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Promoting Employee Voice in the American Economy: A Call for Comprehensive Reform

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PROMOTING EMPLOYEE VOICE IN THE AMERICAN ECONOMY: A CALL FOR COMPREHENSIVE REFORM

KENNETH G. DAU-SCHMIDT*

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I. INTRODUCTION

It has become apparent that there are serious deficiencies in the American model of production. Our model of corporate governance has recently come under intense scrutiny in the academic literature and the popular press. There are increasing concerns that American corporations are too focused on short-run profits and stock prices, at the expense of long-term strategies and investments that would benefit the long-run value of the firm, employees, and the American economy at large. In the pursuit of short-run shareholder interests, American corporations have bestowed on senior executives enormous compensation packages that seem increasingly divorced from any notion of rationality, let alone equity. At the same time, there is increasing concern that our system of labor relations is yielding declining benefits for workers and undermining the position of the American economy as


3. See HUTTON, supra note 1, at 11–12; Porter, supra note 1, at 4.

4. As early as 1984, Peter Drucker, the “guru” of modern management persuasively argued that American CEO pay had rocketed out of control and implored boards to hold CEO compensation to no more than 20 times what the rank and file made. What particularly enraged him was the tendency of corporate managers to reap massive earnings while firing thousands of their workers. “This is morally and socially unforgivable,” wrote Drucker, “and we will pay a heavy price for it.” John A. Byrne & Lindsey Gerdes, The Man Who Invented Management, BUS. WK., Nov. 28, 2005, at 97–102; see also Rik Kirkland, The Real CEO Pay Problem, FORTUNE, June 30, 2006, at 78 (“Voters are outraged. Big investors are demanding change. Even some CEOs admit there’s a crisis. But rewards that defy all economic logic don’t simply spring from greed. Corporate America’s executive-compensation system is broken.”).
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a whole. Workers' wages and benefits have been stagnant—or even declining—for decades, increasing income inequality in our economy as risks of job loss, medical expenses, and training obsolescence have devolved from employers to employees. At the aggregate level, personal debt levels are at all-time highs while we suffer burgeoning trade deficits and the loss of vital jobs overseas.

Although there are many factors that contribute to these problems, there is at least one underlying cause—the under-representation of employee voice in the American economy. Among the three founding corporate stakeholders, shareholders, management, and labor, the interests of labor are treated as subordinate and less important. In the American model of corporate governance, the shareholders and management are perpetually allied, leaving labor to fend for its interests largely through individual bargaining. This subordination of labor in firm governance leaves the shareholders without an important in-house ally in the monitoring of management performance and leaves management without an important long-term ally in considering the merit of long-term strategies and investments. Similarly, within the American system of labor relations, labor's interests are treated as


6. Although government debt and non-financial business debt have remained relatively stable for the past 50 years and each accounted for debt amounting to about 50% of GDP, since 1980 household debt has increased from roughly 50% of GDP to about 100% of GDP, while financial sector debt has increased from about 15% of GDP to over 100% of GDP. As a result of this private borrowing, total debt in the U.S. has risen from slightly over 150% of GDP in 1980 to slightly under 350% of GDP in 2008. Henry Blodget, Our Debt Problem, Explained, BUS. INSIDER, Apr. 4, 2009, http://www.businessinsider.com/henry-blodget-our-de-2009-4. Over the same period, the US balance of trade has gone from approximately a $20 billion deficit in 1980 to a $700 billion deficit in 2008. U.S. CENSUS BUREAU, FOREIGN TRADE DIVISION, http://www.census.gov/foreign-trade/statistics/historical/gands.txt. As the trade deficit soars, more and more jobs go overseas.


8. Id. at 96–97; see also Matthew T. Bodie, Workers, Information, and Corporate Combinations: The Case for Nonbinding Employee Referenda in Transformative Transactions, 85 WASH. U. L.R. 871, 900 (2007) (stating that employees are a natural fit in the role as information provider even though there is a general lack of unionization among private sector employees); Kent Greenfield, The Place of Workers in Corporate Law, 39 B.C.L. REV. 283, 301 (1998) (highlighting that an employee knows where his skill and labor are allocated and is in an ideal position to observe the important indicators of management strategy and performance); Antoine Rebéroux, Does Shareholder Primacy Lead to a Decline in Managerial Accountability?, 31 CAMBRIDGE J. ECON. 507, 521 (2007).
subordinate. For the most part, the terms and conditions of employment are set by management through a unilateral offer without any express voice by the employees.\(^9\) Employee interests are, once again, left to the vagaries of individual bargaining and the inefficient signaling mechanism of exit.\(^10\) Once the terms of employment are offered and accepted by performance, employees are left with no effective means of enforcing those rights, short of suing their employer.\(^11\) The subordination of employee interests in labor relations ensures that those interests are not adequately represented, increasing turnover and ensuring under-consumption of public goods in the workplace.\(^12\)

In this essay, I will examine the problems caused by the current lack of employee voice in American corporate governance and labor relations. In Part II, I discuss the current state of corporate America, including both our system of corporate governance and our system of labor relations. In Part III, I discuss the current problems in the American system of production. Although the problems of the American system of production are much broader than just our most recent setbacks, a discussion of the near collapse of our financial sector and the Great Recession will feature prominently in this exposition. In Part IV, I discuss alternative formulations of corporate governance and labor relations and the potential benefits of promoting employee voice. Examples are drawn from the law and practice of corporate governance and labor relations in Germany and Japan. In Part V, I present proposals for amending American law to promote employee voice in our corporate governance and labor relations. Although a proposal to promote employee voice by necessity must favor the interests of labor over those of capital, in my proposal I attempt to include a balance of initiatives, some of which will probably appeal to employers. My hope is


11. For a discussion of the difficulties facing employees who wish to sue their current employers, see Deborah L. Brake, Retaliation, 90 MINN. L. REV. 18, 19–25 (2005); Nantiya Ruan, Bringing Sense to Incentives: An Examination of Incentive Payments to Named Plaintiffs in Employment Discrimination Class Actions, 10 EMP. RTS. & EMP. POL’Y J. 395, 396–97, 410–11 (2006).

12. FREEMAN & MEDOFF, supra note 10, at 14–16; see also Freeman & Medoff, supra note 10, at 72–78.
to not only present a workable collection of proposals, but also one that
is politically feasible. Finally, I close with my conclusions.

II. THE CURRENT STATE OF CORPORATE AMERICA

A. The Shareholder Value Model of Corporate Governance

For the last three decades, the dominant model of corporate
governance in the United States has been the "shareholder value"
model of governance. The model's theoretical underpinnings were
established in the academic literature of the '70s and '80s, but its
biggest proponents were probably corporate leaders such as Jack Welch,
the CEO of General Electric from 1981 to 2001, and Roberto Goizueta,
the CEO of Coca-Cola from 1981 to 1997. Under this model, the sole
objective of corporate management is to "serve shareholder interests"
by endeavoring to maximize the value of corporate stock. It is
assumed that the interests of other possible stakeholders in the firm,
such as consumers and employees, will be met in the quest of
maximizing share value. By providing customers with the goods they
want and retaining valuable employees, management will increase the
profitability of the firm and so the share price. It is also assumed that
maximizing share price will appropriately balance the short-run and
long-run interests of the firm. If management adopts policies that do
not adequately take account of the long-run interests of the firm, the

13. See generally ALFRED RAPPAPORT, CREATING SHAREHOLDER VALUE: THE NEW
STANDARD FOR BUSINESS PERFORMANCE 1 (1986); Michael C. Jensen & William H.
Meckling, Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure, 3
J. FIN. ECON. 305 (1976). For a modern view, see William W. Bratton & Michael L. Wachter,
Shareholder Primacy's Corporatist Origins: Adolf Berle and The Modern Corporation, 34 J.
CORP. L. 99, 143-44 (2008); Michael C. Jensen, How to Pay Bosses, ECONOMIST, November

14. In the popular literature, the origin of the model is often attributed to a 1981 speech
Jack Welch gave to financial analysts at New York's Pierre Hotel, shortly after taking the
helm at GE, entitled "Growing Fast in a Slow-Growth Economy." In the speech Welch
argued that lagging businesses—those not No. 1 or No. 2 in their markets—should be "fixed,
sold, or closed" and asserted that GE would "no longer tolerate low-margin and low-growth
units." Welch boasted that GE "will be the locomotive pulling the GNP, not the caboose
following it." Although in his 1981 speech Welch never actually used the term "shareholder
value," he made it clear that his number one goal at GE was consistent earnings growth and
his report card for this effort would be stock price. Welch became the star of the shareholder

15. RAPPAPORT, supra note 13, at 1; Roger Martin, The Age of Customer Capitalism,


17. Id. at 61–62.
market will realize this and the value of the firm’s stock will drop.

To closely ally management interests with shareholder interests, firms adopted management compensation schemes that included lucrative performance bonuses and stock options. Under these schemes, management directly benefits from any increase in firm stock price and thus management and shareholder interests coincide. Should these compensation mechanisms fail to adequately motivate managers to serve shareholder interests, an active market for corporate control provides a back-stop. If the firm’s current management does not follow production and labor relations policies that maximize share value, then corporate raiders will have incentive to buy control of the firm and amend corporate practices with new management and management policies that increase stock price.

There are at least three important problems with this model of corporate governance. First, the model is highly dependent on the existence of perfect capital markets for some of its bolder claims. It is assumed that stock traders act rationally on the basis of perfect information so that current share prices represent an accurate evaluation of the firm’s current management policies and the firm’s short-run and long-run strategies. Recent experience in the financial sector suggests that capital markets are far from perfect in either the available information or the rationality of the participants. Firm stock prices are driven by shareholders’ expectations about future earnings, with traders buying stocks if their expectations are high relative to the current price and selling them if their expectations are low relative to the current price. If a business is doing well, shareholders will ratchet-up their expectations, eventually to a point that cannot be met, so that stock prices fall regardless of management and firm performance. Peoples’ expectations suffer from a “herd mentality” or “animal spirits” so that they are both overly optimistic about advances and overly pessimistic about declines. Thus, it is impossible to continually

18. Jensen & Meckling, supra note 13, at 353; Martin, supra note 15, at 60.
20. RAPPAPORT, supra note 13; Martin, supra note 15, at 61.
22. Use of the term “animal spirits” to describe this phenomenon is attributed to John Maynard Keynes. JOHN MAYNARD KEYNES, THE GENERAL THEORY OF EMPLOYMENT, INTEREST AND MONEY 161 (1936). For a more recent discussion of this term, see generally GEORGE A. AKERLOF & ROBERT J. SHILLER, ANIMAL SPIRITS: HOW HUMAN PSYCHOLOGY DRIVES THE ECONOMY, AND WHY IT MATTERS FOR GLOBAL CAPITALISM (2009).
increase shareholder value and any management team that takes this as its credo is on a fool's errand. Of course American management is no one's fool, they realize that stock prices are cyclical and the best they can do is make changes that raise short-run expectations and stock prices and then cash in their stock options and get out before the inevitable crash.24 Such an alignment of management's interest with short-run "get rich quick" schemes is not in the interests of shareholders, employees, or the U.S. economy at large.

Second, the model fails to make use of important long-run interests and insider information that the managers and employees have about the operation of the firm. It implicitly assumes that, through stock prices, stock traders have the same interests as customers and employees of the firm and that they can know as much, or even more, about the efficient short-run and long-run operation of the firm as the management and employee insiders who actually operate the firm.25 In American corporations, management and shareholders are permanently allied and enter the market to buy labor as a commodity. Manager interests have been co-opted by shareholder interests in the short-run price of firm stock, and employee interests have been completely subordinated and left to protection only by individual bargaining, exit, and an imperfect market for stock prices. Under this system of governance, the firm forfeits important long-run interests in favor of short-run stock prices, and the shareholders give up employees as a valuable inside ally in the monitoring of firm management. Nimble capital, which in the information age can be transferred across the globe in the blink of an eye, does not have the same long-run interest in the firm as either the employees or the managers. As a result, American corporations do not adequately take account of long-run strategies, and investments that would benefit the firm, employees and society at large.26 Moreover, shareholders do not have the same access to information on the running of the firm as the two inside players, labor and management. As a result, they end up paying their top management ever increasing amounts of money, which are more and

24. Id. at 61–62.
25. RAPPAPORT, supra note 13, at 6; Martin, supra note 15, at 61.
26. For example, it has been suggested that American corporations do not adequately invest in market position, product improvement, or product quality. Howard Gospel & Andrew Pendelton, Corporate Governance and Labour Management: An International Comparison, in CORPORATE GOVERNANCE, supra note 7, at 1, 14–17; Jackson et al., supra note 7, at 96–97.
more divorced from actual firm performance.\textsuperscript{27}

Finally, it has been argued that both the effort to maximize share value and the permanent alliance of capital and management that occur under the American model work to the detriment of employee interests. The focus on maximizing shareholder value is thought to have a distributional impact on the proceeds of the firm favoring the capital and management alliance because firms have a limited capacity to realize real increases in returns.\textsuperscript{28} In other words, the focus on shareholder value shifts the claims against the firm in shareholders' and management's favor, but it does not increase the surplus actually generated by the firm, and may actually decrease it.\textsuperscript{29} Moreover, because of the focus on share value and the permanent management-capital alliance, efforts to increase share value come largely at the expense of labor, often in the form of employee layoffs.\textsuperscript{30} Because production is organized by management and capital for the primary benefit of capital, labor is left to absorb the ups and downs of the market through layoffs. Hall and Soskice have suggested that weaker legal protection for job security in the United States facilitates this shift of risk from capital to labor.\textsuperscript{31} There is also a growing body of empirical work questioning whether absorbing financial downturns through layoffs is good for the long-run performance of the firm.\textsuperscript{32} By relying

\textsuperscript{27} As CEO of Coca-Cola, Roberto Goizueta became the first corporate manager to become a billionaire on the basis of stockholdings in a company he neither founded nor took public. At the time of his retirement from GE, it is estimated that Jack Welch owned over $900 million of the company's stock. Martin, supra note 15, at 62. At least these CEOs were successful, but under our system of executive compensation even mediocre executives or failures are richly rewarded. As Warren Buffett said in the 2005 Berkshire-Hathaway annual report: "Too often, executive compensation in the U.S. is ridiculously out of line with performance. That won't change, moreover, because the deck is stacked against investors when it comes to the CEO's pay. The upshot is that a mediocre-or-worse CEO—aided by his handpicked VP of human relations and a consultant from the ever-accommodating firm of Ratchet, Ratchet and Bingo—all too often receives gobs of money from an ill-designed compensation arrangement." Scott Brown, Excessive Executive Compensation: When is Too Much, Too Much?, INVESTMENT U, June 8, 2009, http://www.investmentucourse.com/iucourse/executive-compensation/; John Schroy, Warren Buffett Attacks Buyback Schemes, CAPITAL FLOW WATCH, June 16, 2006, http://capital-flow-watch.net/2006/06/16/warren-buffett-attacks-buyback-option-schemes/.

\textsuperscript{28} Gospel & Pendleton, supra note 26, at 14.

\textsuperscript{29} Id.

\textsuperscript{30} Julie Froud et al., Restructuring for Shareholder Value and Its Implications for Labour, 24 CAMBRIDGE J. ECON. 771, 776 (2000).

\textsuperscript{31} Peter A. Hall & David Soskice, An Introduction to Varieties of Capitalism, in VARIETIES OF CAPITALISM: THE INSTITUTIONAL FOUNDATIONS OF COMPARATIVE ADVANTAGE 1, 16 (Peter A. Hall & David Soskice eds., 2001).

