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Individual Employment Rights and the Standard Economic Objection: Theory and Empiricism

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TABLE OF CONTENTS
I. Introduction ................................................................. 101
II. Price Theory, Minimal Terms and the Standard Objection ................................................................. 104
   A. The Price Theory Model of the Labor Market .......... 104
   B. Minimal Terms and the Standard Objection .......... 109
   C. An Aside on Waivable Terms ......................... 115
III. Justifications for Minimal Terms Within the Price Theory Model .................................................. 119
   A. Efficiency Justifications ................................... 120
      1. Collective Terms .................................. 120
      2. Imperfect Information ............................... 127
      3. External Costs ...................................... 132
      4. Summary of Efficiency Justifications .......... 133
   B. Distributional Justifications .............................. 134
IV. Conclusion ............................................................... 138

I. INTRODUCTION

For more than fifty years, labor law in American law schools has been synonymous with the law of collective labor relations.¹ Until recently,² labor law courses and scholarship have heavily emphasized

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² This symposium issue is the latest evidence of the increased interest in individual employment rights. See also M. ROTSTEIN, A. KNAPP & L. LIEBMAN, EMPLOYMENT LAW (1987); Federal Regulation of Work From Recruitment to Retirement, 49 LAW & CONTEMP. PROBS., (Autumn 1986); St. Antoine, Federal Regulation of the Workplace in the Next Half Century, 61 CHI-KENT L. REV. 631, 634-35, 655-61 (1985); Wirtz, On Teaching Labor Law, in THE PARK CITY PAPERS 1 (1985); Sum-
the relationship between unions and employers, while de-emphasizing (or completely ignoring) other important aspects of the employment relationship. With the gradual, but seemingly inexorable, decline in the proportion of the workforce that is unionized, it has become increasingly evident that this conception of labor law is too narrow. For the vast majority of today's workers and employers, labor law is relevant only to the extent it considers individual employment rights, employment rights outside of the context of collective bargaining.

This article considers one type of individual employment right, a type which I will call "minimal terms." Minimal terms are minimal substantive terms of employment which are required by the government and which are usually nonwaivable. Minimal terms are certainly not a new phenomenon. They can be found in English law as early as 1464 in the late Middle Ages, and have a long history in this country as well. In recent years, however, the importance of minimal terms in this country has increased as the significance of collective bargaining has diminished. The government has increasingly stepped in to require minimal terms which, it was once hoped, would be provided through the collective bargaining process.

Minimal terms present a basic challenge to the student of labor law. Unlike collective labor relations, the subject does not have a natural organizing principle. Minimal terms are found in dozens, if not

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4. Professor Weiler has described contemporary labor law with its emphasis on collective bargaining as "an elegant tombstone for a dying institution." Weiler, supra note 3, at 1769.
5. See infra notes 47-60 and accompanying text.
8. The United States has been a relative latecomer to the widespread use of minimal terms. Other countries, and in particular European countries, have used them earlier and more extensively. Estreicher, Unjust Dismissal Laws: Some Cautionary Notes, 33 Am. J. Comp. L. 310 (1985); Kahn-Freund, supra note 6, at 37-54. See generally Business Law in Europe (M. Ellis & P. Storm eds. 1982).
9. This result was predicted by Otto Kahn-Freund in his classic work Labour and the Law. Kahn-Freund, supra note 6, at 52.
10. Study of collective labor law is naturally organized around the National Labor Relations Act.
hundreds, of separate laws; they pursue different and sometimes conflicting policy objectives; they have separate and diverse enforcement schemes. One value of an economic analysis of minimal terms is that it provides a mechanism for organizing this vast and unruly subject. Economics permits a general analysis of minimal terms which avoids the distracting maze of rules, policies and procedures which interferes with other types of general analyses.

Economic analysis, of course, promises more than simply to organize. It also promises answers, very predictable answers if the author of the analysis lists the University of Chicago in his resume. Outside of Chicago, answers are more difficult to come by, although economic analysis may lead to answers if coupled with a rigorous empiricism. The value of a more theoretical economic analysis such as this one, however, is not that it provides answers, but that it directs our attention to the justifications and consequences of minimal terms. It defines the battleground, a battleground which might be quite different than the traditional battleground.

The battleground of law-and-economics, of course, has its own set of controversial assumptions, particularly with respect to labor economics. Although I do not believe that law-and-economics is the

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11. See infra notes 29-36 and accompanying text.
17. A number of economists and sociologists believe that conventional neoclassical analysis is unreliable when applied to the labor market because conventional neoclassical analysis assumes a relatively flexible market while labor markets are subject to institutional constraints which make them relatively rigid. See, e.g., Unemployment and Inflation: Institutionalist and Structuralist Views (M. Piore ed. 1979); Beck, Horan & Tolbert, Stratification in a Dual Economy: A Sectoral Model of Earnings Determination, 43 Am. Soc. Rev. 704 (1978); Cain, The Challenge of Segmented Labor Market Theories to Orthodox Theory: A Sur-
only way, or necessarily even the best way, to analyze minimal terms or that the neoclassical model is the best economic model to use when analyzing minimal terms,18 I do not deal with those underlying assumptions here. Rather, because law-and-economics is being used to argue against such terms, I explore in this article the circumstances in which the most common economic model can buttress rather than undermine the case for minimal terms, while emphasizing that the question is ultimately an empirical one.

II. PRICE THEORY, MINIMAL TERMS, AND THE STANDARD OBJECTION

A. The Price Theory Model of the Labor Market

The price theory model19 of the labor market is a specific instance of the more general neoclassical economic model in which the price of a commodity in a competitive market is determined by its supply and demand. The price theory model describes how the labor market would operate in a perfectly competitive environment. Although by now the basic outline of the model should be familiar to most lawyers,20 it may be helpful to begin by examining the model in broad

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relief.

Under the price theory model, the supply of labor and the demand for labor determine the equilibrium wage and the quantity of labor utilized. A basic understanding of labor supply and demand, then, is essential to an understanding of the price theory model.

As indicated in Figure 1,21 the demand curve for labor generally slopes downward.22 That is, assuming a fixed supply of capital, the marginal value of each unit of labor to employers declines as the quantity of labor utilized by employers increases. The downward slope of the demand curve for labor makes sense intuitively. Consider, for example, the demand for manual labor to dig a ditch.23 One worker using a large shovel may be able to dig 100 feet per day; two workers using medium-sized shovels24 might be able to complete 150 feet per day; three workers with tiny shovels might be able to complete 180 feet per day; and so on until there are many men with small trowels. The marginal product of each unit of labor decreases as more units of labor are added, assuming once again that capital is held constant. The marginal product of the first worker is 100 feet, of the second worker fifty feet, of the third worker thirty feet, and so on. Employer demand for labor depends on the marginal product of labor. An employer might be willing to pay the first worker the equivalent of 100 feet of ditch (the first worker's marginal product), but the second worker is only worth the equivalent of fifty feet of ditch, the third worker only thirty feet, and so on.25 If we graphed this phenomenon,
Figure 1.

![Graph of supply and demand curves for labor](image)

the marginal product for ditch diggers (which would determine the demand for that type of labor) would slope downward like the demand curve in Figure 1.\(^26\)

The supply curve for labor indicates the quantity of labor that is available at a particular wage rate. The supply curve for labor generally slopes upward, as indicated in Figure 1. Once again, the slope is intuitively sensible because a higher wage would tend to encourage workers to work more hours and to encourage non-workers to enter the labor force.\(^27\)

26. The downward slope of the demand curve for labor is one application of an important principle of economics—the law of diminishing returns. The law of diminishing returns states that as one adds units of one factor (labor in the example) to a fixed input of another factor (capital), the variable factor will produce diminishing marginal returns. See R. Lipsey & P. Steiner, Economics 190-92 (6th ed. 1981); L. Reynolds, Labor Economics and Labor Relations 86-87 (7th ed. 1978).

27. Economists call this phenomenon the substitution effect. Individuals choose how much to work by weighing the advantages of work against the advantages of leisure (which I use here to mean any activity other than work). When an individual decides not to work, the individual in effect has decided that the value of that amount of leisure time is worth more than the wages she could receive by working. An increase in the wage rate may tip the balance. After the increase, the wage may be worth more than the leisure time. As a result, the individual may
The intersection of the demand curve and the supply curve determines the equilibrium wage and quantity of labor employed. (See Figure 2). The wage and quantity of labor are in equilibrium in the sense that that level is the only stable position. Employers have no incentive to pay more than the equilibrium wage; as Figure 3 illustrates, they can attract sufficient labor to meet their demand at $W_1$. Indeed, the employer demand for labor at a higher wage, $W_2$, is only $Q_3$. Since there is an excess supply of labor at that wage level, (with $Q_2$ willing to work, but employers only willing to hire $Q_3$), workers will be unemployed, which should result in competition between workers for the available jobs, which should drive the wage down toward $W_1$, the equi-

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substitute work time for leisure time and, hence, increase the amount of time she devotes to labor activities. Portions of the supply curve may also be backward bending. That is, the supply of labor may decrease as the wage rate increases. If workers are already satisfied with the income they are receiving, an increase in the wage rate may lead them to reduce the amount of time they devote to work. They can earn the same amount working less hours and, thus, have more time available to devote to non-work activities. Economists call this phenomenon the income effect.
librium wage. In much the same way, as indicated in Figure 4, if employers pay a lower-than-equilibrium wage, employers will demand $Q_2$ workers, but only $Q_3$ workers will be available. The resulting competition between employers for the available workers should drive the wage up toward $W_1$. As a result, when wages are higher or lower than equilibrium, there are forces which drive the wages toward equilibrium. In contrast, when wages are at the equilibrium level, these forces are absent. The equilibrium wage is stable because, at that wage, employers can hire the optimal amount of labor given the demand for their products, while workers can optimally balance their demands for work and leisure.

