State Court Restrictions on the Employment-at-Will Doctrine

Cameron D. Reynolds and Morgan O. Reynolds

The American economy, with its fabulous job machine, has the reputation of being the freest labor bazaar on the planet. Labor agreements here remain freer from government dictate than in most of the world, but that is little comfort in view of the regimentation elsewhere.

Today perhaps the biggest menace to employment freedom comes from the state bench. The traditional "employment-at-will" labor regime has been quietly undermined in a series of inventive state rulings over the past 15 years. A few states verge on a "just dismissal" regime, in which employers must be able to demonstrate that each firing was not a violation of public policy, a breach of implied contract, or a private tort. No court has yet proclaimed a general right against "arbitrary" dismissal, though the Supreme Court of Montana came dangerously close in 1984. In the *Crenshaw v. Bozeman Deaconnes Hospital* case, the majority held that "employers can still terminate untenured employees at will and without notice [but] simply may not do so in bad faith or unfairly." The supreme courts of California and Michigan, long-time innovators in restraining dismissals, have recently hesitated to take at-will exceptions to their logical conclusion, namely, a just dismissal regime. In *Foley v. Interactive Data Corporation* (1988), the Supreme Court of California denied the tort remedy for violation of the good faith doctrine; and in *Rowe v. Montgomery Ward* (1991), the Supreme Court of Michigan found that employers' verbal statements and handbooks do not create an expectation among employees that dismissal is only for cause.

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The Employment-at-Will Regime

During the 19th century the U.S. political and legal regime treated the laws of supply and demand on a par with the Ten Commandments. As with other areas of commerce, governments

treated labor markets with benign neglect. Freedom of contract was the general legal doctrine prior to the New Deal legislation of the 1930s. Under the freedom of contract regime, the most common labor agreement came to be known as "employment at will." If an employment arrangement was no longer satisfactory to either party A or party B, the dissatisfied party was free to end the arrangement at any time. An oft-quoted 1884 decision by the Tennessee Supreme Court expressed the idea this way: "Men must be left without interference to buy and sell where they please and to discharge or retain employees at will for good cause or for no cause, or even for bad cause, without thereby being guilty of an unlawful act per se. It is a right which an employee may exercise in the same way, to the same extent, for the same cause or want of cause, as the employer."

The courts' respect for property and contracts meant that a wage earner was the full owner of his labor services, and the capitalist the full owner of his capital. Each was free to exchange on whatever terms he saw fit, although impersonal markets always set relatively narrow bounds on the mutually advantageous terms of trade.

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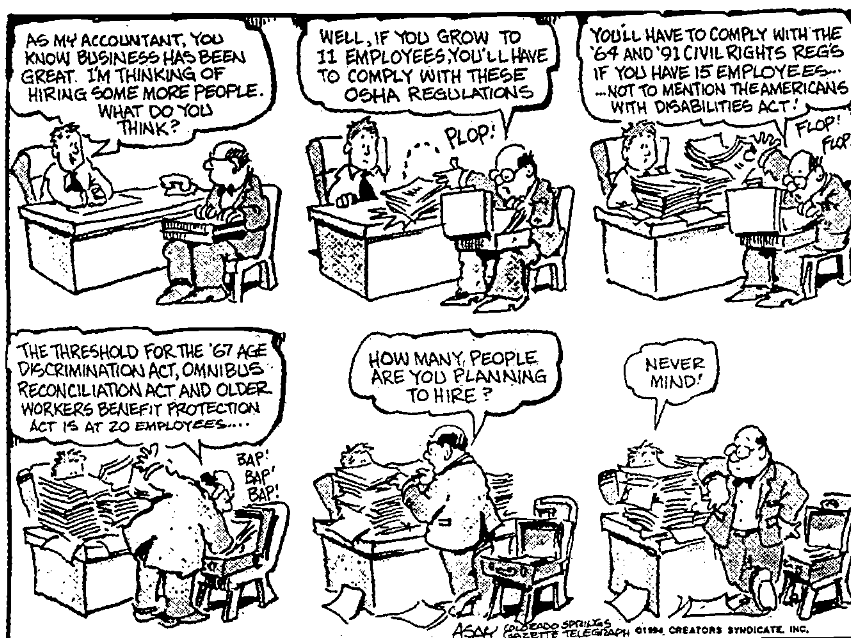
If at-will contracts are not the best arrangement for those involved, the parties are always free to modify their agreement to mutual advantage. Transaction costs between the two parties are extremely low, and advocates of intervention have never been able to document any substantial third-party effects that justify interference on efficiency grounds. The at-will contract allows more-or-less continuous minor adjustments of contract terms in any direction on a mutually agreeable basis. The arrangement is self-enforcing because a mix of formal and informal controls link payments to employee value and effort rendered. The arrangement avoids the problems inherent in explicit contract language and its inevitable unforeseen gaps, as well as the incentive deficiencies and shirking problems accompanying a fixed duration of employment. While average U.S. job tenure is eight years, it is voluntary markets, not unjust dismissal laws, that sustain such relations.