\textsuperscript{32} WAYNE F. CASCIo, RESPONSIBLE RESTRUCTURING: CREATIVE AND PROFITABLE
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primarily on layoffs to absorb economic fluctuations and maintain short-run profits, firms lose valuable employees and their human capital investments in the firm, discourage employees from making human capital incentives in the firm, and increase distrust and turnover among retained employees. 33

B. The Individual Contract System of Labor Relations

Since the birth of the republic, the American system of labor relations has been dominated by individual contract. With the industrial revolution and the de-skilling of jobs through “scientific management” and the development of the assembly-line, management gained valuable bargaining power over individual employees. 34 American courts buttressed employer bargaining power and management control by embracing the doctrines of “freedom of contract” 35 and “employment-at-will.” 36 The strict adherence of American courts to the doctrine of freedom of contract not only allowed employers to fully exploit their bargaining power in individual contracts but also, for a time, was constitutionally enshrined under the Lochner doctrine and used to prohibit employee protective legislation. 37 The Lochner doctrine could


37. In Lochner v. New York, 198 U.S. 45, 53 (1905), the Supreme Court struck down a New York statute limiting to sixty the number of hours bakers could work in a week, under the theory that this limitation unconstitutionally infringed on the employers’ and employees’ “liberty” to contract for longer work hours, as protected in the 14th Amendment. The Court
not survive in a modern economy because a national economy requires national regulation of the employment relationship to ensure economic stability and growth. However, even in the days since *Lochner's repudiation*, the doctrines of employment at will and unilateral contract have combined to give American employers extraordinary power in determining and changing the terms and conditions of employment through individual bargaining. Under the most rigid interpretations of these doctrines, unless the parties expressly state otherwise, the employer can end the current employment relationship at any time for any reason and unilaterally offer new terms which the employee "accepts" by continuing to work to support his or her family.

reasoned that the state could only infringe on such liberty pursuant to a valid exercise of its police power to protect vulnerable classes of people, regulate particularly dangerous activities or safeguard the general health and well-being. During what would later be known as "the Lochner Era" the Court used its theory of "substantive due process" under the 5th and 14th Amendments to strike down over 200 federal and state statutes which, in its view, impinged on liberty and freedom of contract without adequate justification. Some of the most notable of these cases include *Adair v. United States*, 208 U.S. 161, 180 (1908) (invalidating section 10 of the Erdman Act prohibiting "yellow dog" contracts), *Coppage v. Kansas*, 236 U.S. 1, 26 (1915) (invalidating a state statute prohibiting "yellow dog" contracts), and *Adkins v. Children's Hospital*, 261 U.S. 525, 539, 543, 562 (1923) (invalidating a federal statute establishing a minimum wage for women and children in the District of Columbia).

38. As the economy continued to grow and develop into a national economy, the problems of ham-stringing federal and state legislative power under the Lochner doctrine became more and more apparent. See KENNETH G. DAU-SCHMIDT, ET AL., supra note 34, at 32-39, 63; James Gray Pope, *Labor and the Constitution: From Abolition to Deindustrialization*, 65 TEx. L. Rev. 1071, 1072 (1987).

39. The first major realignment on the constitutionality of New Deal legislation occurred in *West Coast Hotel Co. v. Parrish*, 300 U.S. 379, 386, 389, 400 (1937), when Roberts joined Chief Justice Hughes, and Justices Louis Brandeis, Benjamin N. Cardozo, and Harlan Fiske Stone to uphold a Washington State minimum wage law, five to four. The same majority upheld the constitutionality of the Wagner Act on April 12, 1937. NLRB v. *Jones & Laughlin Steel Corp.*, 301 U.S. 1, 49 (1937).

40. ALVIN L. GOLDMAN, *LABOR AND EMPLOYMENT LAW IN THE UNITED STATES* ¶ 133 (1996). Most jurisdictions have developed some exceptions to the at-will doctrine to limit the most egregious instances of employer misbehavior in discharging employees, for example giving the employee a tort cause of action for wrongful discharge when he is fired for refusing to violate the law, *Petermann v. International Brotherhood of Teamsters*, 344 P.2d 25, 26, 28 (Cal. Dist. Ct. App. 1959), or in order to avoid paying the employee commissions or benefits that have already been earned, *Fortune v. National Cash Register Co.*, 364 N.E.2d 1251, 1253 (Mass. 1977). However, these cases generally don’t limit the employer’s ability to use the at-will doctrine to end one set of terms and conditions of employment and begin another. In this regard there have only been a very limited number of cases suggesting that employers might need to give "reasonable notice" in order to eliminate prior promises of job security of indefinite duration, see, e.g., *Bankey v. Storer Broadcasting Co.*, 443 N.W.2d 112, 113 (Mich. 1989) (holding that the employer, upon reasonable notice to employees, may modify employee handbook to provide for employment-at-will), or to impose new requirements that impinge the employee’s constitutional right to privacy, *Luedtke v. Nabors*
Employees' only recourse is to go elsewhere, based not on what they have accomplished for their current employer, but instead on the promise of what they will do for a future employer, a promise that inevitably fades with age. The rise of global production using the new information technology has further undermined employees' ability to achieve significant input into their jobs through individual bargaining. Although individual bargaining may have served the colonists and frontiersmen well when labor was scarce and new opportunities were just over the horizon, in today's "flat world" economy in which Americans compete with workers in developing countries across the globe, cheap labor undermines every deal.

Collective bargaining is of limited and declining importance in the American system of labor relations. Although worker organization and collective bargaining have been a part of American labor relations since colonial times, union density has never exceeded 33.2% in the private sector and has been declining, more or less steadily, since that zenith was reached in 1955. Today less than 7% of private sector employees in the United States are members of a union. Under the “New Deal” of the 1936 Wagner Act, it was the policy of the United States to foster

Alaska Drilling, Inc., 834 P.2d 1220, 1225-26 (Alaska 1992) (holding that the employer was required to give “reasonable notice” before it could impose new drug testing requirement on employees).


42. In the 1990s the global labor market experienced a near doubling of the relevant labor force with a concomitant downward pressure on wages and benefits. Since 1990, the collapse of Communism, India's turn from autarky, and China's adoption of market capitalism have led to an increase in the relevant global labor force from 3.3 billion to 6 billion. Because all of these countries are relatively capital poor, their entry into the global economy has brought no corresponding increase in global capital, and as a result, the capital-to-labor ratio in the global economy has dropped approximately forty percent. See RICHARD B. FREEMAN, AMERICA WORKS: THE EXCEPTIONAL U.S. LABOR MARKET 128-40 (2007). This abrupt change in the ratio of available labor and capital in the global economy has put tremendous downward pressure on wages and benefits on workers in developed countries that are subject to global competition. The downward pressure on wages and benefits exists not only in manufacturing, but in any service in which work can be digitalized and sent to qualified people elsewhere in the world. Id.

43. Press Release, Bureau of Labor Statistics, Union Members 2009, 7 tbl.3 (Jan. 22, 2010), available at http://www.bls.gov/news.release/archives/union2_01222010.pdf. Because union density is higher in the public sector (41.1%), the overall union density rate for the United States in 2009 was 12.3% or 15.3 million members. Id. at 1.

employee organizing and collective bargaining, thus promoting employee voice through “industrial democracy.” Collective bargaining was viewed as a useful mechanism that would allow employees to bargain with employers on an equal footing, while still allowing decentralized solutions to the problems of the workplace that were derived by the parties themselves and which minimized regulatory intrusion. However, beginning with the 1947 Taft-Hartley amendments to the National Labor Relations Act (NLRA), national labor policy lapsed into one of, at best, benign indifference to employee organizing and, at worst, one favoring employer property rights over the right to organize.

At the same time federal policy was regressing to a state of indifference or even hostility with respect to employee organizing, the employment relationship was undergoing dramatic changes that would further reduce the relevance of the National Labor Relations Act to labor relations. By employing the new information technology, employers have been able to invest in and organize production across the globe in ways that subject American labor to a global market not previously experienced. These new methods of organizing production have undermined the corporate administrative rules, long-term employment relationships, and even the notion of “employee” upon which the NLRA system of collective bargaining was founded. As a


48. See, e.g., Lechmere, Inc. v. NLRB, 502 U.S. 527 (1992) (upholding employer’s right to exclude union organizers who were not its employees from even public areas on the employer’s property); Trs. of Columbia Univ., 350 N.L.R.B. 574 (2007) (denying union’s right to e-mail addresses of employees at sea during election campaign because union e-mails would use employer server).


result, even among the employees still represented by unions, collective bargaining under the NLRA has become a less important factor in determining corporate policies and the terms and conditions of employment.\footnote{PAUL C. WEILER, GOVERNING THE WORKPLACE: THE FUTURE OF LABOR AND EMPLOYMENT LAW 249–50 (1990); Cynthia L. Estlund, The Ossification of American Labor Law, 102 COLUM. L. REV. 1527, 1527 (2002).}

The most recent government effort to address workers' interests in the employment relationship has been the modern movement to develop a web of employee-protective legislation. Even before the repudiation of the \textit{Lochner} doctrine, some jurisdictions used their police powers to adopt significant protective legislation in the form of child labor laws,\footnote{David E. Bernstein, \textit{Lochner's Legacy's Legacy}, 82 TEX. L. REV. 1, 36–37 (2003). Even under \textit{Lochner}, State courts routinely upheld child labor legislation. \textit{E.g.}, \textit{Ex Parte Weber}, 86 P. 809, 810 (Cal. 1906); \textit{Inland Steel Co. v. Yedinak}, 87 N.E. 229, 236 (Ind. 1909); \textit{Bryant v. Skillman Hardware Co.}, 69 A. 23, 25 (N.J. 1908); \textit{State v. Shorey}, 86 P. 881, 882 (Or. 1906).} minimal health and safety regulations,\footnote{For example, under \textit{Lochner}, Oregon passed, and the Supreme Court upheld, protective labor legislation favoring women. \textit{Muller v. Oregon}, 208 U.S. 412, 421–23 (1908); \textit{see also} Melvin I. Urofsky, \textit{State Courts and Protective Legislation During the Progressive Era: A Reevaluation}, 72 J. AM. HIST. 63, 64 (1985).} and workers' compensation laws.\footnote{Steven M. Ingram, Taking Liberties With \textit{Lochner}: The Supreme Court, Workmen's Compensation, and the Struggle to Define Liberty in the Progressive Era, 82 OR. L. REV. 779 (2003). The United States Supreme Court found New York's workers' compensation law constitutional in \textit{N.Y. Cent. R.R. Co. v. White}, 243 U.S. 188, 209 (1917).} \textit{Lochner}'s demise, during the throes of the Great Depression, not only allowed the New Deal program of wage and hour regulation,\footnote{Fair Labor Standards Act of 1938 (FLSA), Pub. L. No. 75-718, 52 Stat. 1060, \textsection 201–219 (1938)).} unemployment compensation insurance,\footnote{The Social Security Act of 1935, ch. 531, \textsection 301, Pub. L. No. 74-271, 49 Stat. 626 (codified as amended at 42 U.S.C. \textsection 501) (Unemployment Insurance).} and social security insurance,\footnote{\textsection 1 (Old-age Assistance).} but also opened the door for the more recent legislative developments of the 1960s, '70s, and '90s. Perhaps the most important post-war legislative development with respect to the employment relationship was the passage of the 1964 Civil Rights Act, with its prohibitions on employment discrimination.\footnote{42 U.S.C. \textsection 2000e–2000e-17 (1988 & Supp. III 1991).} Since that time, Congress has enacted a number of important laws regulating the employment relationship, including the Occupational Safety and Health

Although these statutes have placed important limitations on employer discretion in the employment relationship, they provide only a very crude and limited method for facilitating employee voice in the methods of production and the terms and conditions of employment. As represented in legislation, employee voice acts only indirectly, through the votes of their elected representatives. Moreover, legislation is subject to intense lobbying in which concentrated and well-financed employer interests have distinct advantages. The decline of the American labor movement has further undermined employee voice in state legislatures and Congress, as membership rolls decline and the weight of organized labor's legislative presence recedes. Legislation provides only a crude tool for representing employee interests in the workplace, providing only general guidance not carefully tailored to the needs and preferences of the affected parties. Finally, national and international competition undermines even efficient regulation, since it may mean a loss of jobs. Even efficient regulation can place employers at a competitive disadvantage in national and international markets, encouraging the state legislatures and Congress to engage in a legislative "race to the bottom" to preserve jobs.

Even if employees do achieve some individual rights through contract, the common law, or legislation, these rights can have only limited effect because, generally, individual employees have no good way to enforce these rights. Absent discharge, employees are hesitant to strictly enforce individual rights because they fear alienating their employer and incurring future retaliation in pay, promotion, and retention decisions. As a result, the vast majority of employment law cases arise only after discharge or the employee quits, making litigation

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64. MICHAEL GOLDFIELD, THE DECLINE OF ORGANIZED LABOR IN THE UNITED STATES 57-77 (1987).
PROMOTING EMPLOYEE VOICE

little more than a very costly exit strategy without much additional communication. Indeed, even after the employment relationship is over, litigation costs make the enforcement of rights by individual workers prohibitive for all but the most highly paid employees. Sometimes government agencies are charged with enforcing individual employment rights, and this aids enforcement for low-wage employees, but it is still true that with limited enforcement budgets, many infractions of individual employee rights go unredressed. Finally, in the enforcement of individual rights, employees are almost always “one-shot” players while their opponent, the employer, is a “repeat player,” with all the attendant advantages. It is well established in both the socio-legal literature and the law and economics literature that repeat players have advantages in experience and an interest in precedent which allow them, collectively, to promote the evolution of the law to their favor. In enforcing their legal rights, individual employees are almost always inexperienced and without adequate motivation or resources to look after their interests, while employers suffer no such infirmities.

There is of course a proud intellectual tradition which advocates for “freedom of contract” and individual bargaining, with a minimum of government regulation, as a means of securing for people not only liberty, but wealth. Although this intellectual argument stretches back to Adam Smith, it finds ready representation in the neoclassical analysis of economic theory and the work of more recent proponents such as Milton Friedman and Richard Epstein. The basic argument is that, at least in the context of competitive markets with perfect information and zero transaction costs, the individual parties to a contract know best their preferences and costs, and they will agree to


70. Milton Friedman & Rose D. Friedman, Free to Choose: A Personal Statement 2–7 (1980).

terms and conditions of employment only if the benefits of those terms to the parties exceed their cost, thus maximizing wealth.\textsuperscript{72} If an employer offers terms and conditions of employment that do not adequately compensate his employees for the value of their contribution, or asks them to work under conditions that are inefficiently unsafe or arduous, the employees' remedy is to take a job with another employer who will be glad to hire productive employees on competitive terms and make a profit.\textsuperscript{73} In a competitive labor market with adequate information and insignificant transaction costs, employer and employee self-interest will drive the market to a competitive equilibrium in which each employee is paid the value of his or her marginal product and ensures efficient working conditions while maximizing societal wealth.\textsuperscript{74} Unions and protective legislation yield only rent-seeking and inefficiency in production and consumption, as they move the labor market away from competitive equilibrium.\textsuperscript{75}

Although there is no doubt that the market can be a very useful and efficient mechanism for decentralized decision-making and the organization of production through individual bargaining and contract, once again there are important limits on this institution that must be taken into account in the regulation of an efficient and just society. This is particularly true in considering the employment relationship and the machinations of the labor market, since people and their problems are so much more marvelously complex than any good that might be traded in a market. Far from being the finely tuned mechanism for allocating resources and rewards described in neoclassical economic analysis, some economists have argued that labor markets are always and everywhere imperfect.\textsuperscript{76} This is evident in the fact that, contrary to the prediction of the neoclassical model, labor markets never clear in that the unemployment rate is never zero. Bruce Kaufman has persuasively argued that the employment relationship would not even exist in the absence of market imperfections since, in the absence of information

\textsuperscript{72} \textit{Id.} at 951.

