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The Trouble with Employment Law

by Walter Olson

Over the past 35 years, legislators, regulators, and courts have invented and imposed on the American workplace a vast new body of law ranging from sexual harassment and handicap-accommodation law to age discrimination law to mandated family leave to new common-law doctrines making employers liable for "wrongful termination," "workplace defamation," infliction of emotional distress by harshness in supervision, and much more. Practicing lawyers refer to that new body of law as employment law and distinguish it from the earlier labor law associated with the New Deal. It is mostly advanced, not by unions or by collective worker sentiment or action, but by lawyers' threats to sue for large damages on behalf of one or a few workers. It aspires to regulate, not just hiring, firing, and wage setting, but the whole range of working conditions, including conversations and psychological interactions on the job.

Individually, these laws have been adopted on a variety of rationales. Taken as a group—and in the minds of many of their supporters—they embody a more wide-ranging objective. They aim to bestow on workers a form of job security, assuring them they will not be fired, denied promotion, or subjected to other adverse action for what a court deems bad reasons. In effect, the laws press employers not to proceed with hiring and firing decisions unless they have in hand what they are prepared to argue before a judge or jury is "good cause."

As time has passed, it has become apparent that the effect of these laws has been less neat than the intention. While implicitly promising to tie employers' hands only from acting with "bad cause," the laws in fact deter many actions taken for good cause as well, simply because many employers will put up with much genuine incompetence or insubordination rather than take even a small risk of being dragged into an expensive lawsuit with some random chance of losing in the end. The result has been harm to the cause of excellence and even basic competence in the workplace, with serious resulting costs not only for businesses and their owners but also for coworkers and customers.

What of the promised benefits? Here, too, employment law often backfires: labor markets adjust to the new climate in ways that hurt the intended beneficiaries and undercut the aim of job security. If employers and employees are left free to do so, most will find it advantageous to negotiate arrangements that reflect the traditional legal

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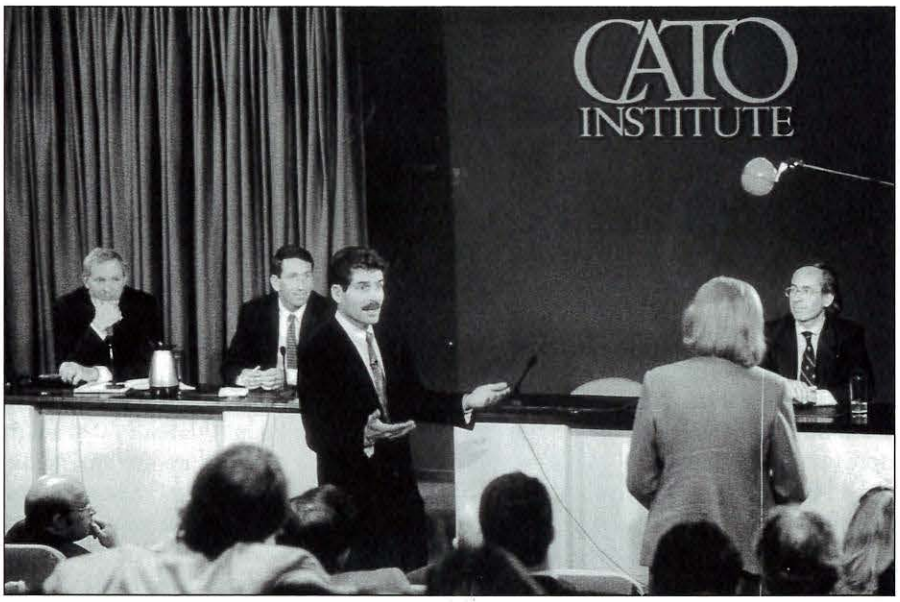
Walter Olson is a senior fellow at the Manhattan Institute. This article is excerpted and adapted from The Excuse Factory: How Employment Laws Are Paralyzing the American Workplace, *published by the Free Press.*



John Stossel moderates a Town Hall meeting on Social Security for *20/20* with Sam Beard, Rep. Mark Sanford, and José Piñera at Cato's F. A. Hayek Auditoruim.

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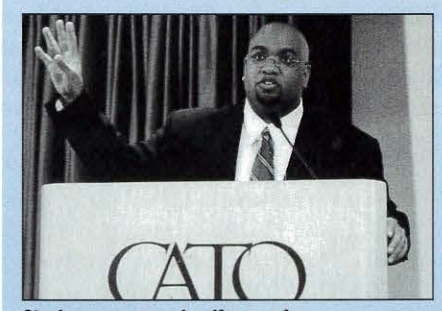

Stephney on rap and welfare, p. 4.