Consider the problems of a labor contract that does not allow withdrawal at will. Suppose an employer agrees to pay an employee a fixed sum for less-than-fully specified services over a fixed period of time. The labor supplier has a strong incentive to shirk because, from his perspective, the private marginal benefit of expending productive energy is low or zero, while the marginal cost of effort is high. The employee also must refuse any superior offer arriving at any time during the life of the contract. By contrast, the firm's marginal compensation costs are zero because they are contractually fixed, or sunk, yet the marginal benefits from the employee's productive effort are positive. Hence, a long-term contract tends to undermine the coincidence of interests necessary to harmonious exchange. Such "job security" contracts invite abuse, shirking, contentiousness, and costly litigation.

Justifications for Intervention

The ideology behind most statutory exceptions to the at-will doctrine is that helpless employees must be protected from the omnipotent corporation. It is almost impossible to find more sophisticated reasoning than that in support of these interventions. For example, Marvin Levine, a management professor at the University of Maryland, asserts in a 1994 *Labor Law Journal* article that the U.S. Supreme Court defense of the at-will doctrine in *Adair v. United States* (1908) erred: "Implicit in its reasoning was the assumption that employer and employee had 'equal power.' Yet the employment-at-will doctrine favored employers more than employees."

And that is it. Apparently, Levine does not feel a need to offer any empirical evidence or logical arguments to substantiate his claims. They are taken as obvious to all men of good will, or at least all readers of the *Labor Law Journal*.



But jurists need not assume equal gains from trade or employ the nebulous concept of "equal power" to protect equal rights. Few academic minds seem facile enough to distinguish between war and commerce: while size is an advantage in warfare, it means little in exchange. For example, a housewife of modest means walking into Sears to shop for a new washing machine is not "at the mercy" of Sears, a corporation that has lost hundreds of millions of dollars in recent years. She has the power to shop elsewhere. Workers have 5 million alternative employers available to them on any given day, and the set changes daily in an entrepreneurial economy. Self-employment is also an option—currently exercised by nearly 10 percent of the labor force.

Levine argues that "the percentage of private sector workers enjoying protection against arbitrary dismissal is declining." How do we know this? Because the number of private sector workers working under collective bargaining agreements has been declining. Growing numbers of nonunion employees are working under contracts that are at will except for protections granted by federal legislation. The National Labor Relations Act of 1935, for example, prohibits discharge of an employee for union activity, filing charges against an employer, or testifying against an employer. The Civil Rights Act of 1964 prohibits discharge of an employee because of race, sex, pregnancy, national origin, or religion. The Occupational Safety and Health Act of 1970 prohibits discharge of an employee for exercising legally protected rights. The Americans with Disabilities Act of 1990 prohibits discharge of an employee because of a legally protected disability.

Levine laments that employers are still free to fire workers for other causes, and notes that "it is precisely these 'other causes' that have prompted recent judicial scrutiny." Into the void step the caped crusaders of the state courts.