\textsuperscript{73} \textit{FRIEDMAN \\& FRIEDMAN}, supra note 70, at 246.

\textsuperscript{74} As Adam Smith famously wrote on the virtue of self-interest "It is not from the benevolence of the butcher, the brewer, or the baker, that we expect our dinner, but from their regard to their own self-interest. We address ourselves, not to their humanity but to their self-love, and never talk to them of our own necessities but of their advantages." \textit{SMITH}, supra note 69, at 14.


and transaction costs, there would be no reason for companies to exist\textsuperscript{77} or for one person to employ another.\textsuperscript{78} As a result, it is somewhat paradoxical to try to analyze the employment relationship and labor markets within the context of a perfect neoclassical market.

In critiquing the neoclassical analysis, economists commonly begin with several possible imperfections or "market failures" that undermine the assumptions of neoclassical economic analysis—all of which have relevance to the labor market and the employment relationship. First, it seems evident that the reality of imperfect information often leads to sub-optimal results.\textsuperscript{79} It may be that both the employer and the employee suffer from the same lack of information, or that one of the parties has an advantage in gaining information so that there is an "information asymmetry" in the negotiation of the terms and conditions of employment. For example, if employees do not understand that the chemicals they work with will cause cancer in twenty years, they will not ask for adequate compensating wages or look for safer jobs, and as a result the employer will not have adequate incentive to make the workplace safe. Another commonly cited market imperfection is significant transaction costs.\textsuperscript{80} This would seem particularly important in long, complex relationships such as the employment relationship where it is too costly to completely and expressly specify all terms of the relationship so that some terms remain implicit giving rise to incentives for opportunism. For example, prior to the passage of ERISA, employers had incentive to renege on their implicit promise not to discharge employees before their thirty-year pension vested in order to cheat the employee of that benefit. A final form of market failure that is commonly attributed to the labor market is that many terms of employment are "public goods."\textsuperscript{81} A public good is a good that is non-

\textsuperscript{77} Nobel laureate Ronald Coase has asserted that, in the absence of transaction costs, firms would not exist. Instead people would conduct all business and production through arm's length individual contracts. Ronald H. Coase, \textit{The Nature of the Firm}, 4 ECONOMICA 386, 388 (1937).

\textsuperscript{78} Bruce E. Kaufman, \textit{The Economics of Regulating the Labor Market}, in LABOR AND EMPLOYMENT LAW AND ECONOMICS 3, 28–29 (Kenneth G. Dau-Schmidt et al. eds, 2009) [hereinafter LABOR AND EMPLOYMENT].

\textsuperscript{79} Ann-Sophie Vandenberghe, \textit{Employment Contracts}, in LABOR AND EMPLOYMENT supra note 78, at 61, 83–86.


\textsuperscript{81} John T. Addison & Barry T. Hirsch, \textit{The Economic Effects of Employment Regulation: What are the Limits?}, in GOVERNMENT REGULATION OF THE EMPLOYMENT
rivalrous, in that many people can enjoy the same good, and non-excludable, in that if one person enjoys the good they cannot exclude others from also enjoying the good. Common examples in the workplace include the speed of the assembly line, the cleanliness of workplace air, the level of noise in the plant, and even the type of health insurance the employer provides. The problem with public goods is that the benefits of the good will be shared by all while the costs of concessions to gain the good are born by the individual employee who negotiates for them. As a result, in individual bargaining, each employee has incentive to hold back and “free-ride” on the efforts of others to gain the public good, with the result that too little of the good is negotiated.

The criticism of the neoclassical analysis that economists rarely discuss, but that occurs almost immediately to everyone else, is that employers generally have much more bargaining power than their employees. Economists generally discuss imbalance in the employment relationship only in cases in which there is a single monopsonistic employer, but generally assert that such cases are rare. However, it is evident that important imbalances in individual contract negotiations can and do often exist in situations well short of a single all-powerful employer. If you define bargaining power as the ability to influence negotiations to gain a larger share of the benefits of the bargain, a party's bargaining power depends on his or her alternatives and the party's ability to resist agreement relative to the other party to the agreement. In individual contract negotiations, employers generally have more bargaining power because they have more choice of employees than the employees have choice of jobs, and large employers are usually not significantly inconvenienced by the loss of an employee, while an employee loses his or her livelihood with the loss of

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83. A monopsonist is a buyer who enjoys market power because it is the only buyer, or one of only a few buyers, in a market. As a result the employer recognizes its ability to set wages and maximizes profits by cutting wages and cutting employment. William M. Boal & Michael R. Ransom, Monopsony in the Labor Market, 35 J. ECON. LITERATURE 86, 86 (1997); ALAN MANNING, MONOPSONY IN MOTION: IMPERFECT COMPETITION IN LABOR MARKETS 3–4 (2003).

Moreover, labor is perishable in that a day of unemployment is a day of labor (and wages) that is forever lost to the employee. Employers also generally enjoy advantages in resources, information, and legal rules. I have already discussed how American employers enjoy advantages in the setting of the terms and conditions of employment under the combined doctrines of employment at will and unilateral offer and acceptance. As a result of these advantages, employers can hold out better in bargaining and enjoy advantages in negotiation and enforcement of the agreement.

Some economists have also argued that there are macroeconomic reasons why society might not want to leave the growth and direction of the economy merely to the whims of individual bargaining. They point out that the simple neoclassical model provides just a snapshot of the labor market at one instance in time. In fact, the economy changes dynamically over time and can grow or shrink as it “cycles up” or “cycles down.” They argue that, by promoting stable employment and better wages and working conditions, unions and protective legislation encourage workers and employers to invest in the workers’ training and experience. Just as we want to promote profitable stable markets to encourage small businesspersons to invest in their business, so too we want to encourage profitable, stable labor markets and employment relationships to encourage employers and workers to invest in the workers’ “human capital.” By promoting investment in human capital, society encourages the economy to cycle up to a higher equilibrium with higher productivity and wages. Economists also argue that, through strategic planning, a country can position itself and its industries in international competition so as to use its current advantages to grow into a more advantageous niche in the global economy. Rather than going head-to-head in competition with low-wage countries in the production of nails or other low-tech goods, a country might encourage investment in companies that produce surgical tools or other high-tech, high-quality goods that cannot be made by low-skill, low-wage labor.

86. Kaufman, supra note 78, at 34.
87. See supra note 40 and accompanying text.
88. Kaufman, supra note 78, at 36-46.
Finally, some theorists have raised fundamental objections to the neoclassical economic analysis, pointing out that human labor is not a commodity. The labor of a human being requires the investment of a portion of that person’s life and, even though employment necessarily requires some subordination to the will of another, human beings have rights independent of any value of their labor as property or wealth. Thus, for example, we do not allow slavery, or even allow people to sell themselves into slavery, regardless of any possible impact such an arrangement would have on efficiency or wealth. As a result, it is imperative that we take account of values other than efficiency in the regulation of the labor market. John W. Budd has summarized the relevant concerns as efficiency, equity, and voice. In other words, in addition to trying to promote the efficient use of resources, when regulating the employment relationship, we need to remember that workers are people and try to promote equity between employees and employers and give workers a voice in the relationship. These concerns are lost in the simple neoclassical economic model.

III. THE RECENT FAILURES OF THE AMERICAN MODEL

Given the subordination of workers’ interests in the American systems of corporate governance and labor relations, it is not surprising that those interests have always been less well served than the interests of American management and capital. This problem has become particularly acute recently with the near collapse of our financial system and the rise of the global economy.

A. America’s Recent Experience Under the Shareholder Value Model of Corporate Governance

Beginning in the late 1990s the American real estate market seemed a “sure bet” for steady appreciation into the foreseeable future. To exploit this opportunity, financial institutions developed new mortgage


91. Historical data suggests that slave labor on the large plantations of the antebellum South was more productive than free labor on farms in the North, largely due to the gang system and economies of scale. Patrick Belser, The Economics of Slavery, Forced Labor and Human Trafficking, in LABOR AND EMPLOYMENT LAW, supra note 78, at 418, 423–24. Nevertheless, we fought a just war to end this horrible institution.

92. BUDD, supra note 90, at 13.
“derivative” instruments to aggregate mortgages and sell or insure portions of mortgage returns and risks. These instruments were rated by the American credit rating agencies of Moody’s, Standard & Poor’s, and Fitch Ratings, and sold to financial institutions world-wide, but especially in the “wild west,” or “casino” atmosphere of the American financial markets.

The top five U. S. investment banks—Lehman Brothers, Bear Sterns, Goldman Sachs, Morgan Stanley, and Merrill Lynch—were all heavily invested in these derivatives with AIG providing counter-insurance for these investments world-wide. To increase their profits in the mortgage business, the financial institutions heavily leveraged their positions, borrowing and then loaning or investing many times the amount of capital they actually held. In their leveraged positions, the institutions stood to make huge profits on the borrowed money, but would lose their capital if the deals turned sour. To meet the ever increasing demand for mortgage-backed securities, banks and mortgage institutions made “sub-prime” loans to less reliable borrowers with little or no money down, assuming that future real estate price increases would collateralize the loans even if the borrowers defaulted. Many of these loans were made with adjustable payments that would increase over time or if interest rates rose. The fact that the original lending institution could resell derivatives on these questionable loans and would not bear the burden of the questionable lending practices gave further impetus to the relaxation of lending standards.

93. Timothy E. Lynch, Gambling by Another Name? The Challenge of Purely Speculative Derivatives at 3–8 (Forthcoming, copy on file with the author).


96. From 2004–2007, all five of these investment banks significantly increased their financial leverage, which increased their vulnerability to a financial shock. These five institutions alone reported over $4.1 trillion in debt for fiscal year 2007. Stephen Labaton, Agency’s ’04 Rule Let Banks Pile up New Debt, and Risk, N.Y. TIMES, Oct. 3, 2008, at A1.

Inevitably the bubble burst and real estate prices began to decline in America. As prices declined, the banks and mortgage institutions suffered losses on the under-capitalized sub-prime loans that went bad—an event that occurred with increasing frequency as the borrowers' payments were adjusted up beyond their means or the value of the now-depreciated property. The losses were serious enough that in September 2008 the federal government found it necessary to take over Fannie Mae and Freddie Mac to ensure their continuance and the availability of mortgage funds. Financial institutions around the world who were invested in the new mortgage instruments also suffered losses which, because of their heavily leveraged positions, threatened their continued viability. In September 2008, Treasury Secretary Henry Paulson and the Bush administration decided to allow Lehman Brothers to default, sending the company into bankruptcy. The threat of further bankruptcies among major financial institutions sent a panic through the American financial market and dried up the credit market as financial institutions declined to loan money to each other for fear the borrower was over-invested in the new mortgage instruments. Panic in the financial markets led to panic in the stock market, which was also over-valued, resulting in substantial losses for those invested in stocks.

To avoid a collapse of the money supply like the one that occurred in 1929–1930, the U.S. government undertook a massive effort to prevent the failure of financial institutions by buying the risky mortgage instruments or taking equity positions in the firms. At the time this


102. In October 2008, Congress passed the Emergency Economic Stabilization Act, which authorized the Treasury Department to spend $700 billion in the Troubled Asset
essay is written, this effort seems to have avoided a collapse of the magnitude that occurred before the Great Depression, although it also seems likely that the recent problems in the credit markets and the decline of the stock market will result in a decline in aggregate demand and a significant slowing of the economy that will last for some time to come.

Although there are a variety of factors that contributed to the financial crisis of 2008, one has to ask why the managers of some of the world’s largest and most sophisticated financial institutions took such extreme risks, from highly leveraged positions, dealing in uncertain financial instruments that were only in the long-run interest of investors and the economy as a whole if the American housing market became the first market in the history of the world to never suffer a set-back in prices? At its base, the answer is that, under the compensation schemes of the share-holder value of corporate governance, it made sense for the managers to invest in derivatives they hoped would yield further short-run increases in stock prices, which they would be rewarded for in their stock option bonuses, even though these investments could not be in the long-run interests of the firm, the employees or the American economy.

The failure of the investment banks, mortgage lenders and insurance companies in the recent near collapse of our financial system are the most dramatic example of the problems of our system of corporate governance, but similar examples of penny wise, pound foolish executive decisions litter the landscape of the American economy. Eager to maximize the value of current stock options, American executives have adopted numerous strategies to boost short-term stock prices including undertaking risky “proprietary trading” strategies with

Relief Program (TARP) to combat the financial crisis. In July of 2010, the financial regulation overhaul reduced the amount authorized for TARP to $475 billion. Of this total, $69.83 billion was used to shore up AIG and $65 billion was used to shore up the investment banks. Additional spending to secure personal mortgages also benefited the banks. For a list of firms receiving TARP bailouts and the amounts see Emergency Economic Stabilization Act: The TARP, PROPUBLICA.ORG, http://bailout.propublica.org/initiatives/2-emergency-economic-stabilization-act (last visited Mar. 24, 2011).


104. Nelson D. Schwartz, supra note 2, at B2. There is even evidence of out-right fraud on the part of Goldman Sachs and other financial institutions in selling derivatives to customers that the firm knew or at least were betting were going to fail. The SEC is entertaining allegations that Goldman created and marketed securities that were deliberately designed to fail, so that an important client could make money off that failure. Paul Krugman, Looters in Loafers, N.Y. TIMES, Apr. 19, 2010, at A23.
credit default swaps and other derivatives; adopting massive stock-buyback programs that drained much-needed capital out of firms; and cutting payroll, health and safety measures, or research-and-development budgets. Sometimes, such as in the Enron case, these get-rich-quick schemes are accompanied by outright fraud in order to cover questionable practices and allow executives to cash out their bonuses before shareholders and employees are any wiser.105

The case of the investment banks and the recent financial crisis presents a good example of the first strategy of undertaking risky investments. Another common strategy is for management to use corporate funds for massive stock buy-back programs designed to raise stock price. Between 1980 and 2005, the amount of corporate funds committed to stock repurchases has increased from $5 billion to $349 billion.106 Although there can be legitimate reasons for corporate stock repurchase plans, including avoiding dilution of corporate ownership or to gain tax advantages, the plans can also be used to give a short-run boost to stock prices for the benefit of executive bonuses at the expense of needed corporate cash liquidity. Shortages or corporate cash can slow innovation and job creation at the long-run expense of the firm, the workers, and society at large.107 The growth and abuse of corporate stock repurchases in recent years under the shareholder theory of value model of corporate governance has left shareholders crying for reform that limits such repurchases.108

The American auto industry poses an example in which executives have postponed important research and development at the long-run expense of their workers and firms, in order to pursue short-run profits. If there was any doubt that in the world of limited resources fuel economy would eventually become of crucial importance in consumers' car-buying decisions, the initial OPEC-induced gas price shocks of the 1970s should have removed all doubt. Despite this experience and the damage done to the American car industry during that time, the Big

Three Detroit auto executives pursued a course of short-run profits based on large, relatively inefficient cars throughout the 1990s. However, during this same time, Japanese auto company executives realized that the future belonged to the efficient and undertook costly investment in hybrid technology. By the time the next set of gas price shocks inevitably occurred in the early twenty-first century, the Japanese were several years ahead on this important technology and the world production of the high-quality batteries necessary for hybrid cars was organized in Asia. As a result, not only have Japanese automakers continued to capture a larger and larger share of the U.S. and world markets, at the expense of American automakers, but Japanese, Korean, and Chinese manufacturers make the valuable batteries necessary for hybrid technology. With the near collapse of the U.S. financial markets and the advent of the Great Recession, two of the three largest American auto manufacturers were forced to ask for government assistance in order to survive. The employees, as the party with the longest term investment in the modern American corporation, were left holding the bag and, many of them, losing their jobs.

