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The Economic Dimension of the Employment Relationship

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5.1 Introduction

At its most basic level, the employment relationship is a matter of economics. Individuals offer their skills and abilities to an employer for a price. Economic considerations, such as wages, salaries, and levels of benefits, are major factors in individual and firm decisions to establish the employment relationship. Economic forces and markets also exert a strong influence on the employment relationship, once established. The vast majority of private employers operate in market environments and many are subject to competition that is global in scale. Even public employers are indirectly subject to market forces to the extent that these determine levels of government funding.

Neoclassical economics provides the dominant theoretical approach to understanding the employment relationship as an economic transaction. This theory stresses that individuals and firms make, respectively, utility-maximizing and profit-maximizing choices based on market-determined prices that they cannot influence. In a perfectly competitive environment, the choices they make lead to optimal outcomes for individuals, firms, and society as a whole.

Whereas economic theory provides a tool to understand the employment relationship, the extent to which societies allow market forces to determine or dominate the nature of the employment relationship is a public policy decision reflected in the laws that govern employment and labor relations. Some countries, such as the United States, have strongly based their public policy toward labor and employment on neoclassical economic theory and assumptions of competitive labor markets. Other countries, most notably those in the European Union, have regulated the employment relationship with greater recognition of imperfect competition in the labor market; the European Union has been much more willing than the United States to provide employees with specific legal rights in the employment relationship (Block et al. 2003).

This chapter examines the economic dimension of the employment relationship on three levels. First, we discuss how economic theory describes the employment relationship. Second, we examine how economic theory is used to create social and legal structures that define the employment relationship, using the United States and
the European Union as case examples. Third, we consider how these differing social and legal structures based on assumptions of economic theory manifest themselves in structuring employment at the firm level.

5.2 The economic foundations of the employment relationship

The neoclassical economic theory of the firm and consumer behavior provides an integrated explanation of the employment relationship as a set of transactions that optimize individual and social welfare. First fully synthesized by Marshall (1891), it premises that economic actors rationally seek their own best ends: Firms maximize profits and employees/consumers select their best possible bundle of commodities (including leisure) given their endowments (employee’s skills and abilities) and tastes. Given a competitive market in which: (a) consumers choose “rationally” and freely; (b) consumer satisfaction increases with consumption; (c) firms’ production technologies are not everywhere characterized by economies of scale and are well known; and (d) consumers and firms are mobile and informed about their markets, and price competition is efficient, and provides the goods, services, and leisure most valued by society. This model is general enough to incorporate diverse dimensions of the employment relationship including safety and health, life cycle decisions, and non-standard work, and the evaluation of alternative labor market policies. Within economic theory, the employment relationship may be viewed from the perspective of employee decisions about work and employment (labor supply), the firm’s hiring decisions (labor demand), and finally the integration of the supply and demand sides of a market, as well as conditions that cause competitive markets to produce undesirable outcomes.

5.2.1 The labor supply decision

Individuals’ decisions about work are a consequence of decisions about consumption. Individuals are seen as optimizing their well-being (utility) through consuming goods and leisure subject to constraints on their income and time and market prices inclusive of their wage rate. Utility increases with the consumption of goods and leisure. In the economic model, work does not of itself create utility; rather, it is a means of earning income that permits individuals (employees) to purchase utility-creating goods and leisure. This view that consumption, rather than work, creates well-being shapes public policy in countries such as the United States, where the desires of consumers for low prices are favored over the desires of workers for high wages and legal rights.

The relationship between work and utility is formalized in theory through constraints on individuals’ expenditures and time. Consumption purchases cannot exceed individuals’ earnings from working at their going wage and non-labor income. As time is finite over the model’s decision period, leisure time is limited by individuals’ decisions about consumption and, in turn, about working time. While leisure does not have a price in the market (e.g. it cannot be formally purchased),
its implicit price is the wage rate—the income foregone by taking leisure. Based on their tastes and preferences, employees then chose their optimal (utility maximizing) combination of leisure and consumption, given the wage available to them in the market and their non-labor income.2

Wages play a central role in employee decisions about labor market participation and working time. Higher wages increase labor market participation, but their effect on working time is ambiguous. Increased wages motivate individuals both to reduce leisure time (as its implicit cost is higher) and increase leisure (as higher incomes induce increased consumption of most goods). Although the effect of wages on individual work time is ambiguous, higher wages draw additional workers into a market and result in a positive relationship between the wage and labor supply at the level of the market. Decisions about labor supply are influenced not only by wages in the individual’s current labor market, but wages in related labor markets in which individuals might reasonably obtain employment, as well as the prices of goods and services individuals wish to purchase.

5.2.2 The labor demand side

Although firms may, for a time, pursue ends such as maximizing market share, economic theory stylizes firms as maximizing profits, the difference between revenue and costs, in the long term. Inputs, including labor, are available to the firm at the market price and the firm, facing these prices and the technical relationship between inputs and outputs (the production function), selects the set of inputs that provide the greatest return. While the firm’s problem differs somewhat in the short and long terms, the fundamental rule for profit maximization is that use of an input is increased to the point at which the increment to revenue (the product of the increment to output and the price of output) from an additional unit of that input is equal to its unit cost. Most production processes are characterized by diminishing returns, the increment to output is positive but declines as additional units of a particular input are applied. This produces a negative relationship between the price of an output and the amount demanded by a firm, the downward-sloping labor demand curve of the firm. As the rule on unit costs is applied to all inputs, marginal output per dollar spent is equalized across inputs and the use of inputs is affected by (a) its incremental productivity and price, (b) the incremental productivity and price of other inputs, and (c) the price of output.