"Legislators, regulators, and the courts have imposed on the American workplace a vast new body of law . . . mostly advanced by lawyers' threats to sue."

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assumption of "employment at will," in which either side can break off the relationship. Employers value such a deal because they want to control their payroll and seek out the best talent; employees would benefit too because such an arrangement improves the chance that an employer will go out on a limb to offer them attractive jobs in the first instance. By stepping in to forbid such contracts, our lawmakers and courts suggest that they are more intent on imposing their own values than on respecting workers' own choices of acceptable tradeoffs in the workplace.

The Assault on Competence

In *The Excuse Factory*, I trace dozens of examples of how the new employment law has protected alcoholic pilots, firefighters who lack the physical strength to lift hoses or rescue bodies, secretaries who can't type, blue-collar workers who can't make it in to work on time, teachers who can't spell or pronounce words, operators of dangerous industrial machinery who smoke pot on break or can't read warning signs, and office workers who steal from their colleagues' purses and desks. This is hardly what we were promised when the new laws were introduced. Most of the new laws on their face seemed only to rule out employment decisions based on improper factors such as bias, spite, personality conflicts, and the like. Thus, during the debate over the 1964 Civil Rights Act, Sen. Hubert Humphrey foresaw a new emphasis on "qualifications" in hiring, with the result that the law would "not only help business, but also improve the total national economy." Not only were we going to keep on permitting merit hiring; we were going to require it.

The rapid rise of reverse preference and affirmative action inevitably changed the tone. By 1968 the University of Minnesota had adopted a pioneering "policy commitment" that contained a not exactly inspiring promise to "hire and promote disadvantaged persons wherever there is a reasonable possibility of competent performance." An EEOC consent decree provided for an "affirmative action override" allowing AT&T to "promote a 'basically qualified' person rather than the 'best qualified' or 'most senior.'"

ABC's *20/20* assembled examples of guidelines for federal hiring: Federal Aviation Administration guidelines provide that "the merit promotion process . . . need not be utilized if it will not promote your diversity goals." "In the future," a Defense Department memo specifies, "special permission will be required for the promotion of all white men without disabilities." The U.S. Forest Service achieved a formulation that was hard to improve on: "only unqualified applicants will be considered."

Not surprisingly, critics of employment law have focused on the case against reverse preference and affirmative action. But even if both disappeared tomorrow, the new employment law would continue to prevent employers from filling jobs with the most competent workers. Prevailing EEOC doctrines would still divide workers into "qualified" and "unqualified" universes and forbid preferring the highly qualified to the minimally qualified. Most ways employers measure or document merit at either the hiring or the firing stage would still be under a legal cloud. A dozen laws would still make it risky to fire or discipline rebellious underperformers.

Putting Us in Danger

In the early years of the new law, the courts tended to go easy on second-guessing employer decisions where the consequences of get-

Cato Calendar

NATO Enlargement: Illusions and Reality
Washington • Cato Institute • June 25, 1997
Speakers include Sen. Kay Bailey Hutchison, Susan Eisenhower, Ronald Steel, James Chace, and Fred Iklé.

Beyond the Telecommunications Act of 1996
Washington • Cato Institute • September 12, 1997
Speakers include Lawrence Gasman, Tom Hazlett, Eli Noam, Peter Pitsch, Peter Huber, Gigi Sohn, Henry Geller, Tom Tauke, and Richard Epstein.

Ayn Rand's *Atlas Shrugged:* 40th Anniversary Celebration
Cosponsored with the Institute for Objectivist Studies
Washington • Capital Hilton • October 4, 1997
Speakers include Nathaniel Branden, David Kelley, John Stossel, Ed Snider, John Aglialaro, Robert Poole, Edward Hudgins, and Rep. Chris Cox.

Money and Capital Flows in a Global Economy
Fifteenth Annual Monetary Conference
Washington • Cato Institute • October 14, 1997
Speakers include Alan Greenspan, Jerry L. Jordan, Lawrence Kudlow, Michael Prowse, Roberto Salinas-León, and Judy Shelton.