The recent accident and oil spill by British Petroleum at the Deepwater Horizon in the Gulf of Mexico is a good example of how corporate governance under the shareholder theory of value can lead to the adoption of safety procedures that may yield short-run cost savings but are ultimately disastrous for the firm, workers and society at large. The U.S. Congress has released findings that reveal a pattern of reckless

114. Although British Petroleum is a British firm, firms in the United Kingdom have also adopted the shareholder value theory of corporate governance aping American firms. Gospel & Pendleton, supra note 26, at 2.
and negligent behavior by BP.\footnote{See Letter from United States Congress Committee on Energy and Commerce to Tony Hayward, Chief Executive Officer of British Petroleum (June 14, 2010), available at http://online.wsj.com/public/resources/documents/WSJ-20100614-LetterToHayward.pdf.} This behavior appears to be characteristic of a company that put growth ahead of safety for many years.\footnote{Sarah Lyall, \textit{In BP’s Record, a History of Boldness and Blunders}, \textit{N.Y. TIMES}, July 13, 2010, at A1.} In addition to the death of the eleven workers involved, the Deepwater Horizon oil spill damaged the economy and ecology of the Gulf of Mexico, resulting in liability that will severely damage the financial health of the firm.\footnote{BP faces up to $17.6 billion in civil fines, in addition to the $32.2 billion dollar accounting charge it has taken to cover clean-up costs and the $20 billion it has put into escrow to pay claims. Margaret Cronin Fisk & Laurel Brubaker Calkins, \textit{The Oil Spill Ends. Now Come the Fines}, \textit{BLOOMBERG BUSINESSWEEK}, Aug. 9, 2010, at 26. In addition, BP faces substantial claims for consequential damages. An Oxford Economics study commissioned by the U.S. Travel Association estimates that the cost to the gulf coast region’s tourism industry will exceed $22 billion. \textit{OXFORD ECONOMICS, POTENTIAL IMPACT OF THE GULF OIL SPILL ON TOURISM 2} (2010), available at http://www.ustravel.org/sites/default/files/page/2009/11/Gulf_Oil_Spill_Analysis_Oxford_Economics_710.pdf.} As of June 2010, two months after the ongoing Gulf Spill, BP’s market capitalization had been halved.\footnote{Gregory White, \textit{And Now BP’s Market Cap Has Been Halved}, \textit{BUS. INSIDER}, June 9, 2010, http://www.businessinsider.com/bp-market-cap-2010-6.} Of course the workers, as the party with the true long-term investment in the enterprise, are dead.

As these examples demonstrate, the inordinate focus on the short-run profitability of the firm that is fostered by our current system of corporate governance has a negative impact on the long-run profitability of the firm, the interests of workers, and the general health of the American economy. Under our current system of corporate governance, management’s interest in short-run profits and maximizing the value of their stock options causes them to sacrifice profitable long-term investments in technology, human capital, and relationships for the benefit of short-term gain. As a result, our industry suffers from too little investment in long-term resources like long-term relationships with productive workers, investment in human capital, and investment in long-term strategies for the benefit of the firm and the American economy as a whole.

The United States emerged from World War II as the only intact industrial power in the world. During this post-war period, America's captains of industry determined that the "best" management practices were to build large, "vertically integrated" firms, supported by a stable workforce. Large, vertically integrated firms were best because they allowed coordination of production methods and the realization of economies of scale. Managers wanted a stable workforce to ensure their supply of this valuable resource in coordinating production. To maintain workforce stability, firms developed administrative rules for the retention, training, and promotion of workers within the organization. Economists refer to these systems of administrative rules as the "internal labor market" because, although these decisions are made in reference to external market forces, they define the terms of compensation and promotion within the firm in a way that is not directly determined by the "external" market. The vertical integration of firms facilitated the retention of employees over the course of their careers because integrated firms had layers of positions within the firm for employee advancement. Thus, in the immediate post-war period, employees could rely on their employers as an important source of training and economic security throughout the course of their lives.

In the mid-1970s, the system of trade and technology that served as the foundation for post-war labor relations began to change. With the rebuilding of Europe and the rise of the "Asian tigers," international trade began to make serious inroads into the American economy. Manufacturing jobs began to migrate overseas or disappear entirely as industry strived to become more efficient. In the 1980s, new

119. Indeed, due to government investment during the war, the United States economy was much stronger after the end of the war than before. STEPHEN A. HERZENBERG ET AL., NEW RULES FOR A NEW ECONOMY: EMPLOYMENT AND OPPORTUNITY IN POSTINDUSTRIAL AMERICA 7 (1998).

120. A classic example of such integrated production was Ford's River Rouge plant where it was bragged that the process went "from iron ore to Mustangs, under one roof!" Dau-Schmidt, supra note 50, at 909; see also CAPELLI, supra note 49.


information technology accelerated globalization and allowed for the
efficient organization of firms horizontally across the globe.123
Employers no longer had to be large and vertically integrated to ensure
efficient production; they just had to be sufficiently wired to reliable
subcontractors. The “best business practices” included outsourcing, and
subcontracting as firms concentrated on their “core competencies”—
that portion of production or retail that they did best.124 In this
economic environment, employers sought flexibility rather than stability
in employment and the average length of job tenure began to drop as the
number of “contingent employees” who are leased or sub-
contracted reached new heights in the American economy. The new
horizontal organization of firms broke down the job ladders and
administrative rules of the internal labor market, and firms became
more market driven.125 In the 1990s, the developed world experienced a
near doubling of the relevant labor force from 3.3 billion to 6 billion
with the collapse of communism, India’s emergence from autarky, and
China’s adoption of “mediated” market capitalism.126 Because all of
these countries are relatively capital poor, their entry into the global
economy has brought no corresponding increase in global capital, and as
a result, the capital-to-labor ratio in the global economy has dropped
approximately forty percent, putting tremendous downward pressure on
worker’s wages and benefits world-wide.127
Finally, in 2008 the United States—and the rest of the world—found
itself in the worst financial crisis since the Great Depression. As
previously discussed, the burst of a speculative bubble in the American
real estate market threatened the economic viability of mortgage
institutions, banks, and financial institutions that had heavily leveraged
their positions to invest in mortgage instruments.128 Credit markets

123. CAPPELLI, supra note 49, at 102–04.
124. Id. at 99–100.
125. Perhaps the most extreme example of these horizontal methods of production is the
Volkswagen truck plant in Resende, Brazil, where the employees of various subcontractors,
under one roof, assemble trucks made from parts from around the world, with only a handful
of actual Volkswagen employees on hand to perform quality control. Id. at 104.
127. Id. at 130.
128. See supra note 96 and accompanying text.
ground to a halt as financial institutions became afraid to loan money to each other because of uncertainty about the borrower’s exposure in mortgage instruments. To avoid a collapse of the global financial system, governments around the world intervened to prevent the failure of financial institutions by buying the troubled mortgage instruments and taking equity positions in troubled financial institutions. Although it seems that these interventions have succeeded in preventing a global economic depression, there seems little doubt that the stress on the credit markets and the decline of the stock markets we have experienced will result in a significant slowing in economic growth for some time. Such a slowdown will undoubtedly have an impact on employee’s wages and benefits.

The new age of trade and technology that has developed since the 1970s has not been kind to American workers. At least since the 1980s, real compensation received by American workers has remained fairly flat, even though productivity has steadily risen. From 1979–2009, the index of average real hourly compensation for American nonfarm business workers rose from 206.12 to 281.62 (1947=100) or just 36.6%, while the index of hourly productivity for those workers rose from 219.09 to 400.66 (1947=100) or 82.9%.

This “wage gap” is shown in Graph 1 below. The gap is even more striking if one examines only the wages of non-supervisory workers whose average real hourly wages increased from $18.64 to $19.01 (2009 dollars), or merely 2%, between 1979 and 2009. As shown in Graph 1, prior to 1980, the hourly compensation of American workers largely kept pace with hourly productivity increases during the post-wage period. However, since 1980, the hourly compensation of American workers fell further and further behind their productivity increase.

129. See infra tbl.1. Over the period 1970–2009, the index of hourly productivity for American workers rose from 184.65 to 400.66 (1947=100) or 117% while their index of average real hourly compensation rose from 182.69 to 281.62 (1947=100) or just 54.2%. See MISHEL ET AL., supra note 5, at 58 fig.1G, 128 tbl.3.2.


131. MISHEL ET AL., supra note 5, at 130.
The wealth generated by the increases in productivity since 1980 did not just disappear, but instead became ever more concentrated in the highest income earners, including, of course, corporate CEOs. From 1979 to 2007, the percent of total income going to the top 5% of income earners increased from 15.5% to 20.1% and the ratio of their average income to the average income of families in the bottom 20% of the income distribution rose from 11.4 to 19.7.132 Similarly, between 1978 and 2006, average CEO pay increased from thirty-five times the average worker’s pay to 275 times the average worker’s pay-- over $12 million per year.133 As a result, the decline in the rewards to labor is even more pronounced if one examines just non-supervisory salaries. In Graph 2, I present a graph of the non-supervisory employee’s share of nonfarm domestic product over the years 1964 to 2009. As can be seen in Graph 2, there is a pronounced drop in the non-supervisor employees’ share beginning in about 1974.

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132. Id. at 60-61. Of course wealth was even more concentrated. In the period from 1983 to 2004, the ratio of the average wealth of the 1% wealthiest people in the United States rose from 131 times the median wealth of Americans to 190 times the median wealth of Americans. Id. at 269 fig.5C.

133. Id. at 221 fig.3AE.
Economists have provided three interrelated explanations for this increase in income inequality and the decline in "labor's share" of Gross Domestic Product (GDP) in the U.S. The first is that the improvements in technology wrought by the new information technology have improved capital's productivity and thus its earning power—increasing capital's share of GDP. Second, globalization has undermined the bargaining power of workers in developed countries, particularly low-skill workers, as they have been thrown into competition with low-wage workers across the globe. Finally, changes in national product and labor market policies, for example decreases in the

134. "Labor's share" of GDP and the "wage gap" describe the same phenomenon.

\[
\text{labor's share} = \frac{\text{wages}}{\text{GDP}} \\
= \frac{\text{wages/employees}}{\text{GDP/employees}} \\
= \text{average wage/productivity} = \text{wage gap}
\]

real minimum wage and declining support of public education and labor unions, have undermined workers' bargaining power.\textsuperscript{135} Although it is difficult to determine how much each of these three factors has contributed to the "wage gap" in the United States, Mishel, Bernstein, and Allegretto have argued that a reasonable estimate is that each factor is responsible for about a third of the currently observed gap.\textsuperscript{136}

The decline of labor's share and the growth of income among the wealthiest Americans have led to growing inequality in the distribution of income and wealth among Americans. There are a variety of measures of income inequality in a country including the Gini coefficient and the ratio of the income earned by the top 10\% to the income earned by the remainder of the population—all show significant increases in inequality in recent years.\textsuperscript{137} Economists Thomas Piketty and Emmanuel Saez conducted a study of the growing income inequality in the United States and produced a graph of the share on national income earned by the top 10\% of income earners that has gotten a lot of attention and which is reproduced in Graph 3 below.\textsuperscript{138} Piketty and Saez' analysis shows that the share of national income earned by the top 10\% declined after World War II, during a period of relative income equality which Piketty and Saez refer to as the "great

\begin{itemize}
  \item \textsuperscript{137} The Gini coefficient is defined based on the "Lorenz curve," which plots the proportion of the total income of the population that is cumulatively earned by the bottom x\% of the population. The line at 45 degrees thus represents perfect equality of incomes. The Gini coefficient is given by the ratio of the area that lies between the line of equality and the Lorenz curve over the total area under the line of equality. The Gini coefficient can range from 0 to 1 with a low Gini coefficient indicating a more equal distribution of income. A Gini coefficient of 0 corresponds to complete equality, while Gini coefficient of 1 corresponds to complete inequality. After holding steady at about 0.4 during the post war period, the Gini coefficient for the U.S. increased from 0.403 to 0.468 over the period 1980 to 2009. \textit{UNITED STATES CENSUS BUREAU, HISTORICAL INCOME TABLES—HOUSEHOLDS, GINI RATIOS FOR HOUSEHOLDS BY RACE AND HISPANIC ORIGIN OF HOUSEHOLDER}, http://www.census.gov/hhes/www/income/data/historical/household/index.html (last visited Mar. 25, 2011). In 2005, the Gini index for the EU was estimated at 0.31. \textit{EUROFOUND, GINI INDEX} (Aug. 26, 2009), http://www.eurofound.europa.eu/areas/qualityoflife/eurlife/index.php?template=3&radioindic=158&idDomain=3.
\end{itemize}
compression,” but that since 1980 the share of national income earned by the top 10% has increased to levels not seen since the Great Depression, a phenomenon Piketty and Saez refer to as the “great divergence.” The increasing inequality in the distribution of income and wealth in the American economy is a matter of some concern. Not only does it undermine our democratic institutions and the American ideal of equal opportunity, but some economists have suggested that the growing income inequality is a drag on the economy itself because high income earners spend a lower share of their increased incomes, decreasing aggregate demand.139


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Moreover while compensation has remained largely stagnant for American workers over the last three decades, their uncertainty and risk have increased in the new economic environment. In the new age of trade and information technology, as corporations have reorganized themselves horizontally across the globe using outsourcing, subcontracting, and investment abroad, they have increasingly jettisoned long-term employment relationships and the attendant administrative rules and long-term benefits that the corporations used to promote such relationships. The simplest measure of increased job insecurity is the average length of current job tenure. Turnover rates and job tenure varies by age, gender, and education. However, looking at all age, gender, and education groups, for workers 35–54 years of age, all demographic groups suffered decreases in the length of job tenure between 2000–2006, and all groups, except women, suffered decreases in the length of job tenure between 1973–2000.\textsuperscript{140} Older men and the less educated suffered the largest drops in job tenure over this period, ranging from twenty-five months for men 45–54 years old and nineteen months for workers with a high school degree or less to the loss of only a month in average job tenure for the young and college educated.\textsuperscript{141}

The security of employer-provided employee benefit plans has also declined in the last three decades. In 2007, there were 2.7 million fewer Americans covered by employer-provided health insurance than in 2000, and the percent of the non-elderly population covered by such health insurance had dropped from 68.3% in 2000 to 62.9% in 2007.\textsuperscript{142} This loss of health insurance was felt most by the low-skilled, low-wage workers. Similarly the percent of private sector workers who are covered by an employer-provided pension has decreased from 50.6% in 1979 to 42.8% in 2006.\textsuperscript{143} Moreover, beginning in about 1980, American employers began to abandon defined benefit pension plans in favor of defined contribution pension plans, shifting the risk of investment loss and gain and actuarial miscalculation to the employee. As a result, while in 1980 roughly three-fifths of employer-provided pension plans were defined-benefit plans, by 2004 slightly less than a quarter of such plans were defined-benefit plans.\textsuperscript{144}

\begin{footnotes}
\footnotetext[140]{Mishel et al., supra note 5, at 259 tbl.4.9.}
\footnotetext[141]{Id.}
\footnotetext[142]{Id. at 336.}
\footnotetext[143]{Id. at 150, tbl.3.13.}
\footnotetext[144]{Samuel Estreicher & Laurence Gold, The Shift from Defined Benefit Plans to Defined Contribution Plans, 11 Lewis & Clark L. Rev. 331, 331–32 (2007); James Poterba et al., The Changing Landscape of Pensions in the United States (Nat'l Bureau of Econ.}
\end{footnotes}
In order to maintain their living standards, cover losses from unemployment and illness, and provide their children with educational opportunities to compete with the higher classes, American middle-class workers have taken on increasing levels of debt. Since 1979, total household debt has grown from 13.8% of all assets and 73.5% of disposable income to 19.9% of all assets and 141.3% of disposable income. The costs of debt as a percent of disposable income are growing the fastest for the middle class and the near-rich, and slowest for the rich. In 2004, the middle and fourth quintiles on the income distribution were spending an average of 19% of their disposable income on debt service, while the richest decile was spending just 9.3%. This desire to borrow fed into the mortgage financing crisis as many middle income Americans borrowed against the inflated prices of their houses to consume. Minimum asset and liquidity requirements prevent poorer workers from borrowing money.