One’s employability depends on the wage one is willing to work at and whether one possesses the skills and abilities to be considered an acceptable productive input. However, the firm’s demand for a particular type of labor is affected not only by its own price (the wage) or quality, but also by the price of other types of labor as well as the prices of other inputs. Market driven shifts in these prices will cause the firm to adjust its use of inputs, including labor. As suggested by Marshall, labor demand is more sensitive to changes in its own wage when (a) consumer demand is sensitive to changes in the price of output, (b) when other inputs can readily be substituted for labor in the production process, and (c) when the prices of other factors are not sensitive to increased demand for those factors.3
5.2.3 The interaction of supply and demand in the labor market

The market wage for a particular type of labor is determined in the labor market through the interaction of the labor supply and demand. The interaction of firms and workers through the market moves supply and demand toward equality and establishes a market clearing—equilibrium—wage. Suppose that the market wage is above the level that equates supply and demand. At this wage, more labor is offered than firms are willing to hire. Some of those who are not employed may offer their work for less than the market wage. The lower wage increases the demand for labor by firms (since demand rises with declines in the wage), and reduces supply as individuals withdraw from the market. As the wage falls, unemployment is reduced by continued absorption and withdrawal of workers until there are no additional workers who are willing but unable to find work at the going wage. Supply and demand are restored to equality and the downward adjustment of the wage ends. This process explains why increased competition from low wage labor can cause downward pressure on wages and force people out of the labor market. Achieving equilibrium in the labor market is a dynamic process that can alter the employment relationship and often change the conditions of employment.

From a theory perspective, there is no unmet demand for labor and no involuntary unemployment at the point of market equilibrium. All the labor that is willing to work at the going wage is employed; firms’ demand for labor is exactly met. The market may be moved off this equilibrium, which in a world of change is no more than a tendency, by shifts in output prices or the prices of non-labor inputs, by changes in technology, by changes in consumer tastes, or by government policy. Such changes will initially result in an imbalance between supply and demand but adjustments in the market wage moves the market to a new equilibrium. Prices, in this case the wage, play the central role in conveying information about market conditions and initiating actions by firms and individuals that restore equilibrium. They are the medium through which society signals economic actors how to reallocate resources to adjust to changes in technology, in tastes, or to conditions in other markets.

5.2.4 Market transactions and social welfare

Neoclassical economic theory does not just claim that this is a good way to organize the workplace. Rather, it maintains that under perfect competition the optimizing decisions of market participants produce the best possible outcomes for both individuals and society. As such, government or other intervention in properly functioning markets is unlikely to improve individual or social welfare. Suppose that government desires to increase employees’ earnings and intervenes by establishing a “minimum wage” above the competitive wage. Although some employees realize an improvement in their incomes and labor income on aggregate may rise, for society as a whole the gain is illusory. Most of the gain to labor comes from redistribution of income from other productive inputs, but the higher wage also reduces employment
as employers substitute other inputs for the more expensive labor and consumers respond to higher production prices by reducing consumption. And while producers affected by the minimum wage use too much capital, energy, and other inputs relative to society’s endowment, the labor released from that production is underutilized, being either unemployed or employed in an unregulated sector at a lower wage. In sum, a minimum wage raises costs, reduces output, and results in a smaller and less desirable set of consumption goods than was previously available. Society would be better off with an unregulated regime, in this case a regime without a minimum wage.

Regulation may also be objectionable because it prevents employees from arranging their leisure, consumption, and conditions of work to best fit their desires. Presumably, employees in a competitive market can choose suitable work and hours to fit their needs and wants. Those who desire shorter hours, safer conditions, or greater security from dismissal are at liberty to find employers who offer such employment packages. Others, less desirous of these conditions, can seek employment contracts that address their particular wants. By limiting freedom of contract, laws that regulate the conditions of labor preclude at least some employees from establishing their desired balance of consumption but do not improve the consumption of other employees (who have previously attained the now regulated conditions through individual bargaining).

5.2.5 Market failures

The conclusion, that markets produce socially desirable outcomes, is only assured where markets are reasonably competitive: Firms and individuals are price takers and prices are determined by the interaction of market supply and demand. Such outcomes may not be obtained where there are market imperfections: Where there is monopoly or monopsony (one buyer) in the labor market, when information about markets is incomplete, where participants are immobile, or where participants decisions do not allow for the effect of those decisions on others.

In the presence of market imperfections, prices no longer provide the appropriate signals to individuals or firms or these parties are unable to respond to those signals. For example, when there are monopsonies or oligopsonies, few buyers in the labor market, those buyers will maximize their profits by setting a wage below the competitive wage and employing too little labor. Labor will be misallocated across markets relative to the socially optimal allocation—away from its best use.

Competitive markets will also not produce individually or socially optimal outcomes if the information available to firms and individuals is incomplete or if labor is immobile. The efficient functioning of the market system requires that relevant information about markets be conveyed by price signals and that individuals and firms are able to respond. The wages paid by firms and industries reflect both worker productivity and working conditions. If workers value better working conditions and are aware of the conditions which are offered by firms, firms which offer
substandard conditions will have to pay a premium, a compensating differential, to recruit sufficient numbers of employees. This compensates workers for the poor conditions, protects the profitability of firms that offer better conditions, and provides an incentive for improving conditions. When information is lacking on working conditions, workers cannot signal their preferences for better conditions and there is no incentive for employers to provide the conditions which workers desire (and are willing to pay for in a reduced wage). This problem is most acute where dangers are not readily apparent, as is often the case with occupational illness.

Market processes will also fail to produce socially optimal outcomes where individual decisions affect the utility of others, such as when a large employer moves a manufacturing facility from a small- or medium-sized city. In such instances, individuals’ decisions will be based on their individual gains and losses and will not account for the wider consequences of their decisions, such as the loss of jobs in firms that depend on the existence of the facility. Wages and prices will not reflect the social dimension of decisions and, as a consequence, market adjustments will then reflect individual rather than social gains or costs.

5.2.6 Implications of the neoclassical model for labor market policy

The neoclassical economic theory carries clear prescriptions for labor market policy. If one believes that that markets are fundamentally competitive, social welfare is best served by policies that lessen market imperfections and remove barriers to competition. Efforts to improve the functioning of markets through regulatory policies which affect the price mechanism may be intended to achieve desired social ends, but they inevitably carry the cost of reducing economic efficiency. These strong conclusions are modified if one believes that market imperfections are pervasive and not readily overcome, or that markets do not appropriately value social and non-economic outcomes. Under such conditions, there is additional latitude for improving social welfare and economic conditions through restructuring and regulation without negative effects on efficiency.

