



Employee Relations

Legal and Political Foundations

Raymond L. Hogler



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Employee Relations: Legal and Political Foundations

By Raymond L. Hogler
Colorado State University

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Introduction

At one time, the American steel industry was the largest and most important manufacturing activity in the world. Steelworkers played a dominant role in creating the modern labor movement when employees at the U.S. Steel Company agreed to unionize in 1937, under the leadership of John L. Lewis and the Committee for Industrial Organization, later called the Congress of Industrial Relations. Through World War II and into the 1970s, steelworkers helped to establish a middle class in this country through collective bargaining. Labor contracts offered good wages and benefits, job security, and secure retirement. Workers during those years expected to enjoy rising incomes for themselves and their families.

By 2011 private sector union membership had fallen to less than seven percent, and steel production had largely dispersed to other countries. Unions were a negligible factor in labor markets. Wages for American workers were stagnant or falling between the late 1970s and the first decade of the twenty-first century; unemployment rose above 10 percent in the worst recession since the Great Depression; most “baby boomers” lacked adequate retirement income; the federal deficit reached historic levels, and income inequality was at its highest point since 1929. Things had changed, and not necessarily for the better for most citizens.

The employment relations environment likewise underwent tremendous change. Along with collective bargaining laws, New Deal legislators enacted a number of protective laws for workers, such as fair labor standards, social security, and unemployment insurance. In 1964 Congress passed the Civil Rights Act, one part of which protected minorities against discrimination in employment. This was followed by additional laws regulating health and safety, disabilities in the workplace, family and medical leave, and most recently, health insurance. States have also been active in workplace regulation, and their laws supplement the basic federal statutes.

One result of the historical evolution of the employment system and overlapping federal and state authority is a complicated, sometimes

contradictory, body of legal doctrine. In a thoughtful essay, law professor Orly Lobel analyzed “four pillars of work law.”¹ She described employment law as the individual dealings between employees and employers, labor law as the study of unions and collective bargaining, employment anti-discrimination law as the legal protection of designated groups, and employee benefits law as dealing with pensions, health coverage, and workers’ compensation. Because these four areas have different origins and concerns, they do not make up an integrated domain with coordinated rules. Instead, human resource managers and legal specialists must have a broad familiarity with a range of issues connected with work.

This book is designed as a supplement to courses in employment relations and human resource management. The book uses a historical perspective to study American employment. Chapter 1 focuses on the background prior to the New Deal revolution. An important part of that background was the idea of “employment-at-will,” which permitted an employee without a fixed contract to quit work at any time, and permitted the employer to fire the employee at any time. This idea was so important that the U.S. Supreme Court created a constitutional rule prohibiting any legislative attempt to regulate work relations. The law now recognizes a number of exceptions to employment-at-will, and the Constitution has been reinterpreted to allow both state and federal laws regulating employment in many ways. Insurance to protect workers against on-the-job injuries came into existence in the 1920s, and its birth and development offer an interesting variation on modern regulation.

Chapter 1 takes up the expansion of federal power during Franklin D. Roosevelt’s first term as president, which is generally known as the New Deal era. The economic collapse of the early 1930s transformed American ideas about the role of government in society, and Roosevelt undertook dramatic steps to regulate labor markets. The Great Recession, beginning in 2008, raised similar questions about the role of the state in managing the economy, and the discussion of the two events offers a framework to evaluate policies. In 1935 Roosevelt signed the Wagner Act to promote collective bargaining and unionism. Wage and hour laws limited hours of

¹Orly Lobel, “The Four Pillars of Work Law,” *Michigan Law Review*, 104 (no. 6), 2006, pp. 1539–57.

work and established a minimum wage, and social security created a pension system still in effect. Unemployment insurance remains an important part of the safety net for workers.

Chapter 3 describes the Occupational Safety and Health Act (OSHA) of 1970. The law is the basic protection for workers against unsafe working conditions. It has a simple and efficient design, but its implementation is sometimes problematic. Many employers agree with the proposition that workers deserve a safe and healthy workplace, but there is some disagreement about whether or not OSHA is the best way to achieve that goal. The conflict between rules and individual behaviors is endemic to our society, and OSHA is often attacked as a prime example of the “nanny state” interfering with personal liberties and industrial efficiency.

A word of thanks goes to the staff at Cognella who helped put this project in print. Al Grisanti provided editorial guidance from the start and helped to shape the book. Amy Wiltbank located an ideal picture for the cover and designed the accompanying format. Jessica Knott, the Managing Editor, helped me to meet our agreed-upon deadlines. Jamie Giganti moved the manuscript through the editing phase of production, ensuring a consistent and accurate text. I’m grateful for all the help along the way.

CHAPTER 1

Legal and Political Origins of the American Employment System

I. American “Exceptionalism” Briefly Explained

In most industrialized countries, workers cannot be terminated from employment without a legitimate managerial justification. The United States follows the “employment-at-will” rule explained and illustrated below. Simply stated, employment-at-will means an employee can be fired at any time for a good reason, a bad reason, or no reason, provided the reason is not illegal. Since there were no legal protections for employees until the New Deal era in the 1930s, discharges were at the sole discretion of the employer. Workers who tried to form a union, for example, could be fired regardless of how well they performed their work.

Part of the reason there were no laws protecting workers generally was that the U.S. Supreme Court typically struck down legislation that interfered with the employment-at-will rule. The Court said that the Constitution safeguarded *liberty* and *property* rights in this country, and the government had no authority to deprive employers or employees of those rights. A worker who wanted to work in a unionized workplace, for example, had a right to seek out such employment; an employer who preferred to remain nonunion had a right to hire and retain nonunion workers. The Court did not deal with inequality of power between employees and employers, but assumed that the freedom to bargain for wages would sufficiently balance the various interests.

The constitutional doctrine had serious implications for the development of working-class movements, because employers could resist

collective bargaining with trade unions, and workers consequently lacked a unified voice in economic matters. Another important factor was that our political system discouraged a national “labor party,” which developed in other countries. Political influence was tied to two dominant parties that co-opted any splinter movements, and our state and federal system was largely decentralized in terms of labor relations until the New Deal. As a result, our politics tends to be more conservative, less egalitarian, and more congenial to business interests than those of many other national governments.¹

In 1937 the Supreme Court issued a landmark decision in the *Jones & Laughlin Steel Corp. v. National Labor Relations Board*. It upheld federal legislation protecting the right of workers to join and form unions and engage in negotiations over wages, hours, and working conditions. Unions grew rapidly throughout the 1940s and 1950s, and labor contracts typically contained a clause stating that workers would not be discharged except for “just cause.” The Civil Rights Act of 1964 prohibited employers from discriminating on the basis of race, religion, gender, and national origin, among other characteristics. Other legislation followed to prevent discrimination because of age, disability, or exercising rights of safety and health. Presently, there are numerous laws making it illegal to terminate employment for various protected groups, but the burden is on the employee to prove the discharge was for an unlawful reason, rather than on the employer to prove there was a justifiable reason.

In addition to the federal legislation, state courts began to create common law exceptions to the employment-at-will rule during the 1980s. They ruled that employees could not be terminated for reasons that were contrary to “public policy,” or that employees could have contractual rights in employment, even if the hiring was for an indefinite period. Some state courts even recognized a “covenant of good faith and fair dealing” implicit in the employment relationship. These changes in judicial thinking added another layer of legal doctrine to employment relations and led to a surge of litigation. One state, Montana, reacted to the judicial activism by adopting a statute that accommodated the interests of employees and employers; since 1987, it has provided a model for a reasonable adjustment of the interests of the parties. Materials later in this chapter take up these points in more detail.

To begin the analysis, we first consider some early cases articulating the employment-at-will rule and how that rule fits into America's culture of free markets and individual economic dealings. The rule applied even under circumstances that we might now consider to be ethically unacceptable. An excerpt from a leading U.S. Supreme Court decision sets forth the constitutional dimension of employment-at-will and its connection with economic dimensions of our system. Turning to more recent developments, the California Supreme Court decided that a person using medically certified marijuana could be discharged from his job, despite the fact there was a law allowing its use, and that decision will be included later in the chapter. The discussion of employment-at-will concludes with an article summarizing the state of the common law at the beginning of this decade.

II. Major Judicial Developments

A. Origins

Legal historians trace the beginning of the employment-at-will rule to a treatise writer named Horace Gray Wood. Judges and lawyers in the early 19th century did not have easy access to the opinions issued by various state courts, and the treatise writers performed a valuable service by collecting and summarizing the doctrine on a given point of law. Wood, like others following his craft, reviewed judicial decisions and provided a summary and analysis of the cases. In 1877 Wood published a book titled *A Treatise on the Law of Master and Servant*. He stated the "American," as opposed to the British, rule of employment was as follows: "the rule is inflexible, that a general or indefinite hiring is prima facie a hiring at will, and if the servant seeks to make it out a yearly hiring, the burden is upon him to establish it by proof" (p. 272). By this, Wood meant that an employee who claimed to have a contractual right to employment had the burden of proving there was a contract. Otherwise, the law presumed there was not one.

One of the leading cases adopting the employment-at-will rule was *Payne v. Western & Atlantic R.R. Co.*, 81 Tenn. 507 (1884). The Tennessee Supreme Court said that "men must be left, without interference to buy

and sell where they please, and to discharge or retain employees at will for good cause or for no cause, or even for bad cause without thereby being guilty of an unlawful act per se. It is a right which an employee may exercise in the same way, to the same extent, for the same cause or want of cause as the employer.” The court explained that the policy underlying the rule rested on the idea that the law did not correct imbalances of power, but left the exercise of power to the negotiations of the parties. In the court’s words, “The great and rich and powerful are guaranteed the same liberty and privilege as the poor and weak. All may buy and sell where they choose; they may refuse to employ or dismiss whom they choose, without being thereby guilty of a legal wrong, though it may seriously injure and even ruin others.”

The legal principle remained in effect for more than a century, even though it resulted in grave injustices. In *Comerford v. International Harvester*, 178 So. 894 (1938), for example, a salesman was fired because he refused to allow his supervisor to have sex with his wife. The case reached the Alabama Supreme Court, where the justices ruled that Comerford had no right to be reinstated to his job, despite working for the company for more than 20 years, and even though levels of unemployment were still at Depression levels. According to the court, the company would not be liable for the action of its manager even if the act were malicious. Because the employment was at will, the company and its agent had a right to discharge Comerford, regardless of the reason. “If one does an act which is legal in itself and violates no right of another, the fact that this rightful act is done from bad motives or with bad intent toward the person so injured thereby does not give the latter a right of action against the former. Therefore, if the defendant’s acts complained of in this case were legal in themselves, and violated no superior right of the plaintiff, they were not actionable.”

More problematically for workers, the underlying theory of employment-at-will was used as a means to stop Congress from enacting any laws that might interfere with an employer’s prerogatives. Labor leader Eugene Debs led a strike against the mighty Pullman Corporation in 1894, and one of the results of the strike was a massive disruption of the flow of commerce across the nation. Congress decided that a better policy would

be to give railway workers a right to bargain with the owners, and they passed the Erdman Act in 1896 to accomplish that end. The United States Supreme Court struck down the law. Its opinion is a detailed articulation of how free markets work under capitalism. Relevant parts of the decision are printed below.

This case is lengthy and complicated, but the point is simple. The Court holds that Congress did not have authority under the Constitution to regulate employment on railroads. As a result of this case, and many others like it, the federal government could not pass laws protecting workers in their employment. The rule did not change until 1937. In the meantime, there were many destructive labor disputes as workers tried to force employers to negotiate terms of employment with union organizations. There are two dissenting opinions in this case that deserve attention. The opinion by Justice McKenna sets out a constitutional theory based on the federal power over interstate commerce; his point of view became the majority rule during the New Deal, and it now is the foundation for federal activism in work relations. Justice Holmes is one of the most famous people ever to serve on the Supreme Court, and this is one of his best-known dissents.

Here are some concepts you should take away from the case:

- Congress believed that the protection of unions would reduce labor conflict on the railroads.
- The Court said that liberty and property are the most important parts of the Constitution.
- Employment-at-will was protected as a constitutional right of employers and employees.
- “Due process” means that the Court has the power to strike down laws that it thinks are not reasonable.
- The federal power is limited by Article I of the Constitution to those matters which are specifically enumerated.

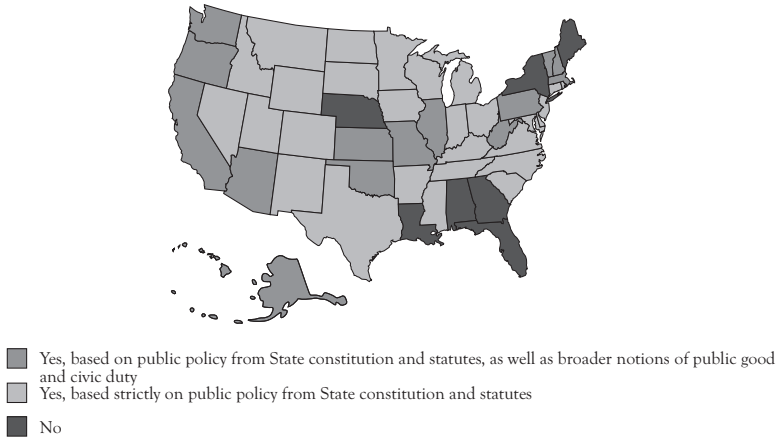
The dissenting opinions offer a different interpretation of many propositions adopted by the majority. You should be aware of what those differences are, and how they are explained.

Public-Policy Exception

Under the public-policy exception to employment-at-will, an employee is wrongfully discharged when the termination is against an explicit, well-established public policy of the State. For example, in most States, an employer cannot terminate an employee for filing a workers' compensation claim after being injured on the job, or for refusing to break the law at the request of the employer. The majority view among States is that public policy may be found in either a State constitution, statute, or administrative rule, but some States have either restricted or expanded the doctrine beyond this bound. The public-policy exception is the most widely accepted exception, recognized in 43 of the 50 States (see map on next page).

Although the significant development of exceptions to employment-at-will occurred in the 1980s, the first case to recognize a public-policy exception occurred in California in 1959. In *Petermann v. International Brotherhood of Teamsters*,² Peter Petermann was hired by the Teamsters Union as a business agent and was told by its secretary-treasurer that he would be employed for as long as his work was satisfactory. During his employment, Petermann was subpoenaed by the California legislature to appear before, and testify to, the Assembly Interim Committee on Governmental Efficiency and Economy, which was investigating corruption inside the Teamsters Union. The union directed Petermann to make false statements to the committee during his testimony, but he instead truthfully answered all questions posed to him. He was fired the day after his testimony.

In recognizing that an employer's right to discharge an employee could be limited by considerations of public policy, the California appellate court found that the definition of public policy, while imprecise, covered acts that had a "tendency to be injurious to the public or against the public good."³ The court noted that, in California as elsewhere, perjury and the solicitation of perjury were criminal offenses and that false testimony in any official proceeding hindered the proper administration of both public affairs and justice. Even though employer and employee could otherwise be prosecuted under the criminal law for perjury or solicitation of perjury, the court found that applying the public policy



Source: Data are from David J. Walsh and Joshua L. Schwarz, "State Common Law Wrongful Discharge Doctrines: Up-date, Refinement, and Rationales," 33 *Am. Bus. L.J.* 645 (summer 1996). Reprinted from the Bureau of Labor Statistics: <http://www.bls.gov/opub/mlr/2001/01/art1full.pdf>.

exception in this context would more fully effectuate California's declared policy against perjury. Holding otherwise would encourage criminal conduct by both employer and employee, the court reasoned.

Courts in other States were slow to follow California's lead. No other State considered adopting such an exception until after 1967, and only 22 States had considered the exception by the early 1980s.⁴ Courts clearly struggled with the meaning of the phrase "public policy," with some finding that a policy was public only if it was clearly enunciated in a State's constitution or statutes and others finding that a public policy could be inferred from a statute even where the statute neither required nor permitted an employee to act in a manner that subsequently resulted in the employee's termination. The courts that refused to recognize the exception generally found that, given the vagueness of the term "public policy," such exceptions to employment-at-will should be created by legislative, not judicial, act.⁵

In 1981, one of the broadest definitions of "public policy" was adopted by the Illinois Supreme Court in *Palmateer v. International Harvester Company*.⁶ In this case, Ray Palmateer alleged that he was fired from his job with International Harvester after he provided information

to local law enforcement authorities about potential criminal acts by a co-worker and indicated that he would assist in any criminal investigation and subsequent trial. The court noted that the traditional employment-at-will rule was grounded in the notion that the employment relationship was based on reciprocal rights, and because an employee was free to end employment at any time for any condition merely by resigning, the employer was entitled to the same right in return. Rejecting this “mutuality theory,” the court pointed to the rising number of large corporations that conduct increasingly specialized operations, leading their employees’ skills to become more specialized in turn and, hence, less marketable. These changes made it apparent to the court that employer and employee are not on equal footing in terms of bargaining power. Thus, the public-policy exception to the employment-at-will doctrine was necessary to create a “proper balance . . . between the employer’s interest in operating a business efficiently and profitably, the employee’s interest in earning a livelihood, and society’s interest in seeing its public policies carried out.”⁷

The Illinois court found that matters of public policy “strike at the heart of a citizen’s social rights, duties, and responsibilities” and could be defined in the State constitution or statutes.⁸ Beyond that, when the constitution and statutes were silent, judicial decisions could also create such policy, the court said in creating a broad scope for its exception. In this case, nothing in the Illinois Constitution or statutes required or permitted an employee to report potential criminal activity by a co-worker. However, the court found that public policy favored citizen crime fighters and the exposure of criminal activity. Thus, *Palmateer* brought an actionable claim for retaliatory discharge.

Two years after *Palmateer*, the Wisconsin Supreme Court rejected such an expansive definition of public policy and limited the application of this employment-at-will exception in its State to cases in which the public policy was evidenced by a constitutional or statutory provision. In *Brockmeyer v. Dun & Bradstreet*,⁹ the court found that the public-policy exception should apply neither to situations in which actions are merely “consistent with a legislative policy” nor to “judicially conceived and defined notions of public policy.”¹⁰

In *Brockmeyer*, the plaintiff worked for Dun & Bradstreet from August 1969 to May 1980, the last 3 years as district manager of the

Credit Services Division in Wisconsin. Brockmeyer had an above-average performance record, but in February 1980, his immediate supervisors learned that he was vacationing with his secretary when it was understood by others that he was performing his normal duties as district manager. The supervisors also learned that Brockmeyer had smoked marijuana in the presence of other employees. The supervisors confronted him with the allegations and stated unequivocally that he would be terminated or reassigned if his performance did not improve. They also suggested that either he or his secretary would have to find a reassignment within Dun & Bradstreet so that they would not continue to work together. When Brockmeyer tried unsuccessfully to find another position for his secretary, the supervisors sought and obtained her resignation. After leaving, the former secretary filed a sex discrimination claim against Dun & Bradstreet; Brockmeyer indicated to his supervisors that he would tell the truth if called to testify at a trial regarding this complaint. Dun & Bradstreet settled the sex discrimination suit, and Brockmeyer was fired 3 days later.

Brockmeyer contended that his termination violated Wisconsin statutes that prohibited (1) perjury, (2) willful and malicious injuring of another in his or her reputation, trade, business, or profession, and (3) the use of threats, intimidation, force, or coercion to keep a person from working. Rejecting these claims, the Wisconsin Supreme Court found that Dun & Bradstreet did not engage in any behavior that violated these statutes. Dun & Bradstreet had legitimate reasons for terminating Brockmeyer, and no evidence demonstrated that Dun & Bradstreet had asked him to lie in the event that the sex discrimination action by his secretary went to trial. The court held that it was not the State's public policy to prevent discharge of an employee because the employee may testify in a manner contrary to his employer's interests.

The court in *Brockmeyer* decided to limit the application of the public-policy exception to "fundamental and well-defined public policy as evidenced by existing law" and held that a wrongful-discharge claim should not be actionable merely because an "employee's conduct was praiseworthy or because the public may have derived some benefit from it."¹¹ The court justified its limitation by saying that it would safeguard employee job security interests against employer actions that undermine fundamental

policy preferences, while still providing employers with flexibility to make personnel decisions in line with changing economic conditions. Later, the court issued a clarification to the effect that public policy could support a wrongful-termination suit in cases where an explicit constitutional or legislative statement did not evidence that policy, as long as the policy was evident from “the spirit as well as the letter” of the constitutional and legislative provisions.¹² The court also now permits public policy to be evidenced by administrative rules and regulations.¹³

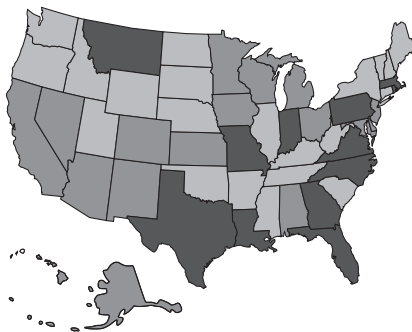
Seven states have rejected the public-policy exception in its entirety: Alabama, Florida, Georgia, Louisiana, Nebraska, New York, and Rhode Island.¹⁴ In *Murphy v. American Home Products Corporation*,¹⁵ the Court of Appeals of New York (the state’s highest court) forcefully argued that such exceptions to the employment-at-will doctrine were the province of legislators, not judges. While recognizing that many other jurisdictions had created a public-policy exception, the court found that legitimacy of the principal justification for such adoption—namely, inadequate bargaining power on the part of employees—was better left to the New York legislature to evaluate. The court found that legislators have “greater resources and procedural means to discern the public will” and “elicit the view of the various segments of the community that would be directly affected.”¹⁶ Because the recognition of such an exception requires some sort of principal scheme for its application, the configuration of that scheme must be determined by the legislature after the public has had its opportunity to communicate its views, according to the court. Finally, the court found that any such change in the employment at-will doctrine would fundamentally alter rights and obligations under the employment relationship and thus should be applied prospectively by the legislature, rather than retrospectively by the court.¹⁷

To summarize, the vast majority of States do recognize some form of a public-policy exception to the employment-at-will doctrine. Such a regulation prevents employees from being terminated for an action that supports a State’s public policy. The definition of public policy varies from State to State, but most States either narrowly limit the definition to clear statements in their constitution or statutes, or permit a broader definition that enables judges to infer or declare a State’s public policy beyond the State’s constitution or statutes.

Implied-Contract Exception

The second major exception to the employment-at-will doctrine is applied when an implied contract is formed between an employer and employee, even though no express, written instrument regarding the employment relationship exists. Although employment is typically not governed by a contract, an employer may make oral or written representations to employees regarding job security or procedures that will be followed when adverse employment actions are taken. If so, these representations may create a contract for employment. This exception is recognized in 38 of the 50 states (see map below).

A common occurrence in the recent past was courts finding that the contents and representations made in employee handbooks could create an implied contract, absent a clear and express waiver that the guidelines and policies in such handbooks did not create contract rights. The typical situation involves handbook provisions which state that employees will be disciplined or terminated only for “just cause” or under other specified circumstances, or provisions which indicate that an employer will follow specific procedures before disciplining or terminating an employee.¹⁸ A hiring official’s oral representations to employees, such as saying that



- Yes, including oral and written assurances by employers; disclaimers not per se defense
- Yes, limited to written assurances; disclaimers nullify employer representation if unambiguous and prominent
- No

Source: Data are from David J. Walsh and Joshua L. Schwarz, “State Common Law Wrongful Discharge Doctrines: Up-date, Refinement, and Rationales,” 33 *Am. Bus. L.J.* 645 (summer 1996). Reprinted from the Bureau of Labor Statistics: <http://www.bls.gov/opub/mlr/2001/01/art1full.pdf>.

employment will continue as long as the employee's performance is adequate, also may create an implied contract that would prevent termination except for cause.

The leading case having to do with the implied-contract exception is *Toussaint v. Blue Cross & Blue Shield of Michigan*,¹⁹ decided by the Supreme Court of that State in 1980. Charles Toussaint had been employed in a middle management position with Blue Cross for 5 years before his employment was terminated. When he was hired, he asked his hiring official about his job security and was told that his employment would continue "as long as [he] did [his] job." Toussaint also was provided with a manual of Blue Cross personnel policies some 260 pages long; within the manual were statements that disciplinary procedures would be applied to all Blue Cross employees who completed their probationary period and that it was Blue Cross' policy to terminate employees only for "just cause."

The court ruled that, even if employment is not for a definite term, a provision indicating that an employee would be fired only for just cause was enforceable and that such a provision could create an implied contract if it engendered legitimate expectations of job security in the employee. If the employee is arbitrarily fired thereafter, then a claim for wrongful discharge is actionable. The court noted that Blue Cross could have established a policy giving it the right to terminate employees for no cause at all, but chose instead to follow a "just cause" termination policy. The court argued that employer policies and practices create a "spirit of cooperation and friendliness" in the workforce, making employees "orderly, cooperative, and loyal" by giving them peace of mind regarding job security and the belief that they will be treated fairly when termination decisions are made.²⁰ If an employer's actions lead an employee to believe that the policies and guidelines of the employer are "established and official at any given time, purport to be fair, and are applied consistently and uniformly to each employee," then the employer has created an obligation.²¹ That obligation is created even though the parties may not have mutually agreed that contract rights would be established by the policies.