This formal and bloodless picture of the labor market describes only how the market would operate in a perfectly competitive environment. In such an environment, employers and workers would have full, perfect and costless knowledge of the market, including information on wage rates and job openings; employers and workers would be entirely rational, with employers attempting to maximize their profits and workers responding to wage differences and attempting to optimally balance their desires for work and leisure; there would be no externalities; workers would be perfectly mobile and able to change jobs without any costs, and would not act in concert; and employers would be numerous, they would not act in concert, and
none would be so large that its decisions would affect the market as a whole.\textsuperscript{28} Obviously, these conditions are seldom, if ever, met. Nevertheless, the model is a useful starting point for discussion. When the conditions affect the analysis, as they inevitably do, the discussion can be advanced by easing the conditions.

B. Minimal Terms and the Standard Objection

Minimal terms are nonwaivable, minimum substantive terms of employment which are required by the government. They come in a wide variety of forms. The government might require employers to pay minimum wages,\textsuperscript{29} to provide a certain level of maternity rights,\textsuperscript{30}

\begin{flushleft}
\textsuperscript{28} See, e.g., A. CARTTER & F. MARSHALL, supra note 19, at 201; Leslie, supra note 19, at 361; Markovits, A Basic Structure for Microeconomic Policy Analysis in our Worse-Than-Second-Best World: A Proposal and Related Critique of the Chicago Approach to the Study of Law and Economics, 1975 Wis. L. Rev. 950, 961-62 [hereinafter Basic Structure].


\textsuperscript{30} A number of states require employers to provide at least some maternity benefits. For a recent survey, see Dowd, Maternity Leaves: Taking Sex Differences Into Account, 54 Fordham L. Rev. 699, 720-35 (1988).
\end{flushleft}
to provide a safe workplace,\textsuperscript{31} to supply information about plant closings,\textsuperscript{32} to pay severance pay,\textsuperscript{33} to make certain provisions for retirement\textsuperscript{34} and possible unemployment,\textsuperscript{35} to provide a certain level of health insurance,\textsuperscript{36} and so on.

In the abstract, effective\textsuperscript{37} minimal terms provide a benefit to workers and impose a cost on employers. All other things being equal, when a minimal term is added to the wage package, both the wage cost to the employer and the effective wages of the workers go up.\textsuperscript{38} Minimal terms which are set at or below market levels are not subject to the standard economic objection described in this section.


\textsuperscript{32} Four states currently require employers to provide notice of plant closings. Maryland, MD. ANN. CODE art. 41, § 7-304(b) (1986); Massachusetts, MASS. GEN. LAWS ANN. ch. 149, § 179B (West 1982); South Carolina, S.C. CODE ANN. § 41-1-40 (Law Co-op 1986); and Wisconsin, Wis. STAT. ANN. § 109.07 (West Supp. 1987). In addition, a number of municipalities require notice, \textit{see}, \textit{e.g.}, PHILADELPHIA, PA., ANN. CODE ch. 9-1500 (1986), as do bills currently in Congress. Omnibus Trade and Competitiveness Act of 1987, S. 1420, 100th Cong., 1st Sess., Title XXII, § 2202 (1987); Economic Dislocation and Worker Adjustment Assistance Act, S. 538, 100th Cong., 1st Sess. §§ 201-08 (1987); Labor-Management Notification and Consultation Act, H.R. 1494, 100th Cong., 1st Sess. §§ 1-10 (1987). \textit{See generally} Brown, \textit{How Often Do Workers Receive Advance Notice of Layoffs?}, 110 MONTHLY LAB. REV. 13 (1987) (about one out of three workers surveyed received advance general notice of layoff; on average, when notice was given, it was provided 46 days in advance of the layoff).


\textsuperscript{35} For a general review of the unemployment insurance system, see Price, \textit{Unemployment Insurance, Then and Now, 1935-85}, 48 SOCIAL SEC. BULL., No. 2 Oct. 1985, at 22.

\textsuperscript{36} A bill currently in Congress would require employers to provide a minimal package of health insurance for all workers. Minimum Health Benefits for All Workers Act, S. 1265, 100th Cong., 1st Sess. (1987).

\textsuperscript{37} By "effective" minimal terms, I am referring to minimal terms that are set above the market level. Minimal terms which are set at or below market levels would not have any effect on the market. If, for example, a minimum wage law requires wages of at least x dollars per hour but the market already pays more than x dollars per hour, the minimum wage would not effectively raise wages and so it would not have the market effects described in the text. Minimal terms set at or below market levels are not subject to the standard economic objection described in this section.

\textsuperscript{38} In this section, to facilitate a discussion of the standard objection to minimal terms, I have simplified the economic effects of minimal terms by analogizing them to exogenous wage increases. The analogy is quite accurate for some minimal terms (e.g., minimum wage laws), but less so for others (in particular, mini-
mal terms, at least in the short run, are the equivalent of a wage increase.\textsuperscript{39}

The standard objection to minimal terms, then, begins with a consideration of the effects of an exogenous wage increase (i.e., a wage increase that is not the result of changes in labor supply or demand) on the labor market. The effects in the short run should be as indicated in Figure 5. The intersection of the supply and demand curves

\begin{enumerate}
\item The standard objection to minimal terms, then, begins with a consideration of the effects of an exogenous wage increase (i.e., a wage increase that is not the result of changes in labor supply or demand) on the labor market. The effects in the short run should be as indicated in Figure 5. The intersection of the supply and demand curves

\item The analogy serves quite well, however, for the purpose of presenting the standard objection. In a later section, the economic effects of minimal terms are discussed in a more sophisticated fashion. See \textit{infra} note 70.

\item I do not include laws that prohibit discrimination within my definition of minimal terms. Even though discrimination laws can be viewed as governmentally required substantive terms of employment, I do not include them as minimal terms because they are economically distinct from minimal terms as I have defined them. To illustrate, consider a law which prohibits race discrimination and, hence, which requires a discriminatory employer to hire blacks. In contrast to minimal terms, the antidiscrimination law should not increase the discriminatory employer's labor costs, nor should it increase the effective wages of workers. Indeed, the cost of labor should be driven downward because the law expands the pool of potential workers and because black workers who face discrimination may be willing to work for less than white workers who have more opportunities.

It can be argued, however, that antidiscrimination laws actually do increase the labor costs of discriminatory employers. Even though the \textit{money} wages paid by employers to workers may not increase because of an antidiscrimination law, the \textit{actual} wage costs to employers do go up. The actual wage costs to employers include the money wages they pay to workers \textit{and} the value they place on satisfying their \textit{taste for discrimination}. Thus, a discriminatory employer might be willing to pay five for white workers even though he could employ black workers for four because he places a value of three on satisfying his taste for discrimination against blacks. That is, the actual cost to the discriminatory employer of employing white workers is five (five in money wages plus zero because he has no taste for discrimination against whites), while the actual cost of employing black workers is seven (four in money wages plus three because his taste for discrimination against blacks has been frustrated). If an antidiscrimination law requires the employer to hire black workers, the money wages paid by the employer should stay the same or even drift downward, but the actual labor costs of the employer (including frustration of his taste for discrimination) would go up. See \textit{generally} G. Becker, \textit{The Economics of Discrimination} (2d ed. 1971). Even if this is true, of course, antidiscrimination laws are distinct from minimal terms because minimal terms increase both the cost of labor to employers \textit{and} the effective wages of workers, while antidiscrimination laws increase the cost of labor to employers without raising the effective wages of workers.

In an important sense, then, antidiscrimination laws are the economic opposites of minimal terms. Minimal terms increase the cost of labor creating a decrease in demand, see \textit{infra} figure 5 and accompanying text, while antidiscrimination laws reduce the cost of labor creating an increase in demand. Antidiscrimination laws are economically distinct from minimal terms and require a distinct analysis. I do not undertake it here. For economic analyses of antidiscrimination laws, see G. Becker, \textit{supra}; O. Ashenfelter \& A. Rees, \textit{Discrimination in Labor Markets} (1973); F. Blau \& M. Ferber, \textit{The Economics of Women, Men, and Work} (1986).
determines the equilibrium wage, $W_1$. A minimal term imposed by the government would have the effect of a wage increase, raising the wage to $W_2$. The wage increase, in turn, would result in a reduction in the quantity of labor utilized from $Q_1$ to $Q_3$. One part of the standard objection to minimal terms, then, is that minimal terms do not confer any benefits on workers as a class. Any benefits received by one set of workers are paid for (and often more than paid for) by other workers in unemployment.

The effects of minimal terms illustrated in Figure 5, however, are not stable. The excess supply of labor creates competition between workers for the available jobs and, as a result, tends to force the wage level back down to equilibrium. Whether the wage actually moves back to (or at least closer to) the equilibrium level depends on

40. The reduction in the quantity of employment can occur in a variety of forms. Employers may lay workers off, refuse to hire workers they otherwise would have hired, reduce the hours of workers, fail to increase the hours of workers, and so on. Thus, in some circumstances (e.g., when employers reduce the hours of workers), workers may pay for their own minimal terms in reduced worktime. In addition, the variety in the ways in which the quantity of labor may be reduced means that the reduction may not appear in the unemployment statistics. See F. Welch, Minimum Wages: Issues and Evidence 23-24, 44 (1978). Nevertheless, for ease of reference, I will refer to the reduction in the quantity of employment as unemployment.