So far, the new age of trade and technology has proven an inhospitable environment for American workers to pursue their interests through individual bargaining. The decline of the American labor movement, deregulation, and low-wage competition from abroad have combined to lower workers’ bargaining power in a system of individual bargaining in which employers have many advantages. As a result, real wages have remained stagnant for decades and workers have been asked to accept greater risk in uncertainty over job security and the provision of employee benefits. American workers are finding it necessary to work longer hours and borrow more money just to maintain their standard of living and compete with the upper class for education and opportunities. As characterized by Professor Bagchi during the symposium, America seems to be developing a “niche” in the world economy for providing “flexible labor” that is willing to work long hours at modest wages. That may sound good from management’s perspective, but is there a way we could evolve to a “niche” in which we did a better job of meeting workers’ needs?

145. MISHEL ET AL., supra note 5, at 284 tbl.5.12.
146. Id. at 288 tbl.5.14.
IV. ALTERNATIVES TO THE CURRENT SYSTEM OF PRODUCTION: PROMOTING EMPLOYEE VOICE IN CORPORATE GOVERNANCE AND LABOR RELATIONS

Of course, the problems of promoting employee voice in corporate governance and labor relations are interrelated. At least in the United States, labor relations is the primary forum through which employees can impact corporate performance and governance. Moreover, in other countries where employees have greater opportunities to affect corporate governance through other channels, these actions inevitably affect labor relations. For the time being however, I will continue to treat these problems separately. My primary argument is that, at least in the United States, we need to promote employee voice in both corporate governance and labor relations.

A. The Benefits of Employees as Active Participants in Corporate Governance

The perpetual alliance of management and shareholder interests in the American system of corporate governance leaves shareholders without an important in-house ally in the monitoring of management performance and management without an important long-term ally in considering the merit of long-term strategies and investments. The three primary stakeholders in corporate governance are management, capital, and labor. They vary in interests, advantages, and liabilities, creating the problem of how best to govern the modern corporation. Management has important informational advantages over shareholders because members of management are "insiders" with important information on the day-to-day running of the firm. These informational advantages are why shareholders hire management to run their businesses and make day-to-day operational decisions. However, by hiring separate management, the shareholders create the inevitable agency problem in that management will have personal interests apart from shareholders and the long-run interests of the firm, and thus must be monitored to make sure they act in the best interests of the firm. Like management, labor also has important informational advantages over the shareholders because they are in the plant and involved in the day-to-day operation of the plant. Like the shareholders, labor also has an interest in monitoring management because of their investments.

148. Bodie, supra note 8, at 899, 900; Greenfield, supra note 8, at 301.
in firm-specific human capital and pensions that are tied to the long-run future of the firm. Indeed, in the modern age of mobile management and capital, it appears that labor is emerging as the stakeholder with the greatest personal interest in the long-run operation of the firm. Also, like management, labor has important personal interests in the running of the firm that may diverge from those of management and the shareholders. Although management, capital, and labor have a collective interest in the success of the firm, they have individual interests in how the proceeds of that success are divided.149

As described by Jackson, Höpner, and Kurdelbusch,150 there are three possible alliances among the three primary stakeholders in corporate governance, each of which can be very useful. In the first and almost universal state of affairs in the United States, management and capital form a “Class Conflict” alliance to monitor labor.151 This alliance is taken to an extreme in the shareholder value system of corporate governance because management interests are consciously allied with at least the short-term shareholder interests through management bonus plans and stock options, and labor is treated primarily as a commodity to be purchased or discarded. The problem with relying solely on this alliance scheme to govern a corporation is that management gives up an important ally with insider information and a long-run interest in the running of the firm in trying to convince shareholders to make investments and do things that insure long-run profitability, and the shareholders give up the same important ally with insider information and a long-run interest in the running of the firm in trying to monitor management. A purported benefit of the American system of relying so heavily on a Class Conflict alliance in corporate governance is flexibility and innovation in responding to changes in the economic environment and technology. However, as previously mentioned,152 this flexibility comes at the expense of employees and long-term investments in human capital and relationships.153 Moreover, as we have seen in the recent economic downturn, flexibility has a negative side—lack of stability.

In the second form of alliance, management and labor form an “Insider-Outsider” alliance to use their information on the running of the firm and the firm’s long-run interests to convince shareholders to

149. Dau-Schmidt, supra note 75, at 446–47.
150. Jackson et al., supra note 7, at 95.
151. Id. at 96–97.
152. See supra notes 21—25 and accompanying text.
153. O’Connor, supra note 33, at 904—07.
undertake investments in capital, training, and relationships that may decrease short-run profits but improve the firm’s long-run prospects. The relative lack of the appearance of this alliance in American corporate governance is a primary source of the inordinate focus on short-term profits by American corporations. In its fully developed form, this alliance might be described as a partnership between labor and management who then enter the capital market to buy capital as a commodity. There are some real advantages for society when labor and management form an Insider-Outsider alliance to run a corporation. First, under such alliances labor and management enter the market to buy capital as a commodity, leaving returns to capital—rather than labor—to suffer the ups and downs of financial fluctuations. Ceteris paribus capitalists are probably in a better position to suffer this risk than workers because they can more easily diversify their investment across multiple firms and industries and because they suffer fewer transaction costs from temporary setbacks. Second, it is probably not a coincidence that countries focusing on corporate governance through labor management alliances enjoy much lower levels of industrial strife in their labor relations. It seems that partnerships in corporate governance lead to partnerships in labor relations.

Finally, the third possible alliance that might be formed in corporate governance is an “Accountability Conflict” alliance between capital and labor in monitoring management. This alliance is useful because shareholders have important mechanisms to exercise control over management, while labor has useful insider information in the running of the firm, and both of these parties have an interest in checking management excesses. The relative lack of the appearance of this alliance in American corporate governance is an important cause of our problem with excessive management compensation, along with lack of effective monitoring by shareholders. Inadequate monitoring of

154. Jackson et al., supra note 7, at 97–98.
155. Id. at 98.
158. See Peter Kuhn, Malfeasance in Long Term Employment Contracts: A New General Model with an Application to Unionism 28–29 (Nat'l Bureau of Econ. Research, Working Paper No. 1045, 1982) [hereinafter Kuhn, Malfeasance]; see also Bodie, supra note 8, at 899–900; Greenfield, supra note 8, at 301; Peter Kuhn, Union Productivity Effects and Economic Efficiency, 6 J. LAB. RES. 229, 230 (1985) [hereinafter Kuhn, Union Productivity]; Reberioux, supra note 8, at 508.
management is a particular problem in the American system of corporate governance because in the United States, managers typically nominate the Board of Directors that monitors them on the shareholders' behalf and for most major corporations, stock ownership is dispersed and ephemeral. Given these disadvantages, it would be particularly useful to American shareholders to have access to employees inside allies.

Figure 1: Three Types of Partial Coalition in Corporate Governance

(a) Class Conflict

(b) Insider- Outsider

(c) Accountability Conflict

B. The Benefits of Employees as Active Participants in Labor Relations

By facilitating a greater role for employee collective voice in American labor relations, we also might hope to address some of the short-comings of the system of individual bargaining. The proponents of the NLRA argued that fostering unionization would allow employees to gain a greater share of the proceeds of their labor and achieve some level of “industrial democracy” in the workplace, and in our larger society. Promoting employee organization was seen as a redistributive policy in which employees would gain at the expense of their employers, hopefully stimulating consumer demand to help ease the ravages of the depression. The organization of workers in unions was also viewed as beneficial because it would give them a greater say in the running of the workplace, and perhaps the country. The analogy was made that if democracy was the most beneficial and fair way of running the government, then “industrial democracy” was necessary for the advantageous and fair running of the workplace. Although these arguments find no support in the neoclassical economic analysis, they find support in economic arguments that accept the imperfections of the labor market.

Employee voice can help address labor market failures due to imperfect information, transaction costs, and public goods. Any effective form of employee voice in labor relations will facilitate the exchange of information between management and the employees and help to minimize these problems—an independent union that can provide protection from retaliation and an efficient means for enforcing labor management agreements can address them all the better. Effective communication between labor and management would facilitate the exchange of information that is available to the parties, for example on job risks and how to deal with them. An independent union might even retain trained professionals in occupational safety and health and generate their own information on how best to deal with these risks that can then be shared with management.

159. See supra note 45 and accompanying text.
160. McCulloch & Bornstein, supra note 46.
161. Id.
162. See John F. Witte, Democracy, Authority, and Alienation in Work 90–91 (1980); cf. Freeman & Medoff, supra note 10, at 8–9 (noting the difficulties faced by a worker without an independent union to back her up in addressing these problems).
163. Most international unions retain such experts, but especially those where such information is paramount to their members, for example the Chemical Workers. History of the ICWUC, http://www.icwuc.org/history.html (last visited Mar. 25, 2011).
in discussions with management can also lower transaction costs and help hold management to the equitable treatment of workers under long-term implicit deals. It would be harder for employers to renege on promises of employment security or pensions if there were employee representatives or an independent union that could call the management on such opportunism. Finally, employee voice will help solve the problem of negotiating public goods in the work place. Once again an independent union that can protect against retaliation and enforce agreements is best, but even representative employee committees can provide management with useful information on employee interests in public goods such as the speed of the assembly-line or the level of air quality or light in the workplace.

Moreover, there are a variety of theories suggesting that “industrial democracy,” or giving workers a say in the workplace, can be productivity enhancing. Workers’ long production hours often result in ideas as to how productivity can be enhanced. If employees are allowed to engage management on an equal basis concerning the methods of production, they can often contribute useful insights. Moreover, workers have an interest in the productivity of their firm, and, if protected from arbitrary discharge by a union, can act as a more effective monitor of management waste than absent shareholders. Some have argued that the mere appearance of a union in the workplace can “shock” management out of lethargy and on to greater productivity. Finally, employee voice can raise productivity in the workplace by promoting the efficient expression rather than the costly “exit” of individual workers dissatisfied with their job. In a competitive labor market, the primary mechanism for expressing dissatisfaction with working conditions is for the worker to take another job or “exit.”


165. FREEMAN & MEDOFF, supra note 10, at 14-16; Freeman & Medoff, supra note 10, at 70-71. For some interesting applications of this argument to labor law, see Keith N. Hylton & Maria O’Brien Hylton, Rational Decisions and Regulation of Union Entry, 34 VILL. L. REV. 145, 152 (1989).


167. FREEMAN & MEDOFF, supra note 10, at 14-16; Freeman & Medoff, supra note 10, at 71.
However, exit is less efficient than "voice" in encouraging changes in working conditions because exit communicates little and results in relocation and retraining costs. Convincing empirical evidence exists that some industries enjoy significant productivity increases from unionism. For example, Kim Clark compared the physical output of cement plants before and after organization, and between different organized and unorganized plants, and found statistically significant productivity increases from unionization that ranged from 6–10%.  

Effective employee voice can also address the inequity in bargaining power between employers and employees—at least where there is an independent union. Collective bargaining is the only way for employees to gain a share of the product market rents or Ricardian rents that their labor produces. Wage increases from these sources are largely redistributive, with minimal impact on efficiency. Although labor cartels like those envisioned in the neoclassical analysis undoubtedly exist in the American economy, the empirical evidence suggests that labor cartel power is less important than these other sources of union wage increases. Few product markets approach a percent of workers organized that might even be imagined a labor cartel. Moreover, the best available evidence suggests that union wage increases come largely at the expense of employers and are strongly associated with the market


170. Product market rents are those rents that the firm earns because its product market is not fully competitive and the firm enjoys some pricing power in the product market. Ricardian rents are those returns the firm earns because either the firm or the workers enjoy some unusually productive resource such as a particularly rich vein of coal close to the surface or an athlete like Michael Jordan. Dau-Schmidt, supra note 75, at 429.

171. Although this assertion can be demonstrated more generally, it is perhaps easiest to see when considering contract negotiations between a union and an employer with rents from a product market monopoly. Assuming that, prior to the organization of the union, the employer was optimally mixing capital and labor in production and optimally pricing his product in order to maximize the value of his monopoly rent, when the employees form a union and demand a share of that rent, any inefficient substitution of capital for labor and any change in product price will serve only to decrease the total size of the rent to be divided between the employer and the employees. Assuming the employer and the union negotiate to maximize the monetary value of their agreement, they will negotiate to increase wages but maintain employment at the current level. Dau-Schmidt, supra note 75, at 424.

172. Dau-Schmidt, supra note 75, at 471.
Promoting employee voice also treats workers more as humans than a commodity, giving them a larger say in the rules that organize our society. Employee voice and organization turns employees from “one-shoters” into “repeat players” in the litigation of legal rules, the development of statutory law and the development of norms in society. In the lexicon of the law and society literature, employee voice and organization turns employees from “have-nots” into “haves” in the legal and social discourse. Although individual employees have no interest in legal precedent, leaving the common law to evolve in employer’s favor, when they bind together into unions they have incentive to pursue efficient legal rules. For example, in litigation against individual employees, employers managed to convince courts that promises of “permanent employment” actually meant that the employee could be discharged at any time, for any reason. This would not seem to be the efficient default for interpreting this language since it is contrary to common usage and employees would have to retain a lawyer in order to know to contract around this result. Job security provisions in collective bargaining agreements enforced by unions are not interpreted so perversely.


174. Dau-Schmidt, supra note 68, at 207.

175. Galanter, supra note 67, at 103–04.

176. Paul Rubin has established that “repeat players” to a legal controversy, such as manufacturers, banks, and employers, who have an interest in precedent, will continue to litigate a dispute with each new “one-shooter,” individual consumers or employees, until a court rules in his favor and precedent favors his position. This is true even though the resulting legal rule may be inefficient. Thus, one can reasonably expect that the law will tend to evolve in favor of repeat players at the expense of one-shoters regardless of the efficiency or equity of the resulting legal rule. However, when both sides to a dispute are repeat-players and have an interest in precedent, only inefficient rules will be litigated and the court interpretations of the law will evolve towards efficiency. Rubin, supra note 67, at 51–63.