An implied contract for employment cannot be disregarded at the employer's whim, but the employer can prevent the contract from being created by including in its policies and provisions a clear and unambiguous disclaimer stating that its policies and guidelines do not create contractual

rights.²² If a company does this, no employee could reasonably expect that the policies and guidelines provided a contractual right to job security or any other benefit described therein.

In *Pine River State Bank v. Mettilee*,²³ the Minnesota Supreme Court agreed with the rationale behind *Toussaint*. In *Pine River*, an employee handbook was given to an employee after he had been working for the bank for several months. The handbook contained two sections that the employee claimed created contract rights. The first was a section titled “Job Security” that described employment in the banking industry (though not the specific bank) as secure. The second involved the bank’s “Disciplinary Policy,” which outlined specific procedures, including reprimands and opportunities to correct one’s behavior, that would be followed if an employee was alleged to have violated a company policy. The court found that the “Job Security” section was insufficient to create contract rights, but that the “Disciplinary Policy” section was sufficient. The court analyzed that provision according to traditional requirements for the creation of a contract: offer, acceptance, and consideration for the contract. The court found that the employer offered employment subject to the terms in the employee handbook; the employee accepted the employment offer by showing up for work. The employee’s labor was the consideration in support of the contract. Thus, argued the court, the employer breached the employment contract by terminating the employee without following the specific procedures outlined in the handbook that created the implied contract. The court reasoned that, when an employer chooses to prepare and distribute a handbook, the employer is choosing to “implement or modify its existing contracts with all employees covered by the handbook.”²⁴

Among the states rejecting the application of an implied-contract exception to employment-at-will are Florida, Pennsylvania, and Texas. In *Muller v. Stromberg Carlson Corporation*,²⁵ a Florida appellate court rejected the exception because of fear that it would lead to uncertainty in the application of the law. Walter H. Muller sued Stromberg Carlson following his termination and alleged that, pursuant to the company’s merit pay plan that required an annual review of an employee’s performance and a recommendation as to pay increases based on that performance, he had an annual implied-employment contract. The Florida court rejected

Muller's claim, finding no justification to depart from the "long established principles that an employment contract requires definiteness and certainty in its terms."²⁶ The court reasoned that, if indefinite terms or assurances were used to imply an employment contract, the courts in Florida would be "flooded with claims that judicial discretion be substituted for employer discretion."²⁷ Addressing the arguments made by the Michigan Supreme Court in *Toussaint*, the court said that the longstanding view in Florida, contrary to that in Michigan, was that beneficial social or economic policy should not be advanced by judicial decisions. The Florida court believed the judicial function to be advancing certainty in business relationships by providing meaningful criteria that lead to predictable consequences. The court had "serious reservations as to the advisability of relaxing the requirements of definiteness in employment contracts considering the concomitant uncertainty which would result in the employer-employee relationships."²⁸ The court added that the inequality of bargaining power between employers and their employees was not a sufficient basis to create implied contracts of employment based on oral or written assurances.

Texas refused to recognize the implied-contract exception in the 1986 case *Webber v. M. W. Kellogg Company*.²⁹ In that case, the court found that a letter offering a position of employment, the classification of an employee as "permanent" rather than "temporary," and the identification in company documents of a scheduled retirement date for the employee some 22 years after employment was initiated were insufficient in sum to create an implied contract of employment for a specific duration. Likewise, in *Richardson v. Charles Cole Memorial Hospital*,³⁰ the Supreme Court of Pennsylvania rejected the implied-contract exception, finding that policies published in an employee handbook did not create a "meeting of the minds," one of the traditional standards for evaluating whether a contract has been created between two parties. Because the terms of the handbook were not bargained for in the traditional sense, the court reasoned, the benefits conferred upon the parties by the handbook were mere gratuities and not rights that were contracted for.

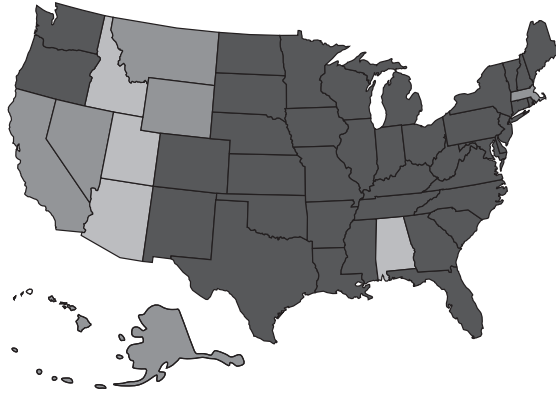
To summarize, then, employers' oral or written assurances regarding job tenure or disciplinary procedures can create an implied contract for

employment under which the employer cannot terminate an employee without just cause and cannot take any other adverse employment action without following such procedures. Employers can prevent written assurances from creating an implied contract by including a clear and unambiguous disclaimer characterizing those assurances as company policies that do not create contractual obligations. Oral assurances must create a reasonable expectation in the employee in order for an implied contract to be created.

Covenant-of-Good-Faith Exception

Recognized by only eleven states (see map on next page), the exception for a covenant of good faith and fair dealing represents the most significant departure from the traditional employment-at-will doctrine.³¹ Rather than narrowly prohibiting terminations based on public policy or an implied contract, this exception—at its broadest—reads a covenant of good faith and fair dealing into *every* employment relationship. It has been interpreted to mean either that employer personnel decisions are subject to a “just cause” standard or that terminations made in bad faith or motivated by malice are prohibited.³²

As with the public-policy exception, California courts were the first to recognize an implied covenant of good faith and fair dealing in the employment relationship. In *Lawrence M. Cleary v. American Airlines, Inc.*,³³ an American Airlines employee who had worked satisfactorily for the company for 18 years was terminated without any reason given. A California appellate court held that, in virtue of the airline’s express policy of adjudicating personnel disputes *and the longevity of the employee’s service*, the employer could not fire the employee without good cause. The court stated that “Termination of employment without legal cause after such a period of time offends the implied-in-law covenant of good faith and fair dealing” and that, from the covenant, “a duty arose on the part of . . . American Airlines . . . to do nothing which would deprive . . . the employee . . . of the benefits of the employment . . . having accrued during [the employee’s] 18 years of employment.”³⁴ This California appellate case was decided in 1980, and the factual situation included an implied employment contract. However, the court did not hold that a covenant



- Yes, plaintiff can sue in tort or contract, or otherwise broader application
- Yes, limited to contractual remedies or narrower application
- No

Source: Data are from David J. Walsh and Joshua L. Schwarz, "State Common Law Wrongful Discharge Doctrines: Up-date, Refinement, and Rationales," 33 *Am. Bus. L.J.* 645 (summer 1996). Reprinted from the Bureau of Labor Statistics: <http://www.bls.gov/opub/mlr/2001/01/art1full.pdf>.

of good faith and fair dealing was actionable only if an employee had an express or implied employment contract from which the covenant could arise. Rather, the appellate court found that a tort action could be maintained for breach of the covenant of good faith and fair dealing in every employment relationship, not just those covered by an express or implied contract. The California Supreme Court subsequently rejected this formulation and eliminated the tort action.³⁵

Later, however, in *Kmart Corporation v. Ponsock*, the Supreme Court of Nevada permitted a cause of action in tort for breach of an implied covenant of good faith and fair dealing in every employment relationship.³⁶ Ponsock was a tenured employee at Kmart, hired until retirement or as long as economically possible. At trial, the jury found that Kmart terminated Ponsock to avoid having to pay him retirement benefits. As part of his case, he claimed that Kmart's discharge was in "bad faith" and that, even without a contract,³⁷ such a termination gave rise to tort liability. The court agreed, citing the employer-employee relationship as one of the "rare and exceptional cases that the duty [of law] is of such a nature as to give rise to tort liability."³⁸

In its opinion, the court recognized the changes that many feel have occurred in the employment relationship:

We have become a nation of employees. We are dependent upon others for our means of livelihood, and most of our people have become completely dependent upon wages. If they lose their jobs they lose every resource except for the relief supplied by the various forms of social security. Such dependence of the mass of the people upon others for all of their income is something new in the world. For our generation, the substance of life is in another man's hands.³⁹

The court found that Ponsock was dependent on Kmart's commitment to extended employment and to retirement benefits based on that employment and that the "special relationships of trust" required a tort remedy in addition to any available contractual remedy if the employer conducts an "abusive and arbitrary" dismissal. Providing such a remedy, the court reasoned, would deter employers from engaging in such malicious behavior. Because the termination in *Ponsock* was motivated by the company's desire to serve its own financial ends, the employee was entitled to recover for a bad-faith agreement.

The vast majority of courts have rejected reading such an implied covenant into the employment relationship. The reasoning used by a Florida appellate court in *Catania v. Eastern Airlines, Inc.*,⁴⁰ is representative. Four employees alleged that Eastern had wrongfully discharged them and claimed, among other things, that they were entitled to a good-faith review of the discharge. The court summarized the plaintiffs' argument as follows:

To require employers to demonstrate valid grounds and methods for an employee's discharge does not unduly restrict employers; it merely provides some balance of power. It is apparent that there is not truly freedom of contract between an employer and employee; the individual employee has no power or ability at all to negotiate an employment contract more favorable to himself. And the traditional common law [the employment-at-will doctrine] totally subordinates an interest of the employee to the employer's freedom.

Rejecting the “plaintiff’s invitation to be a ‘law giver’” and applying reasoning that had been accepted by the Nevada Supreme Court, the Florida court found that the burden on courts of having to determine an employer’s motive for terminating an employee was too great an undertaking.

The employment relationship is forever evolving. Additional statutory and common-law exceptions to the employment-at-will doctrine may be developed in the future, but the traditional doctrine has already been significantly eroded by the public-policy and implied-contract exceptions. In addition to the three exceptions detailed in this article, other common-law limitations on employment-at-will have been developed, including actions based on the intentional infliction of emotional distress, intentional interference with a contract, and promissory estoppel or detrimental reliance on employer representations. Suits seeking damages for “constructive discharge,” in which an employee alleges that he or she was forced to resign, and for “wrongful transfer” or “wrongful demotion” have increased in recent years. Accordingly, nowadays employers must be wary when they seek to end an employment relationship for good cause, bad cause, or, most importantly, no cause at all.

Notes to Muhl’s “Employment-at-Will Doctrine”

1. Shane and Rosenthal, *Employment Law Deskbook*, § 16.02 (1999).
2. 174 Cal. App. 2d 184 (1959).
3. 174 Cal. App. 2d at 188.
4. Deborah A. Ballum, “Employment-at-will: The Impending Death of a Doctrine,” 37 *Am. Bus. L.J.* 653, 660 (summer 2000).
5. See, for example, *Pacheco v. Raytheon*, 623 A.2d 464 (R.I. 1993); and *Murphy v. American Home Products Corp.*, 58 N.Y.2d 293, 448 N.E.2d (1983).
6. 85 Ill.2d 124, 421 N.E.2d 876 (1981).
7. *Id.* at 878.
8. *Id.*
9. 113 Wis.2d 561, 335 N.W.2d 834 (1983).
10. *Id.* at 839–40.
11. *Id.* at 840, citing *Palmateer v. International Harvester Co.*, 421 N.E.2d at 883.

12. See *Wandry v. Eye Credit Union*, 129 Wis.2d 37, 384 N.W.2d 325 (1986).
13. See *Winkelman v. Beloit Memorial Hosp.*, 168 Wis.2d 12, 483 N.W.2d 211 (1992).
14. At this time, it is unclear how Maine views the public-policy exception, as no decision has addressed it directly.
15. 58 N.Y.2d 293, 448 N.E.2d 86 (1983).
16. *Id.* at 302.
17. One year after the decision was rendered, the New York legislature enacted the Retaliatory Action by Employers Act, amending the State's labor law so that it would protect whistle-blowers from wrongful termination. See N. Y LAB. LAW § 740 (*Gould's New York Consolidated Laws Unannotated*, 1988).
18. Shane and Rosenthal, *Employment Law Deskbook*, § 16.03[5].
19. 408 Mich. 579, 292 N.W.2d 880 (1980).
20. *Id.* at 644.
21. *Id.*
22. The following is a sample disclaimer, which must be clear and unambiguous in the handbook or policy in order to be effective: "This policy is not intended as a contractual obligation of the company. The company reserves the right to amend this policy from time to time at its discretion and in accordance with applicable law."
23. 333 N.W.2d 622 (1983).
24. *Id.* at 626–27.
25. 427 So.2d 266 (1983).
26. *Id.* at 268.
27. *Id.* at 269.
28. *Id.* at 270.
29. 720 S.W.2d 124 (1986).
30. 320 Pa.Super. 106, 466 A.2d 1084 (1983).
31. Shane and Rosenthal, *Employment Law Deskbook*, § 16.03[8].
32. *Id.*
33. 111 Cal.App.3d 443 (1980).
34. *Id.* at 455.
35. See *Foley v. Interactive Data Corp.*, 47 Cal.3d 654, 765 P.2d 373. (Cal. 1988).

36. 103 Nev. 39, 732 P.2d 1364 (1987).
37. In the trial, the court did find that an employment contract existed that Kmart had breached.
38. *Id.* at 49.
39. *Id.* at 51, quoting F. Tannenbaum, *A Philosophy of Labor* (1951).
40. 381 So.2d 265 (1980).

III. Workers' Compensation Laws

Protection against work-related injuries makes up a major component of our employment relations system. The laws developed in the 1910s and quickly spread across the United States. Workers' compensation schemes are unique in several respects. First, the legislation consists of state, rather than federal, law, and the conditions for recovery of benefits and the amounts of compensation are determined strictly by the respective states. Second, employers supported the enactment of compensation laws, even though they represented an important deviation from the principle that contractual agreement governed employment relations. Third, the statutes displaced an existing system of common law, which in many cases favored employers and precluded workers from any remedy for workplace injuries.¹

Given the seeming contradictions that workers' compensation posed for the contractual regime of employment, why would employers ever consent to the system? The figure below shows the evolution of workers' compensation laws and their administration. Certain key elements make up the compromise that enables employers to buy into the system while allowing workers to be protected against hazards of work. Under a workers' compensation scheme, the injured worker receives regular and fixed amounts of money for job-related illnesses and injuries. In exchange, the worker surrenders the right to sue the employer in court for damages arising out of the worker's loss of earning capacity. The arrangement protects the employer against the costs of litigation and jury awards, which eventually would be passed onto the consumer in the form of higher prices for the product. It protects employees from the uncertainty of a judicial proceeding, and it protects the public from the economic burdens associated with incapacitated workers.

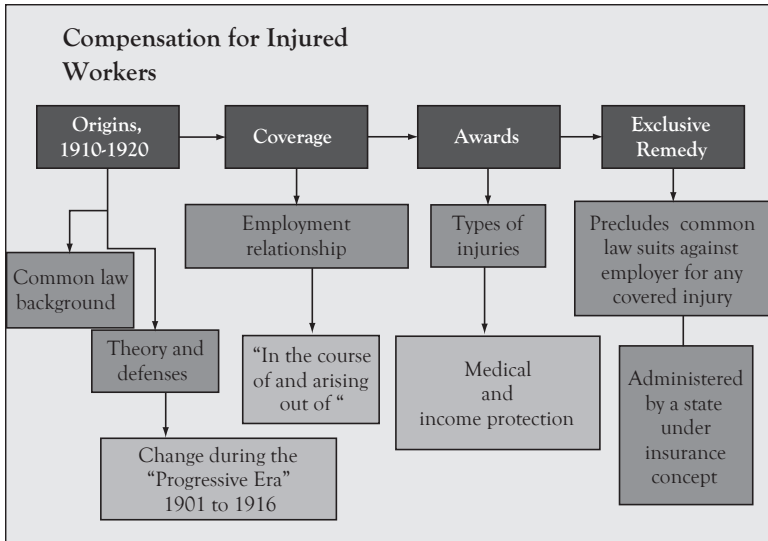


Figure 1 *How Workers' Compensation Works*

The growth of the factory system as a model for industrial production was accompanied by sharp increases in the number of industrial accidents, and the common law doctrines governing employment were inadequate to deal with the problem of injured workers. The result was a surge of state legislative activity in the first two decades of the century; that activity eventually resulted in the particular system of industrial insurance which now exists. Prior to the 1830s, the issue of an employer's duty to compensate an employer for injuries received little legal attention. As cases arose, American judges looked to English common law precedent to determine standards of liability. Under the English rule, an employee was required to prove as a condition of recovery that the employer's negligence had caused the injury. American courts followed that precedent in decisions such as *Farwell v. Boston and Worcester R.R. Corp.*, 4 Metcalf 49 (1842), decided in Massachusetts in 1842. Chief Justice Lemuel Shaw ruled in favor of the railroad, stating that the relationship between an employee and his employer was governed by express or implied contract, and said that wages would factor in the possibility of injury. In his words (p. 57):

The general rule, resulting from considerations of justice as of policy, is, that he who engages in the employment of another for

their performance of specified duties and services, for compensation, takes upon himself the natural and ordinary risks and perils incident to the performance of such services, and in legal presumption, the compensation is adjusted accordingly.

Labor markets, in Shaw's view, reflected a premium for hazardous work, and in theory, the negligence system promoted an efficient method of allocating the costs of industrial injury. By emphasizing the contractual nature of employment, losses due to injury could be regarded as a cost of work.

The common law system of compensation for workers' injuries was inadequate in a number of respects. The injured worker had no recourse for injury other than litigating against the employer. Such litigation was both expensive and time consuming, and the worker and his family required immediate aid. Even assuming the worker prevailed in the suit, the remedies were often not sufficient to defray the costs of litigation and to provide maintenance for the worker and his family, which resulted in a burden to the community. Finally, the common law system became progressively disadvantageous to the employer during the first decade of this century. Although it was difficult for a worker to obtain a remedy through the system, there were an increasing number of suits where the employer was found to be at fault, and the damages awarded to the injured worker were sometimes quite large.

One study concluded that "the rising value of the injured worker's right of action against the employer was at the center of capital's interest in a new system" of compensation for injury. As industrial injuries became more widespread, public attention focused on the problem, and judges and juries grew more sympathetic to claims. Premiums for insurance against such claims rose from \$203,132 in 1887 to \$35 million in 1911, and insurance companies were unable to develop sound actuarial standards for industrial injuries. There was also an obvious political dimension at stake; workers as a class reacted against the perceived callousness of employers and the hardships inflicted on workers' families. Several other aspects of labor unrest contributed to a "crisis of confidence" in business during the period; the compensation issue, however, was particularly symbolic, and it "became the focal point for a debate as to whether

the American state could be modified to provide even a minimum floor to cushion the physical and financial risks of the employment relationship.” Eventually, then, “The compensation crisis of the first decade reached the point where a solution imported from Europe, Workers’ Compensation, presented itself as a form of social insurance that could be adopted to conditions in the United States.”²

A. *The Components of Workers’ Compensation*

1. *There must be an employment relationship.* Workers’ compensation claims are appropriate only where an actual employer-employee relationship exists, and only the employee is covered. Generally, an employee is an individual who routinely and regularly performs remunerative work for another, and is subject to the control and direction of the other. An independent contractor, in contrast, is paid an agreed amount for completion of a task, and the accomplishment of the task is typically within the discretion of the contractor, who is in a position to make a profit or suffer a loss from the venture. Some other major exemptions usually found in statutory provisions include those for agricultural employment, casual employment not in the employer’s course of business, and for employers with less than a specified number of employees.
2. *Coverage is automatic for compensable injuries.* A compensable injury is defined as any injury “arising out of and in the course of employment.” The standard ensures that the injury has some close and substantial connection to the employment relationship. Courts and administrative bodies interpret the phrase very broadly because the legislation is protective in nature. Thus, if a claimant proves that his or her injury resulted from a risk related to employment, as opposed to risks incurred by the general public, compensation will be awarded. Certain issues are particularly problematic, such as the case of employees who are injured away from the workplace or by a natural phenomenon such as a tornado. The cases in the next section help to define the meaning of the formula. In the case of a preexisting condition causing the injury, such as a propensity for heart attacks, the burden of proof rests on the employee to prove that the injury

suffered was aggravated by his or her working conditions. Every state now provides coverage for occupational diseases connected with the employment, either through a broad definition of the term “injury,” or by specific provisions within the statute.

3. *Negligence is not a necessary element of recovery.* Under workers’ compensation, fault is usually irrelevant. In contrast to the common law, the worker need not prove that the employer’s negligence caused the injury in order to recover, nor, typically, will the employee’s own negligence defeat recovery. One exception to that rule is the situation in which the employee’s acts constitute misconduct that has been expressly prohibited by the employer and that is consequently outside the course of the employment. Examples might include an injury incurred while using the employer’s tools to make an item for personal use. A second exception to the no-fault principle is based on specific statutory provisions. For example, defenses to a compensation claim may include a showing of the employee’s “willful misconduct,” the violation of safety rules or positive law, self-induced intoxication, and an intentional self-injury or suicide, unless the suicide is the result of mental derangement produced by the work related injury. In most cases, nevertheless, the focus is on the source and nature of the harm, rather than on an evaluation of the parties’ conduct.
4. *The right to compensation is an exclusive remedy.* In return for a prompt and certain remedy, the worker typically surrenders his or her right to sue the employer for any injury arising out of the employment relationship. Accordingly, the workers’ compensation remedy is deemed to be “exclusive,” and the amount recoverable is the only award to which the employee is entitled. The limitation of the exclusivity concept is offset by the relative ease and efficiency of recovery. Moreover, under some statutes, employer misconduct may affect the principle of exclusive remedy and permit recovery of additional damages. Such misconduct includes intentional injury to the employee, a failure to provide safety equipment, or the employer’s willful misconduct that harms the employee. Courts may reach a similar conclusion in the absence of specific provisions when the employer personally inflicts an intentional injury on the employee, under the theory that the injury is no longer “accidental.” In

addition, exclusivity may not apply when the injury arises from the negligence of a third party outside the employment relationship, and the worker may proceed against the third party. It should also be observed that employers may be criminally liable for intentional harm to an employee, regardless of the employee's right to workers' compensation or to a civil remedy. Indeed, criminal prosecutions against employers are viewed by some scholars as a more effective means of protecting employees than the workers' compensations systems or the occupational safety and health laws.

5. *The statutory system is administered by a governmental body.* Workers' compensation is the responsibility in the first instance of a designated agency created by the state. The function of the agency is to provide prompt and efficient handling of claims for compensation by avoiding the expense and delays associated with litigation. The agency is not bound by the formalities of a judicial proceeding and can thus avoid legal technicalities about evidence and procedure. Hearing officers have substantial expertise and familiarity with the statutory provisions. Typically, once a compensable claim is filed, the claimant will become eligible for benefits in two to seven days.
6. *The employer bears the cost of providing the compensation insurance.* The employer is not permitted to deduct the cost of his workers' compensation premiums from the employee's paycheck, but must assume the initial cost of the insurance. The employer will theoretically pass the costs of the insurance along to his customers in the form of higher prices for goods and services. Likewise, employers also pass some costs on to employees in the form of lower wages, but, in contrast to Social Security, the worker does not directly participate in underwriting the scheme. The arrangement gives employers an incentive to provide a safe workplace.

B. The Benefit System

Once a compensable injury has occurred and the claimant has initiated a valid claim for compensation, the claimant may be eligible for several types of cash benefits. It should be emphasized that the primary concern of workers' compensation is the loss of earning capacity or "disability."

This concept has several dimensions that figure in the policy considerations underlying workers' compensation. The broad categories of benefits available to a worker and his or her family are discussed below.

- *Medical.* In every state an injured worker is entitled to recover for medical expenses incurred as a result of the injury. These expenses broadly include the costs of hospitalization, physician's care, and other necessary expenses, such as transportation and supplies. In addition, the employee may be entitled to rehabilitation services that will enable him or her to return to gainful employment. The medical benefits in most states are not limited either in duration or length of time, and if limited, the period can be extended by administrative decisions.
- *Disability resulting in loss of earnings.* To deal adequately with the matter of lost wages, compensation systems typically utilize a four-part scheme of classification. Benefits may be paid for disabilities within any of the following categories:
 - a. temporary partial—a disability that incapacitates a worker only in part and only for a limited time;
 - b. temporary total—a disability that prevents the worker from performing any suitable work for a definite period of time;
 - c. permanent partial—a disability that impairs the worker's earning capacity and that will continue to do so in the foreseeable future;
 - d. permanent total—a disability that prevents the worker from performing any suitable work and will continue to do so in the foreseeable future.

The amounts paid in each case will depend on the workers' earnings, the extent of disability, and the state's formula for awarding benefits. Those points are discussed more fully below. Keep in mind that the law is subject to legislative modification, so benefits can vary.