41. This objection does not necessarily mean that minimal terms are a bad idea. Depending on the slopes of the demand and supply curves, the gains from the minimal term (in Figure 5, the area enclosed by $W_1W_2$) may outweigh the losses caused by the reduction in the quantity of labor utilized (the area enclosed by $Q_1Q_3$). With perfect competition, the winners could compensate the losers and everyone could be better off.

Under more realistic conditions, however, this objection retains its force. The example in the text assumes that workers are indistinguishable in quality. If, as seems more realistic, worker productivity lies on a continuum, a minimal term that raised wages and reduced employment would result in higher-quality workers retaining their jobs and receiving the benefits of the higher wage while lower-quality workers losing their jobs. Consequently, if one considers the pool of low-wage workers who might be affected by a minimal term, the benefits would flow to those who need them most and the costs would be assessed against those who need them least. The empirical evidence, which suggests that the harshest impact of minimum wage laws is on the young, and particularly the black young, tends to support this view. See F. Welch, supra note 40; Welch, Minimum-Wage Legislation in the United States in O. Ashenfelter & J. Blum, Evaluating the Labor Market Effects of Social Programs 1-45 (1976). But see H. Wachtel, supra note 19, at 453-477.

42. Note that the excess supply of labor created by the minimal term is greater than the reduction in employment caused by the minimal term. The reduction in employment caused by the minimal term is the difference between $Q_1$ and $Q_3$, which is the difference between the quantity of labor required with the effective wage increase and the quantity of labor required at the equilibrium wage. The excess supply of labor includes the reduction in employment just described and the quantity of labor between $Q_2$ and $Q_3$, which is the quantity of labor which is available at $W_2$ but which would not be available at $W_1$, the equilibrium wage.
whether the employer can avoid the minimal term which effectively raised the wage level by making a compensating change in another part of the wage package. That is, an employer may be able to avoid a minimal term by offsetting the effective wage increase caused by the minimal term with an effective wage decrease in another part of the wage package. For example, a minimal term requiring employers to pay workers for maternity or paternity leave would be avoidable if employers reduced the wages of workers by an amount equivalent to the cost of the required leave program. Some minimal terms may not be avoidable. Minimum wage laws, for example, effectively apply only to low-wage, low-benefit jobs, so offsetting the wage increase by an

Note also that in a more sophisticated economic model of the effects of minimal terms, the wage level is likely to move downward in these circumstances, but to a new rather than to the old equilibrium. See supra note 38 and infra note 70.

43. Compensating changes should be distinguished from nonwaivability, which will be discussed later. See infra notes 47-60 and accompanying text. Minimal terms, by definition, are non-waivable. That is, they must be included in the wage package; workers and employers cannot agree to omit them. Minimal terms, however, can be avoided through compensating changes, that is, through wage decreases elsewhere in the wage package. Thus, even though minimal terms are included in the wage package, compensating changes can nullify their effect.
effective wage decrease in another part of the wage package may not be possible. Most minimal terms, however, should be avoidable, at least in the long run. Even if employers cannot make compensating changes immediately, as in the maternity or paternity leave example, they should be able to do so in the long run, for example, by reducing the rate of increase in wages. When minimal terms are avoidable through compensating changes, wages and quantity of labor should tend to move back to equilibrium.

Another part of the standard objection to minimal terms, then, is that workers and employers will find ways to counteract the desired effects of minimal terms and, indeed, that there are economic forces which drive the parties to do so. Since minimal terms are effective wage increases, they can be counteracted by actual or effective wage decreases in other parts of the wage package. The excess supply of labor encourages the counteraction.

A corollary of this objection is that when wages and quantity of labor move back to equilibrium in reaction to a minimal term, both employers and workers are worse off than they would have been if the minimal term had never been imposed. Using the maternity or paternity leave example again, if the wages and quantity of labor move back to equilibrium, the overall wage package is worth the same as the overall wage package before the minimal term was imposed, but its components are different. Before the minimal term, the package provided no maternity or paternity leave, but a higher wage; after the minimal term was imposed, the package provided maternity or paternity leave, but a lower wage. By hypothesis, the ex post position leaves the parties worse off. In a world with perfect competition, if the parties had wanted that wage package, they would have bargained for it ex ante. Since they did not, imposition of the minimal term frustrates the wage package preferred by the parties.

The standard economic objection to minimal terms, then, is that any perceived benefits to workers are merely illusory. Because imposition of minimal terms is the equivalent of a wage increase and because an exogenous wage increase reduces the demand for labor, any benefits to workers from minimum terms in the short run are paid for by other workers in unemployment. In the long run, minimal terms can

44. Employers may not be able to offset the costs of minimal terms immediately for a variety of institutional reasons. For example, they may be parties to collective bargaining agreements which restrict their ability to make adjustments.

45. Governmental attempts to limit the avoidability of minimal terms are likely to be unsuccessful because of high monitoring costs. There are a large number of terms in the ordinary employment contract, it would be difficult for the government to monitor changes in the terms, and it would be difficult to link changes in terms to imposition of minimal terms.

usually be avoided by offsetting the effective wage increase from imposition of the minimal terms with wage decreases elsewhere in the wage package. When minimal terms are avoided, employers and workers are worse off than they would have been if minimal terms had not been required in the first place.

C. An Aside on Waivable Terms

In contrast to minimal terms, the government may establish terms of employment which are waivable by the parties. In most circumstances, waivable terms are gap fillers; they are terms which will be implied if the parties have not spoken on an issue. Thus, the government may say that if the agreement between the parties does not establish termination rules, an “at-will” provision will be read into the agreement. Or, in the same situation, the government might say that a “for cause” provision will be read into the agreement. In either case, so long as the parties can modify the term by contract (i.e., so long as the term is waivable), the government’s action is not subject to the standard economic objection. Examining why the standard economic objection does not apply in this situation tells us something about waivable terms, but it also sheds light on the nature of the standard economic objection to minimal terms.

To explore the difference between waivable terms and minimal terms, consider the example concerning termination rules. The two government positions assign the right to terminate differently. An “at-will” provision allocates the right entirely to employers, while a “for cause” provision allocates at least a portion of the right to workers.47 Regardless of which government position is adopted, if the provision is waivable and there are no transaction costs, the right should end up in the hands of the party who values it more highly. Say that the employer values the right to terminate at ten, while the workers value the right to avoid termination at five.48 Since the employer val-

47. Even under a “for cause” provision, employers could terminate workers for certain “good” reasons, such as worker misconduct or a reduction in the employer’s need for labor. Workers would be able to avoid termination, however, if employers attempted to terminate them in the absence of these “good” reasons.

48. To say that a waivable term will end up with the party who values it most highly regardless of the government’s assignment is not to say that the right will end up with the same party regardless of the government’s assignment. If people value goods which they possess more highly than they value other goods (that is, if people demand more to give up a good in hand than they would pay to acquire that good), the government’s initial assignment of the right may affect the parties’ valuation of the right. Kelman, Consumption Theory, Production Theory, and Ideology in the Coase Theorem, 52 S. CAL. L. REV. 669 (1979); Sunstein, Legal Interference with Private Preferences, 53 U. CHI. L. REV. 1129, 1150-52 (1986). But see Spitzer & Hoffman, A Reply to Consumption Theory, Production Theory, and Ideology in the Coase Theorem, 53 S. CAL. L. REV. 1187, 1198-99 (1980); Schwab, Collective Bargaining and the Coase Theorem, 72 CORNELL L. REV. 245,
uses the right more highly than the workers, the workers will not be able to buy it from the employer if the right is initially assigned to him (they would only be willing to offer five for a right that the employer values at ten), but he should be able to buy it from the workers if the right is initially assigned to them (he can offer up to ten for a right that they value at only five). Thus, when the employer values the right more highly, he should acquire the right regardless of the initial assignment of the right by the government. The converse, of course, is also true; if the workers value the right more highly than the employer, they should acquire the right regardless of the initial assignment.

Waivable terms, if used and understood in this way, should not interfere with the labor market. In initially assigning the right, the government should attempt to predict the bargain the parties would have reached had they considered the issue. If the government initially assigns the termination right to employers, it is judging that employers value the right more highly than workers. Even if the government's judgment is wrong and workers value the right more highly, the initial assignment does not interfere with the market because, if that is the case, the workers can buy the right from employers. A perfectly functioning labor market would allocate rights to the parties

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49. Economists might describe this by referring to opportunity costs. If the right is initially assigned to the workers, the cost to them of exercising the right is the highest valued alternative (or opportunity) that is lost through that exercise. So if the employer values the right more highly, the workers gain $x$ by exercising their right not to be terminated (when $x$ is the value workers place on their right not to be terminated), but they give up more than $x$ because they have lost their opportunity to sell the right to the employer who places a higher value on it. Because of this opportunity cost, then, the workers would be better off to sell the right to terminate to the employer rather than to exercise their right to avoid termination.