Fifth Annual Bionomics Conference
Cosponsored with the Bionomics Institute
San Francisco • Mark Hopkins Hotel • November 13–15, 1997

Tenth Annual Benefactor Summit
Grand Cayman Island • Hyatt Regency • February 11–15, 1998

"The *Texas Law Review* blasted the Supreme Court for its 'inexplicable deference to employer decisions that involve public safety.'"

ting the answers wrong seemed ominous. Thus, while freely ordering employers to revamp hiring practices in supposedly routine clerical or industrial jobs, early judges showed more reluctance to interfere with decisions on the filling of such "high-level" jobs as those of executives, physicians, pilots, or college administrators. They also trod carefully in cases where safety seemed at stake. Thus, in a series of decisions that cheered employers, the Supreme Court allowed New York City to turn away recovering heroin users from transit jobs, allowed states some leeway to say no to prospective prison guards of petite stature, and declined to help out a would-be student nurse who literally was deaf.

But both categories of exception came under sustained attack in the law reviews. After all, who's to say that there isn't a continuum between the "high-level" or safety-related job and the ordinary kind? An influential *Harvard Law Review* article assailed the high-level exception, while a *Texas Law Review* treatment blasted the Court for its "inexplicable deference to employer decisions that involve public safety." Wasn't it all the more demeaning to be turned away from a job because it was considered "too important" and the cost of failure too grave?

The critics were quite right in one sense: there *is* a continuum between high-level and safety-related jobs and the ordinary kind. In almost any job the difference between an outstanding and a wretched jobholder can be a serious matter for the world's welfare, as suddenly becomes clear in an emergency; and no jobs are really free of safety implications, least of all those that strike outsiders as routine. The logical conclusion might be that incompetence should be legally protected no more in supposedly routine jobs than in the elite or perilous kind. But the law reviews concluded the opposite, and the Court seems to have found it hard to ignore them.

The justices began to drop the rhetorical air of deference in high-level cases, and on

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Cato Studies

Assessing Clinton's Constitutional Record

Although President Clinton has expressed support for an "expansive" view of the Constitution and the Bill of Rights, his "record is, in a word, deplorable," writes Timothy Lynch in the new Cato study "Dereliction of Duty: The Constitutional Record of President Clinton" (Policy Analysis no. 271). Lynch, assistant director of the Cato Institute's Center for Constitutional Studies, contends that if "constitutional report cards were handed out to presidents, Clinton would receive an F." As evidence of Clinton's poor record, Lynch cites the administration's attempts to censor the rights of peaceful protesters; its military involvement in Bosnia and missile attacks on Iraq, which did not have congressional approval; and its attempts to federalize health care, crime fighting, environmental protection, and education. On questions of both economic and civil liberties, Lynch concludes, President Clinton has acted beyond his constitutional authority and has placed the liberty of American citizens in peril.

◆School Vouchers: A Free-Market Debate

Disentangling the government from matters with which it should not be involved is often very difficult. Education is a prime example. In the new Cato Institute study "Vouchers and Educational Freedom: A Debate" (Policy Analysis no. 269), Joseph L. Bast and David Harmer square off against Douglas Dewey on the issue of school vouchers. Bast, president of the Heartland Institute, and Harmer, author of *School Choice: Why You Need It, How You Get It,* maintain that vouchers would not subject private schools to excessive government regulation and in fact would eventually lead to the complete separation of school and state. Perhaps more important, they contend that no greater reform is politically feasible. Dewey, president of the National Scholarship Center, counters that vouchers would create a vast system of government contractors and parents with "school stamps," a massive lobby for ever-increasing subsidies. In addition, he argues that Bast and Harmer are wrong in suggesting that vouchers would not lead to greater regulation of private schools. This study is the first "dueling" Policy Analysis the Cato Institute has ever published.

◆The Problems of "Global Leadership"

In a new Cato study, "U.S. 'Global Leadership': A Euphemism for World Policeman" (Policy Analysis no. 267), Barbara Conry, foreign policy analyst at the Cato Institute, argues that "global leadership" should not be the goal of U.S. foreign policy. "Although 'leadership' sounds benign," she writes, "today's proponents of global leadership envision a role for the United States that resembles that of a global hegemon—with the risks and costs hegemony entails." Instead of policing the world, she maintains, the United States should concentrate on protecting its vital national security interests. That could be done through greater reliance on regional security organizations, the creation of spheres of influence, and regional balance-of-power arrangements.