Critics such as Levine have repeatedly charged that the employment-at-will doctrine is anachronistic, archaic, and unfair to workers. But virtually all legal scholars take it for granted that the employee always has a right to quit—for good cause, bad cause, or no cause at all. The asymmetry in contemporary legal treatment between the employer and employee (Justitia raises her blindfold and asks, "Who are you? Oh, in that case . . .") stands in stark contrast to 19th-century jurisprudence. Jurists once clung tenaciously to the employment-at-will doctrine. They had a presumption in favor of personal freedom; a respect for freely negotiated terms among the parties themselves because they are in the best

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position to know their own interests; a reluctance to impose involuntary servitude on either party; and a preference for generality in law (rules should apply to *all* business transactions). The courts once recognized that employment relations are quid pro quo—value exchanged for value—and that workers are traders free of personal dependence and the whim of a single employer. No other institutional framework is likely to work better. As University of Chicago law professor Richard Epstein has noted, "It is one thing to set aside the occasional transaction that reflects only the momentary aberrations of particular parties who are overwhelmed by major personal and social dislocations. It is quite another to announce that a rule to which vast numbers of individuals adhere is so fundamentally corrupt that it does not deserve the minimum respect of the law. With employment contracts we are not dealing with the widow who sold her inheritance for a song to a man with a thin mustache. Instead we are dealing with the routine stuff of ordinary life; people who are competent enough to marry, vote, and pray are not unable to protect themselves in their day-to-day business transactions."

Activist judges often find meddling in other people's affairs a rather pleasant burden, especially if it involves the warm feeling of "doing one's duty."

The Public Policy Exception

Disgruntled former employees can initiate various lawsuits that can be classified as contract, tort, or public policy causes of action. The new public policy doctrines prohibit employers from dismissing employees for performing acts protected by public policy or for declining to commit acts prohibited by public policy. While the public policy exceptions may be the least controversial incursions against at-will employment, problems with these exceptions abound. The term "public policy" evades precise and uniform definition. Can an exception be declared by legislative action only? Or can it emanate from judicial and other sources? The open-ended nature of public policy exceptions is typified by the California court that in *Peterman v. Local 396* (1959) declared that anything that contravenes "good morals or any established interests of society" constitutes action against public policy. Since *Palmattere v. International Harvester* (1981), Illinois courts have expansively defined public policy as "that which is right and just and collectively affects the state's citizenry." And in *Nees v. Hocks* (1975), an Oregon court declared that an employer can be held responsible for dismissing an employee "for a socially undesirable motive."

From an economic point of view, a public policy prohibition on dismissal might have an efficiency rationale based on third-party effects. Consider a relatively uncontroversial example: no dismissal for employee absence due to jury duty. The rationale behind these laws is that jury service is a public service, public good, or externality-rich action that allegedly serves the general interest. But even if this proposition is accepted, the cost is not spread across the entire community; rather, it is forced on the juror-employee and his firm's owners. The tax, or "taking," in other words, is suffered by the absent employee and the unlucky business owners who might otherwise have replaced that employee. The cost of jury duty has been arbitrarily externalized by the courts, legislature, and general public.

The Texas judiciary has been a good example of a reluctant intervenor. State law continues to respect the employment-at-will doctrine, although the Texas legislature has enacted 14 public policy exceptions over time. For example, in Texas it is unlawful to discharge an employee for military service, attending a political convention, or filing a "good faith" workers' compensation claim. The Texas judiciary has created only one judicial exception. In *Sabine Pilot Service, Inc. v. Hauck* (1985), the Supreme Court of Texas considered the case of a deckhand whose duties included pumping the bilges of the boat on which he worked. The deckhand discovered that it was illegal to pump the bilges into the water, so he refused to do it and was fired. The court declared that public policy, as expressed in Texas and U.S. statutes that carry criminal sanctions, required an exception to the at-will doctrine: employees could not be fired for refusing to perform a criminal act ordered by the employer. The new doctrine has since been narrowly interpreted in *Willy v. Coastal Corp.* (1988) and *Pease v. Pakhoed Corp.* (1990), limiting the exception to

instances where the employee act in question carries criminal penalties.

Justice Kilgarlin's concurrence in *Sabine*, however, shows how shaky the constraints on exceptions to at-will employment contracts can be: "Absolute employment at will is a relic of early industrial times, conjuring up visions of sweatshops described by Charles Dickens and his contemporaries. The doctrine belongs in a museum, not in our law. Our decision today in no way precludes us from broadening the exception when warranted in a proper case."

There are several possible responses to Justice Kilgarlin's commentary. First, today's employment agreements can hardly be termed "absolute" employment-at-will, given the myriad legal intrusions on labor contracts. Second, Justice Kilgarlin's rhetoric may be appealing, but it demonstrates a lack of insight into the historical causes of poverty and low wages. As Ayn Rand put it, capitalism did not create poverty, it inherited it. Third, we must be wary of this tendency towards moralizing from the bench. Activist judges often find meddling in other people's affairs a rather pleasant burden, especially if it involves the warm feeling of "doing one's duty." This tendency on the part of judges lends itself to abuses of power.