50. This, of course, is merely an application of the Coase Theorem which holds that, in the absence of transaction costs, rights will ultimately be allocated to the party that most highly values them, regardless of their initial assignment. Coase, The Problem of Social Cost, 3 J. LAW & ECON. 1 (1960). For a brief discussion of the concept, see C. Goetz, Cases and Materials on Law and Economics 51-55 (1984). For a recent criticism of the concept, see White, Coase and the Courts: Economics for the Common Man, 72 IOWA L. REV. 577 (1987).

51. Waivable terms may result in an efficiency gain if the government makes an accurate prediction because the parties would be spared the time and expense of negotiating and drafting a provision on that topic. Kronman, Paternalism and the Law of Contracts, 92 YALE L.J. 763, 766-67 (1983). On the other hand, there should be no efficiency loss if the government makes an erroneous prediction because then the parties would be in the same position (except for bargaining endowments) they would have been in if the waivable term did not exist.
who value them most highly. Waivable terms do not interfere with the labor market, because they reach the same result.

Minimal terms, in contrast, may require that a right be left with a party who values it less. If the government assigns the termination right to workers even though employers value it more highly, the minimal term would interfere with the market. That is, it would frustrate the bargain the parties would prefer. To illustrate, assume once again that the employer values the termination right at ten and the workers value it at five. A minimal term requiring the right to be held by the workers would frustrate the preferred bargain because both the employer and the workers would prefer a different arrangement. Both parties would see themselves as better off if the workers could sell the termination right to the employer and receive between six and nine from the employer in return.

One part of the standard economic objection is that minimal terms prevent the parties from reaching the arrangement which best accommodates their preferences. Waivable rights are not subject to this part of the standard objection because, to the extent they are not consistent with the parties' desires, the parties may override them.

The other major part of the standard objection to minimal terms is that they interfere with the overall functioning of the labor market. Minimal terms are the equivalent of an exogenous increase in wages, which should lead to a reduction in the quantity of labor demanded. Viewed in isolation, one would also expect waivable rights to be subject to this part of the objection. The government's initial assignment of a right should affect the distribution of income between workers and employers. Assume, for example, that the employer has a total pool of resources of 100 and values the termination right at ten, while the workers have a total pool of resources of 100 and value the termination right at five. If the government assigns the termination right to the employer, the right should stay with the employer (the workers will be unable to buy it from him), so the employer's total pool of resources will be 110 and the workers' total pool of resources will be 100. If the government assigns the termination right to workers, the employer should be able to purchase the right for an amount between six and nine. Assume the employer purchases the right for eight. The employer's total pool of resources then would be 102 (his initial pool of 100, plus the 10 from possession of the termination right, minus the eight paid to the workers) and the workers' total pool of resources would be 108.

Thus, viewed in isolation, a change in the assignment of the right from the employer to the workers is the equivalent of an exogenous

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52. See supra figure 5 and accompanying text.
wage increase, while a change in the assignment of the right from workers to the employer is the equivalent of an exogenous wage decrease. In either event, the change in assignment of the right would affect the overall functioning of the labor market. The wage increase or decrease would cause a corresponding decrease or increase, respectively, in the demand for labor.\(^5\)

Once again, however, these short term changes in the labor market would not be stable. Shortages or excesses in the supply of labor should drive the wages back towards the original equilibrium.\(^5\) The route back is likely to be through compensating changes. Assume, for example, that the government has re-assigned termination rights from employers to workers. Using the same numbers as before, the workers should receive a short-term increase of eight. But since that would create an oversupply of labor, the competition between workers should drive the wage back down to equilibrium. The most direct method of return\(^5\) would be for the employer to make a compensating change by reducing the money wages portion of the wage package by eight. In a situation where compensating changes can be made, then, the government's assignment or reassignment of waivable rights should not alter the distribution of income between employers and workers\(^5\) and, as a result, should not adversely affect the overall functioning of the labor market.

Thus, waivable rights, like minimal terms, would adversely affect the overall functioning of the labor market only when compensating changes could not be made.\(^5\) The ability to make compensating changes, however, should be greater with waivable rights than with minimal terms. With minimal terms, the compensating changes must be made in portions of the wage package outside of the minimal term itself.\(^5\) With waivable rights, the right itself can be molded to bring the total wage package closer to equilibrium.\(^6\) Thus, although there may be circumstances in which compensating changes cannot be made

\(^5\) See supra figures 3 & 4 and accompanying text.

\(^5\) See supra figures 3 & 4 and accompanying text.

\(^5\) Because the wage package contains a large number of terms, there is a wide variety in the types of compensating changes that could be made to return the overall wage to the equilibrium level.

\(^5\) Several commentators have made this point in other contexts. See Demsetz, \textit{Wealth Distribution and the Ownership of Rights}, 1 J. Legal Stud. 223 (1972); Demsetz, \textit{When Does the Rule of Liability Matter?}, 1 J. Legal Stud. 13 (1972); Leslie, supra note 19, at 370-72; Schwab, supra note 48, at 262-65.

\(^5\) See supra notes 42-45 and accompanying text.

\(^5\) By definition, the minimal term is nonwaivable and, hence, must be included in the wage package as is.

\(^5\) With termination rights, for example, there is a broad continuum of possible rights, ranging from an unfettered right to discharge vested in the employer to an unfettered right to resist discharge vested in the worker. The valuations of these possible rights by the employer and workers would vary as one moved along the
so that waivable rights would have an affect on the overall functioning of the labor market, that should occur less often with waivable rights than with minimal terms.

III. JUSTIFICATIONS FOR MINIMAL TERMS WITHIN THE PRICE THEORY MODEL

Employers and individual workers face a difficult problem when they wish to enter into a relationship. A number of uncertainties exist which may affect the relationship—uncertainties about the precise work the employer needs done, the ability of the worker to perform it, the employer's long-term need for the work, other work opportunities which may present themselves to the worker, the worker's continued good health, the safety of the workplace, and so on. The proposed relationship is also quite complex—what arrangements should be made for the worker's retirement, for the possibility of a work-related injury, for health insurance, and so on. Minimal terms can be viewed as a set of ready-made contract terms which deal with many of these difficult issues. The government, for example, requires a certain minimum amount to be set aside for retirement and requires certain safeguards if greater amounts are reserved. To the extent the parties would have included the same or very similar terms in the employment contract even if they had not been required by the government, the minimal terms are efficient. They spare the parties the time and expense of having to negotiate the terms. This effect of minimal terms should be uncontroversial. Governments generally enact minimal terms, however, not merely to save transaction costs, but to change the substance of the employment arrangement. That is precisely why minimal terms are nonwaivable. It is this goal—to change the employment contract—which runs into the standard objection. When minimal terms are required and they change the arrangements the parties would otherwise have made, the standard objection leads to the conclusion that the parties are necessarily made worse off.

This section considers circumstances in which minimal terms

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61. Because of this uncertainty and complexity, employment contracts are generally relational, that is, the parties are not able to reduce important terms of the arrangement to well-defined obligations. See Goetz & Scott, Principles of Relational Contracts, 67 Va. L. Rev. 1089 & n.1 (1981).
62. Federal Old-Age, Survivors, and Disability Insurance Benefits (Social Security) Act, 42 U.S.C. §§ 401-433 (1982). It may, of course, be more appropriate to view the old age benefits of the social security program as a straight transfer program from workers to retired persons.
64. See Sunstein, supra note 46, at 1052-53; Kronman, supra note 51, at 766-67.
might not be subject to the standard objection but, rather, may enhance efficiency or lead to a more desirable distribution of resources.

A. Efficiency\textsuperscript{65} Justifications

1. Collective Terms

Some terms of employment are collective in nature; that is, if they are supplied to one worker, they must also be supplied to other workers.\textsuperscript{66} Terms may be collective by their very nature or they may be collective for practical reasons. Health and safety terms, for example, are often collective by their very nature. If an employer supplies clean air or good lighting to one worker, other workers are usually able to share in the benefits.\textsuperscript{67} More often, however, terms are collective for practical reasons. When workers work together closely, an eight hour day for one worker may mean an eight hour day for other workers. When one worker demands and receives a new vending machine in the cafeteria, it is likely that other workers will be allowed to use it. When an employer establishes a disciplinary system for a few workers, it may be efficient to use it for all workers.\textsuperscript{68}

\textsuperscript{65} By efficiency, I mean that a minimal term gives its beneficiaries the equivalent of more dollars than the term takes away from its victims; in simple terms, efficiency means that the economic pie has gotten larger. \textit{Causes and Policy, supra} note 20, at 2-3; \textit{Basic Structure, supra} note 28 at 955-58. For my purposes, I need not deal with the problems of operationalizing this definition. \textit{Id.} at 956-58 & n.8.

\textsuperscript{66} The key element of a collective term, then, is nonexcludability: it must be impossible or impractical for an employer to exclude non-paying workers from using the term if the employer supplies it to one worker. See M. OLSON, \textit{THE LOGIC OF COLLECTIVE ACTION} 14-15 & n.21 (1965). Other, more restrictive definitions of collective terms have been proposed. Poulson and Head, for example, would require both nonexcludability and unlimited joint consumption (i.e., additional use of the benefits of the term by one individual would not reduce the benefits available to others). Poulson, \textit{Is Collective Bargaining a Collective Good?}, 4 J. LAB. RES. 349 (1983); Head, \textit{Public Goods and Public Policy}, 17 PUB. FIN. 197 (1962). For my purpose, which is merely to demonstrate that minimal terms can improve efficiency, this difference in definitions is not important. Although a more restrictive definition would mean that the absolute number of minimal terms which can be justified on this basis would be reduced, the ability to justify minimal terms with this rationale is not affected.