◆Programming Mandates vs. the First Amendment

In August 1996 the Federal Communications Commission adopted rules requiring television broadcasters to air at least three hours per week of "educational" programming for children. In a new Cato Institute study, "Regulation in Newspeak: The FCC's Children's Television Rules" (Policy Analysis no. 268), attorney Robert Corn-Revere argues that that rule is flawed in two respects: it will not

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the safety issue they reversed field with a disability-rights decision known as *Arline*, rebuking a Florida school district that had worried that a tubercular teacher might go off the medication that kept her from being contagious in the classroom. Henceforth, the Court said, employers that wanted to invoke safety reasons for personnel decisions would have to prove "substantial" risk, and the Court's disapproving tone made clear that such claims would be less welcome than in the past. The "inexplicable deference to employer decisions that involve public safety," so offensive to the *Texas Law Review* authors, had been withdrawn.

The Impact of the ADA

The passage of the Americans with Disabilities Act was a decisive success for those who thought a little risk helps spice things up. Barbara Lee writes in the *Berkeley Journal of Employment and Labor Law* that the ADA "will make it very difficult for employers to make a successful safety defense in any but the most extreme cases." ADA advocates have repeatedly stressed that an employer can't win merely by showing an "elevated risk" of injury to customers or coworkers; it must also prove the risk "substantial," "direct," and not to be mitigated by any possible accommodation.

In their 1981 volume, *Teachers and the Law,* Louis Fischer, David Schimmel, and Cynthia Kelly disputed the notion that it's virtually impossible to get a poorly performing teacher out of the classroom. As evidence they offered five real-life cases in which districts were upheld in ousting educators for incompetence. But that was in 1981. Now the ADA has made the authors' examples obsolete; it would give all five of the teachers a shot at contesting their removal.

One of the milestones marked by disabled-rights law lay in the revision of the definition of competence itself. An "employer who performs the traditional 'can the person do the job' analysis," explains one commentator, "generally will have violated the A.D.A." An employer must not insist on the capacity to handle any particular task unless it is demonstrably "essential" to the job, and EEOC guidelines include verbiage endorsing, officially, "the same performance standards and requirements that employers expect of persons who are not disabled." But despite such "soothing language," writes Barbara Lee in the *Berkeley Journal of Employment and Labor Law,* in practice "employers should prepare for a substantial amount of second-guessing about essential functions and . . . production standards."

Indeed, it's hard to think of a type of shortcoming in a worker that might not be a potential manifestation of some disability. In the new age of accommodation, even deficits arising from causes other than disabilities increasingly must be ignored, accommodated, or both. Lack of proficiency in the English language is an example; some who fall short in this area can claim some sort of disability, but another large group has trouble because English is not their native language. The latter group is not covered by ADA but has been brought under legal protection by the simple expedient of stretching the bans on national-origin and alienage bias.

From the perspective of the customer left shouting at the uncomprehending taxi driver or hospital orderly, inability to communicate clearly in English might appear a simple issue of competence, or perhaps safety. But a line of cases descending from the landmark ruling in *Diaz v. Pan Am* (1970) encourages courts to ignore such feelings by suggesting that customer preferences are an improper criterion in hiring. It is "necessary to reject customer preference arguments," agrees Mari Matsuda in a widely cited *Yale Law Journal* article calling for stronger legal enforcement of the emergent legal doctrine against accent discrimination. Matsuda concedes that banning accent discrimination in customer-service jobs "will admittedly impose some hardship on businesses that rely heavily on pleasing customer whims"—an impressive formulation, reducing as it does to a mere "whim" humans' desire to communicate with each other in transacting their affairs.

ADA has the potential to force the rethinking—and watering down—of every imaginable standard of competence, whether of mind, body, or character. In the *Texas Law Review*, Thomas McGarity and Elinor Schroeder argue that rather than let employers go on finding excuses to prefer physically stronger candidates for heavy-lifting jobs, the law should require them "to reduce lifting requirements for all employees." Abolish heavy lifting by law—why hadn't anyone thought of that before?

A widely cited 1991 *Harvard Law Review* article by Stanford professor Mark Kelman refers casually to the "illegitimacy of mainstream judgments of merit." Many people, Kelman concedes, may imagine that "an individual merits a particular benefit as long as he actually possesses the specified qualifications for the benefit," but that is to take "a completely formal and static view of merit." A properly "contingent view of personhood and merit" would recognize that qualifications for a job relate more "to meeting ever-shifting social needs." What that means in practice is that even if "by hypothesis" certain workers are better able to perform some jobs, it is "not obvious" that they are in any way "entitled" to them. "More politically progressive commentators," among whom there is little doubt the author is included, deny "the legitimacy of allowing private employers to distribute [jobs or income] in accord with either current or potential productivity."