The Contract Exception

The contract and tort encroachments on at-will relationships have little or no rational basis. Two contract causes of action have been created by state courts: implied contracts and covenants of good faith and fair dealing. According to the theory behind the first, an employer's conduct, policy statements, or statements in employee handbooks can create an implied obligation to discharge for "just cause" only. The courts might discern implied obligations from any of the following: the longevity of an employee's service; employee benefits that are dependent on an employee's continued service, such as stock options or pension rights; consideration by an employee above and beyond normal service, such as sacrificing another employment opportunity; and promissory estoppel, or detrimental reliance on an employer's promise—for example, moving to another city on the promise of a job, only to find the offer retracted.

The leading case in the area of implied contracts is *Toussaint v. Blue Cross and Blue Shield of Michigan* (1980). The plaintiff asked his employer about job security and was told that he would be with the company as long as he did his job. The personnel manual also stated that the employees would only be released for just cause. The Michigan Supreme Court held that such express statements may give rise to enforceable contract rights, even if the employee never learned of the policy, and despite the fact that the employer could unilaterally change policies without notifying his employees. In 1991, however, Michigan retreated from its liberal interpretation of implied contract doctrine, finding that statements of assurance given orally and in handbooks did not create a legitimate expectation that discharges would be for just cause only.

Texas jurisprudence holds that employee handbooks constitute no more than general guidelines. The most common defensive practice adopted by employers in Texas and elsewhere is to include a disclaimer in the handbooks and have employees sign a waiver. Employment contracts for a definite period of time, however, are not at will, and can only be terminated prematurely for good cause under current common law.

The problem that activist courts seek to address is an imaginary one, and their biased rulings harm the very parties they hope to benefit as a class.

A supervisor's oral assurance of dismissal only for good cause may override an employer's right to fire. The success of an employee's claim of violation of an oral agreement largely depends on the nature of the assurance given by the employer. One defense for employers is the statute of frauds, which provides that an oral agreement is not an enforceable contract unless it is to be performed within one year from the date of the agreement. Defensive personnel policies work best, of course. Many employers head off trouble by announcing that employment is at will or having their employees sign at-will agreements.

From an economic viewpoint, labor markets leave no implied contract role for the courts to fill. Efficiency allows such a "fill-in-the-blanks" role for the courts only if it is not economical for the parties to provide for a given contingency in advance because contracting costs to mutually

agreeable exchange are high or prohibitive, and the contingency is rare. Under these circumstances, socially responsible courts rule in a manner such as the parties might have done in advance to further their joint interests. The actual implied-contract exceptions to the at-will doctrine created by the courts pass none of these tests. Generally, employment contracting costs between the two parties are so low, and the contingency of dismissal so common, that the parties can evaluate the risks realistically. If it is optimal for the parties to have a job security or just dismissal clause, then they will negotiate it voluntarily because the barriers to doing so are trivial.

The problem that activist courts seek to address is an imaginary one, and their biased rulings harm the very parties they hope to benefit as a class. Employees' behavior in the marketplace demonstrates conclusively that most employees are not willing to trade wages or other benefits for just dismissal rights. Confident in the value of their skills in the marketplace, they are smarter about how the world really works than the social engineers on the bench and in the academy.

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At least one professor finds a method in the courts' madness. Cornell law professor Stewart Schwab, in a 1993 *University of Michigan Law Review* article, invokes modern economic jargon about "asset specificity," inability to anticipate future contingencies or states of the world, "inframarginal" (immobile) workers, opportunism, and relative vulnerabilities to justify state courts' piecemeal erosion of the at-will doctrine on efficiency grounds. According to Schwab, the courts are groping to protect early- and late-career employees from employer opportunism, while respecting the at-will doctrine for mid-career workers, who would otherwise perform poorly. There are at least five defects to this "balancing" theory: (1) courts are poor at such fine tuning; (2) contracting costs are always low, and employers have every incentive to retain productive employees at *any* career stage; (3) legal uncertainty stimulates litigation; (4) defensive hiring practices harm the intended beneficiary class; and (5) the empirical evidence for this legal pattern of exceptions by career stage is weak to nonexistent.

