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HUMAN BEHAVIOR AND THE LAW OF WORK

Cass R. Sunstein*

INTRODUCTION

A. A Problem and a Proposal

In allocating rights in the workplace, the law has many options. It might, for example, confer certain rights on employers, but allow employees to purchase those rights (to, say, parental leave, health insurance, or vacation time) through a voluntary trade. It might make certain employers' rights nonwaivable; it might say, for example, that an employee, or a group of employees, cannot buy an employer's right to donate money to political campaigns. It might give employees certain waivable rights, saying, for example, that an employee is presumed to have a right to at least four weeks of vacation each year, but that employers can buy that right through a suitable deal. Or it might give employees rights that cannot be waived, saying, for example, that no worker may be asked to trade

* Karl N. Llewellyn Distinguished Service Professor of Jurisprudence, University of Chicago Law School and Department of Political Science. This Article is the foundation for the McCorkle Lecture, delivered at the University of Virginia on September 25, 2000. Because it is the foundation for a lecture, it avoids the usual extensive footnoting; the reader is asked to make allowances for an Article originally prepared for oral presentation. I am grateful to comments from many people, including Alan Hyde, Russell Korobkin, David Laibson, Eric Posner, and Richard Posner. Participants in the Summer Institute on Behavioral Economics, held in July 2000, provided valuable comments. Special thanks to Daniel Kahneman, for specific and general help, and also to Richard Thaler for overall guidance on behavioral economics. None of these people should be held responsible for errors here.
the right to four weeks of vacation each year. There are many possible variations.

The basic purpose of this Article is to bring a better understanding of human behavior, with the assistance of cognitive psychology and behavioral economics,¹ to bear on the most basic questions in employment law.² I offer two general claims. The first is that waivable workers' rights represent a promising approach for the future, partly because waivable rights lack the rigidity of nonwaivable ones, and partly because they ensure that employers will provide key information to workers. The second claim is that traditional understandings of employee behavior and employment law make many blunders, because they are based on an inadequate sense of workers' actual values and behavior. Contrary to the conventional wisdom:

- Workers are especially averse to losses, and not as much concerned with obtaining gains;
- Workers often do not know about legal rules, including key rules denying them rights;
- Workers may well suffer from excessive optimism;
- Workers care a great deal about being treated fairly, and are willing to punish employers who have treated them unfairly, even at the workers' own expense;³
- Workers often prefer increasing wage profiles;
- Many workers greatly discount the future, sometimes treating it as irrelevant; and

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² I use this term to refer to both "labor law," traditionally taken to refer to the law relating to unions and unionization, and "employment law," traditionally taken to refer to the law relating to statutory protections of workers.

³ This is the basic theme of Truman F. Bewley, Why Wages Don't Fall During A Recession (1999). Id. at 173–80 (discussing this point in particular). In a series of important papers, Ernst Fehr and his colleagues have explored this point in many settings. See, e.g., Ernst Fehr et al., Reciprocal Fairness and Non-Compensating Wage Differentials, 152 J. Institutional & Theoretical Econ. 608 (1996); Ernst Kirchler et al., Social exchange in the labor market: Reciprocity and trust versus egoistic maximization, 17 J. Econ. Psych. 313 (1996).
Workers often care more about their relative economic position, or how their income compares with others, than about their absolute economic position, or how many dollars they are making in the abstract.

In short, workers are like most people. They behave like *homo sapiens*, not like *homo economicus*. Hence one of my principal purposes here is to bring an understanding of behavioral economics to bear on some of the central issues in the law of work—and to show how such an understanding helps correct the prevailing wisdom insofar as it is grounded in neoclassical economics. We shall also find, in incipient form, what might be called the implicit behavioral rationality of certain aspects of contemporary law, as courts and legislatures show an understanding of the points listed above.

More specifically, I will attempt to show how a more realistic understanding of workers' thoughts and actions helps sort out the relevant inquiries in the choice among the four principal approaches to the law of labor-management relations: (1) waivable employers' rights, (2) waivable workers' rights, (3) nonwaivable workers' rights, and (4) waivable workers' rights with constraints on permissible waiver. I suggest that in many situations, the law should confer certain entitlements on employees rather than employers, but allow those entitlements to be waived, either at a market price (an "unconstrained waiver") or subject to governmentally determined floors, whether procedural or substantive (a "constrained waiver"). The principal purpose of this approach is to ensure that employers fully disclose contractual terms to employees and allow employees to waive only when waiver is thought to be worthwhile, without producing the rigidity, inefficiency, and potential harm to workers and consumers alike that are created by systems of nonwaivable, "one-size-fits-all" terms.

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4 See Richard H. Thaler, From Homo Economicus to Homo Sapiens, 14 J. Econ. Persp. 133 (2000).
5 See infra pp. 165-68 for an overview.
6 A system of nonwaivable terms is urged in Charles Fried, Individual and Collective Rights in Work Relations: Reflections on the Current State of Labor Law and Its Prospects, 51 U. Chi. L. Rev. 1012 (1984); my criticisms of the more ad hoc system of modern statutory law apply to Fried’s general proposal as well.
This basic idea could be applied to both unionized and non-unionized workplaces. It could even be applied to the question of whether workers are collectively organized at all: A default rule might specify collective organization and allow workers to opt out rather than specifying the opposite and allowing them to opt in.\footnote{See Paul C. Weiler, Governing the Workplace 228–30 (1990).} It is especially important to see that the default rule matters. What I will ultimately suggest is a two-tiered system of employment law, involving (a) nonwaivable statutory minima, below which no workplace may go, and (b) waivable workers' rights, involving an ample set of safeguards that employers may buy for a fee agreed upon by both workers and employers.\footnote{For a brief suggestion along the same lines for worker safety, see Susan Rose-Ackerman, Progressive Law and Economics—And the New Administrative Law, 98 Yale L.J. 341, 358–60 (1988).} The real questions should involve the content of the two categories.

### B. An Unduly Limited Debate

In the workplace, as elsewhere, the law cannot "do nothing."\footnote{See Guido Calabresi & A. Douglas Melamed, Property Rules, Liability Rules, and Inalienability: One View of the Cathedral, 85 Harv. L. Rev. 1089, 1090 (1972).} For even the most enthusiastic believers in private property and freedom of contract, it is necessary to start somewhere—not with nature or voluntary arrangements but with an initial allocation of legal rights.

Most debates in American employment law have been framed narrowly and in terms of three alternatives: waivable employers' rights, collective bargaining, and nonwaivable workers' rights. Under a system of waivable employers' rights, the law confers an initial entitlement on employers but allows employees to buy the relevant right if they have both the desire and the leverage to do so. It is important to emphasize that the employer has these rights not by nature, and not as a result of anything consensual, but because of a distinctly legal decision to confer the relevant rights on the employer rather than the employee. The rights at issue often involve the most fundamental questions for workers: job security; workplace safety; pensions; health insurance; leave policy; vacation time; freedom from race, sex, and age discrimination; and so forth.
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This simple idea—of waivable employers' rights—captures much of the common law of labor relations. The common law confers a wide range of entitlements on employers, subject to individual bargaining. The single exception is the labor power of the employee. Of course, the law grants employees, not employers, the right to the employee's time and labor. This is a right that employees can and do trade for money and other benefits of employment.

The flexibility of the common law approach is its great advantage. Such flexibility in one sense promotes liberty, because it allows diverse employers and employees to select the approach that fits them best, and also efficiency, because it promises to protect mutually satisfactory deals. But it is not clear that most workers have the information that would equip them to engage in appropriate bargaining, and it is possible to think that many individual employees, bargaining with employers, will lack the knowledge or the power to produce efficient or fair deals without some form of collective organization. In any case, the initial allocation of rights to employers remains to be defended.

In the 1930s, the United States ventured a second approach to labor-management relations. This approach, embodied in the National Labor Relations Act ("NLRA"), was a dramatic, even revolutionary step: a mechanism for solution of disagreements via collective bargaining. On this view, entitlements are generally given to employers, as with the common law, but workers are allowed or encouraged to organize as a group.

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10 This is described and defended in Richard A. Epstein, A Common Law for Labor Relations: A Critique of the New Deal Labor Legislation, 92 Yale L.J. 1357 (1983). What Epstein does not sufficiently acknowledge is the extent to which a number of rights are conferred on the employer by the common law; any suggestion that the common law reflects "laissez-faire," or promotes "voluntary interactions," should be prefaced with this point. In this vein, see Fried, supra note 6, at 1016: "Only by assuming that the preexisting common law system of property rights had some natural, preconventional status can the expropriationary thrust of the Wagner Act (to the extent that there is one) be criticized." A better way to put it would be to suggest that the very claim that there is an expropriationary thrust in the Wagner Act depends on the (implausible) claim that the common law system of property rights has some natural, preconventional status.

11 Note the contrast with a system of slavery, in which the law confers on employers a right to the employee's labor. The employers' right is waivable in the sense that the employer can pay the slave a salary or even grant the slave freedom.

12 Slavery is an obvious exception.

management is decided via a process of employer-employee bargaining, thus organized. In some ways, the NLRA's arrangement is more complicated and more interesting than this account suggests. With respect to mandatory subjects of bargaining—wages, hours, and working conditions—the NLRA removes common law rights from employers and creates bargaining entitlements, that is, entitlements that are not owned by anyone in particular but that will be a product of bargaining, having been deliberately placed, as an initial step, in the hands of neither side.14

This system of worker organization and collective rather than individual bargaining has been justified on many diverse grounds.15 Most obviously, collective bargaining allows information to be shared and pooled among workers, and hence it should permit them to overcome the many evident barriers to informed bargaining (an issue to which I will return). A point especially congenial to the perspective here is that union representation might also respond to short-sightedness, or bounded rationality, on the part of individual workers, producing outcomes that would best serve their long-term interests.16 Perhaps collective organization is simply necessary to produce industrial peace. At the same time, union representation resolves a collective action problem faced by individual workers who would compete, perhaps to their collective detriment, in the process of seeking employment.17 Self-organization could create a kind of workers' cartel, justified on the ground that the result would be to extract better deals from em-


16 For relevant evidence, see Freeman & Medoff, supra note 15, at 20 (emphasizing distinct features of compensation packages favored by unions, including an emphasis on long-term problems).

ployers (possibly at the expense of nonunionized workers). In any case, many of the goods provided by employers—safety, decent lighting, heat, pension benefits, formal procedures in the event of arbitrary discharge—are "local public goods" in the sense that they cannot be provided to one without being simultaneously provided to all or most. In these circumstances a collective voice might ensure against the underproduction of such goods. Whatever its goals, the collective bargaining approach has fallen on hard times with the decline of union representation since the 1950s, a decline related to workers' uncertainty about whether unionization would help or hurt them.

The third approach involves nonwaivable employees' rights. Under this system, the law confers the relevant right on employees, and employers and employees are forbidden from contracting around the legal guaranty. The relevant right might be a right to protection from occupational risks; it might be a right to be free from discharge on grounds of race, sex, or age; it might be a right not to be discharged for engaging in collective bargaining or for refusing to violate the law on the employers' behalf. As a matter of history, the third approach seems largely a reaction to the first, fueled by complaints about employers' bargaining power and about the perceived injustice of the common law approach.

This approach dominates the current system of statutory protections for workers in America; it also dominates the more aggressively

18 The "union wage premium" is generally estimated at 10% to 30%. See Freeman & Medoff, supra note 15, at 43-60; Harper & Estreicher, supra note 15, at 14. Unions also produce a mix in the compensation package, with particularly favorable effects on fringe benefits. See Freeman & Medoff, supra note 15, at 61-77. Thus unionized "establishments are especially likely to allot funds to deferred forms of compensation favoring senior workers, such as pensions, insurance, and vacation pay, and to have a large impact on smaller establishments." Id. at 77.
19 See Freeman & Medoff, supra note 15, at 8-9.
worker-protective systems of employment and labor law in Europe.

The rise of nonwaivable employees' rights can be seen as a surrogate for a more robust system of collective bargaining. But at the same time, it can be seen as a way of relieving any pressure to create that very system. If statutory protections are in place, a union might seem quite unnecessary, as the law is already giving employees what the union might have provided. A robust system of statutory guarantees would make union representation far less desirable. At the same time, an approach based on nonwaivable workers' rights might be criticized on grounds of its rigidity. Perhaps many workers would be better off with the flexibility to trade some goods for others, and perhaps consumers would benefit as well.24

C. Workers' Rights, With Bargaining

This, then, is a basic picture of contemporary issues and debates in employment law. But several things are missing from the picture. Most important: What if the law allocates the relevant entitlement to employees, but also makes the right waivable, in the sense that the employer could buy it, and the employee could sell it, for a fee? In principle, there is nothing at all strange about this idea. With respect to the employee's time, for example, the common law allocates rights in exactly this fashion; before employment, the individual has a property right over the course of his day that the employer can purchase for whatever amount the employee is willing to accept.25 We could easily imagine a system in which rights of this sort were a far larger part of the picture than they currently are. For example, employees might have and be permitted to waive rights not to be discharged without good cause;

24 This is a generalization of the argument in Richard A. Epstein, Forbidden Grounds (1995).
25 This is meant not in the sense that workers can "sell themselves into slavery," but in the sense that workers can make binding contracts to do certain things, on pain of sanctions.
rights not to be fired on grounds of race, sex, religion, or age; rights
to health insurance or occupational safety; rights to parental leave;
or rights to vacation time. All of these rights would operate as de-
fault rules for employers to purchase if a mutually agreeable deal
could be arranged. Waiver might operate individually or collect-
evatively; the law might or might not impose constraints on waivers.

What is absent from the traditional account is not only a full
sense of the legal possibilities, but also an adequate picture of
workers’ judgments and motivations. To the extent that analysis of
labor law has worked from any such picture, it is the one found in
traditional economics. But we know enough to know that this pic-
ture is inaccurate. Indeed, we know a great deal about how it is
inaccurate, and about what must be done to make it more nearly
correct. I attempt here to bring a better understanding of human
behavior to bear on the various alternatives.

This Article comes in six parts. Part I will discuss the debate over
at-will employment, with reference to emerging developments that
suggest a possible waivable right to be discharged for cause. The
at-will debate is well-trodden ground, but a behavioral approach
offers some new perspectives, and in many ways the particular is-
...
benefit such as more leisure time, better health, or more time with their families.