Economic theory’s most powerful insights into the employment relationship may, however, come not from attending to the implications for optimality and social welfare, but rather from its focus on the operation of markets and their consequences. Firms and individuals operate across a multiplicity of markets. The logic of markets compels actors to be, to a great degree, economically rational if they are to survive and prosper. There are many different approaches to the employment relationship within firms, but these approaches must permit firms to compete effectively in their markets.

Nations are in a somewhat different position as they have been better able to structure national markets and impose barriers to international markets in the interests of national goals. Even national systems may, however, provide less shelter from market pressures in the future as changes in transportation, communication, and the international trading system expose ever larger segments of each nation’s economy to world markets.
In Section 5.2, we discussed the economic principles underlying employment. The extent to which these economic principles form the basis for organizing and defining the terms of the employment relationship vary across countries. We use the United States and the European Union as benchmarks for comparison. Although the United States and the European Union are both western capitalist economies, we contend that the United States and Europe represent fundamentally different concepts of the employment relationship and these different concepts account for the observed differences between the United States and the European Union with respect to the legislated labor standards (Block et al. 2003). The employment relationship in the United States is much more influenced and shaped by neoclassical economic thought than the employment relationship in Europe. These different concepts can be illustrated in differing societal beliefs in four areas: (a) the importance of individual rights; (b) the principle of the corporation as a legal individual; (c) the importance of property and property rights; and (d) views regarding the appropriateness of government regulation of markets, including the labor market. This part of the chapter will explore these beliefs in the United States and Europe.

5.3.1 Societal beliefs and assumptions

Individual rights and employment

The United States: Attempting to understand the social order in the United States, five sociologists noted that “individualism lies at the very core of American culture” (Bellah et al. 1985: 142). Lipset has observed that the “American creed can be subsumed in four words: Antistatism, individualism, populism, and egalitarianism” and that its “institutions reflect the effort to apply universalistic principles emphasizing competitive individualism and egalitarianism” (Lipset 1989: 26).

There are two employment-related implications that flow from the belief in individualism. The first is the assumption that the “normal” default employment relationship is individual rather than collective (Block 1990). Consistent with the neoclassical model, the employment relationship is presumed to be a relationship between two individuals in a competitive labor market, with the employee maximizing utility and the employer maximizing profit. Neither can be forced into establishing or continuing a relationship as to do so will require an individual employee or employer to agree to enter into a relationship or to accept terms and conditions of employment that will not maximize utility or profit, resulting in an outcome that is both inconsistent with individual rights and is associated with a misallocation of resources.

The second major implication revolves around views of individuals acting collectively and the freedom of association. There is a tension between the political principle of freedom of association and the economic principle of efficient labor markets as seen through the lens of neoclassical economic theory. While freedom of association is
valued, the neoclassical theory of the employment relationship, postulating a competitive labor market with individual employers and workers, each of whom has no influence on the price of labor, suggests that permitting workers to associate for purposes of collective bargaining has the potential to create inefficient suboptimal outcomes by giving workers monopoly power to influence wages, the price of labor.

In the United States, this tension is resolved by incorporating within the freedom to associate the freedom not to associate if one so desires, thereby addressing the neoclassical economic problem of suboptimal markets. By permitting employees to refuse to engage in collective activity and to act individually in the labor market, individuals/employees whose utility is maximized by accepting the (assumed market optimal) wage offered by the employer may do so, contrary to the wishes of those in the collectivity who chose to associate. Employees have the fundamental right to act as utility-maximizing individuals, and the collectivity may not impair that right.6

Europe: Unlike the United States, the European Union does not place a high value on individualism in the labor market. In Europe, unionism and collectivization of the employment relationship is considered a legitimate way and is often the dominant way of determining terms and conditions of employment. In many European countries, union density is greater than 50 percent of the labor force and workers covered under labor union contracts exceed 80 percent. Unions in Europe are afforded status such that individual employees are required to subsume their individual interests to the interests of collectivities to a much greater extent than in the United States. Indeed, unions are recognized as legitimate representatives of employees in the Treaty of Amsterdam and are given explicit roles in European Union policy-making (Treaty of Amsterdam 1997; Szyszczak 1999). In addition, labor unions in some European countries serve quasi-public roles. For example, in Sweden and Belgium labor unions manage the unemployment insurance system (Visser 1996: 191).

The European system of labor relations assumes a basic economic model of the labor market that is at variance with the U.S. model. The European model assumes that the normal labor market situation is not competitive. Rather, employers have substantial market power to maintain wages below competitive market rates. By establishing labor unions as the normal representative of the employees, countervailing power is established in the labor market. If union power offsets employer power, the assumption is that wages and terms and conditions of employment close to those that would emerge from a competitive market will be agreed upon.

The individuality of the corporation
The United States: As law in the United States has evolved, corporations are legal individuals. With the exception of the right to vote, corporations have the same rights as persons. Corporations may make contracts, buy and sell assets, hire and terminate employees, and engage in some political activity, such as contributions to candidates and speaking out on issues. This individuality makes corporations equivalent to employees in the eyes of the law. Although corporations are, technically, nothing more than collectivities of shareholders who combine their assets, their individuality supports the assumption that their size does not distort the labor market when they
participate as employers. Thus, the neoclassical presumption of competitive markets

can be applied, as the corporation's individuality supports a presumption that both

employer and employee have no influence on the price of labor.

Europe: In Europe, there is a much greater willingness than in the United States to

recognize corporations for what they are, businesses that are large collectivities of share-

holders with substantial market power, the existence of which may be inconsistent with

the price-taker assumptions of the neoclassical model. While their size gives corpora-
tions the opportunity to realize economies of scale and efficiencies in production, this

size can also provide corporations with monopsony or oligopsony power in the labor

market, leading to suboptimal outcomes. With less willingness to accept the notion of

the corporation as a person, there is more willingness on the part of the European Union
to recognize differences between employees, on the one hand, and corporations as

employers on the other. Thus, at least with respect to the labor market, European law

requires corporations to deal with unions as a countervailing force. In other words, the

European Union does not assume that legal individuality necessarily implies economic

individuality. European law does not assume equality between the corporation and the

individual employee; it assumes inequality. Equality is obtained through forcing

employers to deal with unions.

