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The Idea and Practice of Contract in U.S. Employment Relations: Analysis and Policy Implications¹

For several decades, the idea of contract in U.S. employment relations was predominantly reflected in practice by collective bargaining agreements negotiated between representatives of unionized employees and employers. At their peak these agreements directly covered only about one-third of the U.S. workforce, but they often served as benchmarks that spilled over to affect the terms and condition of employment of non-union employees, including supervisors and managers.

During that period, roughly from 1940 to 1980, employment contracting basically meant collective contracting. This was, of course, no accident. The 1935 National Labor Relations Act (i.e., the Wagner Act) expressly supported unionism and collective bargaining as public policy. This policy remains in place today despite numerous amendments to the Wagner Act, the subsequent sharp decline in private sector employee unionism, and continuing controversy over the role and function of the National Labor Relations Board in administering this law.

While scholars have long debated the factors, including the Wagner Act, that accounted for rapid private sector union growth during and immediately following World War II, there's little doubt that collective contracting was for a while the dominant way in which terms and conditions of employment were set and codified for tens of millions of employees. There's also no doubt that those employees were able to exercise collective voice.

Beyond collective bargaining, implicit employment contracting—largely unwritten and unpublicized—was also practiced on a wide scale. The terms of those implicit contracts were quite clear: an individual, typically a man, joined a company, worked at that company for his entire career, and retired from that company whereupon he received defined-benefit pension payments. Early on during his career that individual was paid less than the value of his performance (i.e., productivity), whereas later on he was paid more than the value of his performance. This helps explain why long-term employment contracting prevailed for a time in the U.S.: there was an obligation of one party to the other party during an employee's career.

¹ Concepts for this paper were presented at the 65th Annual Meeting of the Labor and Employment Relations Association (LERA) as outgoing president David Lewin's address advocating comprehensive reform of national labor policy to address key changes in the 21st century workplace. LERA offers many forums for the open discussion of quality research, policy development and best practices for the fields of labor and employment relations. Visit www.LERAweb.org or www.employmentpolicy.org for more information and to join in the conversations. See the live presentation at: <http://youtu.be/b7EefZFBgok>.

Such implicit contracting was accompanied by explicit layoff and recall provisions of collective-bargaining agreements. Hence, even during recessions, the dominant presumption was one of continuous employment with the same employer.

Today, on the occasion of the Labor and Employment Relations Association's 65th annual meeting, private sector collective contracting and long-term individual implicit employment contracting are in substantial decline to the point where they are considered by some to be relics of the past. How much of a decline? U.S. Department of Labor data for 2012 indicate that among 110 million private sector employees, only about seven percent were represented by unions and 6.5 percent were dues-paying union members. The decline of private sector unionization has occurred despite examples of highly unionized companies, such as Southwest Airlines, Willamette Industries and Boeing Corporation, that are financial performance leaders in their respective industries, and despite research on mutual gains negotiations that documents the benefits that accrue to unionized employees, management, and other constituents from cooperative, integrative bargaining.

Further, in the U.S. private sector workforce long-term employment with the same employer continues to decline, as does employee coverage by defined-benefit pension plans. Unsurprisingly, therefore, newer labor force entrants expect to change jobs often and to be employed by several different employers during their careers. The inescapable conclusion is that the labor market is becoming more of a short-term spot or commodity market and less of a long-term institutionally based or governed labor market.

In light of these developments, it appears that individual voice in the employment relationship is the only option for most private sector employees. But is it? The answer to the question is no based on research and practice in two areas: non-union employee representation (NER) and strategic human resource management (SHRM). NER research indicates that a majority, perhaps a large majority, of non-union U.S. companies have adopted one or another type of internal employment conflict-resolution system or procedure. These procedures are often subsumed under the label alternative dispute resolution (ADR).

What exactly is ADR an alternative to? It's an alternative to either employee unionization or to litigation over employment-related disputes. To the extent that internal ADR procedures are adopted by non-union companies to ward off employee unionization, this can be linked to external human resource regulation, for example, the Civil Rights Act, the Occupational Safety

and Health Act, the Employee Retirement Income Security Act, and the Family and Medical Leave Act. These laws together with the rising prevalence of ADR procedures provide a dual macro-micro level substitution explanation of the decline in U.S. private sector employee unionization.