II. AN ILLUSTRATION: THE AT-WILL DEBATE

The debate over the contract at will has recently become one of the liveliest in all of private law. This debate is in some ways unique, for reasons that I will discuss in some detail, but it also has features in common with related debates involving, for example, parental leave, vacation time, health care, and age discrimination. With the decline in private-sector unions, the common law is now a principal arena for new contests about the nature of management-labor relations; the permissible grounds for discharge under the evolving common law have thus received a great deal of judicial as well as academic attention. My particular goal is to show how a better understanding of human behavior casts new light on the issue, in a way that unequivocally suggests the hazards of relying on a system of waivable employers' rights, and that also suggests, though more equivocally, the value of creating waivable employees' rights instead.

A. Background and Movement

In America, the general rule is that employment is at will: An employer can fire an employee for any reason or for no reason at all.  


See Estreicher, supra note 20, at 4–20. The percentage of the private nonagricultural workforce belonging to unions fell from about 35.7% in 1953 to about 11.5% in 1992. Id. at 3 & n.1.


As far as I am aware, the only existing discussion of the contract at will, from this point of view, can be found in the illuminating discussion in Issacharoff, supra note 30.
all. In recent decades, however, courts have made three inroads on this rule, involving third-party effects, opportunistic behavior, and promises inferred from ambiguous statements.

1. Third-Party Effects

There is now a set of public policy exceptions to the at-will rule. For example, an employer may not discharge an employee for refusing to commit a crime on his behalf. The key organizing idea behind the public policy exceptions is that when a third-party interest is at stake, the at-will principle does not apply. Insofar as such interests are at stake, the decisions make a great deal of sense. The analysis is straightforward, and the decisions do not present difficult issues about workers and their motivations.

2. Opportunistic Discharges and the Implicit Behavioral Rationality of the Modern Common Law

In a separate and more complex line of cases, courts have found an implied "covenant of good faith and fair dealing." This idea seems to forbid "opportunistic discharges"—as, for example, when an employer discharges an employee immediately before the employee is to receive a commission, a pension, or some other benefit that he seems to have earned. The best rationale for these decisions is that they violate implicit contractual understandings. To understand this point, some brief background is in order, for this is the first place where we shall see how a behavioral understanding unsettles the conventional view and better explains both the data and the case law.

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34 Mark A. Rothstein et al., Employment Law 690–94 (2d ed. 1999).
36 See Schwab, supra note 28, at 33.
In the conventional view, the interests of workers and employers ensure against opportunistic discharges, understood as discharges in violation of the parties' implicit agreements. As the standard account of life-cycle justice goes, employers subsidize workers during an initial training period in which wages exceed productivity. Here the employer is making an investment in workers, hoping to recoup that investment after the training period is finished, as workers build up firm-specific human capital. After training, the worker's productivity inside the firm increases over time, as do workers' wages. But wages increase less rapidly than does productivity for the remainder of the worker's career. In effect, the worker was subsidized in the training period; after that time, he subsidizes the employer, because productivity is higher than wages even though both continue to increase.

For purposes of law, the distinctive feature of this account is that the law need not intervene to bind the employer to the employee, or the reverse. The worker wants to stay, because his inside wage is higher than his wage in other workplaces where he lacks firm-specific human capital. At the same time, the employer wants the worker to stay, because the worker's wage continues to be lower than his productivity inside the firm. The elegance of the account lies in its purported demonstration that the self-interest of both parties will prevent behavior that might be opportunistic, inefficient, or unfair.

As Stewart Schwab has shown in an important essay, there are serious problems with this conventional account. An obvious difficulty is posed by the widespread existence of mandatory retirement rules, now unlawful under the Age Discrimination in Employment Act ("ADEA"). If productivity continues to be higher than wages, why on earth would employers seek to get rid of older workers? The question suggests that productivity will not, at a certain stage, be higher than wages after all—or at least that an employer can do better with replacements. A further problem stems from evidence that workers' wages are, toward the end of ca-

37This account is outlined in detail in Schwab, supra note 28, at 13–15. I draw on Schwab's superb account throughout this discussion, adding only a fuller sense of the behavioral foundations of the view he defends.
38See id. at 15–19.
reers, higher than productivity, so that late-career workers are, in effect, being subsidized by employers, in a way that apparently provides compensation for workers' subsidy of employers in mid-career. An additional problem—or perhaps it is an explanation of the problem just noted—comes from detailed evidence of the "efficiency wage," by which employers pay employees a bit more than they must, in order to prevent shirking. An examination of the relationship between productivity and wages suggests that promises of payment in late career, including pensions and wages above productivity, are part of a bargain by which employers induced good work from people who might otherwise choose merely adequate work.

On this account of the situation, the deal between employers and employees is not self-enforcing. Employers have an incentive to behave opportunistically, by discharging late-career employees, in violation of the implicit deal. There is a potential role for law to prevent this opportunistic behavior, thus promoting efficiency and fairness alike. More specifically, law might forbid discharges in violation of the bargain revealed by an understanding of the life-cycle model of employment. In fact, a number of cases involving violations of an implied covenant of good faith and fair dealing seem to reflect a judgment of exactly this sort. Thus it is possible to see, in the modern developments, an implicit behavioral foundation to the innovation away from the simplest form of the contract at will.

I have yet to provide an understanding of why the relationship between productivity and wages takes the form that it does. Here behavioral economics provides some clues. The first point has to do with fairness and its relationship to morale. Behavioral econo-

42 See Schwab, supra note 28, at 19.
43 See sources cited supra note 35; see also Schwab, supra note 28, at 38-51 (describing cases best explained by the life-cycle model).
mists emphasize that people care about fairness—about being fair and perhaps even more about being treated fairly. Hence they are likely to sacrifice economic self-interest, especially to punish those who have been unfair to them. Evidence shows that workers care a great deal about being treated fairly, that judgments about fairness do not depend only on the absolute level of wages, and that employees are entirely willing to punish employers who violate employees' perception of fairness. Employers are aware of this fact and behave accordingly, so as to maintain morale and thus prevent shirking or worse. The existence of the efficiency wage is best explained in these terms. Employers give employees somewhat more than they need to give; in return, employees do the same for employers. At the same time, the promise of benefits down the line—pensions, increasing wages—encourages the employee to bind himself to the employer, both by staying there and by doing good work.

The second explanation for the revised understanding of the relationship between productivity and wages is that, like everyone else, employees are loss averse, in the sense that they do not like losses from the status quo. This preference imposes severe pressures on employers' ability to set wage structures. Employees would predictably rebel against an employer's decision to set wages below productivity if the consequence was that late-career employees would find their wages gradually shrinking. Employers' failure to reduce the wages of older workers fits with the understanding that any reduction in wages would cause severe morale problems—a point that helps explain employers' general reluctance to reduce wages, even in recessions.

A third and closely-related point is that employees appear to prefer rising wage profiles. Many people would rather see wages

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46 See Jolls et al., supra note 1, at 1489–96.
41 See Bewley, supra note 3, at 175–76.
40 See id.
39 See id.
38 See id.
for the next four years take the form $50,000, $55,000, $60,000, $70,000, rather than $70,000, $60,000, $55,000, $50,000—even though the latter is worth more. The observed steady increase in wages, even in the face of not-increasing or even decreasing productivity, undoubtedly has something to do with this motivation.

3. Inferences From Ambiguous Statements

Equally important for current purposes, courts have made some movement toward inferring a contractual term of job security. The inferences have been drawn on the basis of highly ambiguous commitments from employers, such as a vague promise (referring to permanent employment) and employee manuals (even those that contain express disclaimers). Here, too, we can find an implicit behavioral rationality in the law, rooted in an understanding of what workers actually think.

As a consequence of these changes, the law is in flux in many states. For example, Montana has enacted a statutory program designed to replace the at-will rule with a nonwaivable for-cause regime, and in 1991 the National Conference of Commissioners on State Laws adopted a similar rule as the Uniform Employment Termination Act.

B. Of Waiver and Default Rules: Does It Matter Who Has the Entitlement?

Under the at-will rule, the common law confers the relevant entitlement on the employer. But entirely within a system of freedom of contract, it would be equally possible to confer the entitlement on workers, protecting them against discharge without cause, but allowing them to waive that protection for an agreed-upon price. The initial question is whether, in a regime of freedom of contract, the default rule matters at all.

Under the conventional view, the default rule does not matter. Here is a second place where, as we shall see, the conventional view is wrong, and a behavioral approach does much better. The

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5 See infra Section II.E.
issue is complex, and lest the forest be lost for the trees, here is the simple conclusion: The default rule may well matter a great deal, because the party who is allocated the initial entitlement, in employment law or elsewhere, is likely to value it far more than he would if the initial entitlement were given to the other side. In other words, the default rule is highly likely to affect valuations, including workers' valuations.

1. The Endowment Effect and "Sticky" Default Rules

The Coase theorem states that if transaction costs are zero, the initial allocation of the entitlement does not matter.\(^5\) The Coase theorem actually suggests two different points. First, whatever the content of the legal rule, the parties will bargain their way to the efficient solution. Second, whatever the content of the legal rule, the parties will bargain their way to the same solution. If these points are right, it does not matter, assuming no transaction costs, whether an employer or an employee is given the relevant entitlement. The question is how the Coase theorem bears on the selection of default rules in the context of employment law.

Let us begin by supposing that with respect to contracting around the job security term, transaction costs are zero. Is the Coase theorem correct? It is clear that the theorem is on firm ground insofar as it suggests that the parties will bargain their way to an efficient result, whatever the content of the legal rule. This is very close to a definition of efficiency. If the employer very much wants an at-will rule, and if the employee does not care much about job security, the contract will provide for at-will employment, regardless of the content of the legal rule. If the background rule is at will, there will be no contractual shift; if the background rule is for-cause, the parties will bargain their way to an at-will situation. Efficiency will follow no matter what the legal rule is.\(^6\)


\(^6\) Of course the legal rule may have distributional consequences. If the employment right at issue is a large part of the wealth of either side, its allocation to one or another side will contribute to relative wealth. But in this context, it is difficult to see how the choice of one or another waivable rule will have significant distributive effects. So long as the parties can bargain, workers are not going to be significantly poorer or richer if the default rule is one way rather than the other.
Will the legal rule be not merely efficient but also the same? Notwithstanding the Coase theorem, there is good reason to think that it will not be. The principal reason is the endowment effect, a central behavioral finding in accordance with which people tend to place a far higher value on an object if it is initially allocated to them than if it is initially allocated to someone else. Default rules have a tendency to stick, in labor contracts as elsewhere. If people are initially given a right to a certain good, they are likely to ask more to give it up than they would be willing to pay for it in the first instance. We do not have direct evidence for the particular case of job security, but if for-cause protection is initially given to the employee, it is reasonable to predict that the employee will demand more to relinquish job security than he would be willing to pay to obtain the right in the first instance. It is less clear that the endowment effect holds for large commercial actors. But if a right to discharge at will is given to employers, it follows that some or many employers will demand more to give it up than they would pay to purchase it in the first instance. Thus the allocation of the legal entitlement, to workers or to employers, will likely matter in the sense that the ultimate outcome will be affected by the increased value placed upon the right simply by virtue of the initial allocation.

So long as the right is initially allocated to one or another side, an endowment effect cannot be avoided. The only way to avoid such an effect would be for the law to refuse to allocate any initial right at all. At first glance this seems to be an incoherent and impossible idea: Any system, to get off the ground, requires an initial allocation of rights, from which bargaining will take place. But the idea is not as impossible as it seems. The law might say, for example, that a contract cannot be enforced unless express provision has

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57 See Thaler, supra note 1, at 7-10.
58 For evidence of the endowment effect in the area of default rules, see Russell Korobkin, Behavioral Economics, Contract Formation, and Contract Law, in Behavioral Law and Economics, supra note 1, at 116.
59 See id.
60 Compare the suggestion in Richard A. Posner, Economic Analysis of Law 359 (5th ed. 1998): "If the requirement were optimal it would be negotiated voluntarily." The suggestion is not wrong, but it neglects the possibility that the initial allocation of the right will determine what it is optimal.
61 I am grateful to David Laibson for this suggestion.
been made for or against job security; without such a provision, the contract is void. Sometimes contract law does take this approach, by refusing to specify terms for the parties. To get a bit ahead of the story, this approach is a draconian form of information-forcing: It requires the parties to be clear, and refuses to create terms for them, even default terms.

But no one is now urging that the law should refuse to enforce contracts lacking an express term for job security. The real question, here and elsewhere, is how to select a default rule in the presence of endowment effects. This remains a largely unexplored question. What I am emphasizing here is that the endowment effect confounds ordinary understandings of the problem, and I do not intend to solve the large question of how to choose a default rule when an endowment effect is inevitable. But the following considerations are relevant to understanding the problem.

- Whether one or another endowment effect is to be preferred cannot easily be decided on standard efficiency grounds. So long as transaction costs are zero, either allocation would produce efficiency. But a less standard analysis, also aimed at efficiency, might point in fruitful directions. It would ask whose welfare would increase most by virtue of having the initial allocation. Suppose, for example, that workers, if they were initially allocated for-cause protection, would generally demand a great deal to give it up (say, $1000); suppose too that employers, if they were not initially given at-will protection, would be willing to buy it only for a small price (say, $100). Suppose at the same time that if employers were given the initial right, they would not value it highly (and would sell it for, say, $110), and also that if employees were not given the initial right, they would not value it highly either (and would buy it only for, say, $120). If this is so, we would have reason to believe that efficiency favors a for-cause default rule because welfare would be higher given that rule. One problem with

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this analysis is that it must usually be conducted in the absence of data and therefore involves some speculation about what people would do or prefer.

- The easiest cases for choosing one or another default rule involve third-party effects. Indeed, if there are significant third-party effects, a nonwaivable rule would probably be best. With job security, however, no such third-party effects are obvious. Compare this with the question of how to handle rights to parental leave. Suppose that children benefit from parental leave requirements (a proposition that is not obviously true; if such requirements reduce wages and employment, children might be hurt as well). If so, the best approach is probably to create a nonwaivable right to parental leave.