The importance of private property

United States: A third important value in the United States is the high status given to

private property (Kaufman 1997). The importance of private property was noted by

Perlman (1966) (orig. pub. 1928). Comparing the labor movement in the United

States with the labor movements in other countries, Perlman observed that the dis-
tinctive characteristic of the U.S. labor movement was an inability to stay organized

for “want of inner cohesiveness.” A major reason for this lack of solidarity, according
to Perlman, was the strength of the institution of private property. Perlman observed
that the labor movement was, fundamentally, an infringement on the right of the

employer to use its property as the employer saw fit. Whether this infringement was

by economic or legislative means, it was viewed as an infringement and would be

resisted (Perlman 1966, orig. ed. 1928).

In the United States, more recent writing on this issue noted that legal doctrine

has established beyond question the principle of deference to employers and their

property. Atleson cites as examples cases in which the public nature of privately

owned shopping malls were at issue (Atleson 1983: 91–6, Lloyd Corp).

The high status given to property rights permits employers to resist expansions

of employee rights by claiming that granting employees such rights would not only

be economically inefficient (as employers are presumed to maximize profits and

efficiency in competitive markets), but also a violation of the employer’s property

rights. Thus, as will be discussed below, property rights is the basis for giving U.S.

employers wide latitude to resist union organizing at the place of employment, and

is likely the reason why there is no mandated employee participation in firms.

Finally, a key corollary of the right of private property is full freedom of contract.

This, in essence, is the right of an individual to dispose of or do with his or her
property as he or she sees fit. By minimizing the constraints on private property, employers are assured of the authority to allocate productive inputs, capital, and labor in manner that they see fit, and that, presumably, maximizes their profits. In the neoclassical model, such profit maximization contributes to the efficient and optimal allocation of resources.

Europe: In contrast to the United States, there is a willingness in the European Union to place constraints on the business use of private property. Because corporations are not seen as economic individuals, and because there is no presumption that the exercise of private property rights by a corporation will necessarily lead to the most efficient allocation of resources, the private property rights of corporations in Europe are more circumscribed than they are in the United States. Thus, statutes have recognized the role of employees as legitimate stakeholders in the firm and given them rights of participation in a variety of decisions. Works council legislation in Germany, France, the Netherlands, and Sweden among other countries provides employees with rights to information, consultation, and co-decision. In Germany, works councils possess rights of co-determination over social policy issues such as payment methods, work schedules, recruitment, promotions, and dismissals. Information and consultation rights apply to issues of personnel planning, work organization, new technology, and job content. In addition, works councils have the right to information on company financial and economic matters and must be informed in good time about planned changes that may disadvantage workers (Visser and Van Ruysseveldt 1996). The European Union now requires large firms that wish to incorporate in more than one EU country to create employee consultation systems (European Union, Council Directive 2001/86/EC).

In addition, the European Union provides substantial protection to employees in the event of an ownership change in a firm. The European Union requires that the successor employer honor the employment “contract,” the basic terms and conditions of employment provided to the employees by the predecessor. EU employees are protected from dismissal due solely to the change in ownership, and are entitled to information and consultation with their representatives. If there is a collective agreement in place, it must be honored (Blainpain 1999). Works council legislation and EU directives on transfer of ownership significantly challenge managerial prerogative and the supremacy of property owners in the employment relationship.

Skepticism regarding government intervention

United States: The three beliefs discussed above feed quite logically into a fourth belief that is found in the United States: A skepticism regarding government intervention in markets in general, and therefore, in the labor market (Block 1992). Given the U.S. assumption that markets are generally competitive and function best if parties are left to maximize utility and profits on their own, government intervention would simply impair the otherwise efficient functioning of the market. This skepticism does not mean that there is no government regulation of markets in the United States. It does mean, however, that the burden of proof is always on those advocating government intervention to demonstrate that markets, left to their own devices, have failed or have
produced undesirable outcomes. Additionally, the existence of government intervention in markets is constantly being re-evaluated, with the costs and benefits of regulation under persistent scrutiny (Schwab 1997). Merely because government intervention exists does not mean it must always exist, as indicated by the movements to deregulate the airlines, trucking, and telecommunications industries in the 1970s and 1980s (Block and McLennan 1985; Keefe and Boroff 1994).

Europe: Because the European Union is less concerned about individualism than in the United States, it is less willing to see the corporation as an individual, has less concern about the rights of corporations to exercise property rights, and is less willing to see markets as competitive, the European Union is far more willing than the United States to place governmental constraints on the employment relationship. Thus, as noted, the European Union regulates the employment relationship to a much greater extent than does the United States (Block et al. 2003).

5.3.2 Employment laws and legal doctrine

Legal doctrine regulating employment is a useful barometer of a society’s norms and values vis-à-vis the employment relationship. It is reasonable to believe that, in a democracy, laws and legal doctrine reflect, albeit in a rough way, the values of the populace that elects the lawmakers.

Europe and the United States have different approaches to protecting workers. In Europe, worker protection is a component of human rights (Harris and Darcy 2001; Samuel 2002). Thus, the European Union directives prohibiting discrimination in employment on the basis of sex, race, religion, age, disability, or sexual orientation are grounded on constitution-like documents, including the Treaty on European Union and the Treaty Establishing the European Community. They are also part of the broader principle of social inclusion that is central to the European Union.

Freedom of association is also so established. The Charter of Fundamental Social Rights makes freedom of worker association and the right to join unions a fundamental EU right. The Treaty of Amsterdam formally incorporates unions, along with management, into the policy-making process of the European Commission by requiring the Commission to consult with representatives of labor and management on matters of social policy (Treaty of Amsterdam 1997; Szyszczak 1999). Moreover, a large number of European countries have established corporate systems in which a high-level labor organization represents workers in national-level negotiations with employers and the state (Turner 2002). This demonstrates that collective worker representation is not only constitutionally protected in the European Union, but may be seen as the preferred method of establishing terms and conditions of employment. Employees are believed to be best off if they subordinate their individual interests to the worker collectivity.

In the United States, on the other hand, legal employment protection has no constitutional basis, nor is it anchored in concepts of human rights (Adams 2002; Gross 2002); it is created through statute. This characteristic makes employee rights
in the United States subject not only to legislative changes, but also to judicial interpretations influenced by the attitudes, values, and views of judges. This section of the chapter will explore the relationship between U.S. social norms discussed above and employment legislation in two important areas: Anti-discrimination laws and laws governing collective bargaining.

