility in offering workplace protections. Unlike many policy decisions, it creates a "win-win" outcome.

Selected Readings

Edwards, Richard. *Rights at Work: Employment Relations in the Post-Union Era*. Washington, D.C.: Brookings Institution, 1993.

Edwards, Richard and Garonna, Paolo. *The Forgotten Link: Labor's Stake in International Economic Cooperation*. Lanham, Maryland: Rowman and Littlefield, 1991.