- It is important to ask whether there is a distributional reason to favor one or another rule. If the allocation of the initial entitlement to workers would have good distributional consequences, there is reason to favor that allocation. I will take up this issue in more detail below, but for the moment note that significant distributive effects should not be expected in this context, because the resource gain from the initial allocation is not a large part of workers’ wealth. In any case the market is likely to adjust to any switch, by, for example, producing a reduction in workers’ salaries, thus negating any distributive change.

- If we know why the endowment effect exists, we might be able to make some progress in deciding on the default rule. In asking about whether to use “willingness to pay” instead of “willingness to accept,” some progress has been made on this question. If the endowment effect stems from confusion, or from bargaining behavior, it would seem to make little sense to shift the entitlement. Perhaps people, and workers in particular, believe that the initial allocation of the entitlement carries a certain moral weight, or presumptive validity, so much so as to drive a wedge

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63 As suggested in Korobkin, supra note 62.
64 See id. at 689–97. See also Sunstein, supra note 62, for more detailed discussion of this point.
between willingness to pay and willingness to accept. In some circumstances, selling a good might appear to be illegitimate, an insult to dignity. Or perhaps some people simply ignore, much of the time, the existence of opportunity costs. For goods that are not simply money tokens, people appear to think that continued ownership is costless, or that the cost of not selling is far less than it is in actuality. This might well be simple confusion. If that is the source of the endowment effect, we should not use “willingness to accept,” and there is no good reason to switch the default rule.

- A final question is whether, aside from efficiency and distribution, desirable social effects would follow from creating a “sticky” default rule of a certain kind. An endowment effect of one or another sort might be supported if it could be shown to have valuable effects on social attitudes and norms. If, for example, it were thought important to inculcate an attitude, on the part of workers, of support for the right of job security, the case for a waivable workers’ right would be strengthened. The point is perhaps easiest to see in the context of sexual harassment. If employers have a right to harass employees sexually, but employees can buy that entitlement through contractual protection, we might think that the situation would have harmful effects on norms and desires—and that a situation in which employees have the right, waivable or not, would be much better. As the example suggests, the line between a very sticky default rule and a nonwaivable right might be one of degree rather than one of kind; I take up this point below.

2. Nonzero Transaction Costs: Paper, Information, Signaling

Thus far we have been exploring the effect of the initial endowment on ultimate outcomes, assuming transaction costs are zero, and hence that workers and employers can costlessly contract around the default rule. Of course, transaction costs are not zero in the context of employment contracts. Some costs are present merely by virtue of the need to generate paper to contract around
an undesired background rule. Some costs come from the phenomenon of signaling.\textsuperscript{65}

\textit{a. Paper and Information}

If courts select a rule that most parties dislike, the paper costs, while unlikely to be huge, may not be trivial. It would be necessary to produce formal documents where silence would otherwise be sufficient. Probably more important are information costs. Employers are repeat players, and many of them have sufficient information to know what they are doing when they ask for or sign a waiver. But employees are frequently imperfectly informed.\textsuperscript{66} If the legal right is allocated to employers, employees may not ask for job security because they mistakenly believe that they have it, or because they are unable to think properly about the subject. The existence of information costs means that the initial allocation of the legal right might turn out to matter a great deal, both to efficiency and to the ultimate outcome. As stated, this point depends on no controversial claims from behavioral economics; I return to it shortly.

\textit{b. Signaling}

Signaling creates special problems in the area of job security. An employer who is willing to offer job security might find that it is attracting marginal workers.\textsuperscript{67} At the same time, an employee who presses hard for job security might be signaling that he will deserve to be discharged. Even if employers and employees would generally be better off with a system of job security, many individual employers and individual employees will rationally refuse to negotiate for it. Note that these points apply to many other contractual rights for which employees might bargain. An employee might fail to seek a right to parental leave, perhaps in the belief that such a right already exists, or, more likely, because he believes that the

\textsuperscript{65} For a general discussion, see Eric A. Posner, Law and Social Norms (2000); in the context of employment law, see the discussion of severance pay in Bewley, supra note 3, at 270.

\textsuperscript{66} See Kim, Bargaining, supra note 28, at 105–06.

very request would signal a lack of commitment to work. In these circumstances, a waivable employers' right is likely to stick even if it is undesirable. There is evidence that this happens with respect to severance pay; employees do not seek severance pay because doing so sends a bad signal.\(^6\)

These points do not demonstrate that one waivable rule is better than another. But they are sufficient to show that the choice of the default rule is likely to matter a great deal—both to efficiency and to ultimate outcomes.

**C. What Mimics the Market?**

Suppose, then, that the legal rule will indeed matter. Under the conventional approach, one with obvious implications for labor-management relations in general, courts should seek the default rule that best "mimics the market," in the sense that it is the rule that employers and employees, armed with adequate information, would generally seek.\(^6\) In the context of labor law, it is not clear that the legal system should choose the approach that would mimic the market, even if it can identify that approach. Perhaps a different approach will redistribute resources in a desired direction,\(^7\) or will have a salutary effect on the formation of preferences. But let us begin by approaching the choice of the waivable term in the conventional terms.

**1. The Simple Case for At-Will Employment**

Those who argue for a waivable employers' right claim that this is what employees and employers would generally seek, and thus that the existing background rule mimics the market.\(^7\) On this view, employers have a strong reason to resist a for-cause regime, to immunize themselves from illegitimate and even frivolous suits and to ensure against shirking. Certainly employment at will seems to be the general rule.\(^7\) With an at-will rule, employers can prevent

\(^6\) See Bewley, supra note 3, at 270.
\(^7\) This is the basic argument in Epstein, supra note 28.
costly litigation whenever someone is discharged. They can also counteract the risk of opportunistic behavior by employees; more particularly, the right to discharge at will operates as an obstacle to employee performance that falls well below what the employee is able to do—a special virtue in light of the fact that shirking is both hard to monitor and hard to prove to third parties. Thus the employer’s right to discharge the employee at will might be seen to complement the efficiency wage, with both operating to induce good, rather than adequate, performance. Because operating a for-cause system is likely to be expensive, and because its costs would be ultimately felt by employees as well as employers, most employers, and most employees, are the beneficiaries of the at-will rule.

For those who believe that at-will is the market-mimicking rule, it is also important to emphasize that most employees are generally unlikely to object to this rule. In a market economy, employers are quite unlikely to fire employees for no reason. It is costly to get rid of good workers, and those who fire people for no reason will have some trouble replacing them, partly because arbitrary discharges will have harmful reputational consequences, thus leading prospective employees to seek work elsewhere. A separate point is that many employees develop at least some degree of firm-specific human capital: They are worth more to their own employer than they are worth to other employers, because they have experience with the firm and know something about its operations and expectations. Such firm-specific capital creates a safeguard against arbitrary discharges.

If employers generally would lose a great deal from a for-cause system, and if employees generally would gain little, the at-will rule stands adequately defended as a background rule that replicates the likely result of bargaining. The only people who stand to gain

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76 See Posner, supra note 60, at 358–59.
77 See Schwab, supra note 28, at 21–25.
from a for-cause system are marginal workers—prominently including those who deserve to be discharged for poor job performance but who would be immunized, in practice though not in law, by an at-will system.

2. Problems

However plausible, this argument is not obviously correct. It depends on a number of contentious empirical assumptions.

Suppose, for example, that a for-cause regime would not much affect employer practices, because in any sensibly-designed system discharge could occur at low cost whenever cause really existed, and employers have little interest in discharging people for a reason other than cause. If for-cause discharge is the ordinary practice and if arbitrary discharges are infrequent, employees should have little to lose from a legal rule that requires cause—unless (and perhaps this is the key point) the cost of administering a for-cause regime turns out to be high. But where cause exists, employees would of course lose their suits in any case, and hence they are unlikely to bring suit in the first place, especially in light of the cost of doing so. A mechanism that pushes contests toward low-cost resolution—such as arbitration—should ensure that employers have little to fear from a for-cause regime. For all these reasons, it is unclear that employers would greatly prefer an at-will system to a sensibly designed for-cause system.

At the same time, many employees might well care a great deal about obtaining for-cause protection, if only to obtain immunity from employer malice or mistake. We have seen that employee concern is likely to be greatest in late career, when opportunistic discharges become more probable; it is here that employers have special incentives to discharge employees in violation of the implicit deal. But even earlier, employees are likely to be willing to pay something for job security, or to require employers to pay something to take it away. On this view, a for-cause regime might be the best market-mimicking approach. The crucial empirical is-

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78This appears to be the aspiration of the Montana system, which encourages arbitration, and hence low-cost litigation. See Mont. Code Ann. § 39-2-901 et. seq. (1999).
79See Schwab, supra note 28, at 19.
sues here are, first, the cost of operating a for-cause system and, second, the extent to which employees would actually be at risk in an at-will system.

Because a final answer would depend on resolving those empirical issues, nothing said here demonstrates that a waivable workers' right would be the market-mimicking solution—that such an approach would actually reflect the outcome of informed bargaining by most employers and employees. But enough has been said to show that any judgment on that point depends on empirical questions that cannot be answered a priori.

3. Informational Problems and the Fairness Heuristic

An additional weakness of the argument that an at-will system is market-mimicking has to do with informational problems. The most important point is that employees appear unaware that in the face of contractual silence they are entering into an at-will arrangement. Even if they know the basic fact, they may not understand exactly what it means. Here, then, is a third problem with the conventional wisdom, illuminated by behavioral economics, though the mechanisms that account for employee ignorance remain unclear.

Recent evidence, compiled by Pauline Kim, strongly suggests that workers believe that employment is generally for cause, not at will, and that discharge is therefore unlawful unless there is a job-related reason for it. In Missouri, for example, Kim found that extremely strong majorities of employees—80% or more—believe that the following grounds for discharge, entirely lawful in Missouri, are in fact unlawful: the employer wants to hire someone else to do the same job; the employer mistakenly believes that the employee stole money; and the employer personally dislikes the employee. Similar results were found in California and New York, notwithstanding substantial variations in the law of the three states. Overwhelming majorities falsely believe that discharges

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80 See Kim, Bargaining, supra note 28, at 105–06; see also Richard B. Freeman & Joel Rogers, What Workers Want 118–21 (1999) (finding pervasive employee ignorance about legal rights).
81 See Kim, Bargaining, supra note 28, at 134 tbl.1.
82 See Kim, Norms, supra note 28, at 451–52.
that fall short of good cause are prohibited by law. Kim also found that worker ignorance cuts across distinctions that might be thought to make a difference—not only geography, but also age, work experience, and union experience. A more general survey found the same results, with worker ignorance and excessive optimism extending well beyond the setting of job security.

Why do workers misstate the law so systematically? It is possible to provide both rational and quasi-rational explanations for worker ignorance. As Kim notes, workers' beliefs to this effect might be based on an understanding of workplace norms, rather than law. Perhaps the informal law of the workplace bars arbitrary discharges, even when state law does not. This is certainly possible, but is it obvious why workers would say that what employers can do, as a matter of law, is the same as what they actually do, as a matter of practice? People are usually capable of distinguishing practices from rights. In places where incivility is absent or rare, people know that incivility is absent or rare, but they do not believe that it is against the law. While workers' ignorance probably has something to do with the perceived norms of the workplace, this cannot be the whole explanation.

Behavioral economics and cognitive psychology suggest alternative explanations. People tend to be optimists, and they often engage in wishful thinking; they also like to reduce cognitive dissonance by drawing their beliefs about how things should be into

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81 See Freeman & Rogers, supra note 80, at 118–21.
82 See id. at 499–501.
Sometimes people might believe that the law is as they wish it to be. People are also subject to self-serving bias; they care about fairness, but their judgments about what is fair are systematically skewed in their own direction. Perhaps people believe that the law is generally fair, and their judgments about what is fair lead to (mistaken) judgments about what the law is. But I suggest a more particular hypothesis: People's beliefs about what the law is tend to reflect their beliefs about what the law should be. In the absence of solid evidence that the law is otherwise, people will say that the law is what they think it ought to be. The hypothesis remains to be tested.

For present purposes, the key point is simple. The fact that workers believe that they have legal protection against arbitrary discharge is devastating to the suggestion that an at-will default rule accurately captures the shared understanding of the parties. In fact the evidence is devastating to the at-will rule as conventionally defended. Traditional understandings of workers' beliefs and motivations cannot easily account for workers' ignorance; behavioral economics provides some clues.

D. The Information-Eliciting Default Rule: A Waivable Workers' Right

If we are uncertain about what rule would mimic the market, we might seek a background rule that operates not to mimic the market but to elicit information—that imposes on one or another of the parties the obligation to provide the crucial information to the other side (and also to courts). On which party should this burden be imposed? It makes obvious sense to say that employers can more cheaply propose a provision that will make matters clear. A simple conclusion follows: If employers really would like a system of at-will employment, then courts should say that the background

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90 Linda Babcock et al., Choosing the Wrong Pond: Social Comparisons in Negotiations That Reflect a Self-Serving Bias, 111 Q.J. Econ. 1, 4 (1996).
91 This is not to say that the rule cannot be defended in other terms. See, e.g., Heckman & Pagés, supra note 75 (showing the harmful effect of job security requirements).
rule is for-cause, simply to elicit a clear statement to this effect, so that both parties to the contract know its real content. Here, then, is an effort to build employment law on a conventional efficiency analysis, informed by a better understanding of workers' beliefs and motivations.

In the abstract, this view might be defended simply on the ground that the choice of the market-mimicking rule depends on empirical issues that have not been resolved. Without evidence, and without reason to believe that evidence would strongly support one or another solution, an information-forcing rule seems best. Kim's findings provide further support for this view. They demonstrate that employees do not know that this is the rule and therefore do not enter into contracts with their eyes wide open. They strongly support the suggestion that the appropriate background rule is for-cause, not to mimic the market, but so as to ensure that employers furnish the relevant information to the employee, and obtain a waiver if they can.

The essential argument for a waivable workers' right to job security is now in place. We lack much ground for confidence about the content of a market-mimicking rule. Lacking that confidence, a for-cause regime seems best, as a way of forcing disclosure and overcoming what appears to be a lack of information on the part of workers. If the argument is sound, it applies in many areas of labor and employment law, as we shall shortly see.