The second contract exception to the at-will doctrine, the covenant of good faith and fair dealing doctrine, is potentially the most far reaching. It also has been classified as a tort, rather than a breach of implied contract. A broad application of this doctrine would destroy what remains of the at-will regime, replacing it with a regime of termination for just cause only. However, this is a vague and tricky area of law. The good faith doctrine is best applied to suppress opportunism: taking advantage of the vulnerabilities of another party created by the sequential character of contractual performance. Since no one puts himself at the mercy of another party voluntarily, the parties may find it economical to specify forbidden "bad faith" acts under warranted circumstances. Another word for opportunism is *monopoly*, or a one-sided situation. Perhaps the clearest examples involve abuses of fiduciary trust relationships, where an agent fails to act in the best interest of the principal.

Some state courts have applied the good faith doctrine to employment relations without giving much thought to its applicability. The Massachusetts Supreme Court, for example, has declared that the requirements of good faith and fair dealing are pervasive in the law and that all parties to contracts and commercial transactions are bound by that standard, ill-defined though it may be. In *Cleary v. American Airlines* (1980), the California courts also held that the covenant of good faith and fair dealing applied to all contracts and that a wide range of employer actions gives rise to an "implied promise by the employer not to act arbitrarily in dealing with its employees." This creates both contract and tort causes of action. In *Foley v. Interactive Data* (1988), however, the California Supreme Court retreated, overruling an appellate court to hold that the good faith covenant does not apply to every employment relationship, only those where there is an express contract.

Texas courts have rejected the good faith covenant in employment relationships. In *Watson v. Zep Manufacturing* (1979), the plaintiff argued that "job security is so important to work-

ers individually and to economic and social welfare generally that the law should impose a duty on employers to deal fairly with workers in terminating their employment, and not to discharge them without cause." The defendant countered that the ability to discharge employees at will was an important management privilege and that its denial would sacrifice operational efficiency, impair management confidence in worker loyalty, and deter management from pruning marginal workers. The court ruled in favor of the defendant. Plaintiff's counsel overlooked the fact that no economic good comes to the firm that dismisses productive employees who earn their keep. Employers have every incentive to keep and reward quality employees. After all, there are some 5 million firms that can bid them away at any moment.

The law has no economic rationale for a good faith and fair dealing intervention in employment relations. The labor market and its invisible hand provide every incentive for good faith and fair dealing among employers and employees. Economic competition does not create a perfect world, but on both the demand and supply sides of the market it provides incentives for civil and cooperative behavior. The at-will contract is an ideal mechanism for avoiding vulnerabilities, opportunism, one-sidedness, and monopoly by either party in a labor agreement. If an employee can be fired at any time and for any reason, that employee has every incentive to be productive. Productivity creates job security. And if the employee can quit at any time, the firm has every reason to be responsive to the employee's concerns. In *McClendon v. Ingersoll-Rand* (1989), the Texas Supreme Court laid to rest repeated attempts to incorporate the good faith doctrine into labor law.

The Private Tort Exception

The final cause of action for wrongful discharge arises under private tort law. Tort remedies include not only the economic damages of contract awards, but also punitive damages and damages for emotional distress. Multi-million dollar awards are usually the result of these add-on remedies. Private tort causes are of three types: (1) a prima facie tort; (2) intentional interference with performance of a contract; and (3) intentional infliction of emotional distress. Private torts are the least important grounds for exceptions to at-will employment relations. Ordinary dismissals, for example, cannot support a claim of intentional infliction of emotional distress.

In Texas, the plaintiff must demonstrate (1) that the conduct in question was intentional; (2) that the action constituted extreme and outrageous conduct, defined as "atrocious and utterly intolerable in a civilized community" and in which a recitation of the facts to an average member of the community would lead him to exclaim, "Outrageous!"; (3) that the plaintiff suffered emotional distress; and (4) that the distress was severe. In *Ugalde v. W.A. McKenzie Asphalt* (1993), a supervisor repeatedly referred to Artemio Ugalde as a "wetback" and a "Mexican," but the court ruled that as a matter of law the supervisor's conduct was not extreme or outrageous. Insults and name-calling, no matter how offensive, are insufficient in themselves to constitute intentional infliction of emotional distress.