In contrast to ADR research, SHRM research emphasizes a proactive approach to employment-relationship conflict featuring various employee involvement and participation systems and practices, especially employee consultation and workplace teams. Sometimes these high-involvement HR systems include an internal dispute resolution procedure. Empirical research indicates that the availability of such procedures for non-union employees together with other high-involvement practices is significantly positively associated with organizational performance. By contrast, actual use of these procedures is significantly negatively associated with organizational performance. In other words and from an organizational performance perspective, an internal ADR procedure is best when it is not used! Nonetheless, the marked growth of such procedures indicates that there is an alternative institutional mechanism to unions and collective bargaining that potentially provides collective voice or quasi-voice to non-employees.

An accompanying development that potentially provides voice to employees is the explicit individual employment contract. Estimating the extent to which such contracting prevails in the U.S. is difficult because there is no extant database or systematic reporting of this particular arrangement. Yet, there is little doubt that it is pervasive. In financial services, for example, employees sign agreements specifying that as a condition of employment any employment-relationship dispute that arises will be resolved through arbitration. Such explicit individual employment contracts are increasingly common in other industries and sectors, such as high-tech, telecommunications and retail trade. It is therefore likely that tens of millions of U.S. private sector employees are covered by explicit individual employment contracts, which have become even more widespread due to a series of U.S. Supreme Court decisions supporting a deferral-to-arbitration doctrine in cases of non-union employment relationship disputes. While these contracts mitigate the threat of litigation over employment-related disputes, they are also relatively one-sided because employers dominate the selection of arbitrators, specify the scope of issues covered by arbitration, and pay arbitrators' fees. In this circumstance, the extent to which employees can exercise independent individual voice is questionable.

It is less questionable, however, for executives and senior managers of companies who increasingly are employed under formal, explicit, individual contracting arrangements that spell out the terms and conditions of such employment; these are known as executive contracts. In prior eras, executive and senior management labor markets were characterized by strict adherence to the doctrine of employment-at-will and handshake agreements—but no longer.

These new era executive contracts are negotiated not by executive and senior managers themselves but, rather, by their agents and company representatives. This is very similar to what occurs in the entertainment industry, particularly in theater, film, television and professional sports. Moreover, these executive contracts are quite comprehensive, often providing for signing bonuses in cases of external hires, deferred compensation, additional compensation if a change of control (such as through a merger or acquisition) occurs, and severance pay in the case of “separation.” They may also contain provisions under which an executive or senior manager can challenge certain decisions of other executives or a board of directors. This is the leading contemporary example of explicit individual employment contracting and individual voice in the labor market and employment relations.

When all of these individual employment contracts are taken into account, they cover many more employees, perhaps five to six times as many employees, as are covered by collective bargaining contracts. More difficult to estimate is the extent to which employees covered by individual employment contracts actually exercise voice and the scope of the issues over which they do so. In my judgment, employees holding lower- and middle-level jobs have a relatively narrow scope of individual voice, whereas senior managers and especially executives have a relatively wide scope. This inequality of voice is closely paralleled by the rising inequality of compensation as between executives and non-executive employees of U.S. companies.

Independent contracting provides another, quite different, example in this regard. The independent-contractor concept is equivalent to that of a vendor who can presumably choose to whom to sell products and/or services. Unlike previous examples, however, this type of contracting does not involve an employment relationship. In fact, independent contracting is a substitute for employment and has been widely adopted by U.S. companies in a number of industries, notably transportation, delivery and telecom.

Consider the example Federal Express, which is essentially a holding company composed

of several independent strategic business units. One of these units is FedEx Express that delivers packages and related items to businesses. Delivery drivers are employees of this unit. Another of these units is FedEx Home and Ground Systems that delivers packages and related items to customers' residences. Delivery drivers of this unit are independent contractors. These two sets of delivery drivers perform exactly the same job tasks and services. However, the non-union FedEx Express drivers are covered by FedEx's NER system that guarantees fair treatment of employees, whereas the independent Home and Ground Systems independent contractors are not covered by this NER system. Further, these practices contrast with the collective voice exercisable by FedEx pilots who are unionized and whose terms and conditions of employment are set through collective bargaining. FedEx is hardly alone among U.S. companies in maintaining these multiple arrangements for labor services.

But just how independent are independent contractors? In the FedEx example, the "independent" contractors can provide services only to FedEx, no one else; can only deliver packages and related items assigned to them by FedEx; can deliver only to FedEx's customers; and can drive only the routes specified by FedEx. These independent contractors are closely managed by FedEx terminal managers and must adhere to FedEx operating rules and procedures. The terminal manager's job is to ensure that they do so, including by regularly evaluating drivers' performance. Independent contractor drivers who violate company operating rules and procedures or who underperform can be disciplined by FedEx, including cancellation of their contracts. While these independent contractors can protest disciplinary actions taken against them and challenge their performance evaluations, they otherwise are not able to exercise voice in their contracting relationships with FedEx's Home and Ground Unit Systems in the way that FedEx Express employee drivers are able to exercise individual voice or that FedEx's unionized pilots are able to exercise collective voice.