E. Doctrinal Support

These suggestions are not entirely without doctrinal support. In the last two decades, courts have moved in the direction of creating an information-forcing default rule for job security. While mere silence does not create a waivable workers' right, ambiguous statements, plausibly interpreted as conferring job security, are often taken to prevent at-will discharge. If employers are to escape that result, they must do so via a disclaimer that is exceedingly clear. Here is another area in which we can find an implicit behavioral rationality in the emerging common law—a system of legal

See id. at 95.
rules built on an accurate, rather than fanciful, sense of what workers are likely to know and how they are likely to react.

1. Old Law

For many decades, an apparent but ambiguous promise by an employer would not create a contractual obligation to provide security.\(^4\) Employment manuals, for example, would not count as part of any contractual relationship. In the same vein, a statement by an employer or a personnel manager to the effect that the employee could work "as long as he did a good job," or "permanently," would not provide a for-cause guaranty, at least if it was unaccompanied by a defined term for employment.\(^5\)

These results seem odd. They treat a promise that apparently gives something to an employee as if it had no meaning at all. How might the pattern of decisions be explained? One possibility is that courts, in the relevant cases, are making a claim about the reasonable expectations of most workers who have heard statements of this sort. Perhaps an employee who has been told that he has "permanent" employment does not reasonably understand this as a promise, rather than a hope or expectation.\(^6\) But a more interesting possibility is that courts are creating a kind of information-forcing default rule, to the effect that ambiguous statements will not create a for-cause situation, and employees must obtain greater clarity if this is in fact what they want. This seemingly harsh result prevents both parties and judges from guessing about the meaning of words that cannot really be taken at face value. An oral reference to permanent employment cannot mean that the employee

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\(^4\) See Clarke v. Atl. Stevedoring Co., 163 F. 423, 425 (C.C.E.D.N.Y. 1908); Comerford v. Int'l Harvester Co., 178 So. 894, 895-96 (Ala. 1938); see also Rothstein et al., supra note 34, at 674-88 (discussing the old law and modern changes).

\(^5\) See Rothstein et al., supra note 34, at 674-88.

\(^6\) A more conventional argument would be that employers cannot be bound because no contract exists unless both parties have manifested an intention to be bound. But here, as elsewhere, the argument is a fake. If there is any background rule, someone is going to be bound, whether or not an intention to be bound has been manifested. Under a system of at-will employment, employees are bound, in the sense that they can be fired for any reason, even though they have not manifested any intention to be bound in that way. The idea that people cannot be bound unless they have manifested an intention to be bound—the consent theory of contract—cannot be made intelligible without a background theory of "natural" entitlements, which in this context, is hard to generate.
will be allowed to work there forever; the statement must be qualified in various ways, and perhaps the court does not want to do the qualifying on its own. Treating the statement as a kind of goal, rather than a promise, prevents judicial guessing-games.

2. New Law

But the law has changed a great deal in the last two decades. Courts have read employment manuals to create enforceable obligations, even when the relevant terms have ambiguity, as in a statement that it is "the policy" of the company to fire people for cause. In *Toussaint v. Blue Cross & Blue Shield*, for example, the personnel manual said in general terms that it "is the policy of the company to treat employees... in a fair and consistent manner and to release employees for just cause only." It was clear that under long-standing law, this statement would not be sufficient to overcome the at-will presumption, in part because no term of years was identified. Nonetheless, the Michigan Supreme Court held that this was sufficient to create an obligation of continued employment, even without a specified term of years. Other cases speak in similar terms, and it is now clear that employment manuals can create obligations.

Indeed, some cases have gone so far as to entrench the relevant provisions, in the sense that once something like a promise has been made, a disclaimer is unlikely to be effective unless it is exceptionally clear. Thus, for example, the Wyoming Supreme Court was confronted with an employee handbook containing the following language: "READ CAREFULLY BEFORE SIGNING. I agree that any offer of employment, and acceptance thereof, does not constitute a binding contract of any length, and that such employment is terminable at the will of either party, subject to appropriate state and/or federal laws." The court held that the disclaimer was ineffective notwithstanding this express statement,

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80 Id. at 903 (quotation marks and emphasis omitted).
81 See id. at 885.
83 See Rothstein et al., supra note 34, at 674–84.
for it "was not set off by a border or larger print, was not capitalized, and was contained in a general welcoming section of the handbook." The court’s decision is hardly unique. In a number of cases, courts have said that disclaimers must be extremely clear. In addition, oral promises are frequently taken as binding, even if they have a degree of ambiguity. Thus, for example, in *Toussaint*, the court was confronted not only with personnel manuals but also with allegations from the plaintiffs that they had been told that they would be able to continue to work “as long as I did my job,” or “[I was] doing the job.” In an alternative holding, the court held that these statements were sufficient to justify an action for wrongful discharge, even if a specific term of years was not identified. Some cases find oral statements of this kind sufficient to create a right not to be discharged without cause.

These cases might reflect a new understanding of the reasonable expectations of employees when presented with statements of this kind. Perhaps the modern cases reflect a belief that reasonable employees think that such statements give them job security. But the decisions might also be understood as a modest step in the direction suggested here: toward a waivable workers’ right to job security, on information-forcing grounds and based on a realistic sense of what workers are likely to think when presented with statements containing apparent promises. The employer is in the best position to control the statements made to employees, and if ambiguous statements are made, the employer ought to correct the ambiguity so as to negate any employee belief that a for-cause arrangement has been created. The disclaimer cases fit this rationale particularly well. They create a kind of consumer protection measure.

103 Id. at 989.
106 *Toussaint*, 292 N.W.2d at 890.
107 See id.
108 See Rothstein et al., supra note 34, at 684–86. Generally, however, separate consideration is required to make an oral statement binding.
ure, saying that if there is any chance that the employee will misunderstand what he has been promised, it is the employer's job to make an unambiguous correction. If a for-cause agreement is not in the parties' interest, the employer can be expected to make corrections by notifying the employee of the situation in the clearest possible terms.

It would not be a giant step from these cases to a waivable employees' right to job security. As we have seen, the evidence suggests that ordinary employees, not told anything at all, are in the same position as employees told that their employers' "policy" is to retain them unless their performance is unsatisfactory.\textsuperscript{109} Employees typically believe that this is both policy and law. And if this is the understanding of most employees, employers should be required to make a correction.\textsuperscript{110}

\section*{II. COUNTERARGUMENTS AND ANTI-WAIVER}

Thus far I have suggested that in the context of job security, a waivable employers' right might be preferred over a waivable workers' right, on the ground that the former may be the market-mimicking rule, but that without good evidence on that question, a waivable workers' right seems better, because it is an information-forcing rule, defensible in light of what we know about what workers think. I have also suggested that the default rule will indeed matter. But I have not discussed whether a nonwaivable workers' right would be best of all. It is now time to explore that possibility.

\subsection*{A. Unequal Bargaining Power and Redistribution}

Many of those who challenge the at-will system stress the possible inequality of bargaining power between employers and (many) employees. They suggest that a shift to a for-cause system would produce a desirable form of redistribution to employees, particularly to the most vulnerable workers.\textsuperscript{111} The reference to inequality of bargaining power must mean that many of the deals between

\textsuperscript{109} See Kim, Bargaining, supra note 28, at 110–11.
\textsuperscript{111} See Blades, supra note 21; Clyde W. Summers, Individual Protection Against Unjust Dismissal: Time for a Statute, 62 Va. L. Rev. 481, 518–32 (1976).
employers and employees are harsh from the standpoint of the latter, and that the law should attempt to ensure a fairer arrangement. We should certainly accept the claim of harshness, at least with respect to many of the relevant deals. Some employees have few good options, and in these circumstances the best arrangement that they can get is often quite harsh, even unfair, in the sense that they are working very hard and receiving little in return. There is no reason whatsoever to think that the market wage has any special moral status.\(^{112}\) It is important to find good ways to supplement employment packages that turn out to be harsh or disadvantageous.

But the redistributive argument nonetheless stands on fragile ground—not because the existing distribution of entitlements and resources is good, but because blocking the exchange, through a nonwaivable right to job security, is not the best way to produce the desired redistribution.\(^{113}\) In fact, such a nonwaivable right might not produce the desired redistribution at all. A nonwaivable workers’ right to job security—and here is a general lesson for employment law—is an unreliable method of redistributing resources to workers.\(^{114}\) A for-cause provision does not directly redistribute resources from employers to employees; instead it creates restructured deals, which may or may not benefit employees as a class.

When mandatory for-cause provisions are imposed, someone must pay for them. The burden may well fall on consumers, or even workers themselves, in the form of lower wages, smaller retirement benefits, or lower employment on balance (through, for example, more extended screening of job candidates, or refusals to

\(^{112}\) To some this will be a controversial claim. I will not defend it here.


\(^{114}\) In the context of accommodation mandates, this proposition is severely qualified, for as Jolls shows, there are conditions in which desired redistribution might well occur. See Jolls, Accommodation Mandates, supra note 70, at 30–33.
take risks by employing people in the first instance). There can be no assurance that any redistribution will make workers better off as a class. Workers might lose in salary or other benefits most of, or as much as, they gain via the nonwaivable term (with the qualification that unionized workers appear to suffer from lower, or no, wage offsets).

The redistributive argument for nonwaivable terms might be fortified with the suggestion that in individual bargaining, workers face a collective-action problem that is best solved via law. John Stuart Mill outlined the argument long ago, suggesting that with respect to a reduction in hours worked, the limitation will not be adopted unless the body of operatives bind themselves to one another to abide by it. For however beneficial the observance of the regulation might be to the class collectively, the immediate interest of every individual would lie in violating it: and the more numerous those were who adhered to the rule, the more would individuals gain by departing from it. Assuming then that it really would be the interest of each to work only nine hours if he could be assured that all others would do the same, there might be no means of their attaining this object but by converting their supposed mutual agreement

115 A good overview is Summers, supra note 113.
116 See id.; Fishback & Kantor, supra note 74, at 64–69 (showing wage cuts after enactment of workers' compensation programs). Note the possibility that workers care not about absolute economic position but mostly or partly about relative economic position; if this is true, nonwaivable workers' rights might be justified on the ground that they provide a benefit, in the form of increased job security, while also keeping relative economic position constant. See Robert H. Frank, Choosing the Right Pond (1985); see also infra Part VI.
117 For analyses finding substantial wage offsets, see Price V. Fishback & Shawn Everett Kantor, Did Workers Pay for the Passage of Workers' Compensation Laws, 110 Q.J. Econ. 713, 736 (1995) ("Analysis of the effect of the introduction of workers' compensation on wages shows that in the coal and lumber industries, workers experienced substantial wage offsets. In the coal industry the offsets were large enough to cover not only the expected monetary value of the benefits, but also the employers' costs of purchasing the insurance to provide those benefits."); Jonathan Gruber, The Incidence of Mandated Maternity Benefits, 84 Am. Econ. Rev. 622 (1994).
118 See Fishback & Kantor, supra note 74, at 68–69 (showing no offsets in the unionized sector).
into an engagement under penalty, by consenting to have it enforced by law.\textsuperscript{119}

Mill’s suggestion is sufficient to show that, with respect to any particular contract term, workers who are currently employed at a firm might do better with a nonwaivable legal constraint than without one. But it does not show that with respect to contracts as a whole, the nonwaivable right helps workers as a class. As an argument that nonwaivable terms promote redistribution, Mill’s argument faces two problems. First, and as noted, the compensation package might be adjusted to the detriment of workers; it is even possible that workers will lose in wages what they gain in reduced hours and that the resulting package might be worse from their point of view.\textsuperscript{120} Second, the result of the nonwaivable term might well be to decrease employment, even if—indeed precisely because—current workers are made better off.\textsuperscript{121} The decrease in employment is a serious problem from the distributive point of view, especially because the people who are thrown into joblessness are likely to be among the least advantaged members of society.

These points do not demonstrate that nonwaivable terms are indefensible as a means of producing desirable redistribution.\textsuperscript{122} Perhaps the wage offset will be less than 100%; in the building trades sector, for example, there appears to have been no wage offset as a result of workers’ compensation legislation.\textsuperscript{123} Perhaps the adverse effect on unemployment will be low and justified in light of the benefits of the nonwaivable term for larger classes of people; perhaps the problem of increased unemployment can be taken care of through other means. My conclusion is not that nonwaivable

\textsuperscript{119} Mill, supra note 17, at 350–51.
\textsuperscript{120} See the evidence of substantial wage offsets for workers’ compensation and parental leave, sources cited supra note 117. But see the relative position problem, taken up infra Part VI.
\textsuperscript{121} See Heckman & Pagés, supra note 75. On the ambiguous evidence that labor unions increase compensation packages while also decreasing employment, see Freeman & Medoff, supra note 15, at 21, 43–60.
\textsuperscript{122} See Jolls, Accommodation Mandates, supra note 70, at 257 (discussing the circumstances in which desirable redistribution will occur from accommodation mandates).
\textsuperscript{123} See Fishback & Kantor, supra note 117, at 734.
terms are always indefensible on redistributive grounds. It is that the case for such terms, on those grounds, is fragile and depends on highly uncertain empirical issues.

B. The Problem of Information, With Notes from Behavioral Economics

One possible reason to create nonwaivable workers' rights is to respond to inadequate information on the part of workers—inadequate information that cannot, realistically speaking, be corrected with information alone. We have seen that shifting the entitlement to the worker, while maintaining freedom of contract, is a way of counteracting worker ignorance. But this may not be sufficient. If workers are allocated the right, but asked to waive it, will they know what they are doing? This is an empirical question, and it lacks an obvious answer.

1. Intransigent Ignorance

With respect to job security, there is evidence that workers will not believe that a waiver is effective even if they are asked to sign it. The most striking evidence here comes from Kim's study. Kim asked employees to evaluate the effects of a personnel manual providing that the employer "reserves the right to discharge employees at any time, for any reason, with or without cause." In New York, California, and Missouri, this kind of provision eliminates any employer obligation. Nonetheless, in all three states

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124 It is generally agreed that regulation via a nonwaivable term is inferior to regulation via a redistributive income tax. See, e.g., A. Mitchell Polisnky, An Introduction to Law and Economics 105–13 (1983); Louis Kaplow & Steven Shavell, Why the Legal System Is Less Efficient than the Income Tax in Redistributing Income, 23 J. Legal Stud. 667 (1994). It is possible, though, that the choice is not between these two options, but between no redistribution at all and regulation via a nonwaivable term.