\textsuperscript{67} This type of collective term, in many instances, should be able to satisfy even fairly strict definitions. \textit{See supra} note 66. With a term requiring clean air, for example, it would be difficult to exclude non-paying workers from the benefits and additional use of the clean air by one worker should not decrease the amount of clean air available to other workers.

\textsuperscript{68} More generally, minimal terms are collective for practical reasons where the cost of providing the benefits of the term to additional workers is low (even though the cost of initiating providing the term might be high) or where the costs of collection for the benefits of the term outweigh the revenues which would be received.
Collective terms\(^6^9\) are likely to be underproduced. That is, the terms will often not be offered even though the cost to the employer of providing the terms is less than the value the workers place on the benefits of the terms. To illustrate why this is the case, consider an employer who employs ten workers and who could install Equipment A at a cost of one, which would clean the air in the plant a bit or Equipment B at a cost of twenty, which could clean the air in the plant quite a bit. Assume that each worker would value the cleaner air produced by Equipment A at two and the cleaner air produced by Equipment B at five (i.e., each worker would be willing to accept a reduction in pay of two and five, respectively, in return for the cleaner air).\(^7^0\) From an efficiency standpoint, the employer should install Equipment B. At a marginal cost of nineteen, the employer can produce cleaner air with a marginal value of thirty (see Table A); both the employer and the workers would be better off if the employer installed Equipment B and reduced the workers' aggregate wages by an amount between twenty and twenty-nine.

Because of strategic behavior and information imperfections, however, Equipment B will not always be installed and, indeed, even Equipment A may not be installed in some instances. Consider the calculations of each individual worker who is deciding whether to accept lower wages for cleaner air. Clearly the best outcome for an individual worker would be to refuse to accept lower wages, but to have the equipment installed because other workers accepted lower wages.

\(^6^9\) I use the phrase "collective terms" to refer to terms of employment that provide collective goods—benefits which by their nature must be supplied to the group if they are supplied to one worker.

\(^7^0\) In this situation, then, the employer and the workers place different values on the minimal term. As a result, the simple economic model used to present the standard objection is not sufficiently sophisticated to describe the situation. See supra note 38. Figures 6 and 7 graphically present a more sophisticated economic model to illustrate the efficiency consequences of installing Equipment A. Figure 6 presents the situation without Equipment A. The size of area ABC represents the efficiency gains from the situation. (Area ABC represents the difference between the total income derived from employing that quantity of labor—area OCBQ—and the minimum amount of wages that would have been necessary to induce workers to devote that amount of time to work rather than to leisure—area OABQ. The allocation of the gains between the employer and the workers depends on the slopes of the supply and demand curves. See infra note 110.) Figure 7 presents the situation with Equipment A installed. The demand curve for labor has shifted downward by an amount equal to the cost of installing Equipment A, from D to D; the employer is willing to pay less for labor with Equipment A because of the cost of installing the equipment. At the same time, the supply curve shifts by an amount equal to the value workers place on Equipment A, from S to S; workers are willing to work for less because they value the cleaner air produced by Equipment A. Because the shift in the supply curve is greater than the shift in the demand curve, area A,B,C is larger than area ABC. Installing Equipment A has resulted in an efficiency gain. See Harrison, supra note 14, at 335-37.
In that situation, the worker would be a free rider; she could share in

Figure 6.
the benefits of the clean air,\textsuperscript{71} but would not have to pay for it. If all of the workers engaged in this type of strategic behavior, neither Equipment A nor Equipment B would be installed.\textsuperscript{72} Thus, one reason the efficient outcome may not be achieved is that individual workers may engage in strategic behavior designed to position themselves as free riders.

The calculations of individual workers also provide another reason why Equipment B may not be installed. With Equipment A, an individual worker can be certain that the equipment will be installed if she eschews strategic behavior and accepts a reduction in wages equal to the value she places on the clean air produced by the equipment. Because the equipment costs one and the worker values the clean air at two, the employer would be willing to promise to install the equipment in return for the agreement to accept lower wages. With Equipment B, however, an individual worker cannot operate with such certainty. Because the equipment costs twenty and any individual

\begin{figure}[h]
\centering
\includegraphics[width=\textwidth]{figure7.png}
\caption{Wages vs. Quantity of Labor}
\end{figure}

\begin{itemize}
\item \textsuperscript{71} This result is required because, by definition, if a collective term is provided to one worker, other workers cannot be excluded from its benefits.
\item \textsuperscript{72} The odds of Equipment A being installed, of course, are greater than the odds of Equipment B being installed. With Equipment A, only one worker need not engage in this type of strategic behavior for the equipment to be installed. For Equipment B, at least four workers must refrain from the strategic behavior.
\end{itemize}
worker would only be willing to agree to a maximum wage reduction of five, the equipment will only be installed if other workers also eschew strategic behavior. As a result, in deciding on the amount of lower wages to accept in return for the cleaner air produced by Equipment B, the individual worker should discount the value of the cleaner air to her (five) by the probability that the equipment will actually be installed. Depending on the size of the discount and the ratio of the marginal cost of the additional equipment to its overall marginal value, Equipment B may not be purchased even though it would be efficient to do so. Thus, even in the absence of strategic behavior, one can only be certain that efficient collective terms will be produced if, as with equipment A, the value of the terms to an individual worker exceeds the cost of producing the terms for all the workers.

The discussion to this point has emphasized factors on the supply-worker side which might lead to the underproduction of collective terms. In a perfectly competitive environment, there would also be factors on the demand-employer side which should lead to the optimal production of collective terms. If one employer offers a collective term and lower wages to its workers and the savings in lower wages exceed the cost of providing the collective term, that employer would have a competitive advantage over employers who do not offer the collective term. All other things being equal, the employer offering the collective term should prosper at the expense of the other employ-

73. The size of the discount will depend on factors such as the individual worker’s risk averseness, the worker’s evaluation of the risk averseness and probability of strategic behavior of her co-workers, and the willingness of the employer to commit to installing the equipment.

74. It would become increasingly more likely that the equipment would not be purchased as the ratio approaches one. (If the ratio were one or above, of course, it would not be efficient to purchase the equipment in any event.)

75. The text discusses only the issue of whether a collective term will be produced. Another issue that arises with collective terms is whether the amount of the collective term produced is optimal. Without collective action, the optimal amount of a collective term will be provided only if “[t]he marginal cost of additional units of the collective [term are] shared in exactly the same proportion as the additional benefits. . . . If marginal costs are shared in any other way, the amount of [the collective term] provided will be sub-optimal.” M. OLSON, supra note 66, at 30-31 (emphasis in original).
Thus, in a perfectly competitive environment, factors on the demand-employer side would tend to produce collective terms even if there were impediments on the supply-worker side.

For a number of reasons, however, there are impediments to the production of collective terms from demand-side pressures, too. A collective term will permit an offering employer to prosper at the expense of other employers only if a number of conditions are met. First, the offering employer will prosper only if the collective term is indeed efficient, that is, only if the cost of offering the term is less than the value of the term to workers. To determine whether the term is efficient, then, the offering employer must accurately assess the value of the term to its workers. But because of the strategic behavior described above, it will not be easy—and may not be possible—for the employer to make that assessment.

Second, employers will prosper only if their managers attempt to determine whether collective terms are efficient and only if the managers then act on correct calculations that the terms are efficient. Managers, however, may not fulfill their role. Because managers would not receive the full savings made by offering a collective term (instead they would have to share them with shareholders, bondholders, other managers, etc.), they may decide that, at the margin, the costs to the manager of offering the collective term outweigh the benefits to the manager from any gains.

Third, employers will prosper from offering collective terms only if the gains affect decisions at the margin. In many instances, however, the gains from offering collective terms may not affect decisions at the margin because they are too minimal or too difficult to detect and assess. For example, one of the ways in which an employer might prosper by offering a wage package that includes efficient collective terms

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76. Employers offering collective terms will, in essence, be hiring workers at a lower rate of pay, thus their money profits will increase, which should encourage them to expand. Because of their competitive advantage, employers offering collective terms should eventually be able to drive other employers out of business.

77. If the cost of the term is greater than its value to workers, the employer would be at a competitive disadvantage; the employer would, in effect, be paying more for labor than its competitors.

is by attracting or retaining workers. Workers, however, are often unaware of collective terms. Even when workers are aware of the terms, the value of the terms is often difficult to assess. The effort required to compare the relative value of cleaner air vis-a-vis a wage increase of two, probably often means that the comparison is simply not made, and the relevant decision is made on other grounds. Finally, even when workers are aware of collective terms and can assess their value, that value may be too insignificant to affect many decisions. For example, if the net gain for a worker from a collective term is two in a total wage package of 1,000, the influence of the gain on the worker’s decision is likely to be overridden by other factors, many of which are outside of the employer’s control (for instance, factors such as commuting time or location of spouse’s employment).

Collective terms, then, present a situation in which the market by itself may not achieve the efficient outcome. Minimal terms are one way of breaking this roadblock. When minimal terms provide collective terms that are efficient and that otherwise would not be provided, the minimal terms are not subject to the standard objection. The terms will not result in unemployment because employers will make a compensating change in the workers’ wages to cover the cost of providing the terms and, as a result, the overall wage and employment levels will not move from equilibrium. Moreover, the workers prefer the new wage package (with the minimal term and a lower wage) because they place a higher value on the minimal term than they do on the lost wages.