Before turning to policy implications of this analysis, there is one other type of labor services contracting arrangement that merits attention, namely, "deputing." To illustrate this concept in practice, consider the India-based company Tata, which recruits and trains hundreds of thousands of individuals annually and then sends—deputes—they to the U. S. where they perform services mainly for very large (i.e., Fortune 100) companies. The services provided by Tata-trained individuals are typically technical and analytical in nature, involving such tasks as code writing, software development and systems analysis.

Deputation assignments can last up to three years and U.S. companies negotiate and pay contract prices to Tata for the services rendered under this arrangement. In some instances, these companies do not directly pay or provide fringe benefits to the individuals performing these labor services and, correspondingly, don't pay payroll taxes to governments. In other instances, U.S. companies directly compensate deputed personnel, however, there is substantial disagreement over whether the associated payroll taxes should be paid to U.S. or Indian authorities. While the extent of such deputation arrangements is unknown, it is likely to involve several million individuals who perform labor services for U.S. companies. More to the point, these deputed individuals are unable to exercise collective or individual voice in their non-employment or quasi-employment relationships with U.S. companies.

Given all this, it is especially pertinent to LERA members to ask whether new public policy initiatives should be adopted to more closely regulate labor markets and employment relationship contracting. If one supports the basic intent of the NLRA and other employment and human resource regulations, which was to mitigate, if not fully offset, unequal bargaining power between company management and employees, then the answer to this question is yes—or yes for most but not all types of employees. If one supports the trend towards spot or commodity type labor markets and employment relationships, then the answer to this question is no—or no for most but not all types of employees.

Following the yes answer, the U.S. should adopt basic minimum-standard employee rights legislation that includes provisions for employee voice. This means that an employee who has a dispute with his or her employer should be able to bring that dispute to the attention of the employer, either verbally or in writing, without fear of reprisal. If such a dispute is taken up in arbitration, the employee or employee's representative together with a representative of management should jointly select the arbitrator. The cost of arbitration can be paid for in several ways. One is to expand the Federal Mediation and Conciliation Service (FMCS) to the Federal Mediation, Conciliation and Arbitration Service (FMCAS). The expanded agency would provide arbitration services for all private sector employment disputes and the cost of such services would in essence be paid from Federal tax revenues. Another way is for private employers to purchase broad-based or generalized employment dispute resolution insurance much in the same way they presently purchase insurance to cover the costs of disputes involving, for example, allegations of discrimination, or in the way that they purchase insurance to cover the loss of key

executives. Still another arrangement would require employee disputants to pay a portion of arbitration costs, especially to mitigate frivolous employment dispute claims.

Furthermore, new employee-rights legislation should not be limited to employees, *per se*, but instead should apply to or cover those who work as independent contractors and deputed personnel. Following this reasoning, almost anyone who provides labor services to a company would be eligible to invoke the minimum-standard dispute resolution procedure and thereby exercise voice. I use the qualifier “almost” in part because it is unclear whether and to what extent such new legislation would apply to customers of companies, who increasingly provide technologically enabled unpaid labor services. For example, those of you here today who bought your airline ticket online and downloaded your boarding pass online just finished providing substantial unpaid labor services to the airline you used. Many other such examples could be provided, but as yet we have no systematic database about the extent of unpaid customer labor usage.

This proposed new employee rights legislation would also exclude employees holding executive and senior management positions in companies. The reasoning underlying this exclusion is grounded in risk/reward and organizational control concepts and evidence. Consider that executives and senior managers accept such positions knowing that they are accompanied by substantially greater compensation than previously earned, but also by potentially greater risks than they’ve previously encountered. The higher executive and senior management compensation in effect incorporates or reflects this higher risk, including the risk of termination if the companies that employ them underperform. Furthermore, these executives and senior managers control the strategies and decisions of companies that fundamentally affect employment and employment relations for tens of millions of non-executive, non-senior manager employees. Based on agency theory and research, company executives and senior managers are far better able to serve and protect their particular interests than are non-executive, non-senior management employees—as additionally reflected in the aforementioned rapid growth of individual executive and senior management employment contracts.