125 It is also possible to think that job security, like safety, is a public good, in the sense that it cannot be provided to one employee without simultaneously being provided to many; job security requires procedures to test the legitimacy of termination, and these procedures are a public good. See Weiler, supra note 7, at 75. To keep the discussion from becoming unwieldy, I defer it until a treatment of the issue of safety.

126 See supra notes 80–82 and accompanying text.

127 Kim, Norms, supra note 28, at 465 (quotation marks omitted).
about three-quarters of respondents believed that a pure cost-saving discharge would be unlawful notwithstanding the disclaimer.\(^\text{128}\)

It would be possible to respond to such evidence by endorsing a mandatory for-cause regime. Perhaps employees simply cannot be adequately informed of an employer's decision to purchase the relevant entitlement. The point may be right. But if the costs of a mandatory regime are very high for employers and workers alike, we have not defended it even if workers' ignorance is intractable. If the costs are high, and workers and employers will both lose, the at-will rule is likely to be best in any event. The best strategy might be to require extremely clear language so as to ensure that waivers are voluntary and knowing, as, for example, through strong verbs and specific language.\(^\text{129}\) This approach would not ensure full information, but it would move things in the right direction, and do so without introducing the possibly substantial costs of a mandatory for-cause regime.

2. Excessive Optimism

I have noted that people tend to be risk optimists;\(^\text{130}\) they believe that they are peculiarly immune from probabilistic harms faced by others. For example, 90% of drivers believe that they are safer than the average driver and less likely to be involved in a serious accident.\(^\text{131}\) Perhaps workers who waive their rights will believe, wrongly, that they are peculiarly immune from the risk to which they are subjecting themselves. If so, waivers will be inadequately informed. But it is not clear how to respond to this possibility. Probably the best remedy is not to ban waiver, but to inform employees in the clearest possible terms, so as to ensure that they are made aware that the risks are ones that they themselves will face.

\(^{128}\) Id.

\(^{129}\) See id. at 465 n.63 (citing Deborah A. Schmedemann & Judi McLean Parks, Contract Formation and Employee Handbooks: Legal, Psychological, and Empirical Analyses, 29 Wake Forest L. Rev. 647, 674–77 (1994)).

\(^{130}\) See Taylor, supra note 88, at 32–33; Jolls, Behavioral Economics, supra note 88, at 1659–63.

\(^{131}\) See Taylor, supra note 88, at 10–11.
3. Inadequate Foresight

Signing contracts before the fact, workers may not have a good sense of what is in their long-term interest. They might be myopic or short-sighted. Recent evidence so suggests. This is another kind of information failure, one that might also argue against allowing waiver.

Consider an example. We have seen that the endowment effect means that those who have a benefit are likely to value it more than those who do not. Oddly, however, it appears that people do not anticipate the endowment effect. In simple studies, people did not see that they would value mundane goods, such as coffee mugs, far more if those goods were initially allocated to them. Apparently people do not quite anticipate how bad it will be to lose something they once had. As Samuel Issacharoff has suggested, a possible conclusion is that workers will be in a poor position to decide whether or not to waive their rights, because they will not know, before the fact, how bad it would be to lose their jobs. If this is so, waiver might be banned in workers' own interests.

This problem might be reduced within a system of waivable workers' rights. In such a system, the presumptive right is with employees, not employers, and hence the endowment effect need not be imagined. On the other hand, it may be quite hard for employees, at the time of signing the agreement, to have a full appreciation of what it is that they may be losing. Workers may not sufficiently bargain to retain a legal right of some sort, simply

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132 Thus John Stuart Mill, no friend of government interference with freedom of contract, went so far as to suggest that an exception to the doctrine that individuals are the best judges of their own interest, is when an individual attempts to decide irrevocably now, what will be best for his interest at some future and distant time. The presumption in favour of individual judgment is only legitimate, where the judgment is grounded on actual, and especially on present, personal experience; not where it is formed antecedently to experience, and not suffered to be reversed even after experience has condemned it.

Mill, supra note 17, at 345.

133 See Bewley, supra note 3, at 268–70 (discussing worker myopia).


135 See Issacharoff, supra note 30, at 1801.

136 See id.
because they may not know how important, for example, continuation in a particular job will be to them.

4. "Editing Out"

People sometimes "edit out" events that have very low probability, even if the ultimate impact of the event is quite large, partly because of simplified "decisional paths" used for choices having multiple attributes. The terms of employment contracts are numerous, and it is unlikely that most employees will be able to focus on more than a few of them. In fact protection against arbitrary discharge seems to be a low priority item for most employees, notwithstanding its potential importance. There may be an analogy here with disaster insurance; people tend not to purchase disaster insurance (for floods and tornados, for example) even when the benefits of doing so clearly seem to exceed the costs.

These various points hardly create a devastating argument on behalf of a system of nonwaivable employees' rights. They raise, first, a number of empirical questions about what is likely to produce waivers and, second, a number of normative questions about how to handle employee mistakes. Any judgment about whether to allow waivers will depend largely on comparing the likely costs of a nonwaivable rule against the likely costs of employee ignorance and mistake. If it is possible to design a nonwaivable rule with low costs of administration—as perhaps Montana has done—speculations about employee ignorance may well be sufficient to carry the day. If, on the other hand, a nonwaivable rule will create serious problems, the speculations should require stronger empirical support before they can be made decisive.

C. Between Waivable and Nonwaivable: Constrained Waivers

Even if the various objections to waiver are taken to have substantial force, it does not follow that waiver should be banned. A more flexible approach would allow waiver, but only under certain

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137 Id.
138 See id.
140 See supra note 78 and accompanying text.
constraints, perhaps in the form of floors on what employees may be allowed to trade in return for waiving their rights. On this approach, the relevant right would be "commodified" in the sense that it could be traded on the market, but to protect employees against an absence of information waivers, would be constrained. It is easy to imagine intermediate solutions.

1. Procedural Constraints

At one extreme, the law could provide that a waiver is acceptable, but not simply when an employee has signed an agreement to waive. The waiver must be shown to be fully informed, perhaps limited to instances where it is accompanied by clear language and a cooling-off period in which the employee is permitted to reconsider and, if he so desires, to consult a lawyer. Consider this a procedural constraint on waivers. A legal constraint of this kind could be designed to furnish information, directly and indirectly, by imposing requirements intended to signal the magnitude of the discussion. A procedural constraint on waiver could be minimal or much more than that.

The general idea has clear antecedents in current law. Under the common law as now understood, employer disclaimers must be extremely clear and conspicuous; explicit language is not enough. Under the ADEA, a similar approach is taken to waivers of antidiscrimination rights. For rights and claims arising before execution of the waiver, the statute permits waiver so long as it is "knowing and voluntary." If it is, the waiver is an affirmative defense. To count as knowing and voluntary, the waiver must specifically refer "to rights or claims arising under" the ADEA; the employee must be advised in writing to consult with an attorney before executing the agreement; the employee must be given "at least 21 days within which to consider the agreement"; and the agreement must provide for a minimum of a seven day post-execution revocation period. Most of these provisions also apply to waivers in

142 Id. §626(f)(1)(B).
143 Id. §626(f)(1)(E).
144 Id. §626(f)(1)(F)(ii).
145 Id. § 626(f)(1)(G).
settlement of charges filed with the EEOC. These provisions of the ADEA are models of a procedurally constrained waiver.

2. Substantive Constraints

At another extreme, waiver might be deemed acceptable, but only at a price determined by government, not at a price determined by the market. Here, there is a substantive constraint on waivers. Substantive constraints, like procedural ones, might be minimal or much more.

This approach also has a place in contemporary employment law. An example is the Fair Labor Standards Act, which allows employees to waive their right not to work more than forty hours a week, but only at a governmentally determined premium (time and a half). Or consider the Model Employment Termination Act, which allows employers and employees to waive the right to for-cause discharge, but only on the basis of an agreement by the employer to provide a severance payment in the event of a discharge not based on poor job performance. This severance payment consists of one month's salary for every year of employment and, interestingly, is therefore targeted to longevity of service in a way that maps onto the employees' likely growing stake in their jobs.

For those who are skeptical of both simple market waivers and government mandates, these various approaches supply a model in the form of a system of substantive constraints, designed to ensure that the employee is given something of definite value in return for waiver.

D. How To Handle Job Security

I have been attempting to work through issues of job security from a perspective informed by behavioral economics. The most important goal is to increase understanding of the underlying issues, not to recommend any particular reform. Nothing I have said suggests that courts should declare that contracts are presumed to

146 Id. § 626(f)(2).
147 Waivers may not apply to rights or claims that arise after the date the waiver is executed; here, waiver is entirely blocked. Id. § 626(f)(1)(C).
149 See Model Employment Termination Act, supra note 54, § 4(c).
contain an implied term for job security. An obvious reason is that judicial activity of this kind would disrupt long-standing understandings on which many people have relied. To be sure, job security is an issue that has been resolved to a large degree by the common law. But when people have organized their relationships on the basis of one understanding, the presumption should be in favor of maintaining the status quo. Another problem is that courts cannot alone devise an important part of a sensible for-cause system: a simple, low-cost mechanism for resolving disputes about whether cause exists. By encouraging arbitration, as Montana has done, a legislature can ensure that the consequence of any for-cause rule is not disastrous for either employers or employees. Even a waivable workers' right could produce serious problems if unaccompanied by a system that ensures that disputes are handled inexpensively. Because a shift in the default rule would have a disruptive effect on worker-employer relations, it probably should not be imposed by the judiciary alone.

There are substantive concerns as well. A waivable right of this kind would impose nontrivial transaction costs for those who seek waiver, and these costs will have to be borne by someone, perhaps consumers and workers themselves. If workers would generally waive, what is the point? The best answer is that we do not know if workers would generally waive, and without knowing whether they would, the point is to test the market by ensuring that waivers are informed. But under certain assumptions, it would make sense to favor an at-will background rule simply because of distrust of workers' refusal to waive, which might itself be inadequately informed—a product of some combination of confusion and alarmism. Perhaps workers would be unwilling to sell their right to job security, even at a fully reasonable price, and that unwillingness might not be in their best interests. On this view, the endowment effect, combined with employee ignorance, would lead employees to demand an exceedingly high premium for waiver, and the consequence would be adverse effects on workers themselves. If

150 See supra note 78.
151 Compare the controversy over genetic engineering of food. Should genetically-engineered food be labeled as such? At first glance, the answer is yes; consumers should be informed of what they are eating. But what if genetically-engineered food is harmless, and consumers believe that it is dangerous? In these circumstances, labeling
workers would systematically overvalue job security, the at-will rule finds support—rather than a challenge—from an understanding of human cognition. This is a plausible speculation but no more than that; it too requires empirical testing.

I conclude with two proposals. First, courts should build on existing law so as to take ambiguous terms as an occasion to require employers to negate any possible worker inference of job security. Second, some state legislatures should experiment with a waivable workers’ right. An approach of this sort would be more cautious and modest than the Montana solution, which appears not to have created serious problems.  

III. WORKERS’ ENTITLEMENTS AND THE PROBLEM OF WAIVER

The analysis thus far might be applied to many areas of employment and labor law. I offer a large number of examples here, not to resolve any of them authoritatively, but to show the generality of the foregoing analysis of entitlements in employment, and also to explore the attractiveness of waivable workers’ rights in various settings.

There are, however, potential differences between the contract at will situation and other contexts in which the legal system might choose among waivable employers’ rights, waivable workers’ rights, nonwaivable workers’ rights, and constrained waivers. These include the existence of third-party effects as a result of some waivers; the possibility that the reform in question is attempting to change norms and preferences, rather than to take them as given; and the fact that some workplace benefits require employers to produce local public goods, for which individual bargaining is unreliable.

A. Occupational Safety and Health

Under federal law, workers are given certain safeguards against hazardous and unsafe conditions in the workplace. But the rele-

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vant rights are not waivable. Should workers be allowed to make trades with their employers? Suppose that employees would willingly trade a certain level of safety in return for other benefits, such as cash, health care, or leisure time. Ought the law to authorize the trade? Recall that the redistributive objection to waiver rests on fragile grounds, because it is far from clear that if adequately informed workers are willing to waive their rights, workers as a whole would be better off if they were banned from doing so.

In an essay in very much the same spirit as this one, Susan Rose-Ackerman has suggested a mixed answer to this question, involving a two-tiered approach to protection of workers.\textsuperscript{154} She proposes that the federal government should issue rules governing legal minima that would not be waivable, because they would reflect levels of safety that reasonable workers would not wish to relinquish.\textsuperscript{155} At the same time, Rose-Ackerman suggests that OSHA should issue "benchmark standards," more protective than the legal minima, that workers could waive for compensation.\textsuperscript{156} The waivers might be agreed upon individually or collectively, via unions or other representative structures.

The proposal has many virtues. By calling for certain nonwaivable minima for truly dangerous conditions, it responds to potential problems with inadequately informed waivers. At the same time, the proposal grants workers a presumptive right to extra protection; the endowment effect should ensure that workers do not relinquish that right for little or nothing. To those who fear that workers will waive their right to safety for too little, it might be responded that safety cannot be assessed through some "off-on" switch. The question is the appropriate degree of safety; informed people can sensibly resolve that question in different ways, trading degrees of safety in return for other goods. Moreover, expensive safety regulation can be harmful to both workers' incomes and to their health.\textsuperscript{157} To the extent that such regulation decreases wages, increases unemployment, or otherwise reduces wealth, it can pro-

\textsuperscript{154} See Rose-Ackerman, supra note 8, at 358–60.

\textsuperscript{155} See id. at 359.

\textsuperscript{156} Id.

duce mortality and morbidity increases as well.\textsuperscript{158} The central question is whether cognitive and motivational problems will lead workers to waive their rights for too little. If the set of nonwaivable minima is adequate, and if the initial grant of the right goes to workers, there is good reason to experiment with a two-tiered approach of this kind.