Minimal terms, however, are not a very fine-tuned method of breaking the roadblock. Minimal terms generally apply to broad classes of employers. As a result, even when they require collective terms, minimal terms may not be efficient with respect to every employer to which they apply. If a minimal term required all employers to provide Equipment B, for example, the minimal term would be inefficient for employers with six or fewer workers, but efficient for employers with seven or more workers. Despite this, minimal terms

79. Employment contracts often contain hundreds of provisions, so it is intuitively sensible that workers are often unaware of particular collective terms. Although I know of no empirical research on the awareness of workers of collective terms, I have ample anecdotal evidence of unawareness. A co-worker of mine, for example, recently commented that he discovered the University provides a spousal life insurance policy only after his spouse had passed away.

80. See supra notes 69-75 and accompanying text.

81. This is true because the marginal cost of Equipment B is fixed, while the marginal value of the equipment to the workers as a group increases with each additional worker. For six workers, then, the marginal cost of the equipment is 19, but the marginal value to the workers (the value of the equipment to the workers over Equipment A—three per worker) is only 18; the equipment costs more than its value and so the requirement that it be provided is inefficient. With seven workers, the cost of the equipment is still 19, but the value to the workers is 21;
would be justified if the efficiencies created by them outweigh the inefficiencies. In the example, a minimal term requiring Equipment B would be justified if the efficiency gains of workers employed by large employers outweigh the efficiency losses of workers employed by small employers.

Viewed in this way, minimal terms which require collective terms are more likely to be necessary in a labor market in which there is a low level of unionization. Collective bargaining is another, but a finetuned, mechanism for breaking the roadblock that results in an underproduction of collective terms. Collective bargaining enables the union, an entity with better access to worker preferences than the employer, to assess those preferences and then to demand the minimal term if it is efficient or to demand instead higher wages if the minimal term is not efficient.\(^8\) Thus, minimal terms may be less necessary when a large portion of the workforce is unionized because the extent of the inefficiencies caused by the roadblock should be less in that type of labor market.

In summary, minimal terms requiring employers to provide collective terms may not be subject to the standard objection. In the absence of minimal terms or collective bargaining, collective terms are likely to be underproduced. Thus, this type of minimal term is justified on efficiency grounds if its effect is merely to produce the quantity of collective terms which would be produced in a perfectly competitive labor market. The efficiency of a minimal term of this type, then, cannot be determined simply by reciting the standard economic objection. Instead, the efficiency or inefficiency of a minimal term which might fall into this category depends upon very difficult empirical assessments, first, to determine whether the good provided by the term is actually a collective good and, second, to determine whether the quantity of the good provided is optimal.

2. Imperfect Information

Imperfect information is a common justification for governmental intervention in markets of various kinds,\(^8^3\) including labor markets.\(^8^4\)

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84. See Sunstein, supra note 46, at 1055-56; Note, Protecting At Will Employees Against Wrongful Discharge: The Duty to Terminate Only in Good Faith, 93 Harv. L. Rev. 1816, 1830-33 (1980).
Various forms of the argument provide weak and strong justifications for minimal terms.

The conventional argument from imperfect information is that workers cannot enter into optimal employment contracts if they do not have all of the information necessary to evaluate their options. If the worker believes that she has some protections against discharge even without a "for cause" provision when in fact she does not, she is likely to underestimate the value of the provision and, as a result, may fail to buy it even though she should. Other workers may understand the limitations of their protections in the absence of a "for cause" provision and yet fail to purchase the provision because they underestimate the risk of discharge and, hence, underestimate the provision's potential benefits. Once again, this information failure could lead to an inefficient result—the worker may not buy the "for cause" provision even though it is worth more to her than the wages.

Imperfect information does not justify intervention, however, merely because individual workers make mistakes. Intervention is justified only if the labor market fails to produce optimal terms because workers make decisions based on imperfect information. Even if many workers make mistakes because of imperfect information, optimal terms may be produced. If some workers seek optimal terms and if employers both wish to attract those workers and cannot distin-

85. Schwartz & Wilde, supra note 83, at 632-35.
86. See discussion of waivable rights supra pp. 115-19.
87. I know of no empirical studies of the perceptions of workers of their protections from discharge in the absence of "for cause" provisions, but I know of considerable anecdotal evidence that workers overestimate these protections. The students in my labor-related classes uniformly overestimate the common law protections workers receive and practicing lawyers tell me that workers regularly, but often incorrectly, expect the law to provide a remedy for discharges.
88. Some evidence suggests that workers tend to underestimate the possibility that they may lose their jobs. See Survey Research Center, Univ. of Michigan, Survey of Working Conditions 360-63 (1970); L. Adams & R. Aronson, Workers and Industrial Change (1957). Cf., J. Getman, S. Goldberg & J. Herman, Union Representation Elections: Law and Reality 87-88 (1976) (workers during a union election campaign tend to discount their risk of job loss during the campaign). This evidence is consistent with evidence that people in general tend to underestimate the risk that bad things will happen to them. See Arnould & Grabowski, supra note 83, at 34-35 (drivers underestimated their risk of an accident); Kunreuther, Limited Knowledge and Insurance Protection, 24 Pub. Pol'y 227, 234-36 (1976) (people underestimate probability of severe floods and earthquakes).
89. A similar inefficiency may occur when there is asymmetrical information. For an example, see Schweb, supra note 48, at 279-80 & n. 130.
90. Schwartz & Wilde, supra note 83, at 638.
91. Workers may make different investments in obtaining information. As a result,
STANDARD ECONOMIC OBJECTION

guish between them and the workers making mistakes, the market should produce optimal terms. In essence, those workers who demand optimal terms protect other workers from the consequences of their limited information. On the other hand, if insufficient numbers of workers seek optimal terms, or if employers do not wish to attract those workers, or if employers can distinguish between those workers and workers with imperfect information, the labor market may fail to produce optimal terms.93

Intervention in the labor market is justified, then, if the labor market fails to produce optimal terms because workers make decisions on the basis of imperfect information. This provides only a weak justification for minimal terms, however, because there are other, less intrusive options for remediying this type of information failure. Ensuring that workers receive fuller information on the "for cause" provision, either by requiring the employer to provide it or by having the government provide it, would remedy the information failure and lead to a more fine-tuned result than simply requiring the "for cause" provision. It would permit those workers who prefer higher wages even when they have knowledge of the true value of the "for cause" provision, to continue to receive higher wages.95

Another type of information failure provides a stronger justification for minimal terms. If there is information failure not because of limited information, but because workers cannot rationally evaluate the available information, the less intrusive remedial option of pro-

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92. Employers, for example, would not be able to distinguish between workers with good information and workers with imperfect information if the term is collective in nature. If the employer offers a collective term to one worker, other workers will be able to share in its benefits. See supra notes 66-68 and accompanying text.

93. Although a full analysis is outside the scope of this article, the labor market displays many of the symptoms of a noncompetitive market, particularly with respect to non-wage benefits. Schwartz & Wilde, supra note 83, at 655-56. Wages and other terms of employment are not clustered. See Weiler, The Wages of Sex: The Uses and Limits of Comparable Worth, 99 HARV. L. REV. 1728, 1760-61 (1986); WOMEN, WORK AND WAGES, supra note 17, at 49-50. Advertising of terms is common only with respect to wages. Comparison shopping is expensive in terms of both time and expense, in large part because employment terms are not generally stated in a standard or easily understandable form. A. Rees, supra note 23, at 88-90.

94. Requiring the employer to provide the information, of course, would be a minimal term in itself. In the absence of a requirement that the employer provide the information, a worker presumably would have to accept a reduction in pay to receive it.

95. Schwartz & Wilde, supra note 83, at 666-71.

96. Even though this challenges the basic assumptions of economics, leading economists have long recognized it as a possibility. Becker, Irrational Behavior and Economic Theory, 70 J. POL. ECON. 1 (1962); Hirschman, Obstacles to Develop-
viding information may not be effective. Minimal terms may be required to correct the suboptimal choices made by workers.

Information overload and cognitive dissonance are two reasons workers may not be able to effectively evaluate the information necessary to make a choice. Evidence from outside the employment context suggests that there is a point at which additional information becomes dysfunctional; that is, the additional information does not contribute to a better decision because the people to whom it is provided are "overloaded" and simply cannot process it.\(^97\) To the extent information overload occurs, one would expect it to occur in the employment context. Employment contracts cover a broad range of topics, many of them quite complex; they are often expected to remain in effect for long periods of time; and workers are often poorly equipped to evaluate them. Thus, minimal terms may be justified when there is evidence of information failure and when it is likely that the failure cannot be remedied simply by providing additional information.\(^98\)

Cognitive dissonance may also interfere with the ability of workers to evaluate additional information. Stated generally, cognitive dissonance means that people are uncomfortable when they simultaneously hold two conflicting ideas. People prefer to view themselves as smart and if new information indicates that a prior belief was in error, the new information tends to undermine the preferred self-image. As a consequence, people tend to reject, ignore or accommodate information that conflicts with prior beliefs.