**Anti-discrimination laws**

Since 1964, the United States, at both the federal and state levels, has enacted numerous laws that prohibit employment discrimination based on the personal characteristics of individuals. These characteristics include race, national origin, religion, gender, age, and disability. The rationale for these laws was that individuals were being prevented from obtaining employment or advancing in their current employment based on factors that were unrelated to their qualifications or expected productivity. In essence, then, these statutes may be viewed as enhancing the operation of the competitive labor market. In addition, because these laws protected individuals from discrimination, they were consistent with the value of individualism.

While they were consistent with the principle of the functioning of the market and individualism, these laws were inconsistent with the principles of private property and government non-intervention in the labor market. To say that a business could not make a hiring decision based on certain criteria was, in a sense, requiring an employer, a property owner, to permit on the owner’s premises an individual whom it may not otherwise permit on the premises. Thus, anti-discrimination laws created tension between values in the United States: The importance of the market and individualism, on the one hand, and the importance of private property and governmental non-intervention in the market, on the other. These tensions would appear in the interpretations of the statutes.

U.S. law prohibiting discrimination on the basis of race and gender has evolved to give racial and religious minorities and women substantial protection (Wolkinson and Block 1996: 24–8). On the other hand, the judiciary has been much less willing to impose restrictions on employers in age and disability discrimination cases. Some insight into why this has been the case can be obtained from the U.S. Supreme Court’s 2000 decision in Kimel et al. v. Board of Regents et al. In that case, Kimel and others had brought suit against their respective employers, state universities in Florida, alleging violation of the Age Discrimination in Employment Act, which Congress had applied to the states. The Court ruled, however, that the provision of the law which applied to the states violated the U.S. constitution, which prevents the federal government from requiring states to subject themselves to suits from their citizens in the absence of a willingness to submit themselves to suits. The court pointed out that unlike race and gender, age was not a “suspect classification.” Put differently, the Supreme Court simply did not believe that discrimination on the basis of age was of sufficient seriousness that discriminating on that basis, by a state as an employer, could not be constitutional. This was because there could, conceivably, be a link between productivity and age. The Court, therefore, found a transaction-based rationale for age-based discrimination.
This case illustrates the constitution–legislative distinction between Europe and the United States. In Europe, the right to be free from discrimination in employment is incorporated in constitution-like documents. In the United States on the other hand, because the right to be free from discrimination in employment is legislative rather than constitutional, it may be limited by constitutional principles that are superior to legislation; in the case of Kimel, the dominant constitutional principle was the sovereign rights granted to individual states within the governing principles of the United States.

Discrimination on the basis of disability was addressed in Sutton v. United Airlines. There, the Supreme Court determined that job applicants with 20/200 uncorrected vision but 20/20 corrected vision who had applied for positions as airline pilots were not disabled for purposes of the ADA because their disability was corrected. In other words, a person with a corrected or mitigated disability would not be considered disabled for the purposes of the ADA, and, therefore, not entitled to protection. This was because a disability, if corrected or mitigated, did not “substantially limit” a life activity. As such, the Court had no need to determine whether the employer’s requirement, a minimum of 20/100 uncorrected vision, was necessary for its business.

The dissent, on the other hand, pointed out that the legislative history of the ADA demonstrated that Congress had meant to define disability in its unmitigated or uncorrected form. More generally, the dissent stated that “I believe that, in order to be faithful to the remedial purpose of the Act, we should give it a generous, rather than a miserly, construction” (Sutton v. United Airlines).

Thus, the Supreme Court has substantially narrowed the coverage of both the age and disability discrimination statutes, consistent with the long-standing principles of property rights and minimization of government intervention in the labor market. This is most starkly revealed in Sutton. In that case, offered a clear choice between two fairly conflicting views, an expansive reading of “disability” and a narrow one, the Supreme Court consciously chose the narrow reading, thus favoring property rights and minimal government intervention in the labor market.

**Collective bargaining and the law**

Collective bargaining in the United States is governed primarily by one statute, amended on several occasions. The National Labor Relations Act (NLRA), first enacted in 1935 as the Wagner Act, provided most private sector employees, except those in railroads and airlines, with the right to self-organize into unions and to bargain collectively with a bargaining representative of their own choosing. Among other things, the purpose of the Wagner Act was to equalize bargaining power between employers and employees.

A law encouraging collective bargaining runs generally counter to the mainstream culture of individualism in the United States. For a period of 130 years in U.S. history, from 1806 through 1935, judicial decisions had generally repressed and made illegal union activity (Lieberman 1960). The NLRA was enacted in 1935, in the midst of the Great Depression, the most serious economic crisis in the history
of the United States. It is reasonable to believe that its passage was an aberration caused by unusual circumstances. That this is the case is indicated by subsequent legislative activity surrounding the NLRA. The 1947 Taft–Hartley amendments created rights of employees not to participate in organizing activity and put numerous constraints on unions. The 1958 Landrum–Griffin Act placed additional constraints on unions in collective bargaining and regulated the internal affairs of unions. Attempts to amend the NLRA to expand union rights were defeated in 1977, 1990, and 1993 (Block 1997). Only the 1974 Health Care Amendments to the NLRA, which brought non-profit private health care institutions under the coverage of the NLRA, can be seen as an exception to the post-1935 trend of narrowing the rights of unions (Block 1997).

This statutory evolution indicates the skepticism with which collective activity is viewed in the United States. While recognizing, in 1935, that there was a power imbalance between employers and individual employees and that collective action was necessary to balance that power, the Congress of the United States was willing to permit individual employees to weaken the bargaining power of the collectivity through individual action and to permit employers to exercise property rights that were the source of their superiority at bargaining power. The importance of property rights and individual rights were explored in two doctrines under U.S. labor law: Organizing, bargaining, and the rights of strikers.