\textbf{B. Age Discrimination}

The ADEA forbids employers from discriminating against anyone who is over forty years of age; it also bans mandatory retirement practices.\textsuperscript{159} Through these provisions, it creates an obvious incentive for employers to devise a retirement package by which older workers might be encouraged to leave the workforce. Although such packages might be deemed a form of age discrimination, it is easy to imagine circumstances in which such a package is in the mutual interest of employer and employee.

Suppose, for example, that the employee is generally interested in retiring but would not do so without some kind of financial cushion. Suppose too that the employer wants to replace the older worker with a younger one, believing that the younger worker will produce substantial productivity gains, at least in the long term. Incentives for early retirement seem a natural and mutually beneficial solution and were a widespread response to the ADEA.\textsuperscript{160} To make the deal worthwhile, employers seek both retirement and a promise not to sue for violations of the ADEA. Congress eventually enacted the Older Workers Benefit Protection Act\textsuperscript{161} ("OWBPA"), which authorizes knowing and voluntary waivers. Because OWBPA does not permit employees to waive rights that postdate the execution of the waiver, it does not amount to the kind of waivable workers' right that I have been discussing here. Instead it permits something like a settlement of a preexisting claim; the settlement operates as a waiver. The question therefore becomes why employers are not permitted to ask for waivers be-

\textsuperscript{158} See Sunstein, supra note 157, at 302–05.
\textsuperscript{161} 29 U.S.C. § 626(f) (1994).
fore the unlawful activity occurs. Why shouldn’t employers be allowed to obtain a waiver of a right to bring suit for alleged age discrimination, if employees are willing to agree?

Christine Jolls has suggested that prospective waivers should indeed be allowed. On her view, the ADEA has, as one of its central purposes, the prevention of opportunistic discharges, which occur when employers discharge employees in late-career, in violation of an implicit promise to provide continued benefits. The statute therefore has a hands-tying rationale that ensures enforcement of these contracts in spite of employers’ incentives to act opportunistically. This is an efficiency argument for the ADEA, but there is a parallel efficiency case for allowing the workers’ right to be waivable. On Jolls’ view,

the basic efficiency argument in favor of prospective waivers is that they allow parties for whom age-based wages are not desirable—or at least not sufficiently desirable to warrant the costs of imposing legal liability for cost-based decisions about older workers—to avoid unnecessary and costly regulation of their private affairs.

There is, however, a potential problem here: myopic behavior by workers. As Jolls acknowledges, young workers are in a poor position to assess the harms possibly to be incurred by their future selves several decades hence. The possibility of myopia may be a sufficient ground to bar waiver. In principle, it does seem unlikely that waivers of the right to be free from age discrimination would be adequately informed. If waivers are nonetheless to be permitted—as I think they should be—it is because freedom from age discrimination is unlikely greatly to benefit workers, and hence the resulting deals are unlikely to hurt workers on balance.

C. Vacation, Leave Time, and Health Care

A great deal of attention has recently been given to various proposals to improve workers’ lives through longer vacations, extended leave time, and better health care benefits. The obvious

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162 See Jolls, Hands-Tying, supra note 44, at 1845.
163 Id.
164 See id.
objection is that statutory mandates would impose a kind of rigid, one-size-fits-all approach on diverse workplaces, and that the best approach is to allow people to bargain. A system of mandatory health insurance, for example, might lead to reductions in wages and other benefits. It should now be clear that this criticism is quite reasonable. If employees would like to sacrifice vacation and leave time, or health care benefits, in return for other elements of a compensation package, is it so clear that they should not be permitted to do so? Note here that good wages are both good for workers' health, and that good wages can be used to purchase education and health care for children. Does the analysis of job security strengthen or weaken the case for a waivable workers' right, or even a nonwaivable workers' right, for interests of this sort?

The contract at will situation has a special feature not present here: empirical evidence that workers believe that they already have the right in question. We lack evidence showing that workers believe that employers are obliged to provide them with vacation, or leave time, or health care. Perhaps they do; this is a worthy area for empirical study. But even if they do not, there are good reasons to ensure that if workers are not going to have these rights, they are made expressly aware of that fact. The natural proposal is that workers have waivable rights to a certain level of vacation and leave time and health care protection—and that employers are able to purchase these rights for a fee.

It is possible that workers will relinquish these rights too cheaply or that collective action problems will induce workers to act against their best interests. For reasons discussed above, this argument cannot be said to be wrong, but it rests on fragile grounds. It is possible that workers lack the information to give fully knowing waivers; it is also possible that a form of myopia will produce impulsive action. But these too are speculations. As in the context of occupational safety and health, the best response would be to produce nonwaivable minima along with procedural or substantive constraints on the waiver of rights that exceed those minima. What

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166 See sources cited supra note 117. In their book, however, Fishback & Kantor find that the workers' compensation program responded well to problems in the private insurance market, and benefits workers. See Fishback & Kantor, supra note 117, at 70–74.
I am generally envisioning, in short, is a two-tiered system in which workers are provided with a floor below which no workplace may go, together with a set of waivable rights that respond to the legitimate claim that one size does not fit all. Of course it would be necessary to say a great deal more in order to grapple with the details.

D. Parental Leave

In 1991 the United States adopted, for the first time, a statute requiring employers to provide parental leave. The Family and Medical Leave Act ("FMLA") requires employers to allow employees up to twelve total weeks of leave during any twelve-month period, if the reason for the leave is to care for a newborn child, to care for a spouse, son, daughter, or parent with a serious health problem, or because of a serious health problem of the employee’s own. Employers are not required to allow employees to continue to work at a reduced rate, nor are they required to pay employees during the time off. The basic idea is that an employee will not lose her job if she takes leave for one of the stated reasons.

The most notable feature of this legislation is that in one bold stroke, it transforms a waivable employers’ right into a nonwaivable workers’ right. Is the legislation desirable? It is tempting to think that it is, because it gives employees an important right that they would otherwise be denied in many cases. Undoubtedly numerous employees are now spending time with their families under circumstances in which this would have been difficult or impossible prior to FMLA—a large gain. But—our now-familiar theme—this is no simple transfer of resources from employers to employees, and an obvious question is who really bears the costs of parental leave legislation. There is some evidence that those who bear the costs are likely to be the same as those who receive the benefits—that parental leave legislation results in a proportional wage reduction for its beneficiaries, mostly women. If this is the case, is the statute undesirable for that reason? On one view, it certainly is. The government has simply forced workers to receive in leave time

168 See id. § 2612.
what they would otherwise have received in income. Having been given the opportunity to contract for this right, workers chose not to do so, receiving higher salary and other benefits instead. If workers' choices reflect their best interests, the restructured deal, with parental leave but probably with a lower salary, is not going to benefit workers.

But by now it should be clear that this argument is not decisive. Workers may be myopic in failing to seek parental leave protections, especially in light of the fact that before having a child, it is hard to have a full and vivid sense of the demands that arise once the child is born. For many workers, there may be no self-conscious thought about parental leave at all; this may be edited out at the time that employment is sought. As in the context of the contract at will, both employers and employees may face a signaling problem. Employers who offer parental leave may find themselves attracting a disproportionate number of workers who want to take such leave; employees who ask about leave policies in advance may be signaling that they are not entirely committed to the workforce. Indeed, workers may face a widespread norm against asking for or taking parental leave, and they may not even know that this norm is something that it is possible to challenge. In any case, parental leave policies can be defended, not principally as protecting workers, but as protecting children and others for whom workers would like to care. If there are third-party effects, the case for a nonwaivable right is greatly strengthened.

At first glance, these considerations would seem to be reasons for transferring the entitlement from employer to employee, and even for disallowing waivers. But they are not decisive. Children's interests are not entirely clear-cut: If parental wages fall as a result of parental leave legislation, children will be correspondingly hurt. In the general run of cases, there is probably little reason to think that parents will not consider the well-being of their children in deciding whether and how much leave time to demand at the time they are hired. Whether workers are in a poor position to make that balance in advance cannot be decided a priori. To be sure, a

170 For an illuminating treatment of some of the complexities here, see generally Jolls, Accommodation Mandates, supra note 70 (discussing the effect of accommodation mandates on wage and employment levels).
real problem is that in initial bargaining, workers are unlikely to be thinking about parental leave. But it would be possible to remedy this problem by giving employees the relevant right, and by allowing them to trade it if and only if the employers make the trade worth their while. It makes sense here to consider a two-tiered system, combining statutory minima with a more ample set of waivable rights.

E. Workers' Compensation

All states now provide workers' compensation programs. Moreover, the right to benefit from such programs is not waivable. Workers enter the employment relationship with assurance that in the event of accident, they will receive appropriate compensation. Workers' compensation programs do not merely have ex post consequences. They also have substantial incentive effects, leading employers to act to reduce accidents and injuries. Indeed, there is reason to think that workers' compensation programs are more effective—actually far more effective—than OSHA regulations in improving workplace safety.

By themselves, however, these points do not justify making workers' compensation programs nonwaivable. As in the context of parental leave legislation, there is evidence that workers' wages are cut correspondingly; what they receive from the program, in the event that they need it, is what they lose in wages. In these circumstances, why shouldn't workers be able to waive the relevant rights? If they did, they would be self-insurers, and self-insurance, so long as it is genuinely voluntary, is not an obviously implausible model for workplace injuries.

The familiar answers might be given here. Workers may lack the information that would make a waiver sufficiently informed, perhaps because of myopia, excessive optimism, or dissonance reduction. But there is an independent issue: Workers who do not wish to waive their rights may face a special kind of collective ac-

171 Compare the discussion of severance benefits in Bewley, supra note 3, at 268–69 (explaining why workers do not seek severance pay).
173 See Fishback & Kantor, supra note 117, at 714.
174 But see Fishback & Kantor, supra note 74, at 70–74 (describing problems in private insurance market).
tion problem, and this problem may well justify a nonwaivable workers' right. More particularly, there is a distinctive free rider problem in this context. To see this, return to the fact that the consequence of workers' compensation programs is to lead employers to increase safety in the workplace. The increases often happen because employers introduce capital improvements designed to reduce deaths and injuries. To the extent that these would have been made in any case, employees who waive their rights for a fee will receive many of the protections of the program without paying for it. It is here that there is a problem. If safety is a local private good—something that, when provided to some, will also be provided to all—rational individual choices by workers are likely to lead to a large number of waivers and hence fail to create incentives to increase safety. This, then, is an area where the argument for creating a nonwaivable workers' right is especially strong.

F. Unionization: Company Unions, Ordinary Unions

What of the right to unionize itself? Should that right be waivable? By whom? These issues are best approached by dividing the inquiry into three issues: individual waivers of the right to unionize; appropriate default rules for union status; and collective waivers of the right not to be faced with company-dominated unions.

1. Nonwaivable Individual Employee Rights

The rights guaranteed by the Wagner Act, the foundation of modern labor law, are not waivable by individual employees. Employers may not buy the right to fire employees who join unions as through, for example, the "yellow dog" contract. The rights to join a union, to strike, and to engage in activity for mutual aid and protection are not subject to waiver. Why does the statute make this choice, rather than creating a system of waivable employees' rights?

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173 On related problems, see id.
174 See Rose-Ackerman, supra note 8, at 359–60 (discussing safety as a local public good).
175 See Fishback & Kantor, supra note 74, at 70–74 (describing problems in private insurance market for workers).
177 See id. §§ 158(a)(1), 158(a)(3).
There is no obvious answer. One justification would rely on some combination of the behavioral grounds described above, involving informational, cognitive, and motivational problems. Perhaps many workers would not know what they were waiving, especially in light of the possibility that the potential benefits of unionization would not be readily apparent at the time the waiver was requested. Perhaps both employers and individual workers would face a signaling problem akin to that which could arise if, in an at-will regime, an employer emphasizes that it will provide job security, and thus attracts marginal workers, or an employee requests the same, and thus signals a realistic risk that the employer will want to fire him.

2. Unions at All? The Current Presumption Against

This system of nonwaivable workers' rights coexists with what is, from the standpoint of the real-world status of unions, probably even more important—the basic background set by a crucial waivable employers' right. No collective representative is in place until employees have affirmatively voted for it. The ordinary assumption of the workplace, and hence the default rule, is nonunion. The situation that workers face is one in which organization must be sought, through the processes of union election. Nothing is inevitable or natural about this situation. On the contrary, this "tilt has its roots in the common law background . . . the tacit legal assumption that the 'natural' status for a workplace is nonunion, with management exercising on behalf of the shareholder-owners the prerogatives of property and contract law to establish the firm's terms and conditions of employment." It is easy to imagine an unusual regime, in which workers are presumed to favor collective organization, but in which they are permitted to vote otherwise. If union representation is thought to have significant advantages, a system of this sort might well be preferred.

Many variations are possible. On one approach, workers would start employment with a presumption in favor of collective organi-

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180 It is possible that the prohibition solves a collective action problem. For discussion, see Keith N. Hylton, A Theory of Minimum Contract Terms, with Implications for Labor Law, 74 Tex. L. Rev. 1741, 1749–51, 1756–65 (1996).

181 Weiler, supra note 7, at 228.
zation. A vote would help to choose the particular form of that organization, including the particular union that would represent workers; at the same time, employees could be asked to reject the option of collective organization if they could be convinced that this is in their best interests. An advantage of this approach is that it could help overcome the effects of management tactics, many of them unlawful, to overcome unionization. Another advantage is that this approach would work like an information-forcing default rule. If we are unsure whether failures of unionization stem from worker preferences or from employer pressure, a presumption in favor of collective organization would help untangle that issue. And to the extent that such organization confers benefits on workers without imposing correlative costs, there is much to be said for enlisting the endowment effect on its behalf. In contrast, if collective organization is thought to produce few real benefits for organized workers, and at the same time to increase both prices and unemployment, the existing default rule would stand on firm ground. What is most important is to see that the default rule represents a choice among a range of options and that it is likely to have extremely important effects; any such rule has to be defended against reasonable alternatives.