- *Scheduled benefits.* A second type of compensable claim, which is distinct from loss due to impaired earning capacity, is loss or loss of use of a member of the body. In all but seven states,

there is a scheduled award of benefits for a specified injury of this kind. The award is usually computed by an award of a fixed number of weeks of payment. Note that the awards have no necessary relationship to a given worker's capacity to perform work or to whether the worker has suffered a wage loss. For example, if a computer operator suffered the loss of a foot in a compensable injury, but returned to work shortly thereafter at the same salary, the operator nevertheless would be entitled to the scheduled award of compensation. The inconsistency is compounded when the amount of the award is based on past earnings; in this case, a high wage earner and a low wage earner receive different amounts for the identical injury.

- *Death and dependency benefits.* In addition to payments to an injured worker, the compensation system pays benefits to the worker's dependents in the event of his or her death from a work-related injury. The amounts may vary from state to state, both in terms of the maximum benefit and the duration; but most states pay benefits to a widow for life or until remarriage, and to children until they reach a specified age. In Pennsylvania, for example, the spouse and family who survive the worker are entitled to the same maximum as the deceased worker, and they receive the award throughout widow- or widowerhood and until age 18, unless disabled or a student under age 23. Most states presume the dependency of surviving spouses and children. Other persons may be entitled to benefits if they prove dependency, but in some relationships, proof of dependency does not result in entitlement. The death benefit in all states includes some payment for the expenses of funeral and burial.
- *Calculating the award.* Generally, workers' compensation statutes use a workers' "average weekly wage" (AWW) as a basis for calculating awards of benefits. This figure is derived from the actual earnings of the worker or from a wage that fairly approximates the worker's earning capacity including such items as tips, bonuses, or other related income. Once

the AWW is determined, it may be reduced to a percentage fixed by statute, such as 66 2/3%. The award may be further subject to a statutory minimum and maximum based on a statewide average weekly wage (SAWW) or some other figure. Thus, for example, a worker in Colorado who is temporarily totally disabled as a result of compensable injury will be eligible for payments amounting to 66 2/3% of the worker's average weekly wage. However, if the worker has high earnings, the award will be limited by the state maximum. That maximum is set at 91% of the state average weekly wage (SAWW), which was \$1,216 in 2010. The highest award under the statute is therefore \$801 per week. For temporary partial and permanent partial disabilities, benefits will be determined by the extent of the disability, or, if applicable, a scheduled award of benefits.

- *How workers' compensation is funded.* Workers' compensation systems are highly politicized, and states have substantial flexibility to alter benefits according to the political climate. In determining levels of benefits, the state must consider the interest of the employee in receiving adequate financial assistance, the interest of the employer in not being unduly burdened by insurance premiums, and the state's own interest in attracting and retaining business activities to provide employment for state citizens. These interests are frequently a topic of legislative and public debate, and they are especially significant in a period of intense competition among states and among the industrialized nations of the world.

C. A Case Study of “In the Course of and Arising Out of Employment”

Tolbert v. Martin Marietta Corp., 759 P.2d 17 (Colo. 1988)

[The plaintiff in this case worked for Martin Marietta. On her way to lunch, she was assaulted and raped by a custodian also employed by the company. She brought suit in federal court, claiming that the assault was not covered under the exclusive remedy provisions of Colorado workers'

compensation law and that she had a right to sue under a tort theory for injuries suffered in the incident. The Tenth Circuit Court of Appeals sent the case to the Colorado Supreme Court for an interpretation of Colorado law. The state Supreme Court held that the tort claim was barred by the exclusive remedy provision of the Colorado statute. Selections from the court's opinion follow.]

The United States Court of Appeals for the Tenth Circuit has certified to the Supreme Court of Colorado a two-part question of law pertaining to a pending federal case: Does the Workmen's Compensation Act of Colorado provide an exclusive remedy for an employee against her employer: (1) for injuries resulting from a sexual assault by a co-worker which was motivated by considerations neither personal to the injured employee nor distinctly associated with the employment; and (2) when the employee has fixed hours and place of employment in a secure facility and the injury occurred while the employee was in her building of employment, but away from her work station, on her way to lunch in the employer's cafeteria? This court has agreed to answer the interrogatory, and now responds to both parts of the question in the affirmative.

In March 1983 Deborah Tolbert was employed by Martin Marietta as an entry level professional. Arthur Martinez was a janitor, a co-employee at Martin Marietta. Tolbert was on her way to lunch in the company cafeteria on the Martin Marietta premises when she was attacked and raped by Martinez. Tolbert also filed a tort action in federal district court, alleging that Martin Marietta had negligently hired Martinez and negligently failed to keep the premises reasonably safe.

Martin Marietta filed a motion for summary judgment in federal district court raising the Colorado Workmen's Compensation Act (Act) as a complete defense. In its motion, Martin Marietta asserted that workers' compensation is Tolbert's exclusive remedy and as a result, her tort action is barred.

The Workmen's Compensation Act Provides

8-52-102. Conditions of recovery. (1) The right to the compensation provided for in articles 40 to 54 of this title, in lieu of any other liability

to any person for any personal injury or death resulting therefrom, shall obtain in all cases where the following conditions occur:

- a) Where, at the time of the injury, both employer and employee are subject to the provisions of said articles and where the employer has complied with the provisions thereof regarding insurance;
- b) Where, at the time of the injury, the employee is performing service arising out of and in the course of his employment;
- c) Where the injury or death is proximately caused by an injury or occupational disease arising out of and in the course of his employment and is not intentionally self-inflicted.

In ruling on Martin Marietta's motion for summary judgment, the federal district court held that it was "undisputed that condition (a) is met, and condition (b) does not appear to be seriously disputed." Thus, the narrow issue of law presented here is whether the injury suffered by Tolbert "arose out of and in the course of" her employment, thus meeting the third requirement.

Our response to the two-part question will determine whether recovery under the Workmen's Compensation Act is Tolbert's exclusive remedy, thereby barring her tort action in negligence. "Recovery under the Act is meant to be exclusive and to preclude employee tort actions against an employer." If we conclude that Tolbert's injury is not compensable under the Act, then her tort action against Martin Marietta is not barred.

The phrases "arising out of" and "in the course of" found in section 8-52-102(1)(c) are not synonymous, and a claimant must prove both requirements. The parties do not dispute that this incident occurred "in the course of" Tolbert's employment with Martin Marietta, so "arising out of" is the phrase at issue here.

An accident "arises out of" employment when there is a causal connection between the work conditions and the injury. For an injury to be compensable under the Act there must be a sufficient nexus between the employment and the injury. The determination of whether an employee's injuries arose out of an employment relationship depends largely on the facts presented in a particular case. "The totality of the circumstances must be examined in each case to see whether there is a sufficient nexus between the employment and the injury."

This nexus or causality requirement is subject to more than one definition. As the federal district court stated, the phrase “arising out of” has been interpreted “in a number of different ways” in various jurisdictions which “have developed different tests of causality.” The court also rested its analysis on the observation that “Colorado courts have not consistently applied any single test to determine whether an assault by a co-employee arises out of the employment relationship.” The issue becomes what test or standard to apply to this “arising out of” language of the Act.

This court has most frequently used the positional-risk or “but for” standard to define the “arising out of” language. An important and growing number of courts are accepting the full implications of the positional-risk test: An injury arises out of the employment if it would not have occurred but for the fact that the conditions and obligations of the employment placed claimant in the position where he was injured. . . .

This theory supports compensation, for example, in cases of stray bullets, roving lunatics, and other situations in which the only connection of the employment with the injury is that its obligations placed the employee in the particular place at the particular time when he was injured by some neutral force, meaning by “neutral” neither personal to the claimant nor distinctly associated with the employment.

The positional-risk test is formulated to assess whether there is a sufficient relationship between the employment and the injury to justify compensation under the Act. “Whether worker’s compensation coverage is invoked as a defense by an employer, or as the basis of a claim by an employee, the test of applicability is the same. Compensation is to be awarded, and the tort remedy is abolished, if the statute’s conditions are all met.” By reviewing the totality of the circumstances using this test, the act’s intentional or non-intentional character alone is not dispositive. Rather, the “neutral force” provides the necessary distinction between conflicts imported into the workplace from outside work, as opposed to a neutral force which would have happened to the employee who happened to be in that particular place at that particular time.

Determination of the Act’s coverage of assaults by co-workers requires the positional-risk analysis. This interpretation of the Act is supported by the rationale that “instead of being so placed by his duties as to receive the impact of a random bullet or a falling cornice, the claimant is so placed as to receive the impact of his co-worker’s personality.” Applying

the positional-risk doctrine, the test is whether the employee, in the course of her employment, was reasonably required to be at a particular place at a particular time and there met with a “neutral force,” meaning that any other person then and there present would have met with attack. The “only connection” required between the employment and the injury is that the job “placed the employee in the particular place at the particular time when she was injured by some neutral force, meaning by neutral’ neither personal to the claimant nor distinctly associated with the employment.”

Does the Workmen’s Compensation Act of Colorado provide an exclusive remedy for an employee against her employer: (1) for injuries resulting from a sexual assault by a co-worker which was motivated by considerations neither personal to the injured employee nor distinctly associated with the employment?

As to the time element, it is evident that Tolbert’s work obligations caused her to be present on the grounds of Martin Marietta. The mere fact that an employee is on lunch hour does not prohibit workers’ compensation coverage, as long as the incident occurred within a time during which the worker is employed. “Courts generally have been liberal in protecting workers during the noon hour,” as long as the worker was at a place where the worker may reasonably be, at a time during which the worker is employed, doing what he or she may reasonably do. The employee need not necessarily be engaged in the actual performance of work at the moment of injury in order to receive compensation. Tolbert was also at a place where she “may reasonably be,” on the premises of Martin Marietta during her lunch hour. Finally, she was doing what she “may reasonably do”: walking to the company cafeteria.

It arises out of the employment if it is connected with the nature, conditions, operations or incidents of the employment. . . . “No break in the employment is caused by the mere fact that the workman is ministering to his personal comforts or necessities, as by warming himself, or seeking shelter, or by leaving his work to relieve nature, or to procure drink, refreshments, food, or fresh air, or to rest in the shade.” An employee need not necessarily be engaged in the actual performance of work at the moment of the injury. Clearly, this case meets the time requirement. This

court has quoted with approval the following passage regarding preparatory acts:

“The course of employment, for employees having a fixed time and place of work, embraces a reasonable interval before and after official working hours while the employee is on the premises engaged in preparatory or incidental acts, such as washing or changing his clothes. The rule is not limited to activities that are absolutely necessary; it is sufficient if they can be said to be reasonably incidental to the work.

The “place” element requires that the injury have occurred at a place where the worker may reasonably be. “Under even the broadest rule, the but-for test, it must be emphasized that the test is not ‘but for the bare existence of the employment,’ but rather ‘but for the conditions and obligations of the employment.’” Tolbert’s presence in the Martin Marietta building where the attack took place was a direct result of her employment. “But for” the conditions and obligations of her employment with Martin Marietta—being at work on the day in question and using the cafeteria provided by her employer—Tolbert would not have been present at this particular location, traveling to the company cafeteria, which caused her to be vulnerable to her attacker. An employee walking from a work station to the employer cafeteria is certainly in a place where a worker “may reasonably be at the time.” The place requirement, therefore, is met.

The third requirement is that the injury must have been caused by a neutral force. Willful assaults upon the claimant, like injuries generally, can be divided into three categories: those that have some inherent connection with the employment, those that are inherently private, and those that are neither, and may therefore be called “neutral.”

The first category, assaults which have an inherent connection with employment, are those in which a dispute arises out of “enforced contacts” which result from the duties of the job. The second category, assaults which are inherently private, are those in which “the animosity or dispute that culminates in an assault is imported into the employment from claimant’s domestic or private life, and is not exacerbated by the employment.” Such assaults do “not arise out of the employment under any test.” It is “universally agreed” that an assault is compensable if it grew out of an argument over performance of work, possession of work tools

or equipment, delivery of a paycheck, quitting or being terminated, or mediating between quarreling co-employees. Further, even if the “subject of the dispute is unrelated to the work,” injuries are compensable if work brought the employees together and “created the relations and conditions” resulting in the dispute. Inherently private assaults typically involve disputes over spouses. Compensation is usually denied “when the fight was caused by a quarrel between the employee’s wives, when the argument was concerned with the assailant’s misconduct with another employee’s wife, or the employee’s misconduct with the assailant’s wife, and when the assault was occasioned by a remark to the co-employee’s wife.”

The third category of neutral assaults includes “assaults which are in essence equivalent to blind or irrational forces, such as attacks by lunatics, drunks, small children, and other irresponsibles; completely unexplained assaults; and assaults by mistake.” The characteristic of a neutral or unexplained assault is that “nothing connects it with the victim privately; neither can it be shown to have had a specific employment origin.” If an employee is exposed to the unexplained assault “because he is discharging his duties at that time and place,” then the injuries are generally compensable. “A minority of jurisdictions are inclined to regard the neutral category as noncompensable, for want of affirmative proof of distinctive employment risk as the cause of the harm; but a growing majority, sometimes expressly applying the positional or but-for test, make awards for such injuries when sustained in the course of employment.” Under the ‘but-for test,’ assaults by co-workers are compensable as long as they are not motivated by personal vengeance stemming from contact with the employee outside of the employment. There is a marked distinction between the holdup in which the robber says to himself, “I am going to track down Henry Davis wherever he may be and steal the gold watch which I know he has,” and the holdup in which the robber says, “I am going to rob whoever happens to be on duty as night watchman at the Consolidated Lumber Company or whoever happens to come down the dark, hidden path from the factory to the rear gate.”

The parties agree that there was no personal or private motivation for Martinez’ attack and rape of Tolbert. The rape was not directly associated with Tolbert’s employment and there was no indication that Martinez had specifically selected Tolbert as a victim. Prior to the assault, Tolbert

and Martinez “had only the slightest contacts, and those were only at Martin Marietta.” The federal district court held: “There is nothing to indicate that any other woman—whether or not a Martin employee—who happened to be in the same area at the time of the attack would not have become the victim.” The parties agree that Tolbert was not on duty when attacked; she was on her lunch hour. She was not at her assigned work place, nor was she at a place where her job expressly required her to be at that moment. Tolbert was on Martin Marietta premises walking from her work station to the employee cafeteria at the time of her assault. The parties agree that there are no facts or circumstances “tending to show that the attack was directed against [Tolbert] as opposed to any other woman who might have been present at the place and time.” The undisputed facts and circumstances surrounding this attack meet the definition of a “neutral” attack.

Does the Workmen’s Compensation Act of Colorado provide an exclusive remedy for an employee against her employer: (2) when the employee has fixed hours and place of employment in a secure facility and the injury occurred while the employee was in her building of employment, but away from her work station, on her way to lunch in the employer’s cafeteria?

The same three-part positional-risk test must be applied. The “fixed hours” aspect of Tolbert’s employment establishes that Tolbert would not have been present at this time but for the conditions and obligations of her work. Tolbert was free to leave her work area during the lunch hour, but was expected to return after lunch. In this case Tolbert stayed on her employer’s premises during lunch hour, thus meeting the time requirement.

The fact that she remained on Martin Marietta premises creates another link between the employment and the injury. Tolbert was on Martin Marietta premises walking to the employee cafeteria, which is a fringe benefit provided by Martin Marietta to its employees. These facts establish that the conditions and obligations of Tolbert’s employment caused her to be at this particular place at this time.

We recognize that [our] ruling may seem to produce an unfair result, in the respect that Tolbert is now barred from bringing a civil action against Martin Marietta. While not unmindful of the dilemma, it must be noted

that “the Workmen’s Compensation Act should be given a liberal construction because its purpose is highly remedial and beneficent.” We agree with New Jersey’s response to this issue: “Even though in this case the injured employee is resisting compensability presumably in order to obtain a larger recovery in a civil action, we are bound by the principle requiring liberal interpretation of the Workmen’s Compensation Act in order to afford a certain remedy ‘Consistency requires us to use the same legal yardstick. . . .’ In keeping with the broad underlying policies and the remedial nature of the Act, we answer both parts of the interrogatory in the affirmative.

D. A Note on Independent Contracting

There is an important distinction between an employment relationship and an independent contractor who stands in a much different legal position. If an individual is an employee, then the primary incidents of employment automatically attach to the job, including workers’ compensation and other protections discussed later. The key element in determining independent contractor status is whether the individual is under direct and detailed control while performing work. If the seller of labor exercises discretion over the methods, execution, and manner of completing the task, he or she has a contractual relationship with the buyer. Some common examples include doctors, dentists, builders, painters, and hairdressers. Conversely, an employee performs under instructions issued by the employer and can be separated from employment if the work is not satisfactory. Independent contractors are not “fired,” but can be sued for failure to satisfy the contract.

Whether an individual is an independent contractor or an employee matters to the person and to the state. The person may lose important protections if he or she is an independent contractor, and the state may lose revenues necessary to sustain vital programs such as workers’ compensation, Social Security, and unemployment insurance. The respective interests are illustrated by ongoing litigation involving FedEx, the freight carrier.

One aspect of the FedEx case has to do with a suit brought by the state of Massachusetts, alleging the company’s failure to pay appropriate employment taxes. The company argued that the affected drivers were independent contractors rather than employees, but the state asserted that by accepted legal guidelines, the drivers were actually employees.

Without admitting any liability, FedEx offered a settlement of \$3 million, and the state accepted the offer in July 2010. The settlement resolves governmental claims against the company, but legal claims by the drivers are continuing.

Drivers for FedEx in Massachusetts brought a class action suit against the company in August 2010. According to an article in Reuters news service, “The suit, which was filed in U.S. District Court in Boston and seeks class-action status, contends the degree of control FedEx exerts over its drivers—including setting rules on uniforms and equipment—amounts to an employer-employee relationship, not a customer-contractor relationship.” If drivers are designated as employees, they will have a right to unionize and engage in collective bargaining as do employees at United Parcel Service. One explanation for FedEx’s designation of drivers as independent contractors is that FedEx gains a competitive advantage in labor costs over the unionized workers at rival UPS.

The standard test for employee status is one of control. Over the years, the Internal Revenue Service has formulated a series of factors that indicate control. The following material is taken from the IRS Web site at <http://www.irs.gov/businesses/small/article/0,,id=99921,00.html>.

Independent Contractor (Self-Employed) or Employee?

It is critical that you, the business owner, correctly determine whether the individuals providing services are employees or independent contractors. Generally, you must withhold income taxes, withhold and pay Social Security and Medicare taxes, and pay unemployment tax on wages paid to an employee. You do not generally have to withhold or pay any taxes on payments to independent contractors. If you are an independent contractor and hire or subcontract work to others, you will want to review the information in this section to determine whether individuals you hire are independent contractors (subcontractors) or employees.

Facts that provide evidence of the degree of control and independence fall into three categories:

- 1. Behavioral: Does the company control or have the right to control what the worker does and how the worker does his or her job?**

Behavioral Control

Behavioral control refers to facts that show whether there is a right to direct or control how the worker does the work. A worker is an employee when the business has the right to direct and control the worker. The business does not have to actually direct or control the way the work is done—as long as the employer has the right to direct and control the work.

The behavioral control factors fall into the categories of:

- Type of instructions given
- Degree of instruction
- Evaluation systems
- Training

Types of Instructions Given

An employee is generally subject to the business's instructions about when, where, and how to work. All of the following are examples of types of instructions about how to do work.

- When and where to do the work.
- What tools or equipment to use.
- What workers to hire or to assist with the work.
- Where to purchase supplies and services.
- What work must be performed by a specified individual.
- What order or sequence to follow when performing the work.

Degree of Instruction

Degree of Instruction means that the more detailed the instructions, the more control the business exercises over the worker. More detailed instructions indicate that the worker is an employee. Less detailed instructions reflect less control, indicating that the worker is more likely an independent contractor. **Note:** The amount of instruction needed varies among different jobs. Even if no instructions are given, sufficient behavioral control may exist if the employer has the right to control how the work results are achieved. A business may lack the knowledge to instruct

some highly specialized professionals; in other cases, the task may require little or no instruction. The key consideration is whether the business has retained the right to control the details of a worker's performance or instead has given up that right.

2. Financial: Are the business aspects of the worker's job controlled by the payer? (These include things like how worker is paid, whether expenses are reimbursed, who provides tools/supplies, etc.)

Financial Control

Financial control refers to facts that show whether or not the business has the right to control the economic aspects of the worker's job.

The financial control factors fall into the categories of:

- Significant investment
- Unreimbursed expenses
- Opportunity for profit or loss
- Services available to the market
- Method of payment

Significant Investment

An independent contractor often has a significant investment in the equipment he or she uses in working for someone else. However, in many occupations, such as construction, workers spend thousands of dollars on the tools and equipment they use and are still considered to be employees. There are no precise dollar limits that must be met in order to have a significant investment. Furthermore, a significant investment is not necessary for independent contractor status as some types of work simply do not require large expenditures.

Unreimbursed Expenses

Independent contractors are more likely to have unreimbursed expenses than are employees. Fixed ongoing costs that are incurred regardless of whether work is currently being performed are especially important.

However, employees may also incur unreimbursed expenses in connection with the services that they perform for their business.

Opportunity for Profit or Loss

The opportunity to make a profit or loss is another important factor. If a worker has a significant investment in the tools and equipment used and if the worker has unreimbursed expenses, the worker has a greater opportunity to lose money (i.e., their expenses will exceed their income from the work). Having the possibility of incurring a loss indicates that the worker is an independent contractor.

Services Available to the Market

An independent contractor is generally free to seek out business opportunities. Independent contractors often advertise, maintain a visible business location, and are available to work in the relevant market.

Method of Payment

An employee is generally guaranteed a regular wage amount for an hourly, weekly, or other period of time. This usually indicates that a worker is an employee, even when the wage or salary is supplemented by a commission. An independent contractor is usually paid by a flat fee for the job. However, it is common in some professions, such as law, to pay independent contractors hourly

3. Type of Relationship: Are there written contracts or employee type benefits (i.e. pension plan, insurance, vacation pay, etc.)? Will the relationship continue and is the work performed a key aspect of the business?

Type of Relationship

Type of relationship refers to facts that show how the worker and business perceive their relationship to each other.

The factors, for the type of relationship between two parties, generally fall into the categories of:

- Written contracts
- Employee benefits
- Permanency of the relationship
- Services provided as key activity of the business

Written Contracts

Although a contract may state that the worker is an employee or an independent contractor, this is not sufficient to determine the worker's status. The IRS is not required to follow a contract stating that the worker is an independent contractor, responsible for paying his or her own self-employment tax. How the parties work together determines whether the worker is an employee or an independent contractor.

Employee Benefits

Employee benefits include things like insurance, pension plans, paid vacation, sick days, and disability insurance. Businesses generally do not grant these benefits to independent contractors. However, the lack of these types of benefits does not necessarily mean the worker is an independent contractor.

Permanency of the Relationship

If you hire a worker with the expectation that the relationship will continue indefinitely, rather than for a specific project or period, this is generally considered evidence that the intent was to create an employer-employee relationship.

Services Provided as Key Activity of the Business

If a worker provides services that are a key aspect of the business, it is more likely that the business will have the right to direct and control his

or her activities. For example, if a law firm hires an attorney, it is likely that it will present the attorney's work as its own and would have the right to control or direct that work. This would indicate an employer-employee relationship.

Businesses must weigh all these factors when determining whether a worker is an employee or independent contractor. Some factors may indicate that the worker is an employee, while other factors indicate that the worker is an independent contractor. There is no "magic" or set number of factors that "makes" the worker an employee or an independent contractor, and no one factor stands alone in making this determination. Also, factors which are relevant in one situation may not be relevant in another.

In September 2010 Senator John Kerry of Massachusetts and Representative Jim McDermott of Washington State introduced legislation to address problems associated with the definition of independent contractor. The bill, titled "The Fair Playing Field Act of 2010 (S. 3786, H. 6128)," corrected perceived weaknesses of the Internal Revenue Code, which allowed companies to avoid tax obligations. In addition to strengthening the tax code, the proposal also requires buyers of labor to disclose that an individual is classified as an independent contractor and the reasons for the classification. The bill includes the following statement of findings in Section 1(b)(4):

Many workers are properly classified as independent contractors. In other instances, workers who are employees are being treated as independent contractors. Such misclassification for tax purposes contributes to inequities in the competitive positions of businesses and to the Federal and State tax gap, and may also result in misclassification for other purposes, such as denial of unemployment benefits, workplace health and safety protections, and retirement or other benefits or protections available to employees.

To conclude, the distinction between an independent contractor and an employee is important in several respects. Employees have

rights attaching to their status, and independent contractors have rights according to their agreement. The state has an interest in the classification, because employment contributes to such programs as Social Security, unemployment insurance, and protections against injuries on the job.

Notes

1. An excellent book on the subject is Price V. Fishback and Shawn Everett Kantor, *A Prelude to the Welfare State: The Origins of Workers' Compensation* (Chicago: University of Chicago Press, 2000).
2. Anthony Balle, "Americas First Compensation Crisis: Conflict Over the Value and Meaning of Workplace Injuries Under the Employer's Liability System," in *Dying for Work: Workers Safety and Health in Twentieth Century America*, ed. David Rosner and Gerald Markowitz (Bloomington.: University of Indiana Press, 1987), pp. 34; 47–49.