While new private sector employee rights legislation of the type proposed here could be added to the current inventory of U.S. labor and employment laws, an alternative is to replace those laws with an overarching employee rights law. The NLRA, the Civil Rights Act (Title 7), the Fair Labor Standards Act, the Age Discrimination in Employment Act, the Occupational

Safety and Health Act, the Employee Retirement Income Security Act, and the Family and Medical Leave Act all focus on and regulate one or another aspect of private sector employment and employment relationships. Obviously this piecemeal approach was not derived from an overall grand plan or design. To the contrary, each of these statutes was enacted to address a particular issue or problem that was thought to be worthy of and correctable by the legislation.

But this approach to labor market and employment relations regulation is increasingly unsuitable to modern times and tends to reflect what scholars characterize as path dependence. Following a systems approach to this matter, a new comprehensive, overriding law would regulate private sector employment relationships and labor services arrangements throughout the U.S. The law would specify basic rights attached to the employment relationship, including those pertaining to non-discrimination, workplace safety, leave from work, minimum pay, overtime, retirement income, and employee voice, including through unions and other channels. Under this new comprehensive law, all types of work would be covered, including work formed electronically and otherwise from home and additional locations. These basic rights would apply as well to independent contractors and those who provide labor services through deputed work.

Further, this new employee-rights law would override or supplant individual state laws that apply to one or another aspect of private sector employment relationships. It would also consolidate or replace the various agencies that presently oversee and administer issue-specific laws with a superagency that would operate under the auspices of the U.S. Department of Labor or, alternatively, under the joint auspices of the Department of Commerce and the Department of Labor—an arrangement that would reflect a mutual interest approach to regulation.

If one believes that new comprehensive private sector employee rights legislation is not warranted, that belief is likely based on the view that there is no market failure in this regard—or, in other words, that employers and employees should be completely free to choose. This view is consistent with neo-classical microeconomic theory and its underlying assumptions of equilibrium, full mobility and perfect information (and with the pure theory of political democracy). It is even more fundamentally applied to product markets in which vigorous competition among firms to supply goods and services demanded by consumers is regarded as yielding individual utility maximization which, when cumulated, yields the greatest good for the greatest number of people in a society.

But this theoretically driven view is belied by the U.S. history of regulation of product

and labor markets. Historical examples such as the Sherman Anti-trust Act, the Food and Drugs Act, the Securities and Exchange Act, and the National Traffic and Motor Vehicle Safety Act, as well as such contemporary examples as the Sarbanes-Oxley Act and the Dodd-Frank Wall Street Reform Act, are but a few of the laws that have been enacted to regulate product markets. Analogously, labor markets and employment relations have long been the subject of national regulation, with such regulation bookended by the NLRA and the Social Security Act on the one hand, and portending new immigration legislation on the other hand.

This brief consideration of product and labor market regulation indicates that the concept of fairness or justice competes with the concept of economic utility maximization as a dominant societal value. In the area of employment relations this is attested to by extensive research on organizational justice. A key finding from this research is that employee perceptions of the overall fairness of their employment relationships is more strongly influenced by their perceptions of procedural justice than by their perceptions of distributive justice. The former refers to the processes through which decisions are made and the latter therefore refers to the results or outcomes of those decisions.

To illustrate, if employees perceive that the processes by which their pay, benefits, work schedules, working conditions and other aspects of employment are determined are basically fair, they will perceive overall organizational justice to be fair even if they perceive the outcomes of one or more of these decisions to be relatively unfair. When this empirical finding is combined with findings from research on unionism, collective bargaining, NER, ADR and SHRM, they underscore that the employment relationship is only partly about pay and work. It is also partly about fairness or justice, which may be the more salient, meaningful part of the employment relationship. This reasoning helps us understand why the employment relationship has so frequently been the subject of regulation and why new, more comprehensive, smarter regulation of U.S. private sector employment relationships may be required.

This line of reasoning also helps us understand why an earlier generation of scholars and practitioners created the Industrial Relations Research Association (the LERA's original name). They believed that the employment relationship was not simply another market transaction but, instead, a special relationship that requires specialized analysis and specialized public policy treatment. Sixty-five years later, that fundamental belief in the importance and necessity of voice in the employment relationship remains as strong and compelling as it was then, even as U.S.

private sector employment relationships and voice arrangements have changed markedly.

As the LERA faces various challenges to its mission, purpose and vitality, it is critical for employment relations researchers, especially those who belong to the LERA, to bring their best efforts to bear in studying and offering policy recommendations regarding employment contracts and relationships of the type that I've spoken about here today.

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