3. Company Unions

Some of the most important and interesting issues in contemporary employment law arise as a result of the statutory ban on employer-sponsored workers’ organizations. Employers are not allowed to create labor organizations, even if employees would be satisfied with them—apparently on the theory that employer-sponsored labor organizations cannot be trusted to protect employee interests. The theory seems to be that the employer should be on only one side of the negotiating table, not on both

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182 See id. at 230.
183 This is the theme of Freeman & Medoff, supra note 15, at 246–51.
sides. Thus Senator Wagner emphasized the coercion and deception involved in the use of company-dominated unions, with the suggestion that such organizations actually served the employers' interests, not those of workers. Hence the statutory prohibition was (and is) defended with reference to a fear of employer coercion, a belief that employees lack the information to make ex ante waivers, a risk of deceptive practice on the part of employers, and a perception that workers' preferences, in this context, may be adaptive to an unjust status quo.

In theory, these objections may have made sense in the 1930s, when company unions were primary tools in union avoidance, and were commonly used as part of a package of union-busting tactics. But in the last two decades, circumstances have changed in two important ways. First, private sector unions have dramatically declined, and hence the real choice is not between unions and company-supported substitutes, but between no union and a company-supported substitute. It is hardly clear that no organization at all is best for workers. Second, there has been a sharp decline in Taylorist conceptions of the workplace, which posit a sharp split between "brainwork" and the highly mechanical work of ordinary laborers. There is a great deal of new interest, on the part of employers themselves, in finding ways to increase the role of employees in designing more efficient workplaces, partly because this step increases worker satisfaction, and partly because it appears to have desirable effects on production. The consequence of these two developments has been to impose sharp pressure on the prohibition of employer-sponsored unions.

Suppose, for example, that an employer wants to create some kind of employee organization to improve efficiency, safety, and working conditions. Under current law, this step is likely forbidden. The relevant right cannot be waived by workers acting individually or even collectively. But suppose that workers have thought long and hard about the issue, and have decided that they would do better with a company union than without collective representation or with an ordinary union. The conventional response

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186 I borrow here from Estreicher, supra note 185, at 134–36.
187 See sources cited supra note 185.
188 See Electromation v. NLRB, 309 N.L.R.B. 990, 992, 995–97 (1992), enforced, 35 F.3d 1148 (7th Cir. 1994).
here is that the employees' judgment to this effect cannot be trusted because the result of a company union is to place the employer on both sides of the bargaining table. In this view, the ban on company unions is designed to ensure against a kind of deceptive packaging—the appearance without the reality of collective representation—and at the same time to counteract the risk that workers' preferences will adapt to an unjust status quo. If it were correct to say that without company unions, most workers would be faced with a choice between well-functioning unions and an absence of collective representation, this argument might be convincing. But the truth is that for a variety of reasons, unions are not a likely option for most workers—and also that for many workers, some kind of employee participation plan seems highly attractive as a source of genuine improvements in workers' well-being.189

The conclusion is that with procedural constraints designed to ensure real freedom of choice, workers should be allowed to waive the apparent protections of the ban on company unions, at least if they do so collectively. A constrained waiver, in short, would seem to be far better than the current nonwaivable one; this is the route that I suggest here.

IV. NONWAIVABLE WORKERS' RIGHTS

In this section, I generalize from the discussion to identify some grounds for disallowing waiver. The central cases involve third-party effects, inadequate information, and efforts to change norms and preferences, which involve third-party effects of a different kind. The discussion of third-party effects draws on conventional approaches; the treatment of inadequate information, and norm-change and preference-change, draws on behavioral economics.

A. Third-Party Effects

Most obviously, a nonwaivable background rule makes sense when there are third-party effects. There are many examples. As

we will see, unions are not allowed to waive workers’ rights to distribute work-related materials, partly because there is no identity of interests between the waiving union and the workers whose rights have been waived. The problem is that the waiver has effects on third parties—that is, workers with interests distinct from those of the union.

I have noted above that in a series of common law cases, courts have created public policy exceptions to the at-will rule. The core cases involve situations in which an employer discharges an employee for refusing to commit a crime (perjury, price fixing) on the employer’s behalf. In other cases, courts have disallowed discharges when the employer is punishing employees for cooperating with the authorities with respect to possible illegality at the company. The defining theme is that employers may not discharge employees if the consequence is to impose harms on outsiders to the contractual relationship. It should be obvious that waivers are unacceptable in these circumstances. The waiver is invalid not to protect workers, but to ensure that others are not adversely affected. For the most part this category of cases is reasonably straightforward, and hence it is not necessary to discuss it in detail here.

B. Inadequate Information

In some cases, waivers will be inadequately informed. As we will see, this is a key reason why the law is more hospitable to union waivers than to individual waivers: Unions are in a far better position to know what they are doing. Individual waivers may be inadequately informed for a large number of reasons, including excessive optimism, dissonance reduction, editing out, and myopia. A great deal of empirical research is necessary to establish the extent of the problem. For the moment, the best approach is to block exchanges of rights that most reasonable people would be unlikely to

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192 See Schwab, supra note 33, at 1945.
But otherwise to allow waiver unless there is a particular reason to believe that workers are giving up too much for too little. When there is a serious risk to this effect, it would be best not to block waiver entirely, but to impose procedural or substantive limits on acceptable waivers. Requirements of full disclosure, along with a cooling off period, might be a minimal way to proceed.

C. Norm and Preference Change

Now let us turn to some of the most difficult and interesting cases for waiver, involving what are perhaps best treated as subtle endowment effects and third-party effects.

1. Waiver: The Basic Case

Suppose that an employer is averse to the threat of race or sex discrimination suits. Seeking to produce a mutually advantageous solution, he asks his employees to sign an agreement waiving their rights to bring suit for race or sex discrimination. The employer adds that he believes that discrimination is wrong and that he does not plan to discriminate. He insists that he is not a discriminator. He asks everyone, not only African-Americans and women, to sign the waiver. He claims that he is willing to pay a premium for a waiver, not in order to discriminate, but to insulate himself from frivolous or trumped-up lawsuits. Suppose too that a small but non-trivial number of employees are willing to waive their rights, because they believe that this is otherwise a good place to work, because the premium is not tiny, and because they are willing to take their chances on race and sex discrimination.

Let us also assume, plausibly, that if employees are presumed to have the relevant entitlement, requests for waivers will be very rare, partly because of the kind of signal given by such requests. An employer who asks for these waivers will scare off a large number of employees and incur reputational sanctions. Nonetheless, it is highly likely that some waiver requests would be made if they were seen as valid. Note in this regard that there is evidence that some discrimination laws do have an adverse effect on hiring members of the protected class, precisely because of a fear of a

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193 See Rose-Ackerman, supra note 8, at 359.
lawsuit; an employee in that class represents a lawsuit waiting to happen.\textsuperscript{194} Perhaps some of the disemployment effect could be removed with waivers. Should these waivers be upheld?

It might be tempting to see in the employer's proposal a coercive offer: An employee is asked to waive his rights in return for a job, and he may seem to have no choice but to waive. On this view, the law should provide protection, and enhance freedom, by banning the coercive deal. But this account is much too simple. In these cases, the employee is not in a position of having no choice; the question is whether the offer is worthwhile for the employee in light of the options, perhaps most of them bad, that are available. Unless there is an informational problem of some kind, the fact that the employee accepts the deal is strong evidence that it is worthwhile.

It is also possible to think that for some classes of workers, the sheer number of job applicants, and the relatively small number of jobs, will mean that employees will be forced to waive; those who do not waive will not end up with jobs. This is certainly imaginable. But in a market that is so unfavorable to workers, all employment terms will be pushed in unfavorable directions, including wages. Unless there is some kind of information problem, perhaps of the kind discussed here, employees who waive stand to gain if they can do so because those who waive will (by hypothesis) win more than they lose. The best solution, in a market with this degree of harshness for employees, is to improve the background conditions faced by those workers, not to block the best available deal, even though that deal may not be very good.

2. Third-Party Effects?

Thus far, at least, it seems that discrimination rights should be fully waivable. But might individual waivers have adverse effects on other workers? Begin with the context of sexual harassment, where it is easy to imagine that they would. If one woman waives her right and is thereafter subject to harassment, other women may well be harmed; the effect will not be easy to cabin. At least this is

\textsuperscript{194} See Jolls, Accommodation Mandates, supra note 70, at 273–82 (discussing evidence of disemployment effect for disabled people); Posner, supra note 165, at 329–33 (discussing disemployment effect for older workers).
so if the waiver leads would-be harassers to believe that harassment is not entirely objectionable or unacceptable, or that reasonable women are willing to subject themselves to a risk of it for a wage premium. A man who believes that it is permissible to harass one woman might believe that it is permissible to harass more than one, even if few waivers have been signed.

The example is easily extended to sex and race discrimination in general. An African-American who is willing to waive the right to be free from racially-motivated adverse employment action might well be affecting other African-Americans, both by signaling the legitimacy of discrimination and by indicating that discrimination is not morally abhorrent but merely a cost, to be purchased and sold like other goods on the market. If discrimination is so regarded, there may well be more of it than if the signal is different—as, for example, where a flat ban suggests that discrimination is illicit, the sort of practice to be eliminated, rather than be brought to some optimal point. Now this does not mean that discrimination should be eliminated at any price. It means only that the moral stigma that is sought to be imposed on discrimination, and properly so, might be weakened if waivers are permitted. If this is so, isolated waivers would have third-party effects.

3. Norm and Preference Change

This claim suggests several more concrete possibilities. Recall, from the earlier discussion of the endowment effect, that the allocation of the entitlement can have effects on values and preferences. In this light we can see that some antidiscrimination law is an attempt to produce norm change. The point of the law is to alter prevailing norms. If rights are waivable, that enterprise might be undermined. If workers are living in accordance with a norm that they abhor and wish to change, they are unlikely to be able to accomplish the change on their own. By its very nature, norm change requires collective action. The waiver is forbidden in

195 Compare the area of pollution. Some people have objected to emissions trading—a kind of waivable nonpollution right—on the same ground. See Steven Kelman, What Price Incentives? 1 (1981). The best response is that there is an optimal level of pollution, and it is not zero, and polluting activity—so long as it is part of a legitimate business, and not an intentional tort—is not the kind of thing that it is appropriate to delegitimate as such.
order to ensure that certain norms are delegitimated. A closely related possibility is that the purpose of the relevant right is to produce *preference change*. If preferences are not being taken as given, but are being treated as endogenous and flexible, an argument for preventing waiver might be defended as a method for ensuring that preferences are in fact changed.

With respect to the validity of discrimination waivers, these arguments are not decisive in the abstract. In a period in which race and sex discrimination are widely stigmatized, it is reasonable to believe that permitting waivers would have few significant effects on workers not parties to the deal, or at least that waivers would not have a material effect in entrenching objectionable norms and preferences. If an employer asks employees to waive the right to be free from race or sex discrimination, it is signaling that it is a possible discriminator—not the most attractive signal to send out to prospective employees. On the other hand, some employees—white and male—might welcome that signal, and in these circumstances the ban on waiver is understandable as an effort to prevent inevitable effects on third parties who are likely to be affected by the legitimation of the underlying practice. When the law is engaged in a self-conscious effort to change norms and preferences, allowing waivers is too likely to defeat the enterprise at hand.196

V. A BRIEF NOTE ON UNION WAIVERS

The discussion thus far has involved individual waivers, but a frequent issue in employment law is whether labor unions are themselves entitled to waive workers' rights. The general answer is that when there are no third-party effects, union waivers are legally acceptable,197 though in some contexts there is a self-conscious ef-

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196 On the other hand, it is clear that victims of discrimination can settle, and at least if they do not “tender back” the money, a financial settlement appears to preclude a suit for reinstatement. See, e.g., Fleming v. United States Postal Serv. AMF O'Hare, 27 F.3d 259, 262 (7th Cir. 1994). But see Rangel v. El Paso Natural Gas Co., 996 F. Supp. 1093, 1096–99 (D.N.M. 1998) (allowing plaintiff's suit to continue without “tendering back” and requiring that severance pay offset any damages).

197 See Metro. Edison Co. v. NLRB, 460 U.S. 693, 705 (1983); Mastro Plastics Corp. v. NLRB, 350 U.S. 270, 280 (1956); Lodges 743 & 1746, International Association of
fort to ensure that any waiver is knowing and voluntary, in a kind of procedural constraint on enforceable waivers. Is it possible to explain the law's receptivity to union waivers?

There are two points here, sharply distinguishing union waivers from individual waivers. First, informational problems are highly likely to have been overcome in the union setting. When a union is waiving, it would be surprising, in the ordinary case, if it did so without really knowing what it is doing. In all probability the problem of myopia will also have been reduced. Note in this regard that unions are not solely concerned with wages, and that various fringe benefits, likely to be favored by those interested in the long term, are a special focus of union bargaining. Second, unions overcome the collective action problem faced by individual workers, and this point lessens the danger that employers will be able to force individual workers to waive by ensuring that they compete to their collective detriment. It should be no wonder that serious concerns about union waivers seem to arise only when the union has a conflict of interest, and hence is not in a position to be a good representative of workers. Thus unions are permitted, in the most noteworthy case, to waive workers' right to strike. With respect to the rights guaranteed by the NLRA, the situation is largely one of waivable workers' rights—with the rights being waivable collectively only, and emphatically not individually.

Compare in this regard cases in which the union cannot be trusted to be a fair representative of workers' interests, exemplified by NLRB v. Magnovox Co. In that case, the union accepted a collective bargaining agreement that banned employees from distributing literature on any of the employer's property, including nonworking areas during nonworking time. It is clear that this rule would violate the law if imposed unilaterally by the employer. Though the union had agreed to it, the Supreme Court held that the waiver was not binding, for a collective bargaining agreement could not eliminate these relevant rights. The Court said that


199 See Freeman & Medoff, supra note 15, at 20.
200 See Mastro Plastics Corp., 350 U.S. at 280.
202 See id. at 323.
waiver would not be permitted "where the rights of the employees to exercise their choice of a bargaining representative is involved—whether to have no bargaining representative, or to retain the present one, or to obtain a new one." The key problem was one of agency—with respect to continuing debates about self-representation, the union could not be trusted to be the faithful agent of workers. This suggests a distinctive reason to disallow union waivers. Magnavox was followed by a series of cases that are generally receptive to waivers by unions, but not when the waiving union is likely to have divergent interests from those individuals whose rights are waived.