CHAPTER 2

Watershed Legal Developments in Modern Employment Regulations

I. Overview of the Chapter

Prior to the 1930s, American employment law was governed by Supreme Court decisions that limited state and federal regulation in important ways. Attempted federal legislation, such as the Erdman Act discussed in Chapter 1, exceeded the constitutional powers granted to the federal government. State laws were subject to review on due process grounds; any exercise of state police powers, as in the *Lochner* case, could be overturned on the theory that the law deprived employers of their property rights. As a result, workers had little recourse against the abusive powers of corporations, and they were subject to legal persecution for engaging in organized action against employers. The onset of the Great Depression led to a transformation in our political and economic system.

The New Deal era initiated by President Franklin D. Roosevelt revolutionized employment in the United States. First, the Roosevelt administration enacted sweeping changes in the legal environment, beginning with the National Labor Relations Act and culminating with the Social Security program. The Supreme Court changed the constitutional theory articulated in its previous decisions, and settled on a rule that authorized regulation under the interstate commerce clause found in Article I of the Constitution. Following that breakthrough, the federal government could legitimately regulate all matters that affected commerce. This clause is the basis for all subsequent employment laws, such as the Civil Rights Act of 1964, and more recently, the Affordable Health Care Act passed

in 2010. One of the important debates during the New Deal addressed the reasons for the Depression and the policies that were necessary to correct the economic collapse. The debate continued in the first years of the Obama administration. We begin with an overview of the subject.

II. From the Great Depression to the Great Recession: Causes and Consequences

In late 2007 the American economy began to unravel. Financial problems sparked a global crisis in banking and credit, and the international system of exchange faced paralysis. Swift action by the Federal Reserve and the U.S. Treasury avoided a worldwide bank collapse by massive injections of liquidity and guarantees of solvency that enabled firms to continue business. In the 2010 midterm elections, the effectiveness of the stimulus and “bailout” activities became a central point of campaign debate. Critics of President Obama’s administration described the efforts as a failure that led to unsustainable expansion of the federal deficit. Other economists argued that the federal government’s intervention did not go far enough in dealing with unemployment. Nobel laureate Paul Krugman, for example, wrote in October 2010 that President Obama failed to act decisively enough in delivering economic stimulus. He said, “When Mr. Obama took office, he inherited an economy in dire straits—more dire, it seems, than he or his top economic advisers realized. They knew that America was in the midst of a severe financial crisis. But they don’t seem to have taken on board the lesson of history, which is that major financial crises are normally followed by a protracted period of very high unemployment.”¹

The severity of the 2007 collapse did not lead to the same levels of unemployment or to massive deflation as in the 1930s. Many commentators, though, viewed the event as potentially devastating as the earlier crash. Two highly regarded economists wrote in 2010, “Eighteen months ago, the global financial system was on the brink of collapse and the U.S. was suffering its worst economic downturn since the 1930s. Real GDP was falling at about a 6% annual rate, and monthly job losses averaged close to 750,000.”² They argued that the federal stimulus bills and the intervention of the Federal Reserve prevented a much more serious deterioration.

The chairman of the Federal Reserve in 2007, Ben Bernanke, received his doctoral degree in economics from Princeton University. He wrote his dissertation on the fiscal conditions underlying the Great Depression of the 1930s. Because Bernanke had a deep understanding of how the country fell into the most severe domestic crisis since the Civil War, he was able to avert another financial panic during his term in office. His decisions followed closely from the main conclusions he drew from his research on the Depression. Some three years before the onset of the Great Recession of 2008, as it has come to be called, Bernanke delivered an address at the College of William and Mary. His speech discusses the major policy elements from the Depression that appeared again in the 2008 banking crisis. Bernanke began with a survey of the nature and depth of the 1930s crisis.³ His description explains why the federal government acted in the 1930s to reverse the effects of the economic downturn.

The impact that the experience of the Depression has had on views about the role of the government in the economy is easily understood when we recall the sheer magnitude of that economic downturn. During the major contraction phase of the Depression, between 1929 and 1933, real output in the United States fell nearly 30 percent. During the same period, according to retrospective studies, the unemployment rate rose from about 3 percent to nearly 25 percent, and many of those lucky enough to have a job were able to work only part-time. For comparison, between 1973 and 1975, in what was perhaps the most severe U.S. recession of the World War II era, real output fell 3.4 percent and the unemployment rate rose from about 4 percent to about 9 percent. Other features of the 1929–33 decline included a sharp deflation—prices fell at a rate of nearly 10 percent per year during the early 1930s—as well as a plummeting stock market, widespread bank failures, and a rash of defaults and bankruptcies by businesses and households. The economy improved after Franklin D. Roosevelt’s inauguration in March 1933, but unemployment remained in the double digits for the rest of the decade, full recovery arriving only with the advent of World War II. Moreover . . . the Depression was international in scope, affecting most countries around the world not only the United States.

Bernanke went on in his speech to describe the monetary dimensions of the crash. He summarized the views of economists prior to the 1980s, who tended to focus mainly on the experience of the United States. Bernanke argued that the best way to understand what took place was to examine the problem in a global framework. He said:

To explain the current consensus on the causes of the Depression, I will first describe the debate as it existed before 1980, and then discuss how the recent focus on international aspects of the Depression and the comparative analysis of the experiences of different countries have helped to resolve that debate. I have already mentioned the sharp deflation of the price level that occurred during the contraction phase of the Depression, by far the most severe episode of deflation experienced in the United States before or since. Deflation, like inflation, tends to be closely linked to changes in the national money supply, defined as the sum of currency and bank deposits outstanding, and such was the case in the Depression. Like real output and prices, the U.S. money supply fell about one-third between 1929 and 1933, rising in subsequent years as output and prices rose.

While the fact that money, prices, and output all declined rapidly in the early years of the Depression is undeniable, the interpretation of that fact has been the subject of much controversy. Indeed, historically, much of the debate on the causes of the Great Depression has centered on the role of monetary factors, including both monetary policy and other influences on the national money supply, such as the condition of the banking system. Views have changed over time. During the Depression itself, and in several decades following, most economists argued that monetary factors were not an important cause of the Depression. For example, many observers pointed to the fact that nominal interest rates were close to zero during much of the Depression, concluding that monetary policy had been about as easy as possible yet had produced no tangible benefits to the economy. The attempt to use monetary policy to extricate an economy from a deep depression was often compared to “pushing on a string.”

During the first decades after the Depression, most economists looked to developments on the real side of the economy for

explanations, rather than to monetary factors. Some argued, for example, that overinvestment and overbuilding had taken place during the ebullient 1920s, leading to a crash when the returns on those investments proved to be less than expected. Another once-popular theory was that a chronic problem of “under-consumption”—the inability of households to purchase enough goods and services to utilize the economy’s productive capacity—had precipitated the slump.

However, in 1963, Milton Friedman and Anna J. Schwartz transformed the debate about the Great Depression. That year saw the publication of their now-classic book, *A Monetary History of the United States, 1867–1960*. The *Monetary History*, the name by which the book is instantly recognized by any macroeconomist, examined in great detail the relationship between changes in the national money stock—whether determined by conscious policy or by more impersonal forces such as changes in the banking system—and changes in national income and prices. The broader objective of the book was to understand how monetary forces had influenced the U.S. economy over a nearly a century. In the process of pursuing this general objective, however, Friedman and Schwartz offered important new evidence and arguments about the role of monetary factors in the Great Depression. In contradiction to the prevalent view of the time, that money and monetary policy played at most a purely passive role in the Depression, Friedman and Schwartz argued that “the [economic] contraction is in fact a tragic testimonial to the importance of monetary forces.”

According to Bernanke, the Federal Reserve sparked the financial downturn early in 1928 by raising interest rates and tightening the money supply. When the stock market crashed in October 1929, the proximate cause was a policy of “tight money.” What followed was a period of falling prices, rising unemployment, and political inactivity by the Hoover administration. Prominent economists, including Hoover’s treasury secretary, Andrew Mellon, thought that the Depression was a self-correcting business cycle and that the economy would stabilize when the “excess” credit was liquidated from the system. In theory, lower prices would lead

to more consumption, lower wages would enable employers to hire more labor, and production would rise. In actual fact, however, consumers hoarded cash, banks were unable to lend, and as unemployment rose, fewer people were able to purchase goods and services. Richard Posner, a federal appeals court judge and a prolific writer on economic matters, titled his recent book *A Failure of Capitalism* (2009). He showed how the experience of 1929 paralleled the crisis of 2007, except for the fact that Bernanke and others responded with the right strategies to prevent a repeat of the Great Depression. Conditions worsened through Hoover's remaining years in office.

Franklin D. Roosevelt's election in 1932 led to a series of measures generally known as the New Deal. Roosevelt initiated far-reaching economic legislation that transformed the economy. Many of the New Deal programs continue today, and will be dealt with later in this chapter; they include Social Security, unemployment insurance, and minimum wage and overtime laws. For the moment, we focus on laws that deal with unionization and collective bargaining. Labor law provided the basis for a new line of constitutional interpretation, the creation of administrative bureaucracies, and the foundation for three decades of middle-class prosperity and economic growth. That prosperity began to fade in the mid-1970s, when average real incomes became stagnant or declining until the late 1990s. They rose briefly, and then continued a downward trend through the next decade. A large body of economic research concludes that declining union membership was a significant factor in the downward wage spiral, for reasons explained below.

III. The National Labor Relations Act and Collective Bargaining Practices

A. *Background*

In 1936 the famous economist John Maynard Keynes published his best-known work on how economies function.⁴ Keynes argued that business conditions were not dynamic, and the system could not extricate itself from depression, either through low interest rates or falling prices, as was predicted by classical economic theory. Keynes said that only some

form of stimulus, such as government spending or improved consumer demand, would lead to recovery. Keynes's ideas fit closely with Roosevelt's programs. The centerpiece of Roosevelt's plan was an ambitious attempt to impose government oversight on wages and prices; the statute was known as the National Industrial Recovery Act (NIRA), and it passed in early 1933.

Prior to the New Deal, Supreme Court rulings like the *Adair* case in Chapter 1 discouraged legislators from enacting broad worker protections, which were likely to be found unconstitutional. Roosevelt believed that the federal government should have the power to act in periods of extreme crisis, and he proceeded with his comprehensive legislative scheme to restore the economy. To gain organized labor's support for the NIRA, Roosevelt invited William Green of the American Federation of Labor to participate in creating the legislation. Green wanted protections for the right to unionize, the right to negotiate, and a ban on company unions. Conceding to those demands, the Roosevelt administration inserted Section 7(a) into the NIRA. Roosevelt chose Senator Robert Wagner (D-NY) to oversee the new National Labor Board and develop a body of law implementing Section 7(a).

The Supreme Court ruled the NIRA unconstitutional in the *Schechter Poultry Company* case of 1935. The Court held that the regulation of poultry farming within the borders of New York State had no direct connection with interstate commerce. Wagner, despite the Court's ruling, continued to draft a comprehensive bill protecting the rights of workers and unions to engage in collective bargaining. He introduced the bill into the Senate in June 1935, just months after the *Schechter Poultry* decision. Wagner's theory was that the federal power to regulate interstate commerce was sufficient to allow federal oversight in the employment regime, and he proved to be correct on that point two years later. Wagner also viewed the legislation as a key element of economic recovery. Consistent with the ideas of John Maynard Keynes, Wagner thought that consumer demand was essential to economic activity, and collective bargaining would provide enough income to workers that they would be able to begin purchasing goods and services. When he introduced his legislation into the Senate in February 1935, Wagner explained how unions would contribute to the recovery. His comments are reprinted below. This

speech is a central document in the New Deal legislative effort, and a cogent policy justification for the policy of collective bargaining.

Senator Robert F. Wagner, Speech on the National Labor Relations Act (February 21, 1935). *Congressional Record*, 74th Cong., 1st sess., Vol. 79, 2371–72, reprinted in *Legislative History of the National Labor Relations Act*, vol. 1 (Govt. Printing Office, 1985), pp. 1311–15.

The recovery program has sought to bestow upon the business man and the worker a new freedom to grapple with the great economic challenges of our times. We have released the business man from the indiscriminating enforcement of the antitrust laws, which had been subjecting him to the attacks of the price cutters and wage reducers—the pirates of industry. In order to deal out the equal treatment upon which a just democratic society must rest, we at the same time guaranteed the freedom of action of the worker. In fact, the now famous section 7(a), by stating that employees should be allowed to cooperate among themselves if they desired to do so, merely restated principles that Congress has avowed for half a century.

Congress is familiar with the events of the past 2 years. While industry's freedom of action has been encouraged until the trade association movement has blanketed the entire country, employees attempting in good faith to exercise their liberties under section 7(a) have met with repeated rebuffs. It was to check this evil that the President in his wisdom created the National Labor Board in August 1933, out of which has emerged the present National Labor Relations Board.

The Board has performed a marvelous service in composing disputes and sending millions of workers back to their jobs upon terms beneficial to every interest. But it was handicapped from the beginning, and it is gradually but surely losing its effectiveness, because of the practical inability to enforce its decisions. At present it may refer its findings to the National Recovery Administration and await some action by that agency, such as the removal of the Blue Eagle. We all know that the entire

enforcement procedure of the N.R.A. is closely interlinked with the voluntary spirit of the codes. Business in the large is allowed to police itself through the code authorities. This voluntarism is without question admirable in respect to provisions for fair competition that have been written by industry and with which business is in complete accord. But it is wholly unadapted to the enforcement of a specific law of Congress which becomes a crucial issue only in those very cases where it is opposed by the guiding spirits of the code authorities. Secondly, the Board may refer a case to the Department of Justice. But since the Board has no power to subpoena records or witnesses, its hearings are largely *ex parte* and its records so infirm that the Department of Justice is usually unable to act. Finally, the existence of numerous industrial boards whose interpretations of section 7(a) are not subject to the coordinating influence of a supreme National Labor Relations Board, is creating a maze of confusion and contradictions. While there is a different code for each trade, there is only one section 7(a), and no definite law written by Congress can mean something different in each industry. These difficulties are reducing section 7(a) to a sham and a delusion.

The break-down of section 7(a) brings results equally disastrous to industry and to labor. Last summer it led to a procession of bloody and costly strikes, which in some cases swelled almost to the magnitude of national emergencies. It is not material at this time to inquire where the balance of right and wrong rested in respect to these various controversies. If it is true that employees find it difficult to remain acquiescent when they lose the main privilege promised them by the Recovery Act, it is equally true that employers are tremendously handicapped when it is impossible to determine exactly what their rights are. Everybody needs a law that is precise and certain.

There has been a second and even more serious consequence of the breakdown of section 7(a). When employees are denied the freedom to act in concert even when they desire to do so, they cannot exercise a restraining influence upon the wayward members of their own groups, and they cannot participate in our national endeavor to coordinate production and purchasing power. The consequences are already visible in the widening gap between wages and profits. If these consequences are allowed to produce their full harvest, the whole country will suffer from a new economic decline.

The national labor relations bill which I now propose is novel neither in philosophy nor in content. It creates no new substantive rights. It merely provides that employees, if they desire to do so, shall be free to organize for their mutual protection or benefit. Quite aside from section 7(a), this principle has been embodied in the Norris-LaGuardia Act, in amendments to the Railway Labor Act passed last year, and in a long train of other enactments of Congress.

There is not a scintilla of truth in the wide-spread propaganda to the effect that this bill would tend to create a so-called "labor dictatorship." It does not encourage national unionism. It does not favor any particular union. It does not display any preference toward craft or industrial organizations. Most important of all, it does not force or even counsel any employee to join any union if he prefers to deal directly or individually with his employers. It seeks merely to make the worker a free man in the economic as well as the political field. Certainly the preservation of long-recognized fundamental rights is the only basis for frank and friendly relations in industry.

The erroneous impression that the bill expresses a bias for some particular form of union organization probably arises because it outlaws the company-dominated union. Let me emphasize that nothing in the measure discourages employees from uniting on an independent- or company-union basis, if by these terms we mean simply an organization confined to the limits of one plant or one employer. Nothing in the bill prevents employers from maintaining free and direct relations with their workers or from participating in group insurance, mutual welfare, pension systems, and other such activities. The only prohibition is against the sham or dummy union which is dominated by the employer, which is supported by the employers, which cannot change its rules or regulations without his consent, and which cannot live except by the grace of the employer's whims. To say that that kind of a union must be preserved in order to give employees freedom of selection is a contradiction in terms. There can be no freedom in an atmosphere of bondage. No organization can be free to represent the workers when it is the mere creature of the employer.

Equally erroneous is the belief that the bill creates a closed shop for all industry. It does not force any employer to make a closed-shop agreement.

It does not even state that Congress favors the policy of the closed shop. It merely provides that employers and employees may voluntarily make closed-shop agreements in any State where they are now legal. Far from suggesting a change, it merely preserves the status quo.

A great deal of interest centers around the question of majority rule. The national labor relations bill provides that representatives selected by the majority of employees in an appropriate unit shall represent all the employees within that unit for the purposes of collective bargaining. This does not imply that an employee who is not a member of the majority group can be forced to enter the union which the majority favors. It means simply that the majority may decide who are to be the spokesmen for all in making agreements concerning wages, hours, and other conditions of employment. Once such agreements are made the bill provides that their terms must be applied without favor or discrimination to all employees. These provisions conform to the democratic procedure that is followed in every business and in our governmental life, and that was embodied by Congress in the Railway Labor Act last year. Without them the phrase "collective bargaining" is devoid of meaning, and the very few unfair employers are encouraged to divide their workers against themselves.

Finally, the National Labor Relations Board is established permanently, with jurisdiction over other boards dealing with cases under section 7(a) or under its equivalent as written into this bill. Nothing could be more unfounded than the charges that the Board would be invested with arbitrary or dictatorial or even unusual powers. Its powers are modeled upon those of the Federal Trade Commission and numerous other governmental agencies. Its orders would be enforceable not by the Board, but by recourse to the courts of the United States, with every affected party entitled to all the safeguards of appeal.

The enactment of this measure will clarify the industrial atmosphere and reduce the likelihood of another conflagration of strife such as we witnessed last summer. It will stabilize and improve business by laying the foundations for the amity and fair dealing upon which permanent progress must rest. It will give notice to all that the solemn pledge made by Congress when it enacted section 7(a) cannot be ignored with impunity, and that a cardinal principle of the new deal for all and not some of our people is going to be supported and preserved by the government.

B. The Structure of the Wagner Act

Wagner's vision for workers began with the fundamental proposition that employers should have no control over the preferences of employees as to unionization. The so-called "company unions" of the time were not strong enough to bargain effectively for employees in place of independent trade unions. If a union representative was selected according to NLRA procedures, that representative had a right to bargain for all employees covered in the unit, regardless of whether the employee had favored representation. Finally, unions had a right to compel all employees covered under an agreement to provide financial support in the form of union dues. Those three elements are the crucial features of the law, and they continue to be central in understanding the statute.⁵ Along with a broad statement of principles, Wagner enumerated five unfair labor practices, which employers were prohibited from engaging in. To enforce the law, the Wagner Act created the National Labor Relations Board, which still serves today as the administrative body responsible for protecting workers' rights. We begin by examining the policy and findings of the Act, reprinted below.

1. Findings and Policies of the National Labor Relations Act

NATIONAL LABOR RELATIONS ACT

Also cited NLRA or the Act; 29 U.S.C. §§ 151–169

FINDINGS AND POLICIES

Section 1§151.] The denial by some employers of the right of employees to organize and the refusal by some employers to accept the procedure of collective bargaining lead to strikes and other forms of industrial strife or unrest, which have the intent or the necessary effect of burdening or obstructing commerce by (a) impairing the efficiency, safety, or operation of the instrumentalities of commerce; (b) occurring in the current of commerce; (c) materially affecting, restraining, or controlling the flow of raw materials or manufactured or processed goods from or into the channels of commerce, or the prices of such materials or goods in commerce; or (d) causing diminution of employment and wages in such volume as substantially to impair or disrupt the market for goods flowing from or into the channels of commerce.

The inequality of bargaining power between employees who do not possess full freedom of association or actual liberty of contract and employers who are organized in the corporate or other forms of ownership association substantially burdens and affects the flow of commerce, and tends to aggravate recurrent business depressions, by depressing wage rates and the purchasing power of wage earners in industry and by preventing the stabilization of competitive wage rates and working conditions within and between industries.

Experience has proved that protection by law of the right of employees to organize and bargain collectively safeguards commerce from injury, impairment, or interruption, and promotes the flow of commerce by removing certain recognized sources of industrial strife and unrest, by encouraging practices fundamental to the friendly adjustment of industrial disputes arising out of differences as to wages, hours, or other working conditions, and by restoring equality of bargaining power between employers and employees.

Experience has further demonstrated that certain practices by some labor organizations, their officers, and members have the intent or the necessary effect of burdening or obstructing commerce by preventing the free flow of goods in such commerce through strikes and other forms of industrial unrest or through concerted activities which impair the interest of the public in the free flow of such commerce. The elimination of such practices is a necessary condition to the assurance of the rights herein guaranteed.

It is declared to be the policy of the United States to eliminate the causes of certain substantial obstructions to the free flow of commerce and to mitigate and eliminate these obstructions when they have occurred by encouraging the practice and procedure of collective bargaining and by protecting the exercise by workers of full freedom of association, self-organization, and designation of representatives of their own choosing, for the purpose of negotiating the terms and conditions of their employment or other mutual aid or protection.

2. Unfair Labor Practices

The original Wagner Act prohibited only certain activities by employers. Wagner said that his bill was intended to aid unions and workers;

consequently, he was not concerned about ways in which unions should be regulated. When the NLRA was modified in 1947 by a Republican Congress in the Taft-Hartley Act, a series of union unfair labor practices was inserted into the law. As a result, the law now consists of sections 8(a) 1–5, and 8(b)1–7. Each of the unfair practices is summarized in the table below.

Employer ULPs	Prohibited acts	Union ULPS	Prohibited acts
Section 8(a)(1)	Unlawful to interfere with or coerce employees in the exercise of their rights	Section 8(b)(1)	Unlawful to coerce or restrain employees in the exercise of their rights
Section 8(a)(2)	Unlawful to control or dominate an entity which represents employees (“company union”)	Section 8(b)(2)	Unlawful to cause employer to discriminate against an employee, except for required union dues
Section 8(a)(3)	Unlawful to discriminate against an employee to encourage or discourage union activity—except to pay union dues under the labor contract	Section 8(b)(3)	Unlawful to refuse to bargain with an employer
Section 8(a)(4)	Unlawful to retaliate against an employee who participates in NLRB proceedings	Section 8(b)(4)	Unlawful to engage in specified “secondary” activities involving a neutral party
Section 8(a)(5)	Unlawful to refuse to bargain with a certified representative	Section 8(b)(5)	Unlawful to charge excessive dues or fees
		Section 8(b)(6)	Unlawful to require employer to pay for services not performed or not to be performed
		Section 8(b)(7)	Unlawful to engage in certain types of picketing

The National Labor Relations Board has established procedures for adjudicating unfair labor practice charges. Charges may be filed against the union or the employer. The NLRB has field investigators who will take up the charge and determine whether it is supported by some evidence. If it is, then the Board will commence a proceeding before an Administrative Law Judge (ALJ). The ALJ is an independent judge who serves outside the direct control of the Board. The judge convenes a hearing, takes evidence, and applies the appropriate law. If the charged party is found to be in violation, the judge will order a remedy. Neither the Board nor the ALJ has the power to compel enforcement of an order; instead, the Board will take the case to a federal court and request enforcement. At that point, the charged party can argue the entire case again before the court and try to get the Board's decision reversed. Occasionally the federal judge will set aside the Board's order because the Board was incorrect about the law, or the evidence clearly does not support the order.

These rules can be illustrated with a simple fact pattern that shows how the law can be strategically used to a party's (usually the employer's) advantage. Assume a union tries to organize a company's employees. During that process, described more fully below, the employer singles out the pro-union employees and fires them. The remaining employees decide they want nothing more to do with the union. The union can file charges against the employer, and the Board will investigate, conduct a hearing, and issue a decision ordering reinstatement of the employees. The employer then appeals to the full five-member NLRB in Washington, D.C. Most likely the NLRB will uphold the ALJ decision and confirm the order of reinstatement. The employer refuses to comply, and the Board files in federal court for enforcement. The judge upholds the Board's order. At this point, the employer may be liable for reinstatement and back pay to the fired employees. In the meantime, between three and four years have passed. The discharged employees probably have new jobs, so back pay is not significant. They most likely are not interested in going back to their old place of employment. Employees at the company have lost their desire to unionize. In short, the employer's unlawful act had a number of beneficial outcomes for the employer. Most labor law experts acknowledge the weaknesses of the NLRA, but it is difficult to make substantive changes in the law. The most recent attempt is discussed later.