Similar arguments concerning the benefits of employee voice and organization in the drafting and enforcement of labor and employment laws can be made on the basis of public choice theory.\textsuperscript{179} Public choice theory posits that, because there are time and information costs to evaluating and opposing or supporting legislation, small organized groups in which individual members enjoy high benefits from a certain legislative position will gain in the legislative process at the expense of large disorganized groups in which the cost of the legislative proposal are broadly dispersed. Even if the general citizenry rise up and demand a legislative position contrary to the interests of the small organized interest group, the interest group will have advantages in influencing the administration of the law. Employers, and especially large corporations, have long been well organized and effective lobbyists. Their hierarchical command structure, access to resources, and organization by industry, state, and nation, have long allowed them to pursue their interests in the legislative and administrative arenas at the expense of less organized and more dispersed groups and the public at large. To the extent that employee voice and organization allows employees to effectively express their views on legislation and enforcement, it can allow employees to act as a counter-balance to employer views resulting in more efficient and equitable legislation. For example, prior to the turn of the twentieth century the common law defenses of “assumption of risk,” “contributory negligence,” and the “fellow servant rule” largely prevented employees injured on the job from collecting from their employers which, combined with inadequate compensating wages, resulted in employers having too little incentive to take safety precautions.\textsuperscript{180} Unions countered employer interests by lobbying for the statutory repeal of the common law defenses, and then settling for workers’ compensation statutes—a much more efficient and equitable result than the old common law. The drafters of the NLRA endorsed the idea that, because capital was already organized, it was only fair to encourage labor to organize in order to provide industrial and political symmetry.\textsuperscript{181}

Finally, employee voice can help promote social norms that benefit employees and society as a whole. Norms are informal standards for


\textsuperscript{181} GROSS, \textit{supra} note 45, at 16.
behavior that are widely held among the relevant population and enforced by the populations' approval or disapproval. Since people are social animals, people's behavior is influenced by norms as well as laws. Indeed, it is possible to think of the legal system as a formal subset of the system of norms. Laws and norms are endogenously determined in that practices that are required by law can become routine or custom and accordingly develop into a norm, and important norms that are broadly held by a population have a high probability of being formalized into law. Economists have hypothesized that society will tend to develop useful or efficient norms as groups of people who hold these norms succeed at the expense of people who do not. This evolutionary theory of norms has been used to explain the development of norms for cooperation, altruism, and "fair treatment." Analogizing from the arguments on the evolution efficient case law and legislation, it seems quite plausible that vocal and organized groups have advantages in the development of social norms. Organized groups can better lobby the beliefs of the population at large and have advantages in litigation and legislation, which also in turn may establish norms. To the extent that employee interests differ from employer interests, organized employees can act as an effective counterweight to organized employer interests and facilitate the production of more efficient and equitable norms. As with litigation, legislation and administration, organized groups have an advantage in the formulation of social norms. Examples of norms that organized labor has influenced to society's benefit through social advocacy and legislation include the norm against child labor, the norm in favor of the forty-hour work week, and the increasing value placed on worker health and safety by society at large.

C. Comparative Examples of Employee Voice in Corporate Governance and Labor Relations

Americans are generally so used to thinking of labor as the subordinate odd-man out in the running of the firm that it is hard for them to conceive of alliances between labor and management or labor and capital to check the excesses of the third party, but in fact such alliances are common, even the norm, in other industrialized countries. In the European political economy literature, Hall and Soskice have

distinguished between “liberal market” economies, usually represented by the United States and Great Britain, and “coordinated market” economies, for example Germany and Japan, in considering international differences in corporate finance, governance and labor relations.\textsuperscript{184} Liberal market economies use predominantly a class-conflict alliance between capital and management to conduct corporate governance, with labor left to absorb financial stresses through cuts in wages, benefits, and job tenure. In contrast, in coordinated market economies the parties undertake alliances that involve labor to conduct corporate governance, and financial fluctuations are more likely to be absorbed by shareholders than labor.\textsuperscript{185} Both systems are market disciplined, the question is whether labor or capital are bought and sold as a commodity and subject to the brunt of economic fluctuations. A similar distinction has been made in the financial economics literature between “market/outsider” finance and governance systems (the United States and Great Britain) and “relational/insider” finance and governance systems (Germany and Japan).\textsuperscript{186} Analogous distinctions have been made in the Japanese academic literature for years and are perhaps most closely associated with the work of Takashi Araki.\textsuperscript{187}

Similarly, Americans are so used to thinking of employees as subordinate in labor relations, largely left to accept the employer’s offer or else search for another job, that it is hard for them to imagine how active employee voice could work to both side’s benefit, but in fact in perhaps every other industrialized democracy in the world labor undertakes a more active role in the determination of their wages and working conditions. The examples of Germany and Japan are once again instructive. In Germany, workers enjoy a legally mandated system of “codetermination” in which every employer with more than five employees is required to have a Works Council of elected employee

\textsuperscript{184} Hall & Soskice, \textit{supra} note 31, at 16.
\textsuperscript{185} Gospel & Pendleton, \textit{supra} note 26, at 8.
\textsuperscript{187} \textit{See}, e.g., Takashi Araki, \textit{Corporate Governance and Employment and Labour Relations in Japan, the US and Germany}, \textit{in Gendai Nihon No Kōretsu Gabanansu (Corporate Governance in Contemporary Japan)} (Takeshi Inagami ed., 2000); \textit{see also} Takashi Araki, \textit{A Comparative Analysis: Corporate Governance and Labor and Employment Relations in Japan, 22 Comp. Lab. L. \& Pol'y J.} 67 (2000).
representatives that is consulted on a broad array of issues concerning the running of the workplace. A somewhat modified form of the German Works Council system is becoming the norm for labor relations across the European Union. The combination of Works Councils, a much higher level of union organization, and national tri-partite bargaining over working conditions and public policy, ensure that German workers have a real say in the running of their workplace. In Japan, the workers engage in a “community of shared fate” with management that is established and governed largely through traditional business practices rather than law. Because of Japan's employee-centered corporate culture, the common Japanese practice of promoting managers and directors from employee ranks, and Japan’s higher levels of union organization, Japanese workers can be sure that their interests will be represented in the firm’s labor relations policies.

1. The German System of Codetermination

Although it has roots in Catholic social theory and the 1920 Works Councils Act, the modern German system of codetermination, or Mitbestimmung, was developed shortly after World War II, beginning first in the coal and steel industries and then expanding to the economy as a whole. The basic idea is that workers have a right to participate in the management of the corporation and that such participation benefits workers, the firm and society as a whole. The system of


191. Id. at 259–60.

192. WEISS, supra note 188, at 169.

Codetermination was enacted into German law through a series of statutes including the Co-operative Management Law of 1951 (amended in 1976), the Workers Committee Law of 1952 (amended in 1972), and the One-Third Participation Act of 2004. Under these laws, every workplace with more than five employees is required to have a Works Council of elected employee representatives. The management of the firm is required to provide information to the Works Council and consult with the Works Council on a broad array of non-wage subjects from break time to safety. In addition, the Works Council selects employee representatives to serve on the company's Supervisory Board, which is akin to the board of directors for an American corporation and monitors management in coordination with the Shareholder's Board. Under German law, for companies with more than 500 employees, one-third of the Supervisory Board members must be employee representatives, and for coal and steel companies with more than 100 employees and other companies with more than 2,000 employees, half of the Supervisory Board members must be employee representatives, subject to a Chairman selected by the shareholders. The combination of the Works Councils and employee representatives on the governing boards of German corporations ensures that workers have at least some input into every corporate decision and have ready access to virtually all information concerning their employer. When the employee representatives on the Works Council and Supervisory Board are supported by an independent labor union, which is common in Germany, the employees can have a real say in the governance of the firm.

The German system of Codetermination helps to alleviate some of the problems in corporate governance that we suffer under the American system of an exclusive management-capital alliance focused

194. Marc Goergen et al., Recent Developments in German Corporate Governance, 28 INT'L REV. L. & ECON. 175 (2008); Thomas Wagerich, BUSINESS LAWS OF GERMANY § 1:95 (2010).
195. WEISS, supra note 188, at 169; Fürstenberg, supra note 194, at 211; Schregle, supra note 193, at 82–83.
196. Fürstenberg, supra note 193, at 211.
197. See WEISS, supra note 188, at 190; Schregle, supra note 193, at 82–83; see also Fürstenberg, supra note 193, at 212–13.
on short-term share value. Direct representation of both labor and financiers in the governance of the firm provides a more balanced perspective between these interests. Because German companies are less focused on short-term share value, they are open to a larger array of rational business strategies, for example pursuing higher market share through a strategy of forward-pricing or entering market segments that have lower returns but large market size and relatively low risk. They also are more willing to accept lower short-run returns in order to make investments in capital improvements and research and development that yield long-run benefits. Moreover, because they feel less urgency to maximize short-run profits, they have a greater ability to absorb fluctuations in raw material prices and are less likely to resort to lay-offs in economic downturns—preserving employee morale and firm-specific human capital. German management is more closely scrutinized by share-holders and labor than American management and has not undertaken the abusive management compensation schemes seen in the United States. According to Towers Perrin's 2006 survey, for industrial companies with over $500 million in sales, American CEOs garnered an average annual total compensation of $2.16 million, 62% of which was incentive pay, while German CEOs were paid on average $1.18 million for the year, with only 18.5% of that comprising incentive pay. Empirical evidence suggests that German firms have higher productivity and lower turnover costs, while German workers enjoy more job stability, greater opportunities for job training, and higher wages than

199. Jackson et al., supra note 7, at 97. They are also aided in this effort by enjoying what has been called "patient capital." Ownership is much more concentrated in the German economy than in the American economy, and there is much less threat of hostile takeovers for corporate control. As a result, German owners are more to enjoy the benefits of long run investments and be open to such strategies. Jackson et al., supra note 7, at 87–89. Bernd Frick & Erik Lehmann, Corporate Governance in Germany: Ownership, Codetermination, and Firm Performance in a Stakeholder Economy, in CORPORATE GOVERNANCE, supra note 7, at 122, 124.


201. See id.

202. See id.

203. Randall S. Thomas, International Executive Pay: Current Practices and Future Trends, in LABOR AND EMPLOYMENT, supra note 78, at 183, 187–89. The Germans’ higher concentration of corporate ownership probably also helps in this regard since shareholders are more likely to pose an organized and powerful block in dealing with management. Jackson et al., supra note 7, at 87.

204. Frick & Lehman, supra note 199, at 134, 137.
their American counterparts.\textsuperscript{205}

As with German corporate governance, German labor relations are dominated by the system of co-determination. The idea of co-determination is that both capital and labor should have a say in the running of the firm and the division of the proceeds from the enterprise, and that such a partnership will encourage cooperation and the avoidance of labor disputes. Although Works Councils are prohibited from undertaking work stoppages, their role in sharing information and consulting with management on a large array of workplace issues ensures that German employees have ready access to important information concerning their employer and a real say in firm labor relations policies. Of course, German workers are also free to associate in independent unions that can undertake work stoppages and are protected from employer discrimination in exercising this right of association. Currently in Germany, about 19\% of all workers are represented by unions, while the corresponding number in the United States is 11.9\%.\textsuperscript{206} The combination of an employee Works Council with employee representatives on the Board of Supervisors and an independent union provides the employees with even more input into the running of their firm. Although enactment of the Codetermination Acts did not seem to have a significant impact on the profits of German firms,\textsuperscript{207} cross-sectional studies suggest Works Councils have a negative impact on firm profits, but not rates of investment or innovation.\textsuperscript{208} Apparently, Works Councils lower the rate of return on capital, but lower the risk of return sufficiently to make up for this drawback. There seems little doubt that the German system of codetermination enjoys significant advantages in promoting labor management cooperation and industrial peace. The number of work days lost to industrial strife per organized worker in Germany is about one-fifth the number of such days lost in the United States.\textsuperscript{209}

\begin{itemize}
    \item 205. Id. at 138 (discussing wages and benefits); Jackson et al., supra note 7, at 90–91 (discussing job tenure, turnover, and training).
    \item 206. ALFS Summary Tables, OECD.ORG, Mar. 27, 2011, http://stats.oecd.org/Index.aspx?DatasetCode=ALFS_SUMTAB. Union density in the U.S. private sector is currently less than 8\%. Id.
    \item 207. Frick & Lehman, supra note 199, at 133.
    \item 208. Id. at 134; Gospel & Pendleton, supra note 26, at 24.
    \item 209. Over the period 1978–94, the average number work days lost to strikes and lockouts per year per thousands organized workers in the United States was 110 while in Germany the number was 22. In Japan the number average number of work days lost was only 13. Daus-Schmidt, supra note 156, at 132 tbl.1.
\end{itemize}
2. The Japanese System: "A Community of Shared Fate"

The modern Japanese system of industrial relations has its origins in the aftermath of World War II. When the Allied Occupation ordered a rapid expansion of private collective bargaining, Japanese executives moved quickly to comply by encouraging their employees to join labor unions. Thus, in Japan, labor unions were born not from virulent class struggles, but from the initiative of company executives. These corporate executives encouraged white-collar workers, as well as blue-collar workers, to join unions in order to moderate union demands. Furthermore, since companies in postwar Japan were mostly formed by managers rather than independent owners, workers have no wealthy propertied class above them, but only a managerial class whose lifestyle is not very different from their own. Indeed, most Japanese managers today, including most members of corporate boards of directors, were promoted from within the company and many were former union members.

The Japanese have developed an "employee centered" system of corporate governance, but this focus on employee interests arises more from Japanese social norms and corporate practices than law. In practice, Japan's larger corporations treat the firm's employees as the most important stake-holder. The rationale for this treatment is that the Japanese view the employees as the stake-holder with the greatest long-term interest in the firm and the stake-holder that makes the largest contribution to and accepts the largest risk in the success of the firm. It is considered dishonorable in Japan for a corporate manager to make decisions that opportunistically sacrifice employee interests for the benefit of share-holders. There is a strong social norm against

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211. Id. at 153.
212. Id. at 154.
217. Itami, supra note 214.
218. Gospel & Pendleton, supra note 26, at 15. In 1993, in the face of a severe recession, some Japanese employers cancelled their agreed promises to employ new graduates. The
employee lay-offs, which is reflected in Japanese case law and statutes that prohibit "abuse of the right to dismiss." As a result, like German corporate managers, Japanese managers are less focused on corporate strategies that maximize short-run profits and see share-holders, rather than employees, as the ones who must absorb economic fluctuations through variations in profits.

It is perhaps hard for Americans, who come from a perspective of share-holder or management primacy and employee subordination, to conceive of how the Japanese, including Japanese managers, would develop such norms. The secret is the Japanese practice of promoting from within the firm, both for positions of management and for positions on the Board of Directors. As a result of internal promotion, in Japan the majority of corporate managers and members of the Boards of Directors have a long history as employees of the firm, and it is quite natural that they would value the employee perspective and consider it dishonorable to turn on their former colleagues. Indeed it is common practice for about half of the corporate Board of Directors to be "directors-with-employee-functions," current employees or managers whose role is to represent the interests of their department on the Board. Also, because of Japan's wide-spread practice of enterprise unionism and employee membership in unions, it is common for corporate managers and directors to have previously been union members in the same corporation. A recent Top Management Survey showed that 28% of top management in Japanese corporations had previously been leaders in the enterprise union for the corporation.

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Japanese Ministry of Labor published the names of the employers who cancelled the contracts in order to shame them, and the act was soundly condemned by the Japanese public. 

Araki, supra note 215, at 271.


220. Id. at 267.

221. It also helps that the Japanese, like the Germans, enjoy "patient capital" in that they have many more large banks and institutional investors and inter-locking ownership of corporations, and much less threat of hostile take-over, so that Japanese investors are more willing to take a long-run perspective on what's best for the firm. Id. at 255.

222. Id.

223. The Top Management Survey shows that 76% of Board members in Japan were promoted from within the corporation and the remaining 24% come from parent or affiliated firms. "Outside" directors are virtually unknown in Japan. Araki, supra note 187, at 324. Also, because of this internal promotion, there is much less difference in class and pay between the average employee and the average member of the Board of Directors in Japan than in the United States. Araki, supra note 215, at 264.

224. Araki, supra note 215, at 264, 278.

The presence of current and former employees in management and on the Board of Directors, combined with the Japanese practice of consultation between labor and management, ensure that employee perspectives are well represented in the governance and management of the corporation.