One final wrinkle is important here. In many contexts, union waivers must be explicit and unambiguous. A general no-strike clause will not bar an unfair labor practice strike, and it will not create an affirmative obligation on union leaders to avert strikes on pain of discipline or discharge. If employers are going to obtain rights beyond those minimally contained in a no strike pledge, they must do so explicitly. Here is a procedural constraint on the waiver of workers' rights.

VI. THE PROBLEM OF RELATIVE POSITION

The discussion thus far has neglected an important and highly relevant point from behavioral economics. I do not discuss it in detail, because it raises many complexities and depends on empirical issues on which unambiguous evidence is lacking. But because the point has been almost universally neglected in the context of employment and labor law, it requires some discussion.

A. Relative Position and the Frame of Reference

Let us acknowledge that the cost of workers' rights, when they are not waived, might be borne in whole or in part by workers, in the sense that the legal grant of a right to workers will result in lower wages. Is the argument against the relevant right therefore

\[203\] Id. at 325.
\[205\] See Mastro Plastics Corp., 350 U.S. at 280–84.
\[206\] See Metro. Edison Co., 460 U.S. at 704–05.
established, on the ground that workers will be net losers? We have seen that one problem with an affirmative answer is that workers might not be net losers. But a more fundamental problem is that with respect to income, part of what workers seem to care about is relative economic position, rather than absolute economic position. In other words, what matters to workers is partly how they compare to others, not how much money they are making in the abstract; and if all workers lose the same amount, each worker will lose very little, because relative position will not be affected. If what workers care about is relative position, nonwaivable rights might, in principle, make workers better off on the dimension along which they are helped, by giving them something important, while not making them worse off along the dimension along which they are apparently hurt, by decreasing their income while also decreasing that of everyone else.

Relative position is found by comparing the worker’s income with that of other salient workers; absolute position is found by looking simply at the number of dollars that the worker makes. The question is whether workers are significantly worse off in a system in which all salient workers lose, for example, 0.5% of their salary, while receiving a benefit (such as increased leisure time, parental leave, safety, or job security). If the economic loss has no significant adverse effect, then any initiative that produces that loss will not, by virtue of that consequence, harm workers at all. If this is so, it is because income above a certain floor is a positional good—a good whose value depends on comparison with the holdings of others. The noteworthy possibility here is that legal initiatives might, in theory, produce real gains of one or another kind (again, leisure time, parental leave, safety, or job security, which are, by hypothesis, nonpositional or less positional goods), without producing real losses (because the only loss is to absolute position in terms of income, and because workers lose nothing if absolute position is slightly worse while relative position is held constant).

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There is considerable evidence that relative position is in fact what people care about, at least with respect to income. Many people would prefer to work in a place where they earn $60,000 and the average worker earns $50,000, to working in a place where they earn $70,000 and the average worker earns $90,000. This preference holds where everything else is equal—for example, where the cost of living is the same in the two places. Why are people prepared to sacrifice income to ensure a certain place in the hierarchy? Undoubtedly envy and status-seeking play a large role. Some people would like to have a high status and are willing to lose money to ensure that they do. Perhaps more people would like not to have a low status and are willing to lose absolute income in order to ensure that they do not. But the more fundamental point is that the economic position of other people sets the frame of reference within which we evaluate various goods. If you now had the same computer that you used ten years ago, you would likely be dissatisfied and frustrated, simply because the frame of reference for evaluation of the computer has changed so dramatically. But if everyone had the same computers that they had ten years ago, your decade-old computer would not seem so bad; indeed it might not seem bad at all.

What is true for computers is no less true for a vast array of goods and services, including cars, radios, televisions, homes, and even artistic and literary work. People care about relative position not only because they care about their status, but also because they are aware that the frame of reference for evaluation is set not individually but socially.

B. Mandatory Terms and Relative Position

For the moment let us simply assume that relative rather than absolute economic position is what most workers care about—that worker well-being would not be decreased by (say) a decrease in annual wages of $25, $50, or $100, so long as all workers face the same decrease. In that event, some nonwaivable terms, such as a

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205 Frank, supra note 116, at 5; see also Frank & Sunstein, supra note 207, at 9–17 (presenting some of the evidence).
209 See Frank & Sunstein, supra note 207, at 11.
210 Id.
right to job security, might be justified on the following ground: The consequence of the new term is to decrease absolute income but to hold relative income constant. From this shift, there is little or no welfare loss to workers. At the same time, workers receive a substantial benefit, such as job security, vacation time, or health care. As far as the worker is concerned, the substantial benefit is given essentially for free, because relative position is held constant. If relative position is in fact what workers care about, this appears to be a powerful argument for a wide range of nonwaivable workers' rights.

C. Difficulties

I believe that this argument is largely correct, but as stated it is too abstract to be entirely convincing. It raises three questions in particular.

Perhaps relative position is also what workers care about with respect to the new, legally granted benefit; perhaps this too is a positional good. Many goods have a mixture of positional and nonpositional features. It does seem reasonable to say that such goods as job security, health care benefits, and leisure time have especially strong nonpositional features. It is important to have these things regardless of what other people have; an increase in any of them, far more than an increase in money, is an independent good. But job security, leisure time, and the like also have positional features; to lack, for example, job security when everyone else lacks job security is probably better than to lack job security when everyone else has it. For the argument on behalf of the nonwaivable term to be made convincing, it must be true that relative position is what matters with respect to income—or to whatever else is lost as a result of the nonwaivable term—but that what matters for the good in question, such as job security, is not relative but absolute position. Perhaps we can conclude that the nonpositional features of job security, health care benefits, and leisure time are enough to give the argument a kind of presumptive validity.

It is possible that a nonwaivable right to a certain largely nonpositional good, such as job security, will lead not only to reductions in income (by hypothesis a positional good) but also to reductions in nonpositional goods (such as vacation leave, sick leave, health care, or parental leave). If the grant of one nonposi-
tional good leads to a decrease in others, there will be nothing to celebrate. There is an empirical question here: When government creates a mandatory benefit, to what extent does the result decrease not income, but other, less positional benefits associated with employment?

To what extent is income actually a positional good? There is considerable evidence that for most people, what matters to perceived well-being is their position in the relevant hierarchy, above a certain minimum level. For very poor workers, of course, absolute income may be what matters. In poor nations, absolute increases in wealth affect self-reported happiness levels, and absolute increases affect self-reported happiness levels among the very poor. To the extent that mandatory terms reduce the income of people with little to live on, such terms are not likely to be justifiable on the ground that I have offered. Of course, few mandatory terms will have this effect.

The nonwaivable right might impose ancillary social costs. It might, for example, force prices to rise, and the resulting inefficiencies may bolster an argument against the nonwaivable term. Even when workers are benefited as a result, the term might not be justified on balance; an increase in prices is hardly good news for workers (especially poor ones), and if unemployment increases as well, the nonwaivable term may not be worthwhile.

In light of these points, an understanding of the importance of relative position does not create a decisive argument for nonwaivable terms in employment law. But it does raise a behavioral possibility, overlooked in conventional discussions of these problems: Even if such terms create a dollar-for-dollar reduction in wages, workers may still benefit as a result.

CONCLUSION

My basic goal in this Article has been to bring a better understanding of human behavior to bear on the three principal options for employment law: waivable employers' rights, waivable workers' rights, and nonwaivable workers' rights. Contrary to the Coase theorem, the default rule is likely to matter a great deal. Contrary

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to the standard view in law and economics, workers are loss averse; they will be reluctant to give up rights and goods that have been initially allocated to them—a point confirmed by employers’ reluctance to decrease wages, even during a recession.212 Contrary to the conventional wisdom, workers do not understand that the current system is at will, even though the law to this effect is well-established. Contrary to the reflexive antipaternalism of many lawyers and economists, workers are likely to have difficulty in deciding whether to waive their rights, and hence the case for non-waivable terms, defended in behavioral terms, is far more plausible than it appears when defended in terms of simple redistribution. Contrary to the standard economic wisdom, workers often care about relative position, not absolute position. Contrary to standard legal practice, waivable workers’ rights represent an attractive alternative in many contexts, responsive in particular to workers’ lack of information. Contrary to a standard legal view, the difference between legal hostility to individual waivers and legal receptivity to union waivers is defensible on the ground that unions are less likely to suffer from myopia and other forms of bounded rationality.

We have seen more particularly that waivable workers’ rights represent a distinctive, promising, and insufficiently explored approach to the law of labor relations. A system of this kind will often be preferable to the more standard alternatives of waivable employers’ rights and nonwaivable workers’ rights. To the extent that workers undervalue the rights initially allocated to them and sell them for a price that is too low, it is sensible to consider, as an alternative to a ban on waiver, a system of constrained waiver—ranging from requirements of disclosure, to a cooling-off period, to legal floors on what employees will receive through the relevant trades.

In the area of the contract at will, I have suggested that legislatures should experiment with waivable for-cause rules, and also that courts should move in this direction by penalizing employers who lead employees to believe that they have protection against at-will discharge (as, for example, through promises of permanent employment and through statements that company policy is to re-
tain all good employees). If progress is to be made in improving worker well-being without introducing excessive rigidity into the labor market, the best route for the future will consist of more creative experiments with waivable workers’ rights.

For many problems, it would make sense to combine a system of nonwaivable statutory minima, consisting of safeguards that no worker should lack, with an ample set of waivable workers’ rights that would be subject to bargaining. There is room for disagreement about what should count as the nonwaivable minima and what should count as the waivable workers’ rights; it is in identifying the content of these categories, rather than in settling on the basic approach, that reasonable disputes will arise. An approach of this general kind is no blueprint, but it suggests an orientation that could provide the foundation for a new system of employment law in a wide range of areas. Equally important, an understanding of the nature of workers’ judgments and motivations, and the possible grounds for choosing among the legal options, could provide the basis for orienting future inquiry and for making progress on the issues, many of them empirical in nature, that remain.
APPENDIX: ECONOMICS, BEHAVIORAL ECONOMICS, AND THE WORKPLACE

In this Article I have discussed many issues in employment law and behavioral economics. The purpose of this Appendix is to outline the central parts of the conventional wisdom that are called into question by evidence and by a better understanding of human behavior. Of special importance is the last column, emphasizing what we do not yet know. Much of my argument here has been for a degree of agnosticism with respect to positive issues (what people do) and normative issues (what the law should do). Much more work is necessary on both sorts of issues.

<table>
<thead>
<tr>
<th>Conventional wisdom, grounded in once-standard or now-standard economic theory</th>
<th>Empirical difficulty</th>
<th>Behavioral mechanism(s)</th>
<th>Legal implications</th>
<th>Implicit behavioral rationality in current law</th>
<th>What we don’t know</th>
</tr>
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<tbody>
<tr>
<td>Continued employment is self-enforcing; opportunistic behavior will not occur</td>
<td>Mandatory retirement; wages increase faster than productivity</td>
<td>Loss aversion; fairness and reciprocity (labor markets as showing gift exchanges); workers’ preference for rising wage profiles</td>
<td>Ban opportunistic discharges</td>
<td>Yes, through ban on opportunistic discharges</td>
<td>How much opportunistic behavior occurs? Does the market, via reputational sanctions, deter it?</td>
</tr>
<tr>
<td>Conventional wisdom</td>
<td>Empirical difficulty</td>
<td>Behavioral mechanism(s)</td>
<td>Legal implications</td>
<td>Implicit behavioral rationality in current law</td>
<td>What we don't know</td>
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<tr>
<td>Workers know about at-will and other default rules</td>
<td>Workers do not know about at-will and other default rules</td>
<td>Unclear. Perhaps excessive optimism; perhaps the “law-is-what-fairness-requires” heuristic</td>
<td>Take ambiguous promises as real promises; waivable for-cause rule</td>
<td>Yes, through aggressive reading of apparent promises</td>
<td>Is it possible to counteract worker ignorance? What is source of that ignorance? Would a waivable for-cause rule do any good? What other rights do workers believe, falsely, that they have?</td>
</tr>
<tr>
<td>Conventional wisdom</td>
<td>Empirical difficulty</td>
<td>Behavioral mechanism(s)</td>
<td>Legal implications</td>
<td>Implicit behavioral rationality in current law</td>
<td>What we don’t know</td>
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<tr>
<td>Default rule is irrelevant without transaction costs</td>
<td>Default rule sticks in experimental and real-world settings</td>
<td>Endowment effect; loss aversion</td>
<td>Unclear</td>
<td>No, except perhaps through non-waivable rights</td>
<td>How should we choose a rule when there will be an endowment effect? Are there significant distributional effects here? How sticky are default rules, for employees and employers?</td>
</tr>
<tr>
<td>Informed workers will reach bargains that are in their interests</td>
<td>Workers appear not to bargain for some items that might be in their interest</td>
<td>Excessive optimism; signaling problems; myopia</td>
<td>Nonwaivable workers’ rights</td>
<td>Maybe, through statutory bans on waiver</td>
<td>Are workers really excessively optimistic or myopic, in general or in specific cases?</td>
</tr>
<tr>
<td>Conventional wisdom</td>
<td>Empirical difficulty</td>
<td>Behavioral mechanism(s)</td>
<td>Legal implications</td>
<td>Implicit behavioral rationality in current law</td>
<td>What we don't know</td>
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<tr>
<td>Unions shouldn't be allowed to waive so much more easily than individuals</td>
<td>Law allows union waivers more readily than individual waivers</td>
<td>Bounded rationality, a problem reduced by unions</td>
<td>Allow union waivers more readily (implicit behavioral rationality in cases)</td>
<td>Yes, through legal distinction between union and individual waivers</td>
<td>Are unions really overcoming bounded rationality of individuals, or instead acting in a self-serving fashion?</td>
</tr>
<tr>
<td>Workers are paid their marginal product and hence non-waivable terms can only help</td>
<td>Labor market appears to show wage compression; people appear willing to sacrifice income for good, or not bad, relative position</td>
<td>People care about relative position, not absolute position, with respect income</td>
<td>Nonwaivable workers' rights</td>
<td>Maybe, through nonwaivable rights to certain nonpositional goods</td>
<td>Which goods are positional goods? How much does relative position account for valuation?</td>
</tr>
</tbody>
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