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Economic Consequences

Since 1980 the number of states adopting some or all of the new doctrines has more than tripled, leaving only five states, Delaware, Florida, Georgia, Louisiana, and Mississippi, as employment-at-will states. Led by California, eight states, Alaska, Arizona, Connecticut, Idaho, Massachusetts, Montana and Nevada, adopted all the new exceptions to at-will employment in the 1980s.

The state courts' attack on at-will employment regimes has had much the same economic impact as the imposition of state mandates intended to benefit workers. Supporters of such mandates argue that private businesses should be forced by either the legislature or the courts to provide employees with a wide range of benefits,

including health insurance, parental leave, child care, disability leave, retraining, and job security and dismissal rights. But microeconomic theory has demonstrated conclusively that mandates cannot improve the welfare of workers. After all, employer mandates stipulate the "currency" in which workers must be paid; this limits their range of choices and lowers their subjective satisfactions. Mandated benefits have lowered employment and wages. Firms hire and keep only those employees whom managers believe add at least as much revenue as cost. Workers earn their keep or they are dismissed. Accordingly, workers ultimately pay for all their fringe benefits through lower wages or slower wage growth.

Mandates impose additional costs on businesses, so mandated benefits that raise the cost of labor without improving productivity must reduce employment. This, in turn, leads to a reduction in flexible or nonmandated compensation for surviving employees. If other wages and benefits are inflexible, some must lose their jobs. Mandated benefits, therefore, diminish the value of the compensation bundle from the perspective of employees.

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Some legislators and judges, however, are hailed for "doing so much" for American workers because the intervention's intent is visible, while the costs, in the form of failed and nonexistent businesses, lost jobs, reduced wages, and slower output growth, remain hidden. If it is enforced effectively, the just dismissal restraint will raise the cost of some employees more than others, and firms will engage in defensive hiring practices that might be termed "discriminatory." Low-wage, minority, part-time, and potentially litigious employees will be screened out. New enterprises will find it harder to survive. Each firm will find its labor flexibility reduced because it is more expensive to let employees go. Employers will come to examine job applicants with the same scrutiny they might use to evaluate a potential marriage partner. Employees will find their opportunities in other firms reduced because expected labor costs will be higher than under an at-will regime until wages fall far enough to offset the increased costs of labor administration, litigation costs, and damage awards. The effort and productivity of employees declines if risk of dismissal for shirking and low productivity declines. These negative economic consequences are enhanced by legal uncertainty and the possibility of state legislation. As with other modern labor interventions, these encroachments on at-will agreements are likely to harm the weak and help the strong.

Economists' quantitative assessments of the job and wage cost of the erosion of at-will law inevitably vary, but it is clear that these costs are significant. The range of estimates reflects the uncertain manner in which the new rules affect employers and workers: the expected cost of labor rises due to increased employer liability, but employers try to shift this cost as much as possible onto workers in the form of lower wages. Complete shifting is tantamount to perfectly inelastic labor supply. The less employers can shift, the greater the number of jobs lost. Hence the nasty tradeoff: job destruction or wage reduction. Once again, the lowest-wage workers are at the highest risk to lose their jobs.

Different studies employ different data and statistical models, assume different wage elasticities of labor demand and supply, and treat cost-shifting by employers differently. International studies have looked at speed of adjustment in the workforce in terms of hours versus employment on the theory that firms in countries with more severe dismissal restraints will rely more heavily on adjustments in employment hours, rather than changing employees. There is some statistical support for this difference, but the studies are too crude to isolate the partial impact of legal dismissal restraints and employment security laws. Changes in employment versus hours are sensitive to a host of differences in labor supply and demand characteristics, as well as many institutional rules and incentives.

Another empirical approach looks at job tenure and separation data. While the United States has shorter tenure on average than do the Europeans and Japanese, the difference is largely due to higher quit rates, especially among the

young, rather than a difference in dismissal rates. Annual dismissal rates are very low on both sides of the Atlantic: only about 4 percent of the workforce annually during economic expansions. By this standard, the U.S. private economy has about the same degree of security against dismissal as the more elaborate worker protection regimes in Europe.