The Law's Elusive "Benefits"

Markets are a moving target. They react to controls by adjusting, often slowly at first and then more and more fully in the long run. Time and again, when attempts are made to impose artificial job security, markets adjust in ways that gradually undercut the goal.

Employment-security buffs used to point with pride to Europe, where employers have long operated under tenure laws that, by American standards, are extremely stringent. To all appearances, the laws had indeed contributed to (as well as resulted from) what one might call a culture of tenure. Labor statistics suggest European workers are much more likely than their American counterparts to stay with a single employer for many years, both because layoffs and dismissals are less frequent and because they quit their jobs at a much lower rate. "My great-grandfather walked 200 miles in his clogs to get here, and I'm damned if I'm going to move out now," said a Welsh coal miner, with no irony intended, during a 1984 strike.

"Wrongful-firing law casts a chill on employers, . . . and that chill may already have seriously hurt the employment climate."

Certain serious problems were apparent in the European job market even at the time of its most apparent success. By American or Japanese standards, it did extraordinarily badly at creating new jobs, and its rate of labor force participation fell well below American or Japanese levels. By 1996 the jobless rate was running at about 11 percent, or double ours, and the rate of long-term joblessness was several times ours. Economists pointed to one overwhelming cause: the Continent's abysmally low pace of new job creation.

In this country, too, there are signs, though far more scattered and preliminary, that our much more recent ventures into labor-market control are beginning to backfire.

One well-documented phenomenon under the new body of law is the small business that resolves to stay small. Occupational Safety and Health Administration regulations kick in at 10 employees, the Americans with Disabilities Act and the Civil Rights Act at 15, age bias and the health insurance continuation provisions of the Consolidated Omnibus Budget Reconciliation Act of 1986 at 20, plant-closing-notification and family-leave mandates at 50, and Employee Retirement Income Security Act and Equal Employment Opportunity Commission reporting at 100. "Many businesses are taking pains to keep their payrolls under 50," reported the *Wall Street Journal* when the family-leave law went into effect.

What about hiring backlash against members of protected groups? Women entrepreneurs may feel freer to speak out about discrimination law than do men. New Yorker Tama Starr, whose family business, ArtKraft Strauss, builds many of the signs in Times Square, caused fainting fits among editorialists with her remarks on the Family and Medical Leave Act: "If you're an employer, you will look at a young woman and say, 'Can we really entrust her to do crucial responsibilities that no one else can do because she's going to take three months off?'" In fact, women's groups did report an upsurge in complaints of firings around the law's effective date. A National Federation of Independent Business survey of 1,000 small businesses found half admitted reluctance to hire women of childbearing age because of leave concerns.

Stifling Growth and Jobs

One of the most remarkable studies of the effects of the new laws was conducted by a research team led by James Dertouzos of the RAND Corporation. Its results suggest that the laws may already have measurably hurt job creation. The team examined trends in employment levels in each state and compared them with the extent to which each state had moved away from traditional employment-at-will law toward new wrongful-firing doctrines. (Discrimination, harassment, and other non-common-law claims were not part of the study.) The apparent effects were surprisingly large: total employment ran between 2 and 5 percent lower in states where the legal climate had turned most hostile to employers, such as California, compared with states that had stayed closest to the old rules. States where dismissed employees could sue for pain and suffering showed more harm to employment levels than those where those employees could sue only for back pay. Hardest hit was service and financial employment, while manufacturing was least affected—consistent with the wide perception that managers file wrongful termination cases more often than do machinists (who are more likely to turn to union remedies or to none at all).

The RAND researchers found that, averaged over the whole universe of employment, the direct, countable costs of the new common-law wrongful-firing doctrines did not seem all that high: perhaps only a tenth of 1 percent of the nation's total wage bill, averaging out to $100 per dismissed worker. Yet in practice, Dertouzos estimates, California employers behaved as if the indirect costs of being sued were 100 times more important to them than the direct costs. Reputation costs and general unpleasantness would boost the multiplier further. If Dertouzos and colleagues are anywhere near correct, then wrongful-firing law casts a chill on employers far in excess of its likely effect of transferring money to lucky workers, and that chill may already have seriously hurt the employment climate in the most litigious states.