The Japanese system of industrial relations is based on the concept of the company as "a community of shared fate." As the name suggests, this concept promotes the idea that all of the company's stakeholders, labor, management, and shareholders, will either prosper together or fail together. Pursuant to this principle, Japanese managers have encouraged lifetime employment relationships, direct employee interest in the profitability of the firm, and frequent consultation between managers and employees concerning a wide variety of employment related topics. Many workers in Japan are hired with the expectation that the firm will employ them on an uninterrupted basis for the rest of their life. Moreover, because promotions are generally made from within the firm, employees have strong incentives to commit themselves to working for the same firm for their entire work life, and managers have a strong commitment to their firm and the employees of the firm. As an accommodation to the Buddhist Bon Festival and New Year celebrations, Japanese workers receive two lump-sum payments each year, which on average, are equal to about four months salary. The size of these lump-sum payments depends on the profitability of the employee's firm, tying employee compensation directly to the profitability of the firm. Finally, Japanese management has made a strong commitment to consultation and the exchange of information at all levels of the firm. This commitment includes a system of joint consultation between labor and management on the day-to-day running of the plant, small group discussions among workers on methods of production such as the well-known quality circles, and a corporate board of directors composed predominantly of past or current employees.

226. Kuwahara, supra note 190, at 257.
227. Id. at 254.
228. Id. at 260.
229. Id.
Japan has also developed an extensive system of laws regulating the conduct of labor relations. The Japanese have no formal method for selecting a bargaining representative and treat the question of union representation as a matter of individual freedom of association for the workers. The Japanese also have no concept of exclusive representation. Different employees with the same employer may designate different unions as their representative. In practice, however, one organization generally dominates within a firm and bargains with the firm on a corporate basis, and about half of Japanese unions have union shop agreements requiring union membership as a condition of employment. Employers have an affirmative obligation to bargain in good faith with any representative designated by their employees, but there is no corresponding obligation for the union to bargain in good faith. The employer's obligation to bargain in good faith can be enforced through an administrative unfair labor practice proceeding similar to that employed in the United States, or through a private civil suit by the union. Remedies for a failure to bargain in good faith include an injunction and tort damages for lost wages and benefits. Collective agreements, including agreements not to strike, are fully enforceable in Japan, although it seems the Japanese rely more on the court system for this task than on private arbitration. Indeed, Japanese courts will infer a "peace obligation" on the part of both parties to a collective bargaining agreement to carry out the terms of that agreement—without resort to economic warfare during the life of the agreement—even if the agreement does not contain an express no-strike clause. Currently, about 18.2% of Japan's employees are represented by a union. This, combined with the Japanese system of promoting managers and directors from the employees within the corporation, ensures that employee perspectives are well represented in Japanese labor relations.

Empirical evidence comparing the Japanese and American systems of corporate governance and labor relations suggests that there are some real advantages to the Japanese system. Japanese companies rely

232. Id. at 471–72.
233. Id. at 438.
234. Id. at 494.
235. Id. at 494–95.
236. Id. at 522.
237. Id. at 520–21.
238. ALFS Summary Tables, supra note 206.
PROMOTING EMPLOYEE VOICE

much less on layoffs to deal with economic fluctuations, preferring instead to accept fluctuations in profits and even decreases in wages. This allows the Japanese to make more investments in firm-specific human capital and lowers turnover costs. While the United States seems to enjoy advantages in market flexibility, job creation, and innovation, the secret of the Japanese system to providing high wages and low unemployment seems to be job training, a higher savings rate, and a gradual systematic approach to change. For most of the post-war period, Japanese employment and training institutions have provided higher growth and less income inequality than their American counterparts. Japanese managers have a longer term planning perspective than American managers, and work for much less money. According to the Towers Perrin’s 2006 survey, for industrial companies with over $500 million in sales, American CEOs enjoyed an average annual total compensation of $2.16 million, 62% of which was incentive pay, while Japanese CEOs on average were paid merely $543,564 with only 22% of that comprising incentive pay, about the same percent in incentive pay received by their employees. Indeed, at least in the recent past, it has been a common belief among Japanese managers that American managers are paid too much and take too many of the benefits of the firm for themselves.

3. Criticisms of the Coordinated Market Systems of Germany and Japan

There have, of course, been some criticisms of the coordinated market systems of Germany and Japan. Furubotn has argued that the coordinated market systems give employees a say in corporate governance that is disproportionate to their capital investment and thus introduce an inefficient management structure because they separate


242. See id. at 158–92.


244. Thomas, supra note 203, at 187–89.

245. VOGEL, supra note 210, at 154.
corporate decision-making from financial responsibility.\textsuperscript{246} This criticism, however, ignores the employees' human capital investment in the firm. Based on the German and Japanese experiences, one can reasonably argue that the American system is less efficient and actually discourages efficient employee investment in—and commitment to—the firm.\textsuperscript{247} Coupled with the argument that the coordinated market system is less efficient, Jensen and Meckling have argued that if codetermination was really more efficient, firms would voluntarily undertake it and the Germans would not have to require consultation by law.\textsuperscript{248} However, the Japanese system of coordinated markets seems at least as organically derived and spontaneous as our own system of shareholder value, raising the question of which leads to market-driven efficiency and under what circumstances. Moreover, even if German codetermination is wealth or social welfare maximizing, managers and shareholders may not voluntarily consent to it because it yields a larger share of the surplus for workers and a smaller share for capital.\textsuperscript{249} Accordingly, management and capital's resistance to codetermination may in fact frustrate efficiency or social welfare maximization and must be overcome with regulation. There are some indications that recently both the German and Japanese systems have evolved to accept some features of the American market-oriented system; both the Germans and Japanese have recently acted to lessen the power of large institutional investors and add flexibility to their labor markets.\textsuperscript{250} Nevertheless, it seems doubtful they will adopt wholesale the American system and much more likely that the “hybrid” system they adopt will retain codetermination and a much higher level of employee voice in corporate governance and labor relations than exists in the United States.\textsuperscript{251} The question is how do we move to a more successful hybrid of our own by drawing on the German and Japanese experiences?

\textsuperscript{247} Frick & Lehman, \textit{supra} note 199, at 136–37.
\textsuperscript{249} Freeman & Lazear, \textit{supra} note 188, at 29.
\textsuperscript{250} Araki, \textit{supra} note 215, at 280–81 (describing the Japanese market); Jackson et al., \textit{supra} note 7, at 99–105 (describing the German market).
\textsuperscript{251} Araki, \textit{supra} note 215, at 281; Jackson et al., \textit{supra} note 7, at 101–02.
V. PROMOTING EMPLOYEE VOICE IN CORPORATE AMERICA

As a result of the United States' strong reliance on the share value theory of corporate governance and individual bargaining in labor relations, American workers have less say in the production process than workers in perhaps any other developed democracy in the world. Professor Estlund has termed this lack of employee voice in the American workplace the "democracy deficit." Not surprisingly, American workers are not happy with having so little say in corporate policies and labor relations. As Freeman and Roger's 1999 survey showed, fully 63% of American workers would like more input into workplace decisions, and most workers would like that influence to come through employee representatives or in cooperation with fellow employees, not through individual bargaining. Even employers say they would like more information from employees, and regularly test the limits of section 8(a)(2) of the NLRA, although it is clear they would like to gather information from employees through employer-sponsored committees, rather than independent employee unions. Moreover, as we have seen previously in this essay, there is good evidence that our failure to take advantage of employee voice is not good for American workers or the American economy. How might we address this problem?

A. Promoting Employee Voice in American Corporate Governance

American corporate governance currently suffers from an inordinate focus on the short-run price of the firm's stock, and this obsession has proved unhealthy for both American workers and the American economy. This inordinate focus arises from several causes: absent and "impatient" shareholders who have inadequate control over corporate management, executive compensation schemes that ally management interests with the short-run value of firm stock, and the almost complete absence of effective employee voice in American corporate governance. There are several ways we might address these underlying problems. To

prevent corporations from avoiding these changes by merely changing their state domicile, these reforms will have to be enacted either through federal law or a uniform code adopted by all states. Given the unlikelihood of the latter option, I think it best that these problems be addressed by Congress. Fortunately, there have been two recent bills enacted with the purpose of reforming American corporate governance: The Sarbanes-Oxley Act of 2002 and the Dodd–Frank Wall Street Reform and Consumer Protection Act of 2010. The Sarbanes-Oxley Act was passed in direct response to the major corporate and accounting scandals of the early 2000s involving Enron, Tyco International, Adelphia, Peregrine Systems, and WorldCom. As previously discussed, these scandals cost investors billions of dollars and shook public confidence in the nation’s securities markets. The Act is aimed largely at ensuring accuracy in corporate accounting and reporting practices that is essential in any meaningful system of corporate governance. The Dodd–Frank Act was passed in response to the recent near collapse of financial markets also discussed in this essay. Some of its provisions address problems discussed in this essay and, where appropriate, I will mention those provisions among my proposals. Unfortunately, neither Act was aimed at promoting

258. Sarbanes–Oxley contains eleven titles that describe specific mandates and requirements for financial reporting: Title I establishes the Public Company Accounting Oversight Board, to provide independent oversight of public accounting firms providing audit services; Title II establishes standards for external auditor independence, to limit conflicts of interest; Title III mandates that senior executives take individual responsibility for the accuracy and completeness of corporate financial reports; Title IV prescribes enhanced reporting requirements for financial transactions and requires internal controls for assuring the accuracy of financial reports and disclosures; Title V defines codes of conduct for securities analysts and requires disclosure of knowable conflicts of interest; Title VI defines the SEC’s authority to censure or bar securities professionals from practice and defines conditions under which a person can be barred from practicing as a broker, advisor, or dealer; Title VII the Comptroller General and the SEC to perform various studies and report their findings; Title VIII prescribes criminal penalties for manipulation, destruction or alteration of financial records or other interference with investigations, while providing protection for whistle-blowers; Title IX increases the criminal penalties associated with white-collar crimes and conspiracies; Title X requires the Chief Executive Officer to sign the company tax return; Title XI identifies corporate fraud and records tampering as criminal offenses and joins those offenses to specific penalties. See generally Pub. L. 107-204, 116 Stat. 745.
259. Corporate Governance issues are addressed in Title IX of the Dodd-Frank Act—designated the “Investor Protection and Securities Reform Act of 2010.” In this Title
employee voice in corporate governance.

First, we should encourage American shareholders to be present patient capital, rather than absent impatient capital, and empower them to rein in managerial excesses. The provisions of the Dodd-Frank Act granting the Security and Exchange Commission authority to adopt regulations requiring that corporations provide procedures for shareholders to nominate directors through the company’s proxy process are a good start. Prior to this provision, shareholders were often left to vote only on unopposed nominees for the Board put forth by management—a procedure that provided inadequate monitoring of management. It is yet to be seen whether these regulations will have meaningful impact, but it is a useful attempt to give shareholders a more active role in the governance of the firm. We might also place term limits on the members of the Board of Directors to ensure that they do not become too entangled with management. The British impose such term limits for just this reason. Other provisions might be enacted to promote shareholder power in the firm; in particular, we might amend ERISA to allow employee pension plans to act on and represent employee interests in the firm beyond just maximizing share price for retirement. Professor Marleen O’Connor has been one of the earliest and most convincing academic advocates for greater roles for pension plans and employees as stock owners in corporate governance. From the perspective of encouraging patient capital, the provisions of the Internal Revenue Code providing for lower tax rates for “long-term”

Congress provides: Security and Exchange Commission authority to adopt regulations providing shareholder access to nominate directors through the company’s proxy process; a requirement of non-binding mandatory shareholder votes on executive compensation and “golden parachute” payments, as to which matters brokers may not vote undirected shares; Security and Exchange Commission authority to mandate compensation “clawback” if executive compensation is based on inaccurate financial statements; national securities exchanges authority to require the independence of compensation committee members, and to grant committee authority to hire independent compensation consultants; and directions that the Security and Exchange Commission issue rules requiring proxy disclosure regarding executive compensation, equity securities hedging by company’s employees or directors, and whether or not the company has divided the CEO and board chairman roles. Investor Protection and Securities Reform Act, Pub. L. 111-203, 124 Stat. 1376.

260. Id. § 951.

261. JOHN GILLESPIE & DAVID ZWEIG, HOW THE FAILURE OF CORPORATE BOARDS IS RUINING AMERICAN BUSINESS AND COSTING US TRILLIONS 263 (2010).

capital gains make sense. However, the current “long-term” for special tax treatment is only one year. It might be advisable to offer additional incentives for capital held five, ten, or even fifteen years.

Second, we should encourage American management to develop independent long-term interests, and perhaps even interests in the welfare of their employees. If managers are going to receive a portion of their remuneration in stock, we should limit the amount of that remuneration to no more than 20% of the total compensation package, or require that the manager hold the stock for no less than ten years before it can be redeemed. The Dodd–Frank Act has made some changes to the law that are intended to provide an independent basis for determining executive compensation and limiting that compensation. The Act provides for independent corporate compensation committee members and consultants, directs the Securities and Exchange Commission to issue rules requiring proxy disclosure of executive compensation and equity securities and provides for non-binding shareholder votes on executive compensation. At a minimum I would think shareholders are entitled to a binding vote on executive compensation. It would also seem useful to tie executive compensation to the compensation and benefits of their employees, either as a factor to be considered by the company’s compensation committee or as a legislated maximum—say 100 times the total paid for salaries and wages divided by the number of employees. This would give managers incentive to take into account the returns to their employees in working for the firm and investing their human capital and lives, just as they take into account the returns to shareholders. The SEC rules implementing the Dodd–Frank Act require companies to report both executive compensation and a measure of the median

263. Short-term capital gains (held one year or less) are subject to ordinary income tax rates up to 35%. Long-term capital gains (held for more than one year) are subject to a 0-15% tax rate depending on the person’s tax bracket. I.R.C. § 1(7)(h) (2006).

264. See supra note 258 and accompanying text.

265. See Rebecca A. Crawford, Comment, Corporate Governance Reform: How to Promote the Long-Term Health and Value of U.S. Corporations, 5 N.Y.U. J. L. & Bus. 905, 919–24 (2009). Crawford explains that shareholders would also receive independent evaluations of the corporation’s performance and projections and detailing the executive compensation package which would include at least 50% stock options, which would not start vesting until one year of service and then continue to vest slowly over time. Id. While shareholders would vote on the overall compensation, they would be guided by looking at the FMV of the stock options when distributed and explaining that the shareholders would have to be provided a detailed list of the components of the compensation package and a breakdown of the company’s profits attributable to market movement and not management efficacy. Id.
employee pay for the firm, but again there is no binding impact from this comparison.

Finally, we should require (or strongly encourage) a significant and meaningful voice for American workers on the corporate Board of Directors. The German and Japanese experiences show that there is just no substitute for this in terms of promoting the long-term interests of the firm or the larger interests of society. We could follow the German model of requiring employee representation only on firms of a certain size, and increasing such representation as the firms grow in size. Small firms that are owner-operated do not suffer the agency costs problems of independent management that give rise to most of the problems discussed in this essay, and in these firms management can directly discuss problems with employees. It seems too much to imagine American corporations with equal numbers of employee and shareholder directors, but perhaps we could start by requiring firms with more than 500 employees to add employee members of the Board of Directors so that such representatives make up 20% of the Board, and requiring firms with more than 2,000 employees to add employee members of the Board of Directors so that such representatives make up 33% of the Board. The employee representatives could be elected to staggered terms so that elections are held every year or two. These elections and representatives would provide information to the employees, and an opportunity to meaningfully discuss and debate the policies of the firm. The representatives would also provide capital with an important ally in monitoring management, and management an

266. Kent Greenfield, Reclaiming Corporate Law in a New Gilded Age, 2 HARV. L. & POL'Y REV. 1, 24 (2008) (stating that “employees could elect a proportion of the board, communities in which the company employs a significant percentage of the workforce could propose a representative for the board and long-term business partners and creditors could be represented as well”); Kent Greenfield, Using Behavioral Economics to Show the Power and Efficiency of Corporate Law as Regulatory Tool, 35 U.C. DAVIS L. REV. 581, 608 (2002); O'Connor, supra note 33, at 904 (stating that under the “neutral referee model” proposal, directors would serve as neutral referees to balance the competing interests of shareholders and employees.).