Dismissals in Europe and the U.S. tend to be concentrated among low-tenure workers, especially a comparatively small minority of low-skilled workers, while wrongful dismissal suits tend to involve higher-skilled, white-collar employees. In Europe, a long-term decline in voluntary quit rates has increased "hiring reluctance" and raised employer concern about dismissal costs, even though contested dismissals have been relatively rare. Business surveys in Europe consistently find that too little flexibility in hiring and shedding labor has a significant effect on employers' decisions to hire.

The real issue boils down to worker insecurity. *Time* magazine insists that the "Great American Job" is gone. The conventional wisdom maintains that job tenure with the same company has deteriorated over the last 20 years. Yet there has been no aggregate change in the duration of jobs over the last two decades, according to Henry Farber, a Princeton University labor economist who studied the Current Population Survey data for 1973 to 1993 on jobs in progress. Long-term jobs have not disappeared, nor are they becoming less common in the American economy.

However, the overall figures mask an important change. Men with less than 12 years of schooling are less likely to work at long-term jobs than they were 20 years ago, while women with at least 12 years of schooling are more likely to do so. The increase in tenure with the same employer among women has offset the decline in tenure among low-skilled men. Highly skilled male workers enjoy much the same tenure they did in the 1970s, despite all the horror stories about corporate downsizing and unemployed white managers.

Although we have a high-turnover economy (in a 1994 Brookings Institution paper, P.M. Anderson and B.D. Meyer found that 23 percent of U.S. job matches dissolve each three-month period), near-lifetime job matches are common. Four out of 10 workers over age 30 will have the same employer for 20 years or longer. The median, ongoing job match here is about four and a half years, with completed tenures for typical workers about eight years. Contrary to popular wisdom, attachments of 15 years or longer are more common in the United States than in Japan. There is no statutory dismissal protection in Japan, so job security there also depends chiefly on performance.

Some observers point out that the direct costs of wrongful dismissal suits are very small in total or per employee hour, and hence have little impact on hiring and firing decisions. But this view ignores the indirect effect of tort and contract law on managers' decisions. Jim Dertouzos and Lynn Karoly of the RAND Corporation have used industry-specific employment data for all 50 states from 1980 to 1986 and found a large negative impact on employment growth in states with the most exceptions to the employment-at-will doctrine. Employment declines averaged 2 percent, and the negative impact was largest in the service sector, among larger firms, and in states recognizing tort damages.

The fact that the U.S. economy performed so well for so long made it seem that it could absorb any abuse and still deliver the goods. But the last 20 years of slow wage and productivity growth show that this is no longer the case.

Meanwhile, independent contracting and the temporary workers industry continue to expand vigorously. Temporary workers allow employers to avoid the high nonwage costs, including expected wrongful dismissal suits, of permanent employees. Surveys show that many firms have had experience with wrongful discharge litigation, with 80 to 90 percent of suits settled out of court. Of course, most firms have reviewed their personnel practices and taken low-cost measures to reduce their expected liability, especially on implied contract grounds, by either making explicit statements that employment is at will or having employees sign at-will agreements. As long as the courts respect voluntary waivers, the market can neutralize some of the new doctrines.

Once again, American businesses and labor markets react to minimize the social costs of bad rules. But one bad rule after another takes its toll. Recent statistical studies by Gerry Scully, a

management professor at the University of Texas, Dallas, and others show that economic growth and efficiency depend heavily on institutional rules. National economies can be thought of as gigantic firms. The efficiency of a firm depends on its internal reward structure, and so does the efficiency of a nation. The fact that the U.S. economy performed so well for so long made it seem that it could absorb any abuse and still deliver the goods. But the last 20 years of slow wage and productivity growth show that this is no longer the case.

What to Do?

There is no political potion that will restore the at-will doctrine overnight. But, fortunately, the situation is still very fluid. Even in states that have encroached furthest against at-will contracts, employment-at-will can be restored by legislative or judicial means. The doctrine remains strongly embedded in the law. In the new political era begun November 8, nearly everything is possible, maybe even the adoption of better ideas. The last thing the business community should do is settle for a "solution" like the one adopted by Montana in 1987—dismissal legislation establishing a compulsory arbitration system with statutory rights to job reinstatement or financial compensation for unjustified discharge. All the business community gets out of this arrangement is a legal limitation on employer financial liability per dismissal case. Such second-best legislation has been introduced in at least eight states. For the sake of investors, as well as the prosperity of American workers and consumers, the business community should not play the chump: it should hold out for restoration of employment-at-will.

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