Another study, by Edward Lazear in the August 1990 *Quarterly Journal of Economics,* found significant negative effects from mandated severance payments, a close cousin to tenure notions. Lazear analyzed data from labor markets in 22 countries over three decades and found that, on average, a mandate of three months' severance could be expected to reduce the ratio of employment to population by 1 percent. If implemented in the United States, he estimates, such a policy would raise the unemployment rate by more than 5 percent; it would also turn 9 million full-time jobs into part-time jobs.

Mandated severance as a benefit would also be self-defeating in another way: mainstream economics suggests that workers commonly wind up "paying for" their own benefit packages in the form of traded-off wages. Thus studies have found that once the market adjusts, more than 80 percent of workers' compensation costs winds up coming out of workers' own pockets. Where they can, as MIT economist Jonathan Gruber has shown in a series of studies, employers will target the offsetting cuts to the particular classes of worker likely to use the benefit in question; thus Gruber found mandated pregnancy coverage to have been accompanied by a slowdown in wage gains for workers in the age group likely to draw that benefit.

A Product No One Would Buy

In short, as time goes on, workers can expect to shoulder the bulk of the costs of a right to sue over things that go wrong in the workplace. Those costs are likely to far exceed the value most rational workers would put on that right. No one trying to design a workplace fringe benefit would ever have devised the features of today's employment litigation. As Mayer Freed and Daniel Polsby of Northwestern University point out in an *Emory Law Journal* article, even employees who obtain individual work contracts with their employers seldom negotiate for open-ended promises of lifelong tenure. They are more likely to ask for and extract fixed-term salary guarantees, severance payouts, "golden parachutes," and the like. Rationally enough, they'd rather go after knowable and definite benefits. Equally rationally, employers would rather offer more money than offer tenure.

There's every reason to think that many workers faced with both the costs and the benefits of easy litigation would decline to buy the product, and of course employers would be reluctant to offer it. In short, if

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allowed freedom to contract, both sides have every reason to contract vigorously out of today's employment law.

As markets go, employment markets are reasonably fluid. Hiring is still a basically voluntary process, and each time it happens the terms can be reordered from scratch. Employers and employees attempt to recouch their relationship in whatever categories are least legally regimented: as arm's-length contraction, long-term "temporary" worker, independent provider of "outsourcing" services, and the like. Thus the new employment law faces an endless struggle against an insidious enemy: choice. Both employers and workers tend to make choices that defeat the law's intent, substituting the kind of security most of us prefer—that of an open economy and society where there will be many places to take our talents—for the Old World style of security where we know our place and everyone else's.

But it would be hasty to count out the forces of legal coercion: they are good at what they do. Already it is unlawful to escape most of the new laws by simply contracting out. Bans on automatic arbitration may be next. It is characteristic of a bad product that it must be forced on unwilling purchasers. And it is increasingly clear that today's employment litigation is just such a bad product. ■

Benefactor Ray Zemon of Chicago kibitzes at a chess match between Charles Murray (left) and Doug Bandow during the Benefactor Summit.

Freshman Sen. Sam Brownback addresses Cato's Ninth Annual Benefactor Summit in Scottsdale, Arizona.

STUDIES *Continued from page 7*

achieve the desired goals, and it is unconstitutional. The theory behind the mandate is that the market will not provide educational programming on its own because the audience does not desire it. If that is so, then regulation is not a solution, since the FCC cannot force anyone who would not have already done so to watch educational programming. Moreover, Corn-Revere argues, "Governmental interest in protecting children from programming deemed inappropriate does not translate into a constitutional mandate to compel programming the government believes is beneficial. The commission's mandate for 'educational' television plainly overreads the extent of the FCC's authority under the Constitution."

◆Chilling Effects on the Internet

In the new Cato Institute study "Chilling the Internet? Lessons from FCC Regulation of Radio Broadcasting" (Policy Analysis no. 270), Thomas W. Hazlett and David W. Sosa of the University of California at Davis maintain that the Communications Decency Act could do much to prevent the free flow of ideas on the Internet. The authors argue that previous federal initiatives aimed at "improving" the content of speech over electronic media actually constrained robust public debate. After the Fairness Doctrine was repealed in 1987, "the volume of informational programming increased dramatically—powerful evidence of the potential for regulation to have a 'chilling effect' on free speech." If upheld by the Supreme Court, Hazlett and Sosa contend, the CDA would likely have a similar chilling effect. ■