3. Union Organizing: Election Procedures and Certification of a Representative

The second major function of the NLRB is to conduct elections to determine if a group of employees wants union representation. Sketched briefly, a union decides that a workplace is suitable for an organizing attempt. The union first recruits sympathetic employees for an in-plant committee. The employees have certain rights inside the workplace and cannot be discriminated against for their union support. These employees try to collect “authorization cards” from their fellow workers. The cards indicate that the signer wants the union to represent him or her for purposes of bargaining. Once the union has enough cards to make a “showing of interest,” the union files a petition, asking the Board to hold an election. The Board decides on a time, day, and place—usually the place of employment—and the parties then begin to campaign. There are a number of rules regulating the campaign process, but the overall objective is to maintain “laboratory conditions,” under which employees can vote free from coercion and undue influence. After the balloting closes, the Board counts the vote and declares a winner. If the union wins, it has the legal right to demand negotiations for a labor agreement. The union’s goal is to gain a contract setting forth wages, hours, and working conditions.

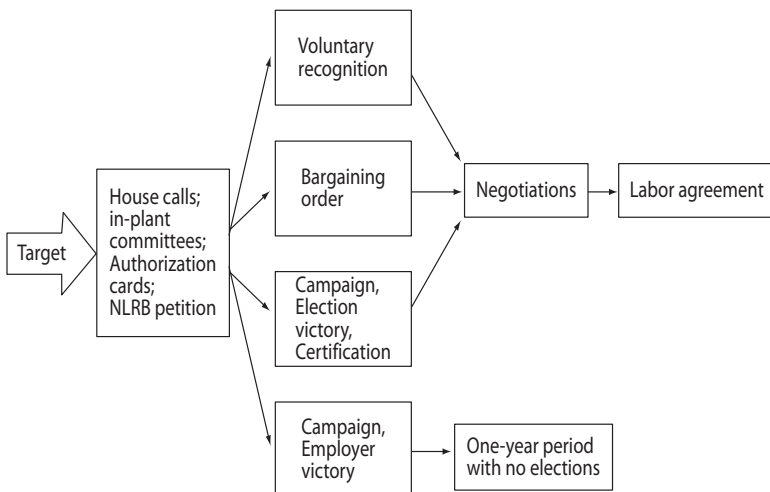


Figure 1 Aspects of the Union Organizing Process

The contract typically has an arbitration clause to enforce the terms of the document. The union collects dues from the employees to pay the costs of representation and maintain the bargaining unit. The figure summarizes the various steps in the process.

4. Unions from the Wagner Act to the Employee Free Choice Act

As Robert Wagner insisted, his bill was designed to protect workers and promote the interests of unions. Most employers in 1935 thought the law would be declared unconstitutional, and they decided not to vigorously oppose the bill in Congress. As a result, the Wagner Act passed fairly quickly and was signed into law. Unions made massive gains in organizing, despite the uncertain legal environment and employer resistance. The foundation was laid in October 1936, when John L. Lewis and several other union leaders formed the Congress of Industrial Organizations (CIO). The organization's objective was to organize the mass production workers that the American Federation of Labor tended to ignore. Lewis's first success came at General Motors, where the CIO led a sit-down strike that paralyzed the company and forced it to recognize and deal with the union. Shortly thereafter, Lewis convinced the United States Steel Corporation to sign a labor agreement. Within two years of the Wagner Act, major sectors of the economy had been organized, and collective bargaining established basic workplace standards going into the future. The Supreme Court in 1937 upheld the NLRA as a constitutional exercise of the federal power to regulate interstate commerce.

America entered World War II in 1941 when the Japanese attacked Pearl Harbor in Hawaii. President Roosevelt created the National War Labor Board to administer industrial relations during the conflict, and the NWLB helped to sustain union membership by means of "maintenance of membership" clauses, which required anyone belonging to the union at the beginning of a contract to remain a member until the contract expired. In exchange, the major national unions agreed not to strike and disrupt the production of war materials. Unions emerged from the war period in a strong position to demand improved wages and benefits; their major achievement came with the "Treaty of Detroit" in 1951, when the United Autoworkers negotiated an agreement that formed the

institutional basis of American employment relations. It also, as two well-known economists explained, made up the “Golden Age” of economic development between 1947 and 1973. They said, “A central feature of that Golden Age was mass upward mobility: individuals saw sharply rising incomes through much of their career and each successive generation was living better than the last.”⁶ What happened next was a trajectory of stagnant real wages for most workers and an increased accretion of wealth for the top one percent of income holders. In their recent book on American politics, Jacob S. Hacker and Paul Pierson attribute much of the rise in wealth for the already rich to a decline in the institutional role played by labor unions.⁷ The chart below illustrates the loss in membership density over the period. Particularly important is the deterioration of collective bargaining in the private sector, where unions played a major role in determining wage and compensation patterns.

Why did unions sharply decline from the mid-1970s forward? One explanation is that employers in the United States never accepted unions as a legitimate institution in this country. After the Supreme Court upheld the Wagner Act in 1937, employers waged intense political battles against labor on both the state and federal levels. Several states passed laws during the war that were aggressively directed to undermine unions. Colorado’s Labor Peace Act of 1943 illustrated the depth and intensity of antiunion sentiment, and that law provided a model for the 1947 Taft-Hartley amendments to the Wagner Act.⁸ The new modifications to the NLRA included Section 14(b), which permitted states to prohibit union security agreements that forced anyone covered by the contract to pay union dues. The legislation is known as “right to work,” and such laws are now in effect in 22 states, primarily in the south and west. According to some research, the presence of right-to-work laws is the most significant factor in union decline.⁹ Other labor relations experts argue that weak and ineffective labor laws are the primary culprit in falling union density. On this view, employers engage in unlawful tactics to discourage union organizing, and the law lacks effective remedies to protect workers. The result is a downward trend, in which weakened unions confront more powerful employers and employees are discouraged from collective action.

Organized labor attempted during President Carter's administration (1976–1980) to change the legal environment to its advantage. The Labor Reform Act of 1977 proposed to increase the membership of the National Labor Relations Board from five to seven members to expedite elections and decision making. It also substantially increased the monetary consequences of employer unfair acts, and it provided for a means of arbitration to resolve impasses in bargaining. The legislation passed in the House of Representatives, and Carter indicated he would sign the bill. Opponents in the Senate mounted a filibuster. Despite numerous attempts to bring the bill for a vote, it died as a consequence of Senate rules. Labor leaders declared that they had been betrayed by business.

When Barack Obama was elected president in 2008, he had the unanimous approval of labor organizations. Obama had expressed support for new labor legislation in 2007 known as the Employee Free Choice Act (EFCA). The bill proposed unionization through “card check certification,” or approval of a union based on signed cards from employees. Like the Labor Reform Act, EFCA also increased penalties for illegal activities by employers and included a means of impasse resolution through binding arbitration. EFCA never came forward in the next legislative session, because the Obama administration faced daunting economic problems along with the reform of the health care system. Ongoing criticism of EFCA indicated that there would be little chance of successful enactment, and after the 2010 midterm election cycle in which Republicans took control of the House, EFCA appeared to have no chance of passage in the foreseeable future.

Most likely, organized labor will continue to lose power and influence in the American economy. That outcome may be disadvantageous for many Americans. Unions were the main source of bargaining strength for workers generally, and to the extent they stabilized or increased wages and fringe benefits for their members, they helped to sustain the institutional basis of American employment relations. With little effective resistance to corporate power, workers have scant means of maintaining incomes and other forms of economic security. The environment is not likely to change for years into the future.

5. Public Sector Unionism

Section 2(2) of the Wagner Act excludes governments from the definition of an “employer” covered by the law. This section provides that the term employer “shall not include the United States or any wholly owned Government corporation, or any Federal Reserve Bank, or any State or political subdivision thereof, or any person subject to the Railway Labor Act. . . .” The reasons for not giving public employees the same rights as private sector employees are both practical and constitutional. In practical terms, public employees worked for a sovereign authority and were paid by the citizens of the governmental unit; consequently, they were historically regarded as a special type of employee. At the constitutional level, Wagner believed that the federal government could not dictate to state and local governments how they should organize their employment relations. As a result, government workers were not and still are not subject to federal collective bargaining laws. Those employees may have rights under federal, state, and local laws, and many of them are covered by union contracts. In fact, union density in the public sector is now substantially higher than in the private sector. The figure below shows total, private, and public union density levels from 1950 to 2010.¹⁰

Federal employees bargain under the Civil Service Reform Act (CSRA), which was enacted in 1978 during the Carter Administration. It protects rights to organize, to bargain over a limited scope of subjects, and

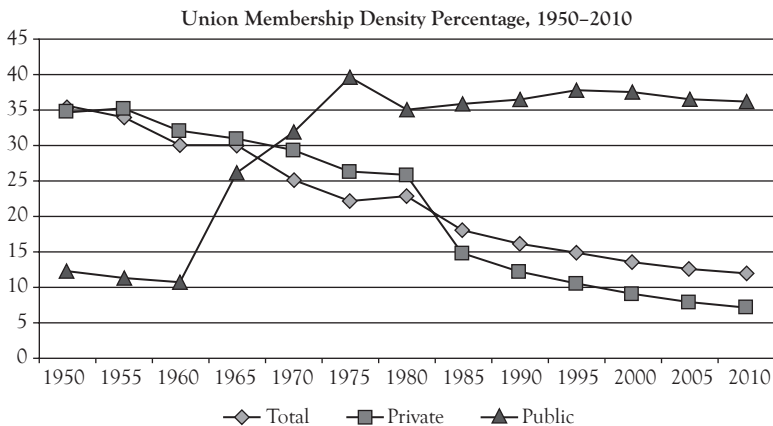


Figure 2 Trends in Union Membership

to enter into contracts. The Federal Labor Relations Authority (FLRA) enforces the provisions of the CSRA, and functions similarly to the National Labor Relations Board. It has authority to adjudicate unfair labor practices, to certify bargaining units, and to resolve disputes in negotiations between the parties. Federal employees generally have no right to bargain over wages and compensation, and they cannot legally strike. When members of the Professional Air Traffic Controllers Organization (PATCO) attempted a work stoppage in 1981, President Ronald Reagan fired them and kept air traffic in operation using supervisors, military personnel, and nonstrikers. Members of the American Postal Workers Union bargain under the National Labor Relations Act, except they are forbidden to strike and can use interest arbitration to resolve bargaining impasses.¹¹

State and local governments can enact their own laws dealing with union organization, and a majority of states have done so. A number of states permit strikes by nonessential workers, usually those not involved in public safety. Where strikes are banned, binding interest arbitration or some nonbinding alternative, such as mediation, may be used to settle bargaining disputes. Each option has weaknesses, and there is no consensus among lawmakers about the best method for allowing employees to unionize while protecting the public interest in levels of service and taxation. The legal environment for public unions became increasingly favorable during the 1960s, when union membership surged dramatically. Following the inflationary spike in the late 1970s and President Reagan's confrontation with PATCO, public sector unionism stabilized at levels significantly above private sector density.

The economic concerns that dominated the 2010 Congressional elections provoked sharp attacks on the "excessive" wages and benefits conferred on public workers. This line of argument focused on the budget problems confronting state and local governments and proposed that employee compensation, particularly for unionized workers, was a major factor in the fiscal shortfalls. To address the issue, legislatures debated ways to restrict the power of unions. According to an article in the *New York Times* in January 2011, "Faced with growing budget deficits and restive taxpayers, elected officials from Maine to Alabama, Ohio to Arizona, are pushing new legislation to limit the power of labor unions, particularly

those representing government workers, in collective bargaining and politics.”¹² *The Economist* magazine featured a cover story on public sector unions, and documented the fact that public workers’ compensation gains exceeded those of private sector workers over the past three decades.¹³ Much of the increase in labor costs is associated with defined benefit pension plans, which public employers continue to provide even though most private employers offer only defined contribution retirement plans. Most importantly, the article points out, public workers exercise substantial political power over the officials who oversee their work. The impending confrontation between unions and political forces will undoubtedly affect the labor relations climate for years to come.

IV. Wage and Hour Laws

The Fair Labor Standards Act of 1938 placed a floor under wages and a ceiling on hours of work. Current law establishes a minimum wage for covered employment and requires the payment of a wage premium for hours of work over forty in a work week. There are a number of issues associated with the FLSA, including the proper level of minimum wage, the definition of exempt and nonexempt employees, and categories of employees excluded from coverage. The FLSA was amended in 1963 to include the Equal Pay Act (EPA). This law requires that women receive equal pay for performing work equal to that of men. Congress recently overturned a Supreme Court decision interpreting the EPA, and pending legislation proposes to broaden the protections under the EPA. This section deals first with minimum wage and overtime issues and then turns to the matter of compensation discrimination.

An important policy dimension of the FLSA involves the question of whether a minimum wage will result in less overall employment. The economic argument turns on the neoclassical assumption that markets will use less labor if the cost of labor increases. This basic principle leads some theorists to assert that the proper level of a minimum wage is zero. Researchers have devoted considerable effort to this problem, and the evidence is mixed. In one famous study by economists David Card and Alan Krueger, the authors found that an increase in the minimum wage in New Jersey did not result in higher unemployment compared to

Pennsylvania, which maintained its minimum wage at the same level.¹⁴ Economists continue to debate the Card-Krueger study, but one fairly clear conclusion is that no definitive evidence shows that raising minimum wages reduces employment. As Card and Krueger summarized in a response to critiques of their work, “The increase in New Jersey’s minimum wage probably had no effect on total employment in New Jersey’s fast-food industry, and possibly had a small positive effect.”¹⁵

A. Scope, Application, and Exemptions from Wage and Overtime Requirements

The FLSA had the same purpose as other New Deal economic legislation, which was to stabilize employment and provide the means for consumers to actively participate in commercial activity. By ensuring some level of income for work, it put a floor under labor markets. By discouraging long hours of work, it motivated employers to efficiently manage their workforce and maintain adequate levels of employment. Over the years, the minimum wage has fluctuated in terms of purchasing power because Congress must take action to raise the wage. If political forces are mobilized in favor of an increase, as during President Clinton’s second term, the wage rises by whatever amount is specified. In 2011, the minimum wage is \$7.25 per hour for covered workers. No further increases are scheduled.

The standard for coverage of the FLSA is a connection with interstate commerce. Congress intended by the law to regulate economic dealings across state lines and to prevent unfair competition through low wages. The U.S. Supreme Court upheld the law in the case of *United States v. Darby Lumber Co.* (1941). In this opinion, the Court discussed the Tenth Amendment, and explained that the federal government can regulate any activity that is encompassed in Article I of the Constitution; all the Tenth Amendment did was to express the truism that power not granted to the federal government is reserved to the states or the people. Because interstate commerce was ruled in *Gibbons v. Ogden* (1824) to be “plenary” and all-inclusive of economic activities, there was no limitation on that power under the FLSA. As Chief Justice John Marshall wrote in the 1824 case, “The wisdom and the discretion of Congress, their identity with the people, and the influence which their constituents possess at elections

are, in this, as in many other instances, as that, for example, of declaring war, the sole restraints on which they have relied, to secure them from its abuse. They are the restraints on which the people must often rely solely, in all representative governments.” In short, if Congress has extended its power too far under the commerce clause, the remedy is for citizens to change Congress, not for the Supreme Court to change the law.

According to the Wage and Hour Division of the Department of Labor, here are the major criteria to determine coverage of the law:

All employees of certain enterprises having workers engaged in interstate commerce, producing goods for interstate commerce, or handling, selling, or otherwise working on goods or materials that have been moved in or produced for such commerce by any person, are covered by FLSA.

A covered enterprise is the related activities performed through unified operation or common control by any person or persons for a common business purpose and:

1. whose annual gross volume of sales made or business done is not less than \$500,000 (exclusive of excise taxes at the retail level that are separately stated); or
2. is engaged in the operation of a hospital, an institution primarily engaged in the care of the sick, the aged, or the mentally ill who reside on the premises; a school for mentally or physically disabled or gifted children; a preschool, an elementary or secondary school, or an institution of higher education (whether operated for profit or not for profit); or
3. is an activity of a public agency.

Domestic service workers such as day workers, housekeepers, chauffeurs, cooks, or full-time babysitters are covered if:

1. their cash wages from one employer in calendar year 2010 are at least \$ 1,700 (this calendar year threshold is adjusted by the Social Security Administration each year); or
2. they work a total of more than 8 hours a week for one or more employers.

Although the law is broad in coverage, there are a number of exceptions regarding workers who may not fall under the minimum wage and overtime requirements. For employers, it is important to classify correctly those persons who can work overtime without extra compensation and are not subject to minimum wage laws. They are known as *exempt* employees, and they make up a category of workers who are typically regarded as “white collar,” as opposed to “blue” or “pink” collar workers. The FLSA defines the exemption in the categories of executive, administrative, professional, computer expert, and outside sales employees as follows:

To qualify for the executive employee exemption, all of the following tests must be met:

- The employee must be compensated on a salary basis (as defined in the regulations) at a rate not less than \$455 per week;
- The employee’s primary duty must be managing the enterprise, or managing a customarily recognized department or subdivision of the enterprise;
- The employee must customarily and regularly direct the work of at least two or more other full-time employees or their equivalent; and
- The employee must have the authority to hire or fire other employees, or the employee’s suggestions and recommendations as to the hiring, firing, advancement, promotion or any other change of status of other employees must be given particular weight.

To qualify for the administrative employee exemption, all of the following tests must be met:

- The employee must be compensated on a salary or fee basis (as defined in the regulations) at a rate not less than \$455 per week;
- The employee’s primary duty must be the performance of office or non-manual work directly related to the management or general business operations of the employer or the employer’s customers; and

- The employee's primary duty includes the exercise of discretion and independent judgment with respect to matters of significance.

To qualify for the learned professional employee exemption, all of the following tests must be met:

- The employee must be compensated on a salary or fee basis (as defined in the regulations) at a rate not less than \$455 per week;
- The employee's primary duty must be the performance of work requiring advanced knowledge, defined as work which is predominantly intellectual in character and which includes work requiring the consistent exercise of discretion and judgment;
- The advanced knowledge must be in a field of science or learning; and
- The advanced knowledge must be customarily acquired by a prolonged course of specialized intellectual instruction.

To qualify for the creative professional employee exemption, all of the following tests must be met:

- The employee must be compensated on a salary or fee basis (as defined in the regulations) at a rate not less than \$455 per week;
- The employee's primary duty must be the performance of work requiring invention, imagination, originality, or talent in a recognized field of artistic or creative endeavor.

To qualify for the computer employee exemption, the following tests must be met:

- The employee must be compensated either on a salary or fee basis (as defined in the regulations) at a rate not less than \$455 per week or, if compensated on an hourly basis, at a rate not less than \$27.63 an hour;

- The employee must be employed as a computer systems analyst, computer programmer, software engineer or other similarly skilled worker in the computer field performing the duties described below;
- The employee's primary duty must consist of:
 1. The application of systems analysis techniques and procedures, including consulting with users, to determine hardware, software or system functional specifications;
 2. The design, development, documentation, analysis, creation, testing or modification of computer systems or programs, including prototypes, based on and related to user or system design specifications;
 3. The design, documentation, testing, creation or modification of computer programs related to machine operating systems; or
 4. A combination of the aforementioned duties, the performance of which requires the same level of skills.

To qualify for the outside sales employee exemption, all of the following tests must be met:

- The employee's primary duty must be making sales (as defined in the FLSA), or obtaining orders or contracts for services or for the use of facilities for which a consideration will be paid by the client or customer; and
- The employee must be customarily and regularly engaged away from the employer's place or places of business.

There are special provisions for police and fire personnel. The "work period" for overtime may be extended for up to 28 days, and the measuring period in hours depends on whether the employee works as a police or fire officer. The FLSA also contains a special provision for compensatory time off for specified public employees. According to the interpretation, "Under certain prescribed conditions, a State or local government agency may give compensatory time at a rate of not less than one and one-half hours

for each overtime hour worked, in lieu of cash overtime compensation. Employees engaged in police and fire protection work may accrue up to 480 hours of compensatory time.”

Other special cases under the FLSA include tipped employees and interns. Tipped employees may have their minimum wage offset by an amount that reflects earnings from tips. According to the Wage and Hour Division, “Tipped employees are those who customarily and regularly receive more than \$30 a month in tips. Tips actually received by tipped employees may be counted as wages for purposes of the FLSA, but the employer must pay not less than \$2.13 an hour in direct wages.” The employee’s total pay from tips and wages must be at least as much as the minimum wage, and the employer may be required to provide records of tips. In some cases, the tipped employee may enter into a tip pooling arrangement with other employees. The law specifically limits the persons who may participate in those agreements. The Wage and Hour fact sheet states, “Tipped employees may not be required to share their tips with employees who have not customarily and regularly participated in tip pooling arrangements, such as dishwashers, cooks, chefs, and janitors. Only those tips that are in excess of tips used for the tip credit may be taken for a pool.” State laws may also regulate tip pooling. A group of baristas employed by Starbucks in California brought a class action claiming they were required to share tips with supervisors; the plaintiffs lost in the appeals court because the California law applied to tips given to individual employees rather than a “team” as a whole.¹⁶

With regard to interns, the Wage and Hour Division recognizes that some individuals may perform services in an organization, but do not fall under the minimum wage standards. The reason for this classification has to do with the difference between an employment relationship and a process of allowing individuals to learn about a business or occupation. The Department of Labor uses a series of factors to determine whether a person is, or is not, an employee subject to the FLSA. The primary criteria for creating an internship rather than employment are listed below:

- the training is similar to vocational school or higher education
- training benefits the trainee

- no regular employee is displaced and trainee works under close supervision
- there is no advantage to employer
- no expectation of job at end
- there is an understanding wages will not be paid

If these factors are satisfied, the intern can engage in any activities related to the assignment without falling under the minimum wage and overtime provisions.

The FLSA also regulates the employment of children under a certain age in certain occupations regarded as hazardous. The Wage Hour Division undertook a revision of child labor rules and published a final rule that became effective July 19, 2010. The Division explained that this is the first major attempt to modernize its child labor regulations in three decades, and it takes into account changes in work environments that ensure a worker's safety and confirms that some occupations are not safe for children. For example, the new rule permits persons under 16 years of age to work as lifeguards at a swimming facility, but "prohibits anyone under 16 from working as a dispatcher on elevated water slides or as a lifeguard at natural environment swimming facilities (lakes, rivers, ocean beaches, quarries, piers)." A comparison of the old and new rules is available at <http://www.dol.gov/whd/cl/SidebySideReg3FinalRule.htm>.

B. Integrating State and Federal Laws

States have legal authority to enact laws that go beyond the basic FLSA requirements, and many states have done so. The map below shows which states exceed the federal standards. In any case, the federal law applies to workers falling within its coverage, and employers in states with no minimum wage laws must comply with the national requirements. Many states have wage and hour laws that are specific to those states. Employers consequently must stay informed about both federal and state laws. To illustrate, Wal-Mart has paid out substantial damages in cases brought under state law. A class action in Minnesota cost the company "\$54.25 million to settle a class-action lawsuit that alleged the discount giant cut workers' break time and didn't prevent employees

from working off the clock in Minnesota.” Other class-action suits likewise resulted in verdicts against the company for millions of dollars. “In Pennsylvania, workers won a \$78.5 million judgment in 2006 for working off the clock and through rest breaks, and the company was hit with a \$172 million verdict in California in 2005 for illegally denying lunch breaks.” Another settlement in Colorado amounted to \$50 million for alleged violations of state law¹⁷ Consequently, it is important to have knowledge of and comply with all applicable laws, whether state or federal. For a convenient summary of laws, the following Web site contains links to relevant legislation: <http://www.eliinc.com/programs-solutions/wage-and-hour-FLSA-50statecomparison.cfm>.

C. *The Equal Pay Act*

In 1963 Congress decided that employers should be prohibited from paying women workers less than men who were doing identical work. Toward that objective, Congress enacted section 6(d) as an amendment to the FLSA. This law is narrow in application, and requires the woman to prove that the work is the same as that done by a man—and not merely similar in nature. There are also four statutory defenses to an equal pay claim. Below is the text of the statute:

No employer having employees subject to any provisions of this section shall discriminate, within any establishment in which such employees are employed, between employees on the basis of sex by paying wages to employees in such establishment at a rate less than the rate at which he pays wages to employees of the opposite sex in such establishment for equal work on jobs the performance of which requires equal skill, effort, and responsibility, and which are performed under similar working conditions, except where such payment is made pursuant to (i) a seniority system; (ii) a merit system; (iii) a system which measures earnings by quantity or quality of production; or (iv) a differential based on any other factor other than sex: *Provided*, That an employer who is paying a wage rate differential in violation of this subsection shall not, in order to comply with the provisions of this subsection, reduce the wage rate of any employee.

The defenses are based on seniority, merit, quality or quantity of production, and a general provision allowing for differences based on any other factor, except sex. Employers can maintain a compensation system that incorporates common methods of evaluation, such as time on the job, performance, a bonus system, or some other measure. In addition, compensation that adjusts for labor market conditions satisfies the criterion as a factor “other than sex.”

Consider a common example. In a university setting, more women tend to be employed as faculty in liberal arts colleges. More men tend to teach in schools of engineering. All faculty do essentially the same job of instructing college students, and the women professors may, in fact, spend more time doing research, interacting with students, and grading student work. The engineers tend to have significantly higher salaries than the liberal arts teachers. Is this a violation of the equal pay act? Or would it be a violation of the Civil Rights Act, which prohibits discrimination based on gender? The answer is that it violates neither.