268. Professor Matthew Bodie has made the interesting proposal that firms should be required to undertake a non-binding employee referendum for transformative transactions that would augment the current shareholder voting system. Matthew T. Bodie, The Case for Employee Referenda on Transformative Transactions as Shareholder Proposals, 87 WASH. U. L.R. 897, 897 (2010); Bodie, supra note 8, at 878, 899, 900. Such referenda would provide an opportunity for providing information to employees and getting their input on important matters.
important ally in selling long-term strategies to the shareholders. Where
the employees are represented by a union, employee representation on
the Board of Directors would encourage cooperative labor relations and
help limit industrial strife. Perhaps most important of all, such
representation would help change management and shareholder
attitudes towards employees so that employees would be seen as
partners rather than a commodity.

B. Promoting Employee Voice in American Labor Relations

American labor relations suffer from a lack of employee voice in
setting the terms and conditions of employment. No other
industrialized democracy on earth gives employers so much power to
command and change the terms and conditions of employment.
America is unique in its adherence to the at-will rule. 269 In Germany,
employers are prohibited by statute from making “socially unwarranted
dismissal” and must give advance notice of terminations not only to the
employee, but also to his Works Council which can object and contest
the termination in a labor court while the employee remains
employed. 270 Indeed, all European countries, even Great Britain, have
at least some statutory protection against “unjust dismissal” and the
employer unilaterally terminating the employment contract. In Japan
“just cause” protection has been interpreted into the Constitution, and
advance notice of the termination of employment contracts is required
by law. 271 The United States is also exceptional in the low percentage of
workers it has covered by collective bargaining agreements. Virtually
all of the European countries and Japan have higher union density
numbers, and even in those that are lower (for example, France),
collective negotiations determine the terms and conditions of
employment for a much higher percentage of employees. 272 In many
countries, for example Germany and the Scandinavian countries, terms
and conditions of employment are commonly based on national
standards determined through tripartite discussions among labor,
management, and the government. Similarly mature industrial
democracies commonly employ less formal and less costly means of
adjudicating employee complaints under the contract or law, works

269. Samuel Estreicher, Unjust Dismissal Laws: Some Cautionary Notes, 33 Am. J.
Comp. L. 310, 311 (1985).
270. Id. at 314–15.
271. Id. at 317.
272. INTERNATIONAL AND COMPARATIVE EMPLOYMENT RELATIONS 379 tbl.A.18
council discussions, and labor courts or arbitration. As a result, employees in those countries have a better opportunity to enforce the terms of employment they achieve. How can we promote greater employee voice in American labor relations?

First we should undertake efforts to promote employee voice in the workplace even in the absence of independent unions. I think we need to address our system of at-will employment combined with unilateral offer and acceptance, which leaves employees almost entirely out of the loop in determining the terms and conditions of employment through individual bargaining. A statutory system of moderate but mandatory severance pay in the absence of an employer showing of good cause, combined with a statutory or common law standard of “reasonable notice” for changes in indefinite contract terms would slow down our system of individual bargaining giving employees some time to give input or else look for another job. The whole system could be efficiently enforced through our unemployment compensation system in which employers already have to adjudicate the question of just cause for dismissal in order to deny benefits. To entice employers to sign on to the system, we could limit the scope or damages available in wrongful discharge suits and accept fair procedures for individual arbitration of such claims. Such a system would be more efficient and provide more severance benefits to a broader array of workers—sort of a workers’ compensation system for employee discharge.

We should also consider requiring or encouraging the use of elected employee committees on a variety of workplace subjects. Although the United States will probably never have a system as extensive as the German Works Councils, I am always surprised at the willingness of even some of my most pro-employer students to consider the idea of employee committees on subjects such as safety, productivity, and working conditions. American employers also seem anxious for a way to communicate with employee representatives on a variety of topics, given the frequency with which they test the limits of Section 8(a)(2) of the NLRA prohibiting Company Unions. We could consider

275. In 1996, Congress passed the Teamwork for Employees and Managers Act of 1995, H.R. 743, 104th Congress (1996), to allow employee participation committees that would not violate Section 8(a)(2). The measure never became law, however, because it was vetoed by President Clinton. Arthur J. Martin, Company Sponsored Employee Involvement: A Union
requiring employers over a certain size to have elected committees on a variety of subjects, or merely encourage such committees by providing employers with a safe harbor from Section 8(a)(2) if they followed certain procedures to ensure representativeness and independence and made necessary information available to the employee committees. In this regard, we might consider some of the suggestions of Professor Finkin on employee committees, and some of Professor Estlund's ideas on responsible self-regulation and promoting constructive "co-regulation" between the parties.\textsuperscript{276}

Second, we should undertake efforts to promote employee voice through independent unions. In this regard, the Employee Free Choice Act currently being considered in Congress is a helpful starting point.\textsuperscript{277} As announced in its first section, the bill's purpose is to "amend the National Labor Relations Act to establish an efficient system to enable employees to form, join, or assist labor organizations, to provide for mandatory injunctions for unfair labor practices during organizing efforts, and for other purposes."\textsuperscript{278} The bill attempts to achieve this purpose through three objectives. First, the bill would rescind the employer's right to demand an election and would allow a union to be certified as the exclusive representative of the employees on the basis of representation cards signed by a majority of workers in an appropriate unit.\textsuperscript{279} This would allow unions to avoid employer abuses of delays and unfair labor practices during the course of an election campaign, which some employers now use to avoid representation. Second, the bill would also require employers and unions to enter into binding arbitration to produce a collective agreement within 120 days after a union is recognized, if one cannot be achieved through collective bargaining.\textsuperscript{280} This is intended to address the current problem that in

\textsuperscript{276} ESTLUND, supra note 252, at 25; see Matthew W. Finkin, Employee Representation Outside the Labor Act: Thoughts on Arbitral Representation, Group Arbitration, and Workplace Committees, 5 U. PA. J. LAB. & EMP. L. 75, 89–100 (2002).

\textsuperscript{277} The Employee Free Choice Act, H.R. 1409, 111th Cong. (2009).

\textsuperscript{278} Id.

\textsuperscript{279} Id.

\textsuperscript{280} Id.
almost half of successful union election campaigns, the union selected by
the employees to represent them never achieves a first contract.\textsuperscript{281}
Finally, the bill would increase penalties on employers who commit
unfair labor practices.\textsuperscript{282} There is no doubt that the current doctrine that
the NLRA is merely remedial and provides no basis for punitive fines
fails to provide adequate incentives for employers to obey the law.\textsuperscript{283}

Of course, the Employee Free Choice Act currently lies moribund in
Congress with little chance of passage in its current, or any, form. The
inability of the Senate to even consider relatively modest changes to the
NLRA when it is so clearly out of date and failing to achieve its
objective of fostering employee voice is a strong indictment of our
legislative process. If reasoned debate \textit{were} possible within the halls of
Congress, and if electoral majorities \textit{meant} anything, there are some
other amendments to the NLRA that should be considered. If we are
going to retain elections as the primary method through which
employees choose a representative, we should undertake some very
simple and common sense changes to improve the efficacy of our
election process. First, employees under the Act should have full and
easy access to their fellow employees for the purpose of organizing and
collective action, like Congress clearly intended in enacting the Wagner
Act. Congress or the Court should overturn the Court's opinion in
\textit{Lechmere, Inc. v. NLRB}\textsuperscript{284} and reaffirm the express language of the Act
to make it clear that protected employees do not have to be the
employees of a "particular employer"\textsuperscript{285} in order to collectively exercise

\begin{quote}
281. \textsc{Weiler}, \textit{supra} note 51, at 250.
282. H.R. 1409.
283. J. \textsc{Freedley Hunsicker}, Jr. \textsc{et al.}, \textsc{NLRB Remedies for Unfair Labor}
Practices} 2 (1986); \textsc{Weiler}, \textit{supra} note 51, at 247–552; Dau-Schmidt, \textit{supra} note 75, at 506–
08; William B. Gould IV, \textit{Some Reflections on Fifty Years of the National Labor Relations Act:}
The Need for Labor Board and Labor Law Reform, \textit{38 Stan. L. Rev.} 937, 941 (1986); see
Charles J. Morris, \textit{The Role of the NLRB and the Courts in the Collective Bargaining Process: A Fresh Look at the Conventional Wisdom and Unconventional Remedies,}
\textit{30 Vand. L. Rev.} 661, 676–87 (1977); Theodore J. St. Antoine, \textit{A Touchstone for Labor Board Remedies,}
285. \textsc{Ellen Dannin}, \textit{Taking Back the Workers' Law: How to Fight the Assault on Labor Rights} 13 (2006). Section 2(3) of the NLRA defines "employee" as follows:

\begin{quote}
The term "employee" shall include any employee, \textit{and shall not be limited to the employees of a particular employer}, unless this subchapter explicitly states otherwise, and shall include any individual whose work has ceased as a consequence of, or in connection with, any current labor dispute or because of any unfair labor practice \ldots but shall not include
\end{quote}
full Section 7 rights. At a minimum, employees of a competing employer or a related employer should have full access to another employer’s employees in non-work areas during non-work time for the purposes of organizing. Congress or the Court should also make clear that “full access” includes the right to have fellow employees’ addresses, phone numbers, and e-mail addresses provided by the employer upon application during an organizing campaign. In order to meaningfully exercise Section 7 rights, employees have to have access to the common low-cost methods of communication of mail, telephone, and e-mail.286 Allowing employers to suppress this information on the basis of minuscule and nebulous private property claims287 needlessly frustrates the exercise of employee Section 7 rights and the Supreme Court’s opinion in Republic Aviation.288 Finally, Congress or the Court should make clear that if an employer provides access to employees for non-profit organizations or charities for any purpose, or to himself for the purpose of lobbying against a union, then he has to give the union equal access to that of the other organizations, or a chance to respond to his criticisms, otherwise the employer discriminates against employees on the basis of their collective activity in violation of Section 8(a)(3). By ensuring that employees have access to low-cost methods of communicating with each other, we help promote employee organization and voice, and avoid the needless waste of union resources.289

Finally, we should reconsider the elevated place of the doctrine of exclusive representation in our labor relations practice and law. Exclusive representation is an obstacle to the exercise of employee voice because it requires majority representation and tends to ensnare us in protracted election campaigns to determine an issue of legal

any individual employed as an agricultural laborer, or in the domestic service of any family or person at his home, or any individual employed by his parent or spouse, or any individual having the status of an independent contractor, or any individual employed as a supervisor, or any individual employed by an employer subject to the Railway Labor Act . . .

289. Dau-Schmidt, supra note 75, at 487.


288. Republic Aviation Corp. v. NLRB, 324 U.S. 793, 793–99 (1945); see also Malin & Perritt, supra note 286, at 45.
representation that in any other setting would be a matter of personal choice. It also sweeps employees who honestly dissent from being represented by the union into a position in which their representative is chosen without their actual consent. Union representation under these conditions is resented and leads to needless litigation under the duty of fair representation. Professor Charlie Morris has argued that our current heavy reliance on the doctrine of exclusive representation and majority bargaining is misplaced under the language and legislative history of the NLRA and labor relations practices at the time of the passage of the Act.\footnote{290} He argues that minority union bargaining is not only allowed under the Act, but that employers are required to bargain in good faith with the representatives of minority unions on behalf of their members. It is only when unions actually want to establish themselves as the exclusive representative that they need to resort to more elaborate methods than a card check, for example a Board election.\footnote{291} Regardless of whether Professor Morris' arguments prevail in the interpretation of the current law, Congress should consider doing away with the doctrine of exclusive representation. Almost no other countries in the world subscribe to this doctrine and it has proven a real obstacle to employee voice.

VI. CONCLUSIONS

The recent performance of American corporations suggests that there are serious problems in the American system of corporate governance and labor relations. The near collapse of our financial system in 2008 demonstrated that our system of lucratively rewarding management based on stock prices under the "shareholder theory of value" results in an inordinate focus by U.S. management on short-run profits that poses a serious threat to the health of our economy. Accounting scandals, environmental disasters, and the failure of the U.S. auto industry to adequately adapt to anticipated consumer demand all show that this inordinate focus on short-run profits is not confined to the financial industry, but exists in large corporations across the American economy. Under the American system of corporate governance there is inadequate ownership control and inadequate input

\footnote{290. CHARLES J. MORRIS, THE BLUE EAGLE AT WORK: RECLAIMING DEMOCRATIC RIGHTS IN THE AMERICAN WORKPLACE I (2005).}

from workers, resulting in excessive managerial compensation and a paucity of long-run strategies and investments to the detriment of American businesses, workers, and the American economy as a whole.

The recent decline in the fortunes of American workers demonstrates that the American system of individual bargaining results in too little attention to the interests of workers and too little investment in long-term employment relationships and human capital. The doctrine of employment at will, combined with unilateral offer and acceptance, gives American management control over the terms and conditions of employment that is unrivaled among industrialized democracies in the world. Individually, employees also have too few resources and too little incentive to enforce the terms and conditions of employment. In the absence of collective voice, employee interests are not adequately represented in American labor relations, resulting in too little investment in public goods and human capital. As a result, American workers are on a path to occupy a niche as moderately trained, moderately paid flexible labor in the world economy. The wages of American workers remain stagnant while they absorb ever greater risk of unemployment and fluctuations in healthcare and pension benefits.

American corporate governance and labor relations would benefit from greater employee participation. If workers were given a greater voice in corporate governance, shareholders would gain an ally in monitoring management and making decisions with inside information on the operation of the firm, and management would gain an ally with convincing capital to invest in the long-run interest of the firm. Production could be organized with management and workers as stakeholders with long-term interests and fluctuations in profits absorbed by capital rather than through wasteful layoffs. In this regard, the systems of corporate governance employed in Germany and Japan that account for employee views either through legislatively required codetermination or the socially constructed “community of shared fate” are instructive. Moreover, if workers were given a greater voice in labor relations it would help solve many of the problems generated by our system of individual bargaining. Worker collective voice would help solve asymmetries in information between management and labor, and aid in the efficient consumption of public goods and enforcement of the terms and conditions of employment. Once again, the institutions employed in Germany and Japan to conduct labor relations present useful lessons.

The United States should adopt legislative measures to promote employee voice in corporate governance and labor relations. Our
economy suffers from an excess of management discretion and greed in the running of our largest corporations, and these excesses threaten the position of our economy in the world and the futures of our children. Greater employee voice in the running of our largest corporations can play an important role in checking these excesses and putting our economy on a solid footing for future economic growth and prosperity benefiting all Americans.
### Table 1: Nonfarm Business Hourly Output and Hourly Wage Indexes (1947=100), 1947-2009

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<th>Output</th>
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Source: Bureau of Labor Statistics Data Sets
### Table 2: Non-Supervisory Employee Share of Private Nonfarm Domestic Product

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Source: Bureau of Labor Statistics Data Sets
Ave Ann Hrs (Table B7) * Ave Nom Hrly Wage (Table B9) / Privt Nonfarm GDP (Table B 10)

### Table 3: Share of National Income Enjoyed by the Top Fifth and Bottom Three Fifths of the US Population (Percent), 1947-2006

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## Table 4: National Income Share of Top 10% of US Population, 1917-2008

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