Cognitive dissonance may also justify minimal terms. To illustrate, consider workers who when they first choose a job, choose an industry that is hazardous, but necessarily hazardous because no safety equipment is available to correct the hazards. Over time, cognitive dissonance may lead the workers to believe that the job is really fairly safe. (Smart workers would not work at a hazardous job, therefore the workers must either view themselves as not smart or their jobs as not hazardous. Viewing the jobs as safe is less threatening to the workers' self-image.) If cost-effective safety equipment then becomes available, the workers will not purchase the equipment (by accepting a reduction in their wages). Because of cognitive dissonance, they have come to believe that their jobs are safe even without the equipment. As a

\(^97\) See Davis, Protecting Consumers From Overdisclosure and Gobbledygook: An Empirical Look at the Simplification of Consumer-Credit Contracts, 63 VA. L. REV. 841, 847-50 (1977) and authorities cited therein. But see Schwartz & Wilde, supra note 83, at 675-76 & n.100.

\(^98\) Minimal terms, then, are more likely to be justified for this reason when the terms cover complex areas of the employment contract and are expected to extend for long periods of time, and when the workers tend to be poorly educated and, hence, unequipped to evaluate the terms.
result, they are unable to evaluate fairly the value of the newly available equipment. A minimal term which required the equipment to be installed would be necessary to achieve the efficient outcome.99

Minimal terms may also correct for information failure from the other side of the ledger—they may increase efficiency by improving the information base of employers. Employers can learn about worker perceptions of the compensation package they offer workers (and, indeed, about worker ideas on ways in which work can be reorganized to enhance productivity) in one of two ways. They can learn when workers quit to take other jobs (exit) or they can learn when workers tell them what they think about the compensation package (voice).100 Clearly, learning through voice has several advantages for both employers and workers: the costs of job search and transfer are minimized; the investment in job-specific training is not lost; the message is clearer since the communication is direct and the employer need not infer worker perceptions from numerous exits; and so on. Nevertheless, voice is likely to be underutilized:

"Workers ... are unlikely to reveal their true preferences to an employer, for fear the employer may fire them. In a world in which workers could find employment at the same wages immediately, the market would offer adequate protection for the individual, but that is not the world we live in. The danger of job loss makes expression of voice by an individual risky."101

Because of this, a minimal term which encourages voice may be efficient. A minimal term requiring cause for discharge, for example, would be likely to cause workers to increase the use of voice to communicate with the employer (because they would be less fearful of discharge when they expressed displeasure), and to decrease correspondingly the use of exit. Thus, the minimal term should result in gains both because the employer has obtained better and quicker feedback from workers which should enable it to make productivity-enhancing changes in the workplace, and because the costs of exit (job search costs, loss of training investment, etc.) can be minimized. If these gains outweigh the costs of administering the "for cause" system, the minimal term would be efficient.102


100. The seminal work in this area is A. Hirschman, supra note 78. Several others have expanded on Hirschman's ideas, most notably Freeman and Medoff. See R. Freeman & J. Medoff, supra note 82; Freeman & Medoff, The Two Faces of Unionism, 57 PUB. INTEREST 69 (1979); Williamson, The Economics of Internal Organization: Exit and Voice in Relation to Markets and Hierarchies, 68 AM. ECON. REV. 369 (1976); Freeman, Individual Mobility and Union Voice in the Labor Market, 66 AM. ECON. REV. 361 (1976).


102. Although I know of no studies dealing explicitly with the effects of "for cause" provisions, there are studies which indicate that increased worker participation
Minimal terms may lead to a more efficient outcome, then, in several circumstances related to information imperfections. Minimal terms may be efficient when workers do not have the information necessary to evaluate the value of an employment term, when workers are intellectually or psychologically unable to value accurately an employment term, or when employers operate with poor information because workers are reluctant to exercise voice.

3. External Costs

Minimal terms may also be justified when employment terms impose costs on third parties, that is, when there are “external” costs that are not weighed by employers and workers when they negotiate the employment contract.103

Consider an employer that hires a worker who smokes. In a price theory world, the employer would pay the worker less than a worker who does not smoke by an amount equal to the extra costs imposed on the employer by smoking. Thus, if smokers are absent from work more often than non-smokers, the employer should pay a lower wage to a worker who smokes to compensate for the costs to the employer of the extra absences. Considering only the employer and the smoking worker, the price theory world would optimally balance the desire of workers to smoke and the employment costs associated with smoking. A worker would smoke if she valued smoking more than the decrease in pay caused by her smoking. An employer would hire smokers if they would agree to work for an amount sufficiently less than non-smokers to compensate the employer for its increased costs.

Some of the costs of smoking in the workplace, however, may be external, that is, they may be imposed on parties other than the employer and the smoking worker. Fellow workers, health and life insurance companies, social welfare agencies, and others may all bear some of the costs of smoking.104 To the extent this occurs, the effi-

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103. The argument from external costs is, in a sense, the flip side of the argument from collective terms. With external costs, some of the costs of employment terms are imposed on third parties, so “too many” of the terms are produced. With collective terms, third parties absorb some of the benefits of the employment terms, so “too few” of them are produced. Both external costs and collective terms, then, result in inefficiencies. At times, the distinction between external costs and collective terms becomes quite fine, if not illusory. Pollution, for example, may be an external cost, while clean air may be a collective good. R. Nelson & S. Winter, An Evolutionary Theory of Economic Change 367-68 (1982).

104. Fellow workers may bear some of the costs to the extent passive smoke causes illness and, hence, increased absences or to the extent passive smoke merely creates a need for more breaks which lowers productivity. Health and life insurance
cient result may not be achieved. The costs of smoking are actually higher than the amount by which the employer reduces the pay of smokers; the employer reduces the pay only enough to recapture its losses, not enough to recapture all losses associated with smoking. As a result, some workers will continue to smoke even though they would not if they had to accept a reduction in pay sufficient to cover all of the costs of smoking. There will be “too much” smoking in the workplace.105

Minimal terms can be used to correct for this type of overproduction. The test of efficiency is what the market would have produced if all the costs of workplace smoking were considered.106 A minimal term which prohibited workplace smoking, or which taxed employers or workers for workplace smoking, would reduce the amount of workplace smoking and may produce an amount of smoking which closer approximates the efficient ideal.

Minimal terms, of course, may overcorrect. A minimal term which prohibited smoking would be likely to produce “too little” workplace smoking because it would prohibit smoking by workers who would smoke even if they had to absorb all the costs. Even in this situation, however, the minimal term may be justified. If the “too low” amount of smoking with the minimal term was closer to the efficient ideal than the “too high” amount of smoking without the minimal term, the minimal term would be justifiable on efficiency grounds.107

4. Summary of Efficiency Justifications

In a number of situations, then, minimal terms may result in an increase in efficiency: when the minimal terms provide collective goods that otherwise would be underproduced; when there are impediments to the free flow of information because of overload, cognitive dissonance, or a suboptimal exercise of voice; or when there are costs which employers and workers do not fully consider when they are negotiating employment terms because they are likely to be borne by

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105. Health and safety laws may be supported by a similar argument. See R. Posner, supra note 14, at 312. See generally C. Goetz, supra note 50, at 441-44.

106. Stated another way, the test of efficiency is what the market would have produced if transaction costs were low. If transaction costs were low, the smoking employees could reimburse all those who have costs imposed upon them by the smoking. See R. Posner, THE ECONOMICS OF JUSTICE 61-65 (1981); R. Posner, supra note 14, at 12-15.

third parties.\footnote{108}

Acceptance or rejection of minimal terms on efficiency grounds, then, does not flow naturally from economic theory alone. Instead, the policy recommendation from an economic analysis of any particular minimal term depends on a complex empirical assessment of the term.

B. Distributional Justifications

Minimal terms are popular politically because the common perception is that they benefit workers at the expense of employers. When the government requires employers to provide maternity benefits or health insurance, the perception is that employers will pay for the benefits, that there will be a reduction in employer profits and a corresponding increase in worker compensation.

The standard objection casts doubt on this type of distributional justification for minimal terms. According to the standard objection, employers shift the costs of minimal terms to workers through unemployment, lower wages, or both. Thus, workers pay for their own minimal terms. The minimal terms make workers worse off because they presumptively prefer fuller employment and higher wages to the minimal terms.\footnote{109}

Whether the common perception or the standard objection better describes the distributional effects of minimal terms depends on the rigidity of the relevant labor market. To the extent employers in the relevant market have the unfettered ability to respond to minimal terms by lowering wages and/or reducing employment levels, the costs of minimal terms can be transferred to workers. The standard objection, then, better describes that type of flexible labor market.

Other labor markets, however, may be more rigid. Certain em-

\footnote{108. Minimal terms may also increase efficiency (and sometimes result in distributional changes) in labor markets which exhibit certain characteristics. Minimal terms may increase efficiency, for example, when there is a backward-bending supply curve, see B. Fleisher & T. Kneisner, supra note 19, at 177-79, or when the labor market is monopsonistic, H. Wachtel, supra note 19, at 94-99; B. Fleisher & T. Kneisner, supra note 19, at 203-11, or oligopolistic. H. Wachtel, supra note 19, at 90-94; A. Cartter & F. Marshall, supra note 19, at 253-56. Minimal terms which applied in jurisdictions in which these types of markets outnumbered more competitive labor markets, or which were narrowly tailored to apply only to these types of markets within a jurisdiction, would result in an increase in efficiency (and/or in desirable distributional changes). I have not considered these types of efficiency justifications for minimal terms because, although the question is ultimately an empirical one, it does not appear that these types of labor markets predominate in any significant jurisdiction, see R. Bunting, Employer Concentration in Local Labor Markets (1962), and because I know of no attempts to narrowly tailor minimal terms so as to apply only to certain labor markets within a jurisdiction.