When a similar case arose in 1985, the Ninth Circuit Court of Appeals rejected the argument that the state of Washington unlawfully

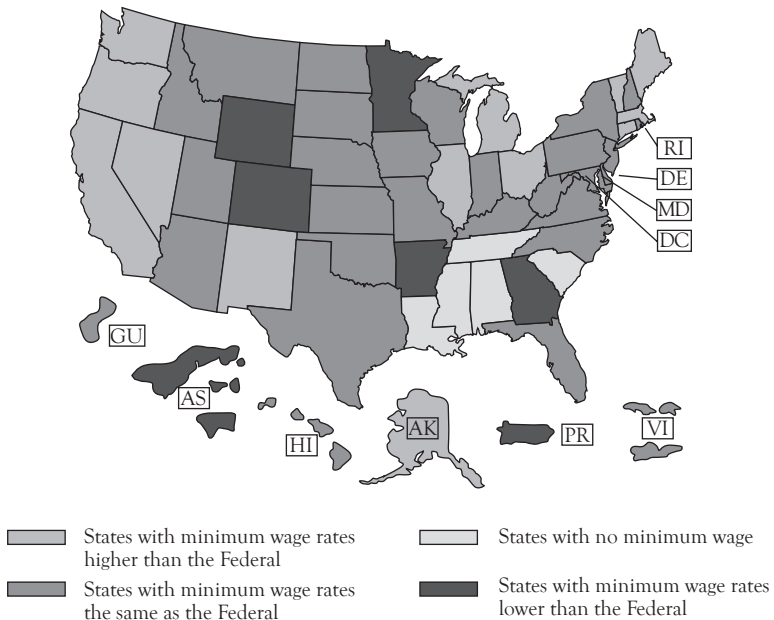


Figure 3 Map of State Laws (Department of Labor)

paid women less than it paid men, even though the jobs were “comparable.”¹⁸ A consultant evaluated civil service pay scales and found that jobs done mostly by women were paid at about 20 percent less than jobs done mostly by men, when those jobs were rated as having equivalent worth to the employer. The plaintiffs relied on the theory that even if the jobs were not “equal” in terms of the EPA, the differentials made out a case of sex discrimination under the Civil Rights Act. In a decision by Judge Anthony Kennedy, now a member of the U.S. Supreme Court, the circuit court rejected the theory. Kennedy wrote:

That concept [of equal pay] would be undermined if we were to hold that payment of wages according to prevailing rates in the public and private sectors is an act that, in itself, supports the inference of a purpose to discriminate. Neither law nor logic deems the free market system a suspect enterprise. Economic reality is that the value of a particular job to an employer is but one factor influencing the rate of compensation for that job. Other considerations may include the availability of workers willing to do the job and the effectiveness of collective bargaining in a particular industry. We recognized in [an earlier case] that employers may be constrained by market forces to set salaries under prevailing wage rates for different job classifications. We find nothing in the language of Title VII or its legislative history to indicate Congress intended to abrogate fundamental economic principles such as the laws of supply and demand or to prevent employers from competing in the labor market.

Accordingly, proof of a gender-based pay differential is not sufficient to maintain a discrimination claim. The Supreme Court ruled that a compensation claim may be brought under Title VII, but it explained that the defenses available under the EPA were also applicable to civil rights suits.¹⁹ The result of the judicial interpretation of the two statutes has been generally to confine pay claims to the EPA standards.

In 2009 Representative Rosa DeLauro and Senator Hillary Rodham Clinton introduced the Paycheck Fairness Act (PFA) into Congress as a legislative means of strengthening remedies for pay discrimination. This

bill was still pending during the 2010 midyear elections, but the Republican victory in the House of Representatives suggests that expansive workplace legislation is unlikely to be adopted in the near future. Regardless of the political climate, the proposed bill illustrates some of the problems women face in labor markets. According to the findings set forth in the bill's preamble, women now make up an important segment of the workforce, but inequities persist. The bill states: "Despite the enactment of the Equal Pay Act of 1963, many women continue to earn significantly lower pay than men for equal work. These pay disparities exist in both the private and governmental sectors. In many instances, the pay disparities can only be due to continued intentional discrimination or the lingering effects of past discrimination."

The proposed act specifies a number of steps to reduce pay disparities. The most important change in the law would modify the final defense in the EPA, which allows the employer to show compensation is based on any other factor other than sex. The PFA eliminates that language and substitutes the following: "The bona fide factor defense described in subparagraph (A)(iv) shall apply only if the employer demonstrates that such factor (i) is not based upon or derived from a sex-based differential in compensation; (ii) is job-related with respect to the position in question; and (iii) is consistent with business necessity." What the modification does is to shift the burden of proof to the employer to justify a compensation plan if the claimant shows it has a disparate impact on women. Returning to the case of the professors, if the women faculty in liberal arts showed they earned significantly less than engineering professors, the university would have to prove the compensation plan was "job related" and a matter of "business necessity." Such a showing would go beyond merely claiming that the market dictated the pay gap. Whether the PFA moves forward or not, the matter of gender equity remains an issue having serious implications.

D. The Davis-Bacon Act

The Davis-Bacon Act is similar in purpose to the minimum wage and other laws seeking to ensure that earnings are maintained at levels which provide adequate security for workers. It is confined to specific

circumstances that involve federal contracting. As explained by the Wage and Hour Division:

The Davis-Bacon and Related Acts, apply to contractors and subcontractors performing on federally funded or assisted contracts in excess of \$2,000 for the construction, alteration, or repair (including painting and decorating) of public buildings or public works. Davis-Bacon Act and Related Act contractors and subcontractors must pay their laborers and mechanics employed under the contract no less than the locally prevailing wages and fringe benefits for corresponding work on similar projects in the area. The Davis-Bacon Act directs the Department of Labor to determine such locally prevailing wage rates. The Davis-Bacon Act applies to contractors and subcontractors performing work on federal or District of Columbia contracts. The Davis-Bacon Act prevailing wage provisions apply to the “Related Acts,” under which federal agencies assist construction projects through grants, loans, loan guarantees, and insurance.

There is no general requirement that workers be paid a set “market” rate for their labor. The statute applies only when the federal government engages in construction activities on public buildings or works.

The Act is sometimes criticized on the ground that it raises the cost of public construction activities and interferes with the normal function of labor markets. Following the damage to New Orleans in Hurricane Katrina, President George W. Bush issued a proclamation in September 2005 repealing the law for the rebuilding effort. Political opposition from Democrats led to Bush’s reversal of the order only a month later, and the law has remained in full force since that time.

V. Social Security and Unemployment

A. Overview

Social Security (SS) came into existence in 1935. It aimed to protect a particularly vulnerable class of citizens—the elderly—from economic

suffering. Over the next 70 years, the act was expanded to provide higher, and more extensive, levels of benefits. The evolution of SS gradually encompassed more participants, and expanded to include protections for survivors, the disabled, and former spouses. Under President Johnson, recipients of SS benefits also qualified for a health care program now known as Medicare. Each new element of SS added costs to the overall program, and Presidents Jimmy Carter and Ronald Reagan undertook measures to reform SS financing. When Reagan implemented changes in 1983, he predicted the SS program would remain stable for the next 50 years. Reagan was correct in his estimate. By 2013, SS revenues are projected to be less than its expenditures. Presently, demographics and economic conditions threaten the long-term stability of the system. A number of changes are under consideration at the national level, and some modifications will most likely take place to stabilize the program.

The Social Security Act of 1935 included a title dealing with unemployment insurance. This program was conceived as a joint state-federal undertaking and continues as such today. The unemployment rate in 2009 reached 10.2 percent and remained above 9 percent into the following year. The depletion of state funds and the problem of long-term unemployment led to several extensions of benefits, placing further pressures on the federal deficit. During the lame duck session of Congress in December 2010, benefits for about 2 million workers expired. The politics of the unemployment problem became a national issue, as discussed in the next section.

The table below describes the major phases of Social Security's evolution. According to most scholars, the addition of a survivor's benefit in 1939 marked the turning point that moved the program from a simple insurance concept to one of social welfare. By allowing a surviving spouse to collect benefits accrued by a wage earner, Social Security paid out money to individuals who needed it, rather than to individuals who had earned it. Stated another way, two workers who had identical earnings for an identical number of years should get identical SS benefits. But if one worker was married, he and his spouse would receive a higher benefit than his unmarried colleague. The result is not equitable to the individuals, but it is appropriate for providing resources to a family unit.

Table 2 Major Social Security Legislation

Law	Date enacted	Major features
The Social Security Act	August 14, 1935	Established individual retirement benefits.
The 1939 amendments	August 10, 1939	Added dependents and survivors' benefits, and made benefits more generous for early participants. Financing at issue.
The 1950 amendments	August 28, 1950	Adjusted, on a major scale, coverage and financing. Increased benefits for the first time. Provided for gratuitous wage credits for military service.
The 1960 amendments	September 13, 1960	Disability benefits at any age.
The 1972 Debt-Ceiling Bill	July 1, 1972	Added automatic annual cost-of-living adjustments.
The 1977 amendments	December 20, 1977	Raised taxes and scaled back benefits. Long-range solvency at issue.
The 1983 amendments	April 20, 1983	Raised taxes and scaled back benefits. Long-range and short-range solvency at issue.
Senior Citizens Freedom to Work Act of 2000	April 7, 2000	Eliminated the retirement earnings test for those at the full retirement age.

Source: Congressional Research Service (CRS) Report RL30920, Major Decisions in the House and Senate on Social Security, 1935–2009.

B. Social Security Benefits

The Social Security system relies on a payroll tax on employers and employees to provide benefits for individual recipients in the program. This method of funding is known as “pay-go,” because it uses incoming revenues to pay current liabilities. As SS evolved, payroll taxes increased to pay for increased benefits. The rates were at a relatively low combined amount of 9.3% in 1981. After the reforms of the Reagan administration, the rates jumped to 14% in 1984, and then to the current level of 15.3% effective in 1990. Congress has declined to enact further tax increases, but it may be forced to do so in the near future to maintain adequate SS funding. The 2010 Trustees Report explained the financing mechanism with the following question and answer:

How Are Social Security and Medicare Financed? For Old Age, Survivors, and Disability Insurance and Hospital Insurance, the

major source of financing is payroll taxes on earnings that are paid by employees and their employers. The self-employed are charged the equivalent of the combined employer and employee tax rates. During 2009, an estimated 156 million people had earnings covered by Social Security and paid payroll taxes; for Medicare the corresponding figure was 160 million. The payroll tax rates are set by law and for OASDI apply to earnings up to an annual maximum (\$106,800 in 2010) that ordinarily increases with the growth in the nationwide average wage. When the cost-of-living adjustment (COLA) for December of any year is zero, which occurred in December 2009 and is projected for December 2010, the maximum taxable amount of earnings is not increased for the following year. This constraint will lower OASDI tax income in 2010 and 2011. In contrast, HI taxes are paid on total earnings. The payroll tax rates (in percent) for 2010 are:

	OASI	DI	OASDI	HI	Total
Employees	5.30	0.90	6.20	1.45	7.65
Employers	5.30	0.90	6.20	1.45	7.65
Combined total	10.60	1.80	12.40	2.90	15.30

Starting in 2013, the Affordable Care Act imposes an additional HI tax equal to 0.9 percent of earnings over \$200,000 for individual tax return filers and on earnings over \$250,000 for joint return filers.

According to the report, the 2010 health care legislation will stabilize expenditures under the hospital insurance component of SS for a decade more than previously predicted. The projected savings are associated with cost controls enacted by the new laws. Despite that, other elements of SS face shortfalls in the near term, and require congressional action in the near future. That issue is discussed more fully after a brief explanation of how SS calculates benefits.

The simplest concept behind SS is that an individual makes required contributions to the program and receives a payment based on the contribution. That concept, however, includes a number of refinements aimed at wealth redistribution, from high earners to low earners. The process by which redistribution is accomplished is an objective one, meaning that the formula applies to all recipients, but the formula itself is complicated and subject to manipulation. It starts with a beneficiary's "primary

insurance amount.” This figure is derived from earnings in the “base years” adjusted for inflation, and then inserted in a mathematical formula which produces a dollar amount. The SSA gives detailed guidance for estimating a retirement benefit at its Web site, <http://www.ssa.gov/policy/docs/statcomps/supplement/2009/apnd.html>. The material below is taken from this page.

Step 1—Determining the Number of Computation Years

For workers born from 1934 through 1947, the number of computation years is 35.

Step 2—Wage Indexing of Earnings

The following description and examples are provided for persons who wish to compute the index factors and indexed earnings. The indexing year is the year a person attains age 60. Beneficiaries born on January 1 are deemed to have attained age 60 on December 31 of the prior year.

The average wage for the indexing year is divided by the average wage in each prior year to obtain the factor for each prior year. For example, for a person attaining age 62 in 2009, the indexing year is 2007. The average annual wage for 2007 was \$40,405.48. The average annual wage for 1990 was \$21,027.98. The amount \$40,405.48 divided by \$21,027.98 yields a factor of 1.9215103.

The worker’s actual earnings covered under Social Security in that year, up to the maximum earnings creditable, are multiplied by the indexing factor to obtain the indexed earnings (see Worksheet 1). For example, actual covered earnings of \$10,000 in 1990, multiplied by 1.9215103, result in indexed earnings of \$19,215.10; actual earnings of \$51,300 (the maximum creditable) result in indexed earnings of \$98,573.47.

Step 3—Computing the Average Indexed Monthly Earnings (AIME)

After the earnings in each year have been indexed, they are used in computing average indexed monthly earnings. The years of highest indexed earnings corresponding to the number of computation years are selected

and totaled. This total is then divided by the number of months in the computation years. The result, rounded to the nearest lower dollar, is the average indexed monthly earnings.

For example, for a person attaining age 62 in 2009, the highest 35 years of indexed earnings are used. If the sum of these earnings equals \$400,000, the AIME is \$952 (\$400,000 divided by 420 = \$952.38, rounded to \$952).

Step 4—Computing the Primary Insurance Amount (PIA)

The PIA, the amount from which all Social Security benefits payable on a worker's earnings record are based, is computed by applying a formula to the AIME. The formula consists of brackets in which three percentages are applied to amounts of AIME. The dollar amounts defining the brackets are called *bend points*, and the bend points are different for each calendar year of attainment of age 62. The PIA is rounded to the nearest lower 10 cents.

For retired workers who attained age 62 in 2009, the bend points are \$744 and \$4,483. Thus the formula is 90 percent of the first \$744 of AIME; plus 32 percent of the next \$3,739 of AIME; plus 15 percent of AIME above \$4,483. The following are examples of PIA computations for such workers with different AIME amounts.

Example 1—AIME of \$300

PIA is \$270

Based on: 90 percent of \$300

Example 2—AIME of \$952

PIA is \$736.16 rounded to \$736.00

**Based on: 90 percent of \$744 (\$669.60); plus
32 percent of \$208 (\$66.56)**

Example 3—AIME of \$5,000

PIA is \$1,943.63 rounded to \$1,943.60

**Based on: 90 percent of \$744 (\$669.60); plus
32 percent of \$3,739 (\$1,196.48); plus
15 percent of \$517 (\$77.55)**

The above calculations are applicable to workers who attain age 62 in 2009. For workers who attained age 62 in prior years, the bend points will be different, and the PIA must be increased to reflect cost-of-living adjustments between the year of attainment of age 62 and 2009. After the PIA is calculated for the year of attainment of age 62, cost-of-living increases are applied for each year through 2008. The result is the current 2009 PIA.

For example, a worker who attained age 62 in 2006 would receive cost-of-living adjustments for the years 2006–2008. The adjustments are cumulative, with each step rounded to the next lower dime. If the PIA at age 62 was \$700, the cost-of-living adjustments would be

2006: \$700 multiplied by 1.033 = \$723.10

2007: \$723.10 multiplied by 1.023 = \$739.70

2008: \$739.70 multiplied by 1.058 = \$782.60

\$782.60 would be the PIA effective December 2008.

Step 5—Computation of the Monthly Benefit

The full PIA is payable to a worker who retires at the full retirement age (FRA). In 2000, the FRA, scheduled to be gradually raised to age 67 for workers attaining age 62 in 2022, began to be phased in.

To compare SS with an insurance concept, consider the SS formula in relation to an annuity. In the latter case, an individual may agree to purchase an annuity from a private investment company. She gives the company a certain amount of money, which the company invests. The company uses actuarial tables to predict how long the worker will live, and then calculates how much it will pay from the date of retirement until death. For example, if she stops work at age 67, the insurer may guarantee a yearly income of some designated amount for the remainder of life. If the worker wants to protect her surviving spouse, the insurer will adjust the annuity downward to reflect an additional risk. If the recipient lives longer than the insurer planned, the insurer takes a loss on the policy. Over time, though, the actuarial calculations will favor the insurer, just as the gambling odds favor a casino.

Now look at the way SS determines an award. It uses contributions to the system as one factor, but it adjusts those contributions by “indexing”

them for inflation. It may also drop some years of lower earnings from the calculation to arrive at an “average indexed monthly earning,” or AIME. Next, the AIME is used to figure the “primary insurance amount,” or PIA, which is then processed through a series of “bend points” to reach a dollar figure for the monthly payment. The examples given above illustrate three different earnings records, and show that lower earners have proportionately greater replacement rates for their earnings history. In addition, awards are adjusted upward for a cost-of-living factor.

Further, the SS program provides benefits to recipients other than the retired worker. As noted, if the worker has a family, she may be entitled to a benefit based on the number of dependents and limited by a maximum family benefit determined by a PIA formula, but not to exceed 150% of the worker’s PIA. A former spouse of an insured worker may claim on the worker’s record if the marriage lasted more than ten years and the spouse has reached the age of 62. Other cases include dependent children or grandchildren under 18 or 19 if attending secondary school. The disability component of SS provides benefits for persons who are unable to engage in substantial gainful work in the national economy and for their dependents. Again, there is a maximum amount available, which is less than the family maximum for old age and survivors. The amount of earnings credit needed to qualify for disability varies according to the beneficiary’s age at the time of disability.

C. SS Financing and the Future of the Program

The “baby boom” generation beginning in 1946 and whose members are reaching retirement in 2010 is numerically larger than preceding or following generations. As a result, the baby boomers created a large surplus in the SS trust funds. The funds will be paid down as the generation retires, and the smaller number of current workers will be supporting a larger number of retirees. The resulting demographic conditions will lead to shortfalls in SS financing. The 2010 Report of the SSA Trustees provides a chart illustrating the trends in SS financing. It shows that the old age and survivors’ component will begin paying out more than it takes in beginning around 2040. The HI fund will be exhausted in 2030, a decade later than predicted in the 2009 report, and which is explained by the

federal health care legislation enacted in 2010. The most serious financing shortfall occurs in the DI fund, which will reach exhaustion in 2017.

According to the August 2010 report of the Social Security Board of Trustees, the fiscal prospects for Medicare have “improved substantially” as a result of the recent health care reforms. Consequently, the Hospital Insurance Trust Fund, for example, will remain solvent for 12 years longer than projected in 2009. Conversely, the recession had a negative impact on SS revenues, which affected other areas of the program. Supplemental medical insurance, enacted during George W. Bush’s second term, is particularly vulnerable. The trustees said that “the aging population will result in SMI costs growing rapidly from 1.9 percent of GDP in 2009 to 3.5 percent of GDP in 2040; about three-quarters of these costs will be financed from general revenues and about one-quarter from premiums paid by beneficiaries.” Overall, the report warns, “The long-run financial challenges facing Social Security and those that remain for Medicare should be addressed soon.”

The urgency of the SS system funding was reflected in a recent interview by the well-known economist Laurence Kotlikoff. He asserted, “The U.S. is bankrupt. Neither spending more nor taxing less will help the country pay its bills. What it can and must do is radically simplify its tax,

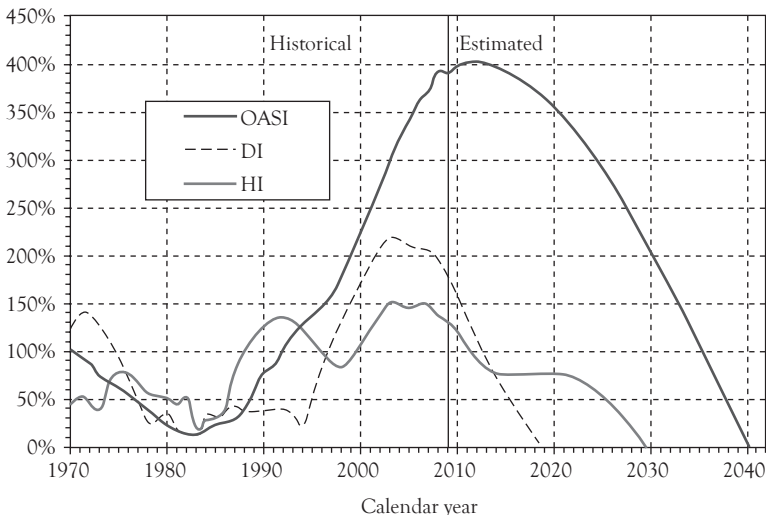


Figure 4 Trends in Funding

health-care, retirement and financial systems, each of which is a complete mess.”²⁰ President Barack Obama’s bipartisan commission on fiscal strategy issued a report in December 2010, which recommended a number of changes in SS, including raising the retirement age and the taxable wage base. The report generated massive media coverage and political controversy. In order to place the recommendations before Congress, a supermajority of committee members had to vote to approve the plan. It failed to gain enough support to form a basis for legislation, but it did bring issues such as retirement and the deficit to the forefront of national debate.²¹ At the same time, other types of retirement plans suffered from the deteriorating economic conditions.

D. The Second Pillar of Retirement: Employment-Based Plans

Defined Benefit Pensions

Social Security is not designed to provide for all of an individual’s needs in retirement. For that reason, a retirement benefit has become a common feature of the employment relationship. Unions established through collective bargaining a type of pension known as the “defined benefit” plan, which many large nonunion employers also adopted. In simplest terms, an employee works for a set number of years, reaches a designated age, and receives a fixed payment of money at given dates. Assume, for example, that a person starts work at a General Motors plant at age 20. He works for a period of time, say 30 years, and is 50 years of age. The pension plan is based on the “rule of 80,” a combination of age and service. The plan might pay \$50 per month per year of service. Consequently, the pensioner would have a monthly income of \$1,500, in addition to a Social Security benefit.

The defined benefit pension imposes a duty on the employer to accumulate enough money to provide payments when due. The fund’s liabilities are determined by actuarial methods, and federal laws regulate the amounts an employer must maintain for fund solvency. If the employer declares bankruptcy and cannot pay the pension, a federally created private insurance company may take over the plan. The Pension Benefit Guaranty Corporation (PBGC) collects insurance premiums from private sector employers with defined benefit plans, and provides a safety net

for workers who might otherwise lose all their retirement income. The PBGC issued its annual report in November 2010.²² Here is a statement from the report that explains the PBGC's purpose and functions:

Even as a fledgling economic recovery slowly takes hold, Americans face uncertainty: uncertainty about the economy; uncertainty that their companies and their jobs will last beyond the next paycheck; and uncertainty about when and how government efforts to help will work.

Throughout this uncertainty, *PBGC continues to help*. Thirty-six years ago Congress set us up to protect and insure pension plans, and make sure workers' benefits get paid. That remains our mission:

- *We work with companies to keep their pension plans.* Last year PBGC staff negotiated with dozens of companies, both in bankruptcy and otherwise, to preserve their plans. Partly as a result 250,000 people will keep their pension plans that otherwise might not.
- *When plans do fail, we step in and make sure benefits keep getting paid.* We work to ensure that retirees get the full benefits provided by law—on time. Over the years we've become responsible for almost 1.5 million people in 4,200 failed plans. Every month, on average, we pay \$467 million for pensions for 801,000 retirees. PBGC is also responsible for future payments to almost 700,000 who have not yet retired. During FY 2010, we assumed responsibility for 109,000 additional workers and retirees in 172 failed plans.
- *We implement pension laws, and work with the President and Congress to improve them.* In FY 2010 we worked with both the private sector and other government agencies to implement the funding provisions provided by the Pension Protection Act of 2006, and, working with other agencies, helped Congress revise it. We will continue to provide policymakers with the information they need to decide if and when future changes are necessary.

We currently protect the retirement hopes of 44 million Americans in more than 27,500 ongoing pension plans. When a PBGC-insured plan cannot keep its pension promises, PBGC makes sure the plan's participants get their benefits, up to the limits of federal pension law.

The PBGC faces actuarial shortfalls over the long term, just as the Social Security system does. According to the report, the corporation paid out \$5.6 billion during the fiscal year in cases where the employer's plan was not able to meet its obligations. Actuarial analysis showed a deficit of \$21.6 billion for single-employer plans, which was due in part to economic conditions and to inadequate plan funding. Another factor was that the PBGC premiums were too low to meet its obligations. The trustees summarized the situation as follows: "Since our obligations are paid out over decades, we have more than sufficient funds to pay benefits for the foreseeable future. Nonetheless, we cannot ignore PBGC's future financial condition any more than we would that of the pension plans we insure."