With respect to bargaining, the law requires an employer to bargain collectively with the union representing its employees. Section 8(d) of the NLRA defines bargaining as “the performance of the mutual obligation of the employer and the representative of the employees to meet at reasonable times and confer in good faith with respect to wages, hours, and other terms and conditions of employment, …” (National Labor Relations Act as amended). In 1958, the U.S. Supreme Court decided that the parties were obligated to bargain only over “wages, hours, and other terms and conditions of employment” (NLRB v. Borg Warner, 356 U.S. at 349). By the same token, then, the parties were not obligated to bargain over matters not considered “wages, hours, and other terms and conditions of employment” (NLRB v. Borg Warner, 356 U.S. at 349). Thus, by the early 1960s, the question arose whether some subjects about which one party may wish to bargain might not be considered “wages, hours, and other terms and conditions of employment,” thereby obviating the obligation to bargain over that issue and creating a class of management decisions that affected employment but that the employer could make unilaterally, without negotiating with the union. The issue was ultimately addressed in First National Maintenance Corp. v. NLRB in 1981.

The employer in First National Maintenance provided cleaning and janitorial services to various nursing homes. The First National Maintenance employees at one of the customers, Greenpark, had unionized. Because First National Maintenance and Greenpark had developed a dispute over the amount of the fee Greenpark would pay First National Maintenance, First National Maintenance informed its Greenpark employees that its contract with Greenpark would be terminated, and, in turn, they would be terminated. The union requested bargaining over the decision to terminate
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the contract and the employees. First National Maintenance refused and the Supreme Court found in favor of First National Maintenance noting:

...in establishing what issues must be submitted to the process of bargaining, Congress had no expectation that the elected union representative would become an equal partner in the running of the business enterprise in which the union’s members are employed. Despite the deliberate open-endedness of the statutory language, there is an undeniable limit to the subjects about which bargaining must take place:

The Court went on to state:

Management must be free from the constraints of the bargaining process to the extent essential for the running of a profitable business (452 U.S. 666, 678–79).

No statute or other source was cited for this statement. In essence, the Court was asserting, consistent with the neoclassical model, that employers operating freely will cause optimal outcomes, and based on the dominant cultural assumption of property rights, an unwillingness to encroach upon a zone of property-based management rights it considered inviolate. Again, the basic assumption is that the optimal employment decisions in society are made by the employer free of regulatory labor market constraints.

Strikers and non-strikers

The greater status of individuals vis-à-vis the collectivity is illustrated in the U.S. Supreme Court decisions in Pattern Makers v. NLRB, issued in 1985, and Trans World Airlines (TWA) v. International Federation of Flight attendants, issued in 1989.

In the Pattern Makers case, the U.S. Supreme Court found it unlawful for a labor union to enforce upon its members an internal union rule that prevented them from resigning either during a strike or lockout or when a strike or lockout was imminent. The Court stated that “(b)y allowing employees to resign from a union at any time, (the law) protects the employee whose views come to diverge from those of his union. . . . (the union rule) curtails this freedom to resign from full union membership” (473 U.S. 95, 107). The four justices in dissent viewed the union as a legitimate economic instrument, noting “(i)n a strike setting, therefore, “[t]he mutual reliance of his fellow members who abide by the strike for which they have all voted outweighs . . . the admitted interests of the individual who resigns to return to work” (473 U.S. 95 at 130).

The TWA case grew out of a 1986 strike against TWA by the union representing its flight attendants. Under prior collective agreements, there existed at the airline a long-established system of job posting and bidding which was designed to permit the longest service senior flight attendants to fly out of the domiciles (home bases) and select the routes and schedules that they wished. The system was also designed to avoid laying off longer service employees by permitting the longer service employees whose positions were eliminated to displace shorter service employees. The result of this system was that the longest service employees had the most desirable positions available.
When the employees struck, TWA informed the union that it had decided to hire replacements for striking employees. The replacements would be assigned based on whatever vacancies (domiciles, routes, or schedules) were available on the hire date. If an employee chose to abandon the strike, he or she would also be assigned based on available vacancies. More senior crossovers, however, would not be permitted to bump less senior replacements. In addition, and more importantly, when the strike ended, the strikers would be assigned based on the available vacancies, as the Company would not permit the more senior strikers to displace the less senior replacements and any less senior crossovers. The result was that senior employees who struck lost their more desirable positions, although they continued to be employed by TWA.

The U.S. Supreme Court ruled that TWA had no legal obligation to permit the more senior strikers to displace less senior crossovers and replacements. The Court noted that the law protects “an employee’s right to choose not to strike,... and, thereby, protects employees’ rights to ‘the benefit of their individual decisions not to strike’…” (489 U.S. 426, 436). The court then went on to observe that

(1) to distinguish crossovers from new hires in the manner (the union) proposes would have the effect of penalizing those who decided not to strike in order to benefit those who did (489 U.S. 426, 438).

The dissent pointed out what the Court was really doing was choosing to favor the crossovers, those who chose not to strike and not to engage in collective activity.

The dissent observed:

The Court...allows TWA to single out for penalty precisely those employees who were faithful to the strike until the end, in order to benefit those who abandoned it. What is unarticulated is the Court’s basis for choosing one position over the other. If indeed one group or the other is to be “penalized,” … what basis does the Court have for determining that it should be those who remained on strike rather than those who returned to work? I see none, unless it is perhaps an unarticulated hostility toward strikes (489 U.S. 426, 447).

The dissent, in essence, challenged the majority to articulate the value judgment and assumptions underlying its decision, that it preferred that any losses associated with the strike be incurred by those who participated in collective action, rather than on those who declined to participate in the collective action. The majority, therefore, was protecting the right of the individual employee to abandon the group, and pursue his or her own utility-maximizing interest, even if it meant that the group would be worse off as a result. When faced with a choice that required deferring to the individual’s right not to strike, or to the collective right to strike, the Court chose the former, consistent with U.S. values.

Ultimately, values derived to a large extent from the neoclassical economic model of the labor market and an assumption of competitive markets determined the outcome of the case, and, more importantly, the relative rights of the individual and the collectivity. Consistent with the neoclassical model, employees have the fundamental right to act as utility-maximizing individuals, and the collectivity may not impair that right.
5.4 Experiences at the firm level

The preceding discussion suggests that the legal and policy environment in the United States is more favorable to employers vis-à-vis employees and unions than the legal and policy environment in the European Union. At the firm level, this difference would be expected to manifest itself in greater legal requirements on companies in their firm-level employment practices in the European Union relative to the United States. In this section, we compare the experiences of EU and U.S. employees in two human resource policy areas: Paid annual leave and part-time work. These areas were chosen because they are areas in which the European Union has enacted directives, in which the United States has enacted no legislation, and in which the United States Bureau of Labor Statistics (BLS) has collected data in the United States. Thus, the minimum requirements in the European Union established by the directives can be compared with market-determined firm-level outcomes in the United States.