\footnote{109. See supra p. 114.}
Employers, for example, may not be able to respond to minimal terms by lowering wages because of minimum wage laws or because of individual or collective contracts requiring a certain level of wages. Indeed, only in very rare circumstances will employers be able to transfer all the costs of minimal terms to workers through lower wages. If un-

110. In the usual case where the supply curve is positively sloped, the employer will have to absorb a portion of the cost of minimal terms which varies depending on the relative elasticities of the supply and demand curves. This is illustrated in Figures 8 and 9 which demonstrate the wage effects of inefficient minimal terms (i.e., ones which cost employers more than they are valued by workers) by shifting the demand curve but not the supply curve after imposition of the term. See supra note 70. In Figure 8, the supply curve is inelastic relative to the demand curves. (That is, changes along the wages axis create smaller changes along the quantity of labor axis for the supply curve than for the demand curves.) As a result, a relatively large portion, but not all, of the total cost of the minimal term (CW₂) is absorbed by a reduction in wages (W₁W₂). The employer absorbs the remainder of the cost (CW₁). In Figure 9, the supply curve is elastic relative to the demand curves. In comparison with Figure 8, then, a relatively small portion, but still some, of the total cost of the minimal term is absorbed by a reduction in wages. The employer will be able to transfer all (or more than) the costs of minimal terms to workers through lower wages only where the supply curve exhibits zero elasticity (or where the supply curve is negatively sloped). See Harrison, supra note 14, at 338-40; B. Fleischer & T. Kneiser, supra note 19, at 175-80.

Figure 8.
employment effects are not considered, employers will have to absorb some of the cost of minimal terms in the vast majority of cases. Similarly, certain employers may not be able to reduce employment levels because of plant closing notification laws or because they have made long-term investments in specialized types of equipment. In these more rigid labor markets, then, employers may have to absorb some of the costs of minimal terms, at least in the short run.

Figure 9.

![Diagram of labor market equilibrium](image)

**Quantity of Labor**

111. In a sense, those people who are unemployed as a result of minimal terms have decided that their nonmarket opportunities are greater than their market opportunities at the lower wage level. Thus, the young may constitute a disproportionate number of those who become unemployed because their opportunities for schooling and other nonmarket training which may increase their future earnings are greater. Viewed in this way, the unemployment effects of minimal terms, although still important, are less troublesome. Instead of dropping into a well of doom and despair, those who become unemployed fall upon the buffer offered by nonmarket activities. Welch, supra note 41, at 36. See generally Becker, *A Theory of the Allocation of Time*, 75 Econ. J. 493 (1965).

112. Depending on the market for their product, employers may be able to shift some of these costs to consumers. Harrison, supra note 14, at 342-45. The precise relationship between effective wage increases and product price increases, however, is quite complex. Goldstein & Smith, *The Predicted Impact of the Black Lung Benefits Program on the Coal Industry* in O. Ashenfelter & J. Blum, supra note 41, at 135-49.

the common perception may be accurate—minimal terms may cause a redistribution from employers to workers.

Despite their differences, both the common perception and the standard objection focus on the distribution between employers and workers. Minimal terms, however, may also have distributional effects between various classes of workers and, as a result, may be more or less desirable depending on the direction of the redistribution and the definition of the classes of workers. A minimal term requiring paid maternity leave, for example, may redistribute resources from male workers to female workers. To the extent the employer shifts the cost of the minimal term to workers, it should be borne by male and female workers in rough proportion\textsuperscript{114} to their numbers in the workforce.\textsuperscript{115} The benefits of the term, however, would flow entirely to female workers. If one believes that female workers are disadvantaged in the workplace,\textsuperscript{116} this type of distributional result would provide a justification for the minimal term.\textsuperscript{117} Other examples of minimal terms that might be justified with this type of distributional argument include (1) prohibitions on discharges for failure to submit to sexual harassment (which should result in a redistribution from

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\footnote{114}{The actual distributional effects of a minimal term may be quite difficult to identify. The minimal term requiring maternity leave, for example, would increase the cost of labor and, as a result, would encourage employers to replace labor with labor-saving equipment (e.g., it would encourage employers to invest in word processing equipment and reduce the number of secretaries employed). To the extent the employer can lawfully distinguish between male and female labor (e.g., where the labor force is sex-segregated by occupation), the costs of the minimal term may be borne disproportionately by female workers.}

\footnote{115}{Assuming that the employer can pass on all of the costs of the minimal term to workers and that the costs are passed on pro rata (both fairly large assumptions), the actual distributional effect would depend on the proportion of men and women employed. The larger the proportion of men employed, the larger the distribution from male to female workers.}

\footnote{116}{See generally WOMEN, WORK, AND WAGES, supra note 17; Blumrosen, Wage Discrimination, Job Segregation, and Title VII of the Civil Rights Act of 1964, 12 U. Mich. J. L. Ref. 399 (1979).}

\footnote{117}{To be complete, the justification would also have to address the claims that the government should not engage in redistribution efforts at all (or, if they must, they should do so only very rarely), see R. NOZICK, ANARCHY, STATE AND UTOPIA 149-53, 167-74 (1974); F. HAYEK, THE CONSTITUTION OF LIBERTY 93-102, 133-61 (1961); M. FRIEDMAN, supra note 14, at 161-76, and that, if a redistribution effort does take place, it should be done through the tax system rather than through a regulatory system. A. POLINSKY, AN INTRODUCTION TO LAW AND ECONOMICS 105-13 (1983); Olsen, An Econometric Analysis of Rent Control, 80 J. Pol. Econ. 1081, 1096-99 (1972). For general discussions of those issues, see Shavell, A Note on Efficiency vs. Distributional Equity in Legal Rulemaking: Should Distributional Equity Matter Given Optimal Income Taxation, 71 Am. Econ. Rev. Proc. 414, 414-18 (1981); Kronman, Contract Law and Distributive Justice, 89 Yale L.J. 472, 489, 510 (1980); Markovits, The Distributive Impact, Allocative Efficiency, and Overall Desirability of Ideal Housing Codes: Some Theoretical Clarifications, 89 Harv. L. Rev. 1815, 1827-8 (1976).}
\end{footnotes}
supervisors who otherwise would harass to workers who otherwise would be harassed);\(^{118}\) (2) severance pay requirements (which should result in a redistribution from workers with stable employment to workers with unstable employment); and (3) perhaps limitations on the discharge-at-will rule.\(^{119}\)

Distributional effects between various classes of workers may also provide arguments against certain minimal terms. The familiar objection to minimum wage laws, which is one instance of the standard economic objection, provides an example. The objection to minimum wage laws is that the benefits which flow to workers in the covered sector who remain employed are paid for by other workers who lose their jobs in the covered sector and are either unemployed or forced to work in the uncovered sector where the wages are depressed because of the increased competition between workers for jobs. The workers who pay for the minimum wage laws, the argument goes, are those with the lowest productive capacity, that is, the young, minorities, those with low levels of education and wealth, and so on.\(^{120}\)

The distributional consequences of minimal terms, then, are relevant to an economic consideration of them. "Good" distributional effects provide a rationale for minimal terms; "bad" distributional effects undermine them. In either event, evaluation of the distributional consequences depends on a sophisticated empirical assessment of the extent of the redistribution, its direction, and the classes of employers and workers affected.

IV. CONCLUSION

This article was "inspired" by a comment made at the 1987 Annual Meeting of the Association of American Law Schools. An anonymous commentator from the audience spoke in response to Professor Lord Wedderburn of the London School of Economics. Professor Lord Wedderburn had argued that the labor force statistics in England did not indicate that England's unfair dismissal law had had any adverse effects on the economy. The commentator said that attempting to empirically measure the effects of the unfair dismissal law on the economy was like trying to determine how much birds weighed by weighing the elephants on which the birds were perched. The weight

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118. Kennedy, supra note 113, at 610.
119. Sunstein, supra note 46, at 1054.
of the elephants dwarfed into insignificance the weight of the birds. Despite the futility of empirical assessments, the anonymous commentator continued, economics offers a powerful theoretical objection to unfair dismissal laws. The commentator asked Professor Lord Wedderburn to respond to the theoretical objection. Professor Lord Wedderburn declined. This article, in a sense, is a response.

The theoretical objection to minimal terms provided by economics cannot be divorced from the very difficult empirical issues raised by economic analysis. The objection is forceful only if certain conditions are met, conditions that can be confirmed or rejected only through empirical studies. Indeed, if the empirical studies indicate that other conditions are present (for example, if the studies indicate that the benefits provided by a minimal term are practically collective or that the minimal terms address certain types of information imperfections), economics can provide powerful support for minimal terms. The value of a theoretical economic analysis of minimal terms is not that it provides definitive answers, but rather that it isolates empirical inquiries that, if answered, might permit us to better understand the value and consequences of minimal terms.

121. Undoubtedly, as the commentator colorfully indicated, resolving the empirical issues will not be easy. There should not, however, be a presumption against the promulgation of individual employment rights while the empirical issues are being addressed because there is no a priori reason for believing that the set of conditions supporting the objection are true. In our worse-than-second-best world, decision makers will often have to act or not act on rough intuitive assessments of the relevant conditions. See Kennedy, supra note 113, at 614.