Defined Contribution Pensions

Because defined benefit pensions place the risk of solvency on the employer, they are declining relative to the other type of plan, the defined contribution retirement plan. This type of plan is often referred to as a "401(k)" retirement program. The designation is taken from the section of the Internal Revenue Code that permits a deferral of income tax on contributions to a plan meeting IRS requirements. The 401(k) concept was initially aimed at high-level executives who could shelter part of their salary by this method. It has become the primary retirement savings vehicle for American workers. The Department of Labor provides the following explanation of the 401(k) plan:

What Are 401(k) Plans?

Your employer may establish a defined contribution plan that is a cash or deferred arrangement, usually called a 401(k) plan.

A participant can elect to defer receiving a portion of their salary which is instead contributed on their behalf, before taxes, to the 401(k) plan. Sometimes the employer may match their contributions. There are special rules governing the operation of a 401(k) plan. For example, there is a dollar limit on the amount a participant may elect to defer each year. . . . Other limits may apply to the amount that may be contributed on a participant's behalf. For example, if the participant is highly compensated, they may be limited depending on the extent to which rank and file employees participate in the plan. An employer must advise participants of any limits that may apply to them.

Although a 401(k) plan is a retirement plan, participants may be permitted access to funds in the plan before retirement. For example, if a participant is an active employee, the plan may allow them to borrow from the plan. Also, the plan may permit a withdrawal on account of hardship, generally from the funds the participant contributed. The sponsor may want to encourage participation in the plan, but it cannot make participants' elective deferrals a condition for the receipt of other benefits, except for matching contributions.

As the quoted material indicates, the employer may decide to offer a contribution along with the contribution of the employee. Employers can develop rules about their contributions to ensure that the employee has a certain length of service before the employer contribution "vests" or becomes the property of the employee. If conditions change, the employer can reduce or eliminate any matching at the employer's discretion. One advantage of a defined contribution plan is that it can be moved or "rolled over" from one place of employment to another. If the employee loses her job, she may cash in a 401(k) to access the funds. Doing so, however, involves tax liability.

The Employment Benefits Research Institute (EBRI) compiled data on pension plans for the years 1979 to 2008. They found that among private sector participants in a retirement plan, 62% had a defined benefit plan only in 1979 and 7% did in 2008. For the defined contribution

(401(k) type) plans, 16% had only such a plan in 1979, while 67% did in 2008.²³ EBRI published a December 2010 analysis of retirement plans, and found that 59 percent of all workers over 16 years of age had an employer who sponsored a pension plan, and 45 percent of that number actually participated in the plan.²⁴ Most workers were offered a defined contribution plan, rather than a defined benefit pension. The risk of having insufficient funds for retirement in a defined contribution plan is borne by the employee.

To sum up, American workers face difficult choices about retirement. Those choices are likely to become more problematic as the federal government takes up budgetary measures to lower the record deficit going forward.

E. Unemployment Insurance

In October 2009 the unemployment rate in the United States rose just above 10 percent for the first time since late 1982, when it peaked at 10.8 percent of the working population. The figure below, downloaded from the Bureau of Labor Statistics (BLS) Web site, shows the historical fluctuations in unemployment rates since the end of World War II. In President Reagan's first term, both unemployment and inflation concerned policymakers, and Reagan implemented a policy of monetary restriction that gradually controlled inflation through high unemployment. Once the economy recovered, unemployment fell into the early 1990s. The election of Bill Clinton in 1992 commenced a period in which employment and incomes rose for the next ten years. The economic crisis precipitated a dramatic increase in unemployment, which continued through 2010.

Most problematically, unemployment in Obama's first two years in office featured very long periods in which individuals could not find work. The *New York Times* reported, "This country has some of the highest levels of long-term unemployment—out of work longer than six months—it has ever recorded. Meanwhile, job growth has been, and looks to remain, disappointingly slow, indicating that those out of work for a while are likely to remain so for the foreseeable future."²⁵ Economists debated whether the causes of long term unemployment were "structural" or "demand" in nature. Structural unemployment occurs when workers do not

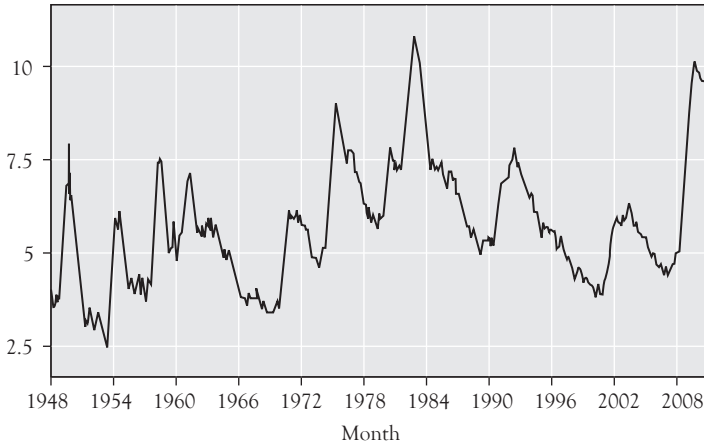


Figure 5 *Unemployment Rates*

have the necessary skills to compete for new jobs, either because the jobs have disappeared or because technology has made their skills obsolete. Unemployment caused by a lack of demand in the economy may be reduced by stimulus measures that encourage businesses to increase production. In past recessions, unemployment fell quickly when economic activity rebounded. The issue is important for formulating appropriate policy responses.

Unemployment benefits are normally paid for 26 weeks, but the federal government provided funds to states for extended benefits. In many cases, claimants received benefits up to 99 months in duration, after which their eligibility expired. The “99ers” included persons who had been regularly employed for years, but were unable to find any type of employment despite their searches. According to the BLS, “The number of persons jobless for a year or more rose from 645,000 in the second quarter of 2007 to 4.5 million in the second quarter of 2010. The group’s share of total unemployment jumped from 9.5 percent to a record high of 30.9 percent.”²⁶ Workers in their 50s and 60s were pessimistic about their chances of ever regaining a foothold in the economy.

During the lame duck session of Congress in November and December 2010, extended benefits played a prominent role in a compromise package of legislation that involved the Bush-era tax cuts, along with various other spending and revenue measures. The Bush administration

enacted a 10-year tax plan that gave high earners a lower rate than during either the Reagan or Clinton eras. Those cuts were scheduled to expire at the end of 2010 for all taxpayers. Democrats argued that the middle class should continue to pay the Bush rates, but Republicans insisted that all taxpayers should continue with existing schedules. Republicans succeeded in keeping all the tax rates in place until 2012, and Democrats succeeded in extending unemployment benefits and passing a payroll tax cut for workers. According to the administration, the compromise measures would provide additional stimulus to the economy without significantly adding to the deficit.²⁷

1. How the Unemployment Insurance System Encourages State Participation

Unemployment insurance originated as Title III part of the 1935 Social Security Act, and is a joint state and federal venture. The Tenth Amendment to the U.S. Constitution grants all powers not expressly given to the federal government. The Roosevelt administration favored an arrangement that involved states in the administration of unemployment benefits. The members of the Committee on Economic Security considered a wholly federal plan, but rejected that approach in favor of the joint project advocated by Roosevelt. As enacted, the Social Security legislation featured a tax-offset mechanism that encouraged states to develop their own programs, and avoided issues of federal constitutional power. Upholding the constitutionality of UI in *Steward Machine Co. v. Davis* (1937), the Supreme Court noted that states were not forced to participate in the UI program, but did so voluntarily. The explanation for the states' "voluntary" participation is that a state may decline to have a UI program, but there are important consequences for doing so.

Under the Federal Unemployment Tax Act, the federal government presently imposes on employers a payroll tax of 6.2 percent on a wage base of \$7,000. This tax is owed directly to the federal government. Employers, however, may be given an offset credit of 5.4 percent if they are covered by, and pay into, an approved state plan. Under the state plans, the tax an employer actually pays is based on the employer's experience rating, which is determined by the benefits charged against the

employer's account. Consequently, depending on the employer's ability to avoid claims, the employer may pay a lower tax—or even no tax—to the state fund. Regardless of the employer's actual tax liability to the state, the employer is given the full 5.4 percent offset for any taxes due under the federal law. As a result, there are powerful incentives for states to provide an unemployment insurance program; if they did not do so, employers in that state would be liable for the full tax to the federal government. Justice Cardozo made the point with a nice rhetorical flourish, when he dismissed the argument that the Tenth Amendment forbids the federal government from “coercing” the states to have an unemployment insurance system. He said, “Who then is coerced through the operation of this statute? Not the taxpayer. He pays in fulfillment of the mandate of the local legislature. Not the state. Even now, she does not offer a suggestion that, in passing the unemployment law, she was affected by duress. For all that appears, she is satisfied with her choice, and would be sorely disappointed if it were now to be annulled.”²⁸ All 50 states currently have unemployment insurance programs in place. The following declaration of legislative policy from the California statutes explains the purpose and function of unemployment insurance.²⁹

Unemployment Insurance Code Sections 100–102

100. As a guide to the interpretation and application of this division the public policy of this State is declared as follows:

Experience has shown that large numbers of the population of California do not enjoy permanent employment by reason of which their purchasing power is unstable. This is detrimental to the interests of the people of California as a whole.

The benefit to all persons resulting from public and private enterprise is realized in the final consumption of goods and services. It is contrary to public policy to permit the supply of consumption goods and services at prices which do not provide against that harm to the population consequent upon periods of unemployment of those who contribute to the production and distribution of such goods and services.

Experience has shown that private charity and local relief cannot alone prevent the effects of unemployment. Experience has shown that if the State awaits the coming of excessive unemployment it can neither create immediately the organization necessary to orderly economical and effective relief nor bear the financial burden of relief without disrupting its whole system of ordinary revenues and without jeopardizing its credit.

The Legislature therefore declares that in its considered judgment the public good and the general welfare of the citizens of the State require the enactment of this measure under the police power of the State, for the compulsory setting aside of funds to be used for a system of unemployment insurance providing benefits for persons unemployed through no fault of their own, and to reduce involuntary unemployment and the suffering caused thereby to a minimum.

It is the intent of the Legislature that unemployed persons claiming unemployment insurance benefits shall be required to make all reasonable effort to secure employment on their own behalf.

2. Qualifications, Reductions, and Benefits

Because UI (unemployment insurance) is intended to provide short-term protection for workers, it has several important conditions that must be satisfied. First, workers must demonstrate an attachment to the workforce through an earnings history, usually consisting of specified dollar amounts earned during the “base year” preceding their application for benefits. Second, the worker must be unemployed “through no fault of his own,” and workers who quit work or are fired for misconduct may be denied part or all of their benefits. Third, the worker must be able to work and be available for work. Individuals injured on the job, for example, are covered under workers’ compensation programs, rather than UI. Individuals who have withdrawn from the labor force, such as a person who enrolls in a full-time course of education or training, will not be available for work. UI programs impose an obligation on recipients to accept “suitable work” that is offered to them. Suitable work may vary, depending on

the length of unemployment and the individual's skills and past earnings history. A software engineer should not be forced to take a job in the fast food industry or lose unemployment benefits so long as there is a reasonable expectation that she will find work commensurate with her level of expertise.

The requirement that a worker be unemployed "through no fault of his own" is a standard interpreted under state law. Each jurisdiction creates statutory law and case interpretation dealing with employee misconduct that will result in no or reduced benefits. The point is important, because employers can reduce their costs of unemployment if there are few charges against their account. For example, if an employer fires an employee for being rude to a customer, the employee may file for benefits and state that she was separated due to lack of work. The unemployment administrator will contact the employer, who can state other reasons for the termination. The state agency resolves the issue through various levels of appeal, which may eventually lead to judicial determination. The employee's incentive is to receive benefits until he finds a job, and the employer's incentive is to protect the solvency of her fund. Remember that if an employer has a reserve in the insurance fund, the state may reduce the amount of tax the employer pays. The state of California provides the following information on its Web site.³⁰

An individual is disqualified for unemployment compensation benefits if the director finds that he or she left his or her most recent work voluntarily without good cause or that he or she has been discharged for misconduct connected with his or her most recent work. An individual is presumed to have been discharged for reasons other than misconduct in connection with his or her work and not to have voluntarily left his or her work without good cause unless his or her employer has given written notice to the contrary to the department . . . setting forth facts sufficient to overcome the presumption. The presumption provided by this section is rebuttable.

The UI system also requires that a claimant undertake a regular job search. Using California law as an example again, the requirement is that

“a person must be physically able to work, available for work and actively looking for work each week benefits are claimed.” To monitor the job search, the claimant must verify the job search by submitting a form every two weeks to the Department. “If the information on the form shows that the individual did not meet eligibility requirements, the Department will schedule a telephone interview. Based on the information obtained, benefits may be reduced or denied. An individual who disagrees with our decision to reduce or deny benefits may file an appeal.” Consequently, the process of obtaining UI benefits entails some very specific requirements. Unemployed workers who fail to comply with the guidelines may lose benefits or be subject to future penalties.

3. A Note on Extended Benefits

During the lame duck session of Congress in late 2010, legislators reached a compromise on the important issues of taxation and unemployment. The Obama administration agreed to support an extension of all federal tax rates due to expire at the end of the year, including the rates paid by earners in the upper income brackets. Congressional Democrats favored repeal of those rates and a reinstatement of the higher rates of the Clinton era. Republicans agreed to an extension of unemployment benefits, provided Democrats would keep tax rates at existing levels for an additional two years. The impact for unemployed workers is explained in the statement from the California state government below. The excerpt explains how unemployment benefits are arranged in tiers to provide extended coverage for long-term unemployment.

New Developments on Federal Unemployment
Extensions (Updated January 18, 2011)

Updated: Number of individuals who have run out of benefits is more than 304,000

The U.S. Congress has approved, and President Obama has signed, a sweeping tax package that includes a reauthorization of federal unemployment extension benefits for another 13 months. While the legislation does not add anything further to the current maximum of up to 99 weeks

of benefits available, it does add more time for eligible unemployed workers to be able to collect those maximum benefits while trying to secure a new job.

In anticipation of Congressional action, the Employment Development Department (EDD) was already taking steps to ensure we are ready to file and pay extended benefits to eligible claimants who were in danger of interruptions in their unemployment checks. A total of more than 250,000 customers who would have normally expected a check during the week of December 20th were in danger of missing that payment unless Congress acted by December 18th.

Approximately 23,000 of those customers had recently run out of their current level of unemployment benefits and were prevented from moving into any further extension claim. The EDD has already filed their next extension claim and sent out claim forms. Now that extensions are reauthorized, these customers should complete their claim forms and return them to EDD as they normally would per the date noted on their form. Once received, it takes EDD a day or so to process the forms and issue payments to eligible customers.

The remaining 235,000 people of the total customers impacted are those with a payable balance remaining on the separate extension known as the FED-ED here in California. Without further Congressional action, the week ending December 11th was the last payable week of FED-ED benefits. The Department has continued to send claim forms to these customers in anticipation of the program being reauthorized. Customers should now complete those claim forms as they normally would and return them according to the date noted on the form. Payments can then be issued for eligible claimants without interruption.

New Filing Deadlines For Federal Extension Benefits

For more than two years, an unprecedented offering of federal unemployment extension benefits has provided additional financial support to unemployed workers hit hard in this long, harsh recession. In addition to the up to 26 weeks of regular UI benefits offered any time an eligible worker becomes unemployed, up to 73 weeks of additional benefits have been available through four different tiers of extension benefits and a separate

extension of benefits known as the FED-ED extension. All together, up to 99 weeks of unemployment benefits have been available to help support unemployed workers, their families, and their communities.

Here is a breakdown of the new filing deadlines for federal extension benefits now that the program has been extended for another 13 months:

Current UI Extended Benefit Duration & Claim Deadlines

UI Benefits Provided During This Recession		
UI Claims	Maximum Weeks of Benefits Provided	Maximum Weeks of Benefits Provided
Regular UI Claim	Up to 26 weeks of benefits	Once someone becomes unemployed
1st Tier of Federal Extension	Up to 20 weeks of benefits	December 25, 2011
2nd Tier of Federal Extension	Up to 14 weeks of benefits	January 1, 2012
3rd Tier of Federal Extension	Up to 13 weeks of benefits	January 1, 2012
4th Tier of Federal Extension	Up to 6 weeks of benefits	January 1, 2012
Separate FED-ED Extension		January 8, 2012
POTENTIAL TOTAL MAXIMUM BENEFITS	Up to 99 weeks of benefits	

This chapter describes the basic elements of the American safety net. Out of the grave economic conditions of the Great Depression came the foundation for modern social protections. As we enter into the second decade of the 21st century, those foundations rest on shifting and unstable ground. Federal spending approaches unsustainable levels, but high levels of unemployment continue to threaten our future prosperity. Inequality in the United States in 2010 was greater than at any time since 1929. Political solutions appear stymied by conflicting views about deficits and employment. A resurgence of New Deal economic programs to stimulate growth is unlikely, but it is equally likely that imposing greater austerity in spending will inflict more deprivation on many citizens. Below are some points for consideration and discussion.

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CHAPTER 3

Workplace Rights and Regulation: Safety and Individual Health Care

I. The Occupational Safety and Health Act (OSHA)

The Occupational Safety and Health Act, or OSHA, was enacted in 1970. The bill followed a long period of Democratic control in Congress and the liberal politics of the Kennedy-Johnson administration. Richard Nixon, a Republican, defeated the Democratic presidential candidate, Hubert Humphrey, in the 1968 elections. Nixon faced a Congress dominated by Democrats, who presented him with a health and safety bill, which he signed into law. OSHA thus represents the culmination of a political era in employment regulation. It was strongly opposed by the business community, which criticized the further expansion of governmental authority into business operations. Organized labor, on the other hand, viewed the event as a landmark victory in the struggle for workplace safety reform.

OSHA is straightforward in its design and implementation. The act sets out safety and health guidelines known as “standards.” It then prescribes a method of enforcement through inspections, citations, and penalties, illustrated by the figure below. Within this general framework, OSHA addresses a number of specific issues, such as the content of the standards, the adequacy of inspections, and the effectiveness of penalties. This section begins with an overview of the law, and then considers in more detail each of OSHA’s operative principles.

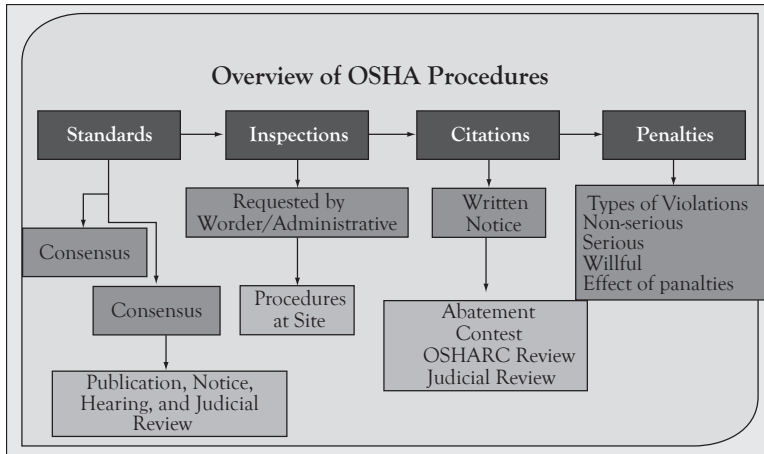


Figure 1 *How OSHA Works*

A. Findings and Purposes of OSHA

Congress articulated an elaborate and detailed explanation of its objective for the occupational safety and health legislation. An excerpt from the statute is quoted below. Congress listed 13 ways in which safety and health might be assured to workers on the job. They included various motivations for employers and employees to participate in creating safe workplaces, a regulatory regime to oversee the law, and means of developing knowledge about safety and health issues. As you consider the congressional goals, you should think about the relative success, or lack of success, which we have achieved through this massive legislative undertaking. Here is the statutory introduction to the OSH Act:

- a. The Congress finds that personal injuries and illnesses arising out of work situations impose a substantial burden upon, and are a hindrance to, interstate commerce in terms of lost production, wage loss, medical expenses, and disability compensation payments.
- b. The Congress declares it to be its purpose and policy, through the exercise of its powers to regulate commerce among the several States and with foreign nations and to provide for the general welfare, to assure so far as possible every working man and woman in the Nation safe and healthful working conditions and to preserve our human resources—

1. by encouraging employers and employees in their efforts to reduce the number of occupational safety and health hazards at their places of employment, and to stimulate employers and employees to institute new and to perfect existing programs for providing safe and healthful working conditions;
2. by providing that employers and employees have separate but dependent responsibilities and rights with respect to achieving safe and healthful working conditions;
3. by authorizing the Secretary of Labor to set mandatory occupational safety and health standards applicable to businesses affecting interstate commerce, and by creating an Occupational Safety and Health Review Commission for carrying out adjudicatory functions under the Act;
4. by building upon advances already made through employer and employee initiative for providing safe and healthful working conditions;
5. by providing for research in the field of occupational safety and health, including the psychological factors involved, and by developing innovative methods, techniques, and approaches for dealing with occupational safety and health problems;
6. by exploring ways to discover latent diseases, establishing causal connections between diseases and work in environmental conditions, and conducting other research relating to health problems, in recognition of the fact that occupational health standards present problems often different from those involved in occupational safety;
7. by providing medical criteria which will assure insofar as practicable that no employee will suffer diminished health, functional capacity, or life expectancy as a result of his work experience;
8. by providing for training programs to increase the number and competence of personnel engaged in the field of occupational safety and health; affecting the OSH Act since its passage in 1970 through January 1, 2004.
9. by providing for the development and promulgation of occupational safety and health standards;
10. by providing an effective enforcement program which shall include a prohibition against giving advance notice of any inspection and sanctions for any individual violating this prohibition;

11. by encouraging the States to assume the fullest responsibility for the administration and enforcement of their occupational safety and health laws by providing grants to the States to assist in identifying their needs and responsibilities in the area of occupational safety and health, to develop plans in accordance with the provisions of this Act, to improve the administration and enforcement of State occupational safety and health laws, and to conduct experimental and demonstration projects in connection therewith;
12. by providing for appropriate reporting procedures with respect to occupational safety and health which procedures will help achieve the objectives of this Act and accurately describe the nature of the occupational safety and health problem;
13. by encouraging joint labor-management efforts to reduce injuries and disease arising out of employment.

OSHA also imposes an obligation on employers and employees under Section 5 of the Act, which describes the “general duty” to maintain a safe workplace:

Each employer—

1. shall furnish to each of his employees employment and a place of employment which are free from recognized hazards that are causing or are likely to cause death or serious physical harm to his employees;
2. shall comply with occupational safety and health standards promulgated under this Act.
 - b. Each employee shall comply with occupational safety and health standards and all rules, regulations, and orders issued pursuant to this Act which are applicable to his own actions and conduct.

B. Coverage of the Law

Note that OSHA is based on the federal power to regulate interstate commerce. As we have seen, this power is very broad, and exceptions to the scope of the statute are ones imposed by Congress, not by the Constitution. Accordingly, the OSH Act applies to the extent that Congress thought politically expedient, and it exempted some activities and some entities from the law’s application.

Generally, the act covers private sector employees in the United States and its protectorates. It *does not* apply to workers in the public sector. States are free to adopt safety measures or not and to participate in the federal regulatory process if they so prefer. Congress intended that states would take an active role in protecting workers, and the law allows states to develop their own programs for both private and public workers and to coordinate with the federal agency. Under Section 18 of the federal law, states with approved plans may receive up to one-half of their operating expenses through a federal subsidy. Presently, 22 states have such plans covering both the private and public workforce. Four states cover only their public employees. According to the OSHA Web site, state plans must be consistent with national principles. The federal requirements are as follows:

States must set job safety and health standards that are “at least as effective as” comparable federal standards. (Most States adopt standards identical to federal ones.) States have the option to promulgate standards covering hazards not addressed by federal standards.

A State must conduct inspections to enforce its standards, cover public (State and local government) employees, and operate occupational safety and health training and education programs. In addition, most States provide free on-site consultation to help employers identify and correct workplace hazards. Such consultation may be provided either under the plan or through a special agreement under section 21(d) of the Act.

More information is available at: <http://www.osha.gov/dcsp/osp/faq.html#oshaprogram>

C. Setting Standards

1. Consensus Standards

When OSHA came into effect in 1970, many employers already had workplace safety programs featuring national voluntary standards for creating safe conditions for workers. Those programs relied on practices

certified by such organizations as the American National Standards Institute and others that described the best way to engage in certain activities. ANSI is still an important part of the business environment, and the organization describes its activities in the following way on its Web site (http://www.ansi.org/about_ansi/overview/overview.aspx?menuid=1):

The Institute oversees the creation, promulgation and use of thousands of norms and guidelines that directly impact businesses in nearly every sector: from acoustical devices to construction equipment, from dairy and livestock production to energy distribution, and many more. ANSI is also actively engaged in accrediting programs that assess conformance to standards—including globally-recognized cross-sector programs such as the ISO 9000 (quality) and ISO 14000 (environmental) management systems.