5.4.1 Paid annual leave

The European Union requires member countries to provide workers with at least four weeks of paid annual leave. The United States has no legal requirement that any employee receive paid annual leave. Consistent with the U.S. practice, the existence and amount of paid annual leave available to employees is based on employer discretion, the market, and the provisions contained in collective bargaining agreements.

The market in the United States dictates that full-time employees receive annual leave. In 1999, 90 percent of all full-time employees in U.S. private industry received some paid annual leave (United States Bureau of Labor Statistics, undated). In 2000, that percentage was up to 91 percent (United States Bureau of Labor Statistics, undated).

Employees in the United States who receive paid annual leave receive far less than their counterparts in the European Union. As shown in Table 5.1, in the 1990s, the most recent time period for which the BLS has published data, only employees who had a tenure of twenty years in medium and large firms had paid leave at approximately the EU minimum. Moreover, only about one-third of employees had ten or more years of tenure with the same employer (United States Bureau of Labor Statistics, “Percent of...”). As the median employer tenure for employees twenty-five years of age and over during the 1990s was between 4.7 and 5 years (United States Bureau of Labor Statistics, “Median Years...”), it is reasonable to conclude that the typical full-time employee in the United States in the 1990s received from 11–14 days of paid leave each year, with variation around this mean. This is more than one week less than the four-week/twenty-day minimum required in the EU.

5.4.2 Full-time and part-time workers

As part of the legal regulation of employment in the European Union, it is generally a violation of EU law for firms to discriminate against part-time employees by denying them benefits that are otherwise available to full-time employees (European Union,
Council Directive 97/81/EC and Council Directive 98/23/EC). Such differential treatment between part-time and full-time employees is not prohibited in the United States. Table 5.2 presents data from the U.S. Bureau of Labor Statistics on the percentage of private sector employees with access to and participation in various employee benefit plans (incidence), by full- and part-time status, in 1999 and 2000, the last time these data were collected.

As can be seen, in 1999 and 2000, there was a substantial disparity in benefit access and participation between full- and part-time employees in the United States. The percentages for part-time workers represent a lower bound since some part-time employees may choose not to take benefits that are offered. However, this possibility is unlikely to close the significant difference in benefits between part- and full-time workers. With the exception of access to and participation in child care and survivor income insurance, the incidence of part-time employees in various benefit plans was always less than one-half of the incidence of full-time employees in comparable plans. Moreover, with respect to the two benefits in which incidence was equal, the full-time incidence was so low as to suggest that these benefits are rarely provided.

5.5 Summary and conclusion

This chapter examined the economic dimension of the employment relationship. The chapter first explored the basic neoclassical economic model of the employment relationship. It showed that neoclassical economic theory conceives of employers/firms as profit maximizers, and employees as utility maximizers, attempting to maximize utility obtained from the combination of income and leisure. Both are considered to be price-takers in the market, with no influence over the price of labor. The section then considered the possibility of market failures due to imperfections in the labor market.
Finally, the section pointed out that the key contribution of economics is its emphasis on markets, both product markets and labor markets, as the fundamental basis of the employment relationship. The employment relationship would not exist if there were not a market for the goods or services produced by the firm/employee and the employer and employee did not derive economic benefit from the relationship.

The next section of the chapter focused on the four beliefs that are linked to the economic concept of employment in the United States: The importance of individual rights; the principle of the corporation as a legal individual; the importance of property and property rights; and views regarding the appropriateness of government regulation of markets. It was shown these beliefs have a basis in the economic conception of employment as it is conceived in the United States. It was also shown that in Europe, where there is a much greater willingness than in the United States to

Table 5.2. Percentage of employees in various benefit plans, by full/part-time status, United States, 1999–2000

<table>
<thead>
<tr>
<th>Benefit</th>
<th>Employment status</th>
<th>1999</th>
<th>2000</th>
</tr>
</thead>
<tbody>
<tr>
<td>Annual leave</td>
<td>Full-time</td>
<td>90</td>
<td>91</td>
</tr>
<tr>
<td></td>
<td>Part-time</td>
<td>43</td>
<td>39</td>
</tr>
<tr>
<td>Accidental death,</td>
<td>Full-time</td>
<td>52</td>
<td>50</td>
</tr>
<tr>
<td>dismemberment insurance</td>
<td>Part-time</td>
<td>11</td>
<td>8</td>
</tr>
<tr>
<td>Retirement plans</td>
<td>Full-time</td>
<td>56</td>
<td>55</td>
</tr>
<tr>
<td></td>
<td>Part-time</td>
<td>21</td>
<td>18</td>
</tr>
<tr>
<td>Child care</td>
<td>Full-time</td>
<td>6</td>
<td>5</td>
</tr>
<tr>
<td></td>
<td>Part-time</td>
<td>6</td>
<td>3</td>
</tr>
<tr>
<td>Dental care</td>
<td>Full-time</td>
<td>39</td>
<td>35</td>
</tr>
<tr>
<td></td>
<td>Part-time</td>
<td>10</td>
<td>6</td>
</tr>
<tr>
<td>Paid holidays</td>
<td>Full-time</td>
<td>87</td>
<td>87</td>
</tr>
<tr>
<td></td>
<td>Part-time</td>
<td>36</td>
<td>39</td>
</tr>
<tr>
<td>Life insurance</td>
<td>Full-time</td>
<td>68</td>
<td>65</td>
</tr>
<tr>
<td></td>
<td>Part-time</td>
<td>15</td>
<td>11</td>
</tr>
<tr>
<td>Long-term disability</td>
<td>Full-time</td>
<td>32</td>
<td>31</td>
</tr>
<tr>
<td></td>
<td>Part-time</td>
<td>4</td>
<td>4</td>
</tr>
<tr>
<td>Medical care</td>
<td>Full-time</td>
<td>64</td>
<td>61</td>
</tr>
<tr>
<td></td>
<td>Part-time</td>
<td>14</td>
<td>13</td>
</tr>
<tr>
<td>Sickness and accident</td>
<td>Full-time</td>
<td>43</td>
<td>39</td>
</tr>
<tr>
<td>insurance</td>
<td>Part-time</td>
<td>15</td>
<td>12</td>
</tr>
<tr>
<td>Paid sick leave</td>
<td>Full-time</td>
<td>63</td>
<td>N/A</td>
</tr>
<tr>
<td></td>
<td>Part-time</td>
<td>19</td>
<td>N/A</td>
</tr>
<tr>
<td>Survivor insurance</td>
<td>Full-time</td>
<td>4</td>
<td>2</td>
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<tr>
<td></td>
<td>Part-time</td>
<td>1</td>
<td>1</td>
</tr>
<tr>
<td>Vision care</td>
<td>Full-time</td>
<td>22</td>
<td>21</td>
</tr>
<tr>
<td></td>
<td>Part-time</td>
<td>6</td>
<td>4</td>
</tr>
</tbody>
</table>