The existence of recognized and widespread safety standards allowed OSHA to incorporate a body of existing rules into the statutory framework, and OSHA may still use that procedure. When OSHA proposed its “Walking-Working Surfaces and Personal Protective Equipment rule,” the American Society of Safety Engineers urged OSHA to adopt the ANSI standard, rather than develop another rule. The group explained, “A voluntary consensus standard is a documented agreement established by a consensus of subject matter experts and approved by a recognized body that provides rules, guidelines or characteristics to ensure that materials, products, processes and services are fit for their purpose. Voluntary consensus standards developed by industry in accordance with ANSI’s procedures for due process, openness and consensus subsequently are often adopted by the government as part of the regulatory framework.”¹ Obviously, coordination between the federal agency and private groups is advantageous to everyone affected by safety issues. It also allows for the effective use of resources in providing safety standards.

2. Promulgation by the OSH Administration

For safety issues that present new risks and problems, such as those emerging in the 1980s with HIV/AIDS, new approaches are needed to

adequately protect workers. Under such circumstances, OSHA may develop a standard which it then implements according to administrative rules. First, OSHA must publish the proposed standard and give affected parties an opportunity to comment on the proposed rule. After that process, OSHA may modify its standard, rescind it, or implement it as drafted. The standard can then be challenged in court to determine such matters as OSHA's scope of authority, the legal basis of the rule, or other related questions. If a court approves the rule, it goes into effect, and becomes binding on all designated parties. Some further examples will show how the process works.

In one of its most controversial rules, OSHA issued a standard regulating the permissible amount of cotton dust to which workers could be exposed while working in a mill, because it caused a lung condition known as byssinosis. The cotton dust standard reached the Court in *American Textile Manufacturers v. Donovan*, 452 U.S. 490 (1981). Writing for the Court, Justice Brennan upheld OSHA's rule that the manufacturers had to reduce the levels of dust to the lowest amount that was feasible. OSHA argued that the law required the government to "enact the most protective standard possible to eliminate a significant risk of material health impairment, subject to the constraints of economic and technological feasibility," and the Supreme Court agreed with this argument. Consequently, the benefits of employee health outweighed economic impacts on the manufacturers, so long as the standard was feasible, or "capable of being achieved."

Although the textile industry strenuously opposed the standard, it had little long-term effect. Global economic forces led to the offshoring of textile manufacturing, primarily to low-wage areas where safety factors played a smaller role. That process has continued into the 2010s. A safety consulting firm recently posted the following comment on its Web site blog under the title "Is OSHA Killing the American Dream?":²

While no one wants to come home in a body bag after a day of work and no one condones bad safety practices, the question is, how much compliance is too much compliance? In today's economy it's difficult to run a shop, keep up with payroll, and accommodate all of OSHA's requirements while others in that industry outsource to foreign countries and enjoy lax labor laws.

The argument goes to an important issue in health and safety, which is the extent to which costs of safety and health should be balanced against the loss of jobs and economic development. This question will be addressed more fully at the end of this chapter.

To consider another contemporary example of an OSHA standard, the agency was confronted in the 1980s with the problem of HIV-AIDS, which is a blood-borne pathogen capable of causing death. OSHA issued an emergency standard to deal temporarily with the problem, and through the standard-setting process, arrived at the “Bloodborne Pathogens and Needlestick Prevention” regulation. OSHA found that “Needlestick injuries and other sharp-related injuries which expose workers to bloodborne pathogens continues to be an important public health concern. Workers in many different occupations are at risk of exposure to bloodborne pathogens, including Hepatitis B, Hepatitis C, and HIV/AIDS.” The standard requires that certain safety precautions be followed, along with improved equipment and record-keeping procedures. OSHA provides informational and instructional materials dealing with the standard at the following Web site: <http://www.osha.gov/SLTC/bloodbornepathogens/index.html>.

D. Enforcement³

Inspections

The OSHA standards are enforced through a process of inspections, citations, and penalties. The procedures for an OSHA inspection are relatively straightforward. To begin with, OSHA prioritizes its inspection activity according to a system aimed at reaching the most hazardous activities. Its first priority, for example, deals with an “imminent danger situations,” which could lead to death or serious physical harm to workers. In such cases, OSHA will request an immediate correction of the problem or removing workers from exposure to the harm. The imminent danger priority is followed by incidents involving the death or hospitalization of an employee, complaints about hazardous conditions, referrals from state agencies or individuals, follow-up inspections to ensure that previous conditions have been abated, and programmed inspections based on evidence of a high-hazard industries or workplaces.

Normally, an OSHA inspection is conducted without notice. When the OSHA compliance officer arrives at the inspection site, the employer may ask for a valid warrant and the officer's credentials before proceeding with the inspection. The officer conducts a preliminary meeting to explain the purpose of the inspection. The employer can appoint a representative to accompany the officer, and employees are also entitled to have a representative during the inspection. The officer has authority to walk around the premises, speak with employees, point out any violations, review records, and ensure that required OSHA posters are in place. The inspection concludes with a closing conference that covers such matters as violations, proposed penalties, and any other relevant safety and health issues. OSHA claims that it has improved its inspection record over the past few years and has become more effective in administering the law and achieving its goals. The tables below are OSHA's statistics about inspections and compliance.

"OSHA Inspection Activity: Focused and Efficient"

By proactively targeting the industries and employers that experience the greatest number of workplace injuries and illnesses, OSHA continues to maintain its high level of annual inspection activity. In FY 2009, OSHA conducted 39,004 total inspections. This year's significant enforcement actions included 120 inspections; each resulting in a total proposed monetary penalty of more than \$100,000. OSHA conducted 24,316 programmed inspections and 14,688 unprogrammed inspections, including employee complaints, accidents, and referrals. The number of fatality investigations decreased by 28.5%; a significant decrease over the past five fiscal years, thus demonstrating OSHA's firm commitment to reducing the number of workplace fatalities.

Hazards Identified: Total Violations Decrease; Serious Violations Increase While total injury and illness rates continue to decline, OSHA continues to direct enforcement resources to those establishments with the highest incidence of serious hazards. In FY 2009, 87,663 violations of OSHA's standards and regulations were found in the nation's workplaces, a 2.8% increase since FY

OSHA Inspection Statistics	FY2005	FY2006	FY2007	FY2008	FY2009	%Change 2009
Total Inspection	38,714	38,579	39,324	38,667	39,004	75%
Total Programmed Inspections	21,404	21,506	23,035	23,041	24,316	13.6%
Total Unprogrammed Inspections	17,310	17,073	16,289	15,626	14,688	-15.1%
Fatality Investigations	1,114	1,081	1,043	936	797	-28.5%
Complaints	7,716	7,376	7,055	6,708	6,661	-13.7%
Referrals	7,787	5,019	5,007	4,880	4,375	-8.6%
Other	4,693	3,597	3,184	3,102	2,855	-39.2%

Figure 2 Inspections

2005. The total number of serious and repeat violations issued increased by 10.9% and 17.5%, respectively, over the past five years. The total number of willful violations issued significantly decreased since FY 2005, decreasing by 46.3%.

Citations and Penalties

If an inspection reveals any violation of a standard, OSHA may issue a citation which will set forth the violations, propose a penalty, and set a time

OSHA Violation Statistics	FY2005	FY2006	FY2007	FY2008	FY2009	%Change 2005-2009
Total Violations	85,307	83,913	88,846	87,687	87,663	2.8%
Total Serious Violations	61,018	61,337	67,176	67,052	67,668	10.9%
Total Willful Violations	747	479	415	517	401	-46.3%

Figure 3 Violations

for the abatement of the condition. OSHA characterizes the violations according to different categories. Those categories are other-than-serious, serious, willful, repeated, and failure to abate. The amount of the penalty ranges from up to \$7,000 for each serious violation, and up to \$70,000 for each willful or repeated violation. The penalties may be reduced for various mitigating circumstances, such as whether the employer acted in good faith, the extent of the employer's past history with OSHA, and the size of the business. If the violation is willful, the penalty will not be adjusted. The statutory language of section 9 is as follows:

- a) If, upon inspection or investigation, the Secretary or his authorized representative believes that an employer has violated a requirement of section 5 of this Act, of any standard, rule or order promulgated pursuant to section 6 of this Act, or of any regulations prescribed pursuant to this Act, he shall with reasonable promptness issue a citation to the employer. Each citation shall be in writing and shall describe with particularity the nature of the violation, including a reference to the provision of the Act, standard, rule, regulation, or order alleged to have been violated. In addition, the citation shall fix a reasonable time for the abatement of the violation. The Secretary may prescribe procedures for the issuance of a notice in lieu of a citation with respect to de minimis violations which have no direct or immediate relationship to safety or health.
- (b) Each citation issued under this section, or a copy or copies thereof, shall be prominently posted, as prescribed in regulations issued by the Secretary, at or near each place a violation referred to in the citation occurred.
- (c) No citation may be issued under this section after the expiration of six months following the occurrence of any violation.

OSHA fines can be substantial, depending on the nature of the violation. In October 2009 OSHA proposed a penalty of \$87,430,000 against BP Products North America, Inc. The violations occurred at a BP oil refinery in Texas City, Texas, following an explosion that killed a number of workers. The OSHA press release is reprinted below.⁴ Note how OSHA explains the amounts imposed in this case:

U.S. Department of Labor's OSHA Issues Record-Breaking Fines to BP

WASHINGTON—The U.S. Department of Labor's Occupational Safety and Health Administration (OSHA) today announced it is issuing \$87,430,000 in proposed penalties to BP Products North America Inc. for the company's failure to correct potential hazards faced by employees. The fine is the largest in OSHA's history. The prior largest total penalty, \$21 million, was issued in 2005, also against BP.

Safety violations at BP's Texas City, Texas, refinery resulted in a massive explosion—with 15 deaths and 170 people injured—in March of 2005. BP entered into a settlement agreement with OSHA in September of that year, under which the company agreed to corrective actions to eliminate potential hazards similar to those that caused the 2005 tragedy. Today's announcement comes at the conclusion of a six-month inspection by OSHA, designed to evaluate the extent to which BP has complied with its obligations under the 2005 agreement and OSHA standards.

“When BP signed the OSHA settlement from the March 2005 explosion, it agreed to take comprehensive action to protect employees. Instead of living up to that commitment, BP has allowed hundreds of potential hazards to continue unabated,” said Secretary of Labor Hilda L. Solis. “Fifteen people lost their lives as a result of the 2005 tragedy, and 170 others were injured. An \$87 million fine won't restore those lives, but we can't let this happen again. Workplace safety is more than a slogan. It's the law. The U.S. Department of Labor will not tolerate the preventable exposure of workers to hazardous conditions.”

For noncompliance with the terms of the settlement agreement, the BP Texas City Refinery has been issued 270 “notifications of failure to abate” with fines totaling \$56.7 million. Each notification represents a penalty of \$7,000 times 30 days, the period that the conditions have remained unabated. OSHA also identified 439 new willful violations for failures to follow industry-accepted controls

on the pressure relief safety systems and other process safety management violations with penalties totaling \$30.7 million.

“BP was given four years to correct the safety issues identified pursuant to the settlement agreement, yet OSHA has found hundreds of violations of the agreement and hundreds of new violations. BP still has a great deal of work to do to assure the safety and health of the employees who work at this refinery,” said acting Assistant Secretary of Labor for OSHA Jordan Barab.

The BP Texas City Refinery is the third largest refinery in the United States with a refining capacity of 475,000 barrels of crude per day. It is located on a 1,200-acre facility in Texas City, southeast of Houston in Galveston County.

A willful violation exists where an employer has knowledge of a violation and demonstrates either an intentional disregard for the requirements of the Occupational Safety and Health (OSH) Act of 1970, or shows plain indifference to employee safety and health. A penalty of up to \$70,000 may be assessed for each willful violation.

A notification of failure to abate can be issued if an employer fails to correct a cited condition and the citation is a final order of the Occupational Safety and Health Review Commission. A penalty of up to \$7,000 may be assessed for each day that the violation remains uncorrected.

E. No-Discrimination Clause

Section 11 of OSHA protects employees against retaliation for exercising their rights under OSHA. The statute provides:

(1) No person shall discharge or in any manner discriminate against any employee because such employee has filed any complaint or instituted or caused to be instituted any proceeding under or related to this Act or has testified or is about to testify in any such proceeding or because of the exercise by such employee on behalf of himself or others of any right afforded by this Act.

One of the most controversial cases to arise under OSHA was decided by the U.S. Supreme Court in 1980. The case involved the Whirlpool

Corporation, which manufactures household appliances. At its plant in Marion, Ohio, employees worked under a steel net, which protected them from falling objects as they were transported across the facility. Workers routinely walked out onto the netting to retrieve items that had fallen. Two employees were ordered to perform that job, but they objected because the screen was unsafe. In fact, employees had fallen through the mesh on previous occasions, and one employee died as a result of the fall. When they refused to perform the work, their supervisor instructed them to punch out and leave for the day. They were later issued written warnings for insubordination.

The Court ruled in *Whirlpool Corp. v. Marshall* (445 U.S. 1) that under a specific set of circumstances, employees might be protected in their refusal to perform work as directed and upheld an OSHA regulation to that effect. The Court noted that OSHA set forth a detailed scheme by which employees could bring a safety issue to the attention of their employer or to OSHA. In the Court's words:

Upon receipt of an employee inspection request stating reasonable grounds to believe that an imminent danger is present in a workplace, OSHA must conduct an inspection. In the event this inspection reveals workplace conditions or practices that "could reasonably be expected to cause death or serious physical harm immediately or before the imminence of such danger can be eliminated through the enforcement procedures otherwise provided by" the Act, the OSHA inspector must inform the affected employees and the employer of the danger and notify them that he is recommending to the Secretary that injunctive relief be sought. At this juncture, the Secretary can petition a federal court to restrain the conditions or practices giving rise to the imminent danger. By means of a temporary restraining order or preliminary injunction, the court may then require the employer to avoid, correct, or remove the danger or to prohibit employees from working in the area.

Despite those general provisions, the Court recognized that a unique situation might arise in which the employee was "ordered by his employer to work under conditions that the employee reasonably believes pose an

imminent risk of death or serious bodily injury, and the employee has reason to believe that there is not sufficient time or opportunity either to seek effective redress from his employer or to apprise OSHA of the danger.” Where the employee exercised a good-faith refusal to submit to an imminent threat of death or serious injury, the employer could not take discriminatory action against the employee.

In its opinion, the Court conceded that Congress rejected a “strike with pay” provision in OSHA that would have required employers to pay workers who refused to perform unsafe work, but the employees in this case received no pay and were not entitled to it. Rather, the employer punished them for exercising their rights by putting a written warning in their records. The Court also discussed Congress’s debate regarding a plant shutdown because of safety issues. This case, they wrote, did not involve a threatened OSHA closure of a place of business. Congress did not give OSHA such powers, and workers could not invoke the law to accomplish that same result. Consequently, the legislative history had little relevance to the given case.

The *Whirlpool* decision illustrates the scope of OSHA and the extent to which workers can engage in self-help to protect themselves. Where workers are represented by a union, the collective bargaining contract typically offers broader protections in matters of safety. Coal miners, for example, usually have rights to request a meeting with a safety officer and a union steward if the worker believes conditions are abnormally unsafe, but even those safeguards may not be sufficient. In April 2010, miners at the Upper Big Branch mine in Montcoal, West Virginia, encountered high levels of methane gas in their work area. The gas exploded, killing 25 miners. Massey Coal Company, which owned the site, took little notice of safety complaints, according to mine employees. One subcontractor said that “workers had regularly been told to work 12-hour shifts when eight hours is the industry standard. He also said that live wires had been left exposed and that an accumulation of coal dust and methane was routinely ignored.”⁵ Obviously, safety issues have not been eliminated from many workplaces.

F. Are the Benefits of OSHA Worth the Costs?

One of the important issues about public policy involves the assessment of risk. To evaluate policies, a cost-benefit analysis may provide useful

information about how we deal with a problem. If, for example, we believe that human activity is driving climate change and such change will have negative consequences for the planet, how much should we spend to ameliorate the problem? The growing field of behavioral economics suggests that our cognitive filters influence the information we get from experts in the field.

By any reasonable standard, there is persuasive evidence of human impact on climate conditions. Despite that, there is also widespread disagreement whether we should limit the emissions of cars and coal plants through international agreements. People respond to the issues based on individualized views of the world. A current example is the way communities react to red-light cameras, which provide surveillance at intersections and result in traffic citations. There is evidence that those cameras reduce accidents, and particularly fatal accidents, but some citizens criticize them because they are too intrusive and represent another case of the “nanny state.” The same analysis can be applied to OSHA.

Cass Sunstein, a well-known legal scholar, discussed this point in a paper that analyzed why public policy is distorted by common human misapprehensions about risk.⁸ He pointed out, among a number of examples, that the OSHA standard dealing with procedures for safeguarding machines against being turned on while someone is working on them—the “lockout-tagout” standard—costs approximately \$70.9 million for every premature death averted. Does the cost of preventing a single death justify the expenditure of \$70 million? Sunstein goes on to discuss some of the obstacles to formulating good policy: “It is true but obvious to say that people lack information and that their lack of information can lead to an inadequate or excessive demand for regulation, or a form of paranoia and neglect.” What is less obvious, he continues, is that the common distortions affecting risk perception often lead to laws that are not adequately based on fact. Because people have a tendency to exaggerate risks or to miscalculate the benefits of risk reduction, they impose poor choices on political leaders. Consequently, he concludes, “The government currently allocates its limited resources poorly, and it does so partly because it is responsive to ordinary judgments about the magnitude of risks. A government that could insulate itself from misinformed judgments could save tens of thousands of lives and tens of billions of dollars annually.”

The debate over OSHA costs and benefits was brought into focus in 2011 debates about the federal budget. House Republicans proposed numerous cuts in the federal regulatory programs. Their justification was that excessive government spending needed to be curtailed, and federal intervention into workplaces simply added further costs to businesses. A story on National Public Radio in March 2011 reported, “Congressional Republicans are promising to scrub the government for what they say are ‘job killing regulations. One of their primary targets is the Occupational Safety and Health Administration, or OSHA.”⁷ Republicans initially tried to cut \$61 billion from the overall budget, and OSHA was targeted for a reduction of \$99 million. The rationale for the cuts was straightforward and consistent with criticisms of OSHA over the past 40 years. According to one Republican representative, “Over the last two years, OSHA has not only attempted to implement several policy changes that would have profound impact on the workplace; it has become an administration more focused on punishment than prevention.” He asserted that OSHA’s job is to prevent injuries, “not simply shame an employer once a tragedy has occurred on the job site.”

Whether OSHA will be defunded at levels demanded by conservatives remains to be seen. If the 2012 elections result in a marked political shift either to the left or the right, OSHA’s fate will hinge on that outcome. In any case, demands for less government spending and attempts to reduce the deficit require politicians to carefully consider how scarce resources are allocated. OSHA, meanwhile, continues to expand its efforts to adequately protect workers. The agency recently proposed guidelines to safeguard hearing loss by imposing obligations on employers to implement whatever steps are feasible in reducing noise. It announced, “Accordingly, OSHA now proposes to consider administrative or engineering controls economically feasible when the cost of implementing such controls will not threaten the employer’s ability to remain in business, or if such a threat to viability results from the employer’s failure to meet industry safety and health standards.”⁸ OSHA extended its deadline for comments until March 2011, after which the agency said it would review the feedback and consider further action. Some experts in the field of audiology supported the approach and argued that the United States is far behind other countries

in noise controls.⁹ The debate will certainly continue over regulation versus employment.

II. Will the United States Have a National Health Insurance Program?

The well-known Swedish furniture manufacturer, IKEA, has an international reputation for its products and employee-relations programs. It has expanded into global markets and maneuvered successfully through the 2008–2009 recession by a combination of low prices and quality furniture. When IKEA moved into the U.S. market, it opened a plant in Danville, Virginia. Residents of the area welcomed the company and anticipated there would be a number of good jobs available to the town's residents, which suffered from the loss of other manufacturing activity and high levels of unemployment. Unfortunately, IKEA turned out to be a low-wage, anti-union company like many of its American counterparts.

According to a story in the *Los Angeles Times*, IKEA received about \$12 million in incentives to locate the plant in Danville.¹⁰ The Americans make products identical to those made in Sweden, but, the report notes: “The big difference is that the Europeans enjoy a minimum wage of about \$19 an hour and a government-mandated five weeks of paid vacation. Full-time employees in Danville start at \$8 an hour with 12 vacation days—eight of them on dates determined by the company.” IKEA also hires about one third of its workforce through temporary agencies, and pays lower wages and no benefits. When the Danville workers contacted the Machinists’ union about an organizing drive, IKEA hired one of the most notorious anti-union law firms in the United States to combat the union effort. One of the union staff members remarked, “It’s ironic that IKEA looks on the U.S. and Danville the way that most people in the U.S. look at Mexico.” Perhaps most ironically, Europeans have a system of health care offered to all citizens, but Americans have yet to attain this basic entitlement.

Part of the explanation for the lack of a national health care program lies in the unique structure of American employment relations. As noted in earlier chapters of this book, America is “exceptional” in that many work-related benefits are negotiated between employees and their employer, rather than being part of a government system. Swedish workers

at IKEA plants enjoy mandatory paid vacations, family leave with pay, generous unemployment benefits, and secure pension plans, along with guaranteed health care provided by national legislation. Famous political figures in the United States advocated similar laws, but those efforts failed to attract sufficient support. After his 1945 inauguration, for example, President Harry S. Truman launched a vigorous campaign for health insurance. According to the Truman Library, the plan “called for the creation of a national health insurance fund to be run by the federal government. This fund would be open to all Americans, but would remain optional. Participants would pay monthly fees into the plan, which would cover the cost of any and all medical expenses that arose in a time of need. The government would pay for the cost of services rendered by any doctor who chose to join the program. In addition, the insurance plan would give a cash balance to the policy holder to replace wages lost due to illness or injury.”¹¹ Truman’s proposal was attacked by the American Medical Association as a “Socialist” plan, and characterized Truman’s staff as “followers of the Moscow party line.”

On March 23, 2010, Congress passed the Patient Protection and Affordable Care Act (PPACA), a fulfillment of President Obama’s campaign promise to enact a national health care system. The November 2010 elections led to a Republican majority in the House of Representatives, and many of the incoming representatives claimed that their election constituted a mandate to repeal “Obamacare,” as they referred to the PPACA. House Republicans actually passed a repeal measure in January 2011, describing health care reform as a “job killer.” An independent analysis rated this claim as “false.”¹² Moreover, given the Democratic majority in the Senate and a Democratic president, the prospects for successful repeal before 2012 are little more than ideological theatrics. Opposition to the program, however, could undermine its effectiveness over the long term. What is clear is that the United States spends more on health care—about 16 percent of our gross domestic product—than any other nation, and costs are persistently above increases in the consumer price index. Health care expenditures are increasing globally as a result of greater longevity, advances in medical technology, and the economic downturn of 2008. The Organization for Economic Cooperation and Development (OECD) issued an excellent recent summary of those trends.¹³

The PPACA has provisions that become effective over a period of years. The official government Web site at healthcare.gov offers a good summary of what the bill contains and the effective dates.¹⁴ A number of provisions have been implemented, including limits on insurers' ability to reject preexisting health conditions and rescind coverage for individuals. Future changes deal with affordability and access to health care, such as the formation of insurance exchanges to be implemented in January 2014. According to the Web site, "Starting in 2014 if your employer doesn't offer insurance, you will be able to buy insurance directly in an Exchange—a new transparent and competitive insurance marketplace where individuals and small businesses can buy affordable and qualified health benefit plans. Exchanges will offer you a choice of health plans that meet certain benefits and cost standards. Starting in 2014, Members of Congress will be getting their health care insurance through Exchanges, and you will be able to buy your insurance through Exchanges too."

If the Obama plan withstands attacks from its conservative opponents, it will profoundly affect U.S. employment relations. No longer will workers seek out jobs because they offer health insurance, and employers will no longer compete on a tilted playing field that favors large firms and attractive worker demographics that reduce insurance risk. Likewise, global corporations such as IKEA will not engage in a race to the bottom by locating in a country where the provision of health insurance is just another optional cost of doing business.

Notes

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3. The information in this section is drawn from the OSHA Fact Sheet describing the inspection and citation process. It is posted http://www.osha.gov/OshDoc/data_General_Facts/factsheet-inspections.pdf
4. The document is available at the following site: http://www.osha.gov/pls/oshaweb/owadispl.show_document?p_table=NEWS_RELEASES&p_id=16674

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Employee Relations

Legal and Political Foundations

Raymond L. Hogler

Raymond L. Hogler is a professor of management at Colorado State University. He has worked and taught in the field of employment relations for three decades. His publication record includes over sixty articles in academic and legal journals and several books, the most recent of which is *Employment Relations in the United States* (Sage, 2004). Among other honors, he was awarded the 2007 Fulbright Distinguished Chair of Labor Law at the University of Tuscia (Viterbo, Italy).



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