question the economic basis of the employment relationship, these four beliefs are not held nearly as strongly.

The final section of the chapter demonstrated how these differences in the conception of employment between the United States and Europe are experienced at the firm level. Exploiting the fact that the European Union regulates the employment relationship to a much greater extent than the United States, this section analyzed the difference between EU legislation in unregulated firm-level practices in the United States in two areas: Paid annual leave and differences between full- and part-time workers. The analysis showed that the regulations applied to firms in the European Union were more favorable to employees than the unregulated, market-driven outcomes in the United States.22

Based on this chapter, it is clear that neoclassical economic theory underlies employment and employment policy in the United States. This is in marked contrast to the European Union, where the employment relationship is considered to have substantial social content. As the European Union continues to evolve into an integrated economy that is not dissimilar to the United States, the contribution to the economic welfare of workers/citizens of the differing emphases on the economic dimension of employment will become an increasingly important issue.

Notes

1. Recent presentations of neoclassical economics as it relates to the employment relationship may be found in Ehrenberg and Smith (2000), Kaufman and Hotchkiss (1999), and Polachek and Siebert (1993).

2. Although institutional constraints normally prevent an individual from ceasing work at the precise moment that the marginal utility of leisure exceeds the marginal utility of an additional monetary unit of income, one can conceive of real world income–leisure tradeoffs. Teachers, for example, are professionals who normally earn less than professionals with comparable levels of education. This difference in compensation can be interpreted as the price of purchasing leisure in the form of summers and long breaks during the school year.

3. More sophisticated labor demand models better mimic the observed operation of labor markets by taking into account such factors as hiring and training costs, the presence of unions, imperfect information, and legislation.

4. For a similar analysis comparing the United States and Canada, see Block and Roberts (2000) and Block et al. (2003).

5. In limiting the chapter to comparing the United States and Europe, we acknowledge that we do not address a third model of the employment relationship—the East Asian model. This model is heavily influenced by Confucianism, which is “concerned with the correct observance of human relationships within a hierarchically oriented society” (Oh and Kim, 2002: 210). For example, both Lee (1992) and Lee (1997) have emphasized the importance of Confucianism in understanding the Korean economic system. Both point out that Confucianism emphasizes the maintenance of proper relationships between those in higher authority and those in subservient positions, for example, between the ruler and ruled, or the government and people.

6. See pp. 108–9, below.
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7. For a historical perspective on private property in the context of the founding of the United States, see Beard (1913, 1935).

8. This is precisely what happened in the United States in 1991 after the 1989 U.S. Supreme Court decision in Ward’s Cove Packing Co. v. Antonio (490 U.S. 642). In Ward’s Cove, the Supreme Court, reversing eighteen years of settled anti-discrimination law in the United States, ruled that an employer need only show a business justification for an employment practice that resulted in disparate impact on racial or ethnic or minorities. Under a 1971 U.S. Supreme Court decision, Griggs v. Duke Power Co. 401 U.S. 424, the employer was required to demonstrate the employment practice creating a disparate impact was necessary for the business. Congress, in 1991, legislatively enacted the Griggs “business necessity standard,” in effect overturning the Supreme Court’s decision in Wards Cove (Wolkinson and Block 1996: 36–8).


15. See also Albertsons v. Kirkburg (1999) and Murphy v. United Parcel Service (1999) in which the U.S. Supreme Court found, respectively, that an uncorrectable vision deficiency that resulted in truck driver having 20/200 vision in one eye and corrected high blood pressure were not disabilities under the Americans with Disabilities Act.

16. There are both employer and employee exclusions from the act. For example, the employees of an employer are not covered by the NLRA if the employer does affect interstate (a very small number of employers), if the employer is a public employer, or if the employer is an agricultural employer. Excluded employees of covered employers include supervisors, managers, and confidential employees who work for managers involved in labor relations matters. Employers and employees in railroads and airlines are covered by the Railway Labor Act, which provides employees with basically the same rights as the National Labor Relations Act. See National Labor Relations Act, as amended.

17. The Railway Labor Act has regulated labor relations on the railroads since 1926, and on the airlines since 1934.

18. The preamble to the Wagner Act, states, in relevant part:
   (t)he inequality of bargaining power between employees who do not possess full freedom of association or actual liberty of contract, and employers who are organized in the
The Economic Dimension

corporate or other forms of ownership association substantially burdens and affects the
flow of commerce, and tends to aggravate recurrent business depressions, by depressing
wage rates and the purchasing power of wage earners in industry and by preventing the sta-
bilization of competitive wage rates and working conditions within and between industries.
Experience has proved that protection by law of the right of employees to organize and bar-
gain collectively...promotes the flow of commerce by removing certain recognized sources
of industrial strife and unrest,...and by restoring equality of bargaining power between
employers and employees.

19. See National Labor Relations Act, Sec. 151.
21. Table 5.1 presents data on small and medium–large firms because that it how the data are
presented by the BLS. A small firm is defined as a firm with less than 100 employees
22. In areas in which the United States chooses to legislate, its labor standards are also lower
than the labor standards promulgated at the EU level. See Block et al. (2003).

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