Tanner lecture comment, by Tyler Cowen on Elizabeth Anderson, 17 February 2015

I am very much a fan of Elizabeth Anderson's attempts to synthesize philosophy and economics, but on the topic of her Tanner entry my views diverge from hers. I see the economics differently, and when it comes to the moral philosophy I would put the practical trade-offs front and center of the argument, and allow them to shape the philosophy, rather than presenting them as an afterthought.

I won't summarize her views, but I will pull out one sentence to indicate her stance: "Here most of us are, toiling under the authority of communist dictators, and we don't see the reality for what it is." These communist dictators are, in her account, private business firms. That description may be deliberately hyperbolic, but nonetheless it reflects her attitude that capitalist companies exercise a kind of unaccountable, non-democratic power over the lives of their workers, in a manner which she thinks is deserving of moral outrage.

As an individual who chose an academic job to maximize some dimensions of my personal freedom, I sympathize with parts of this portrait. Still, I would stress some very different facts and features of the employment relationship.

For instance I don't worry so much about the dictatorial power of companies if the costs of worker exit are relatively low. To be sure, many workers grow attached to their current firms, for instance they may have friends there, a good relationship with the boss, and a preferred commute. Still, the most likely scenario is that such perks accumulate and the wages of these workers fail to advance, due to employer financial exploitation. That may be a problem, but it is hardly the dilemma outlined by Anderson, which has more to do with insufficient worker freedom.

Anderson postulates the existence of "monopsony," namely that a single company has a good deal of market power of the workers it employs. I am worried she doesn't offer much evidence to back up her portrait, save for one footnote to an OK but not very influential book. In contrast to her treatment, the best study I know finds that Walmart – the largest private sector employer in America – does not have significant monopsony power in most regions, some parts of the rural south and center excepted. The monopsony model of employment has attracted some attention – much of it from Princeton I might add -- but most economists assign it only a secondary status in explaining labor markets.[1]

More generally, it is well recognized that larger firms pay workers considerably more than do smaller firms. Strictly speaking, this is not incompatible with a monopsony model (e.g., market power may cause wages to be bid up as a large firm hires more), but it is a very different reality than what Anderson communicates. Note also that larger firms tend to be more tolerant of employee personal tastes than are smaller firms. For instance the local auto parts store, with its "ol' boys network," may be reluctant to hire gays and minorities, but McDonalds has policies favoring tolerance, in part to protect the broader reputation of the company with a wide variety of customers. I would put those facts front and center of any account of the modern business corporation, but Anderson seems to be offering a largely negative portrait of business economies of scale.[2]

In addition to those problems, there is nothing in the monopsony model predicting workers will enjoy less freedom or fewer perks in the workplace. This sounds counterintuitive, as we associate monopsony with lower bargaining power for workers and thus inferior working conditions. But rest assured, I am offering the correct reading of theory. Some time ago economists realized that product monopoly does not predict lower product quality, as profits may be maximized more readily at a higher product quality level than a lower product quality level (e.g., you might rather monopolize diamonds than cheaper stones). An analogous proposition holds for monopsony, namely that employers may improve workplace freedoms so that they may lower worker wages all the more. And this isn't just a theoretical possibility, it seems in the real

[1] For two looks at monopsony, see Boal and Ransom (1997) and Ashenfelter, Farber, and Ransom (2010). On Walmart, see Bonnanno and Lopez (2009). For a look at why the monopsony model has not won over most economists, most of all as an explanation of medium- to long-run phenomena, see Kuhn (2004).

[2] On the wage premium from larger firms, see Cardiff-Hicks, Lafontaine, and Shaw (2014).

world we see employers catering to the job quality preferences of the incumbents, rather than the marginal new hires, really quite often. Or consider an employer who would like to lure in more workers (hiring is profitable under monopsony), but without bidding up wages for all workers as a clumsy monopsonistic giant is likely to do. Offering employees selective workplace freedoms is one possible way to "wage discriminate" and increase profits. I'm not saying it has to work out this way, but it easily can.[3]

So even if the monopsony assumptions were descriptively relevant, they don't do the theoretical work Anderson is needing.

That all said, I readily grant the costs of exiting many jobs are too high and I would suggest focusing on the very concrete question of how public policy could lower these costs. Health insurance, retirement benefits, and immigration status are often too closely tied to particular jobs, largely as artifacts of regulation and tax law. For instance we should level the playing field for employer-supplied health insurance (ACA will do this partly with its “Cadillac tax”), and we should make immigration status for many workers less tied to remaining at particular jobs. In the meantime, it is worth noting some cases of worker dependence on corporations spring from bad government decisions rather than directly from markets.

This may sound counterintuitive or even horrible to many people, but the economist will ask whether workers might not enjoy "too much" tolerance and freedom in the workplace, at least relative to feasible alternatives. For every benefit there is a trade-off, and the broader employment offer as a whole might involve too little cash and too much freedom and tolerance. To oversimplify a bit, at the margin an employer can pay workers more either with money or with freedom and tolerance, which we more generally can label as perks. Money is taxed, often at fairly high rates, whereas the workplace perks are not; that's one reason why a lot of Swedish offices are pretty nice. It's simple economics to see that, as a result, the job ends up with too many perks and not enough pay, relative to a social optimum. I doubt if our response to this

[3] For analyses of some related scenarios under monopsony, see Viscusi (1980), Booth and Zoega (2000), and Green, Machin, and Manning (1996).

distorting tax wedge, which can be significant, should be to increase the perks of the workers rather than focusing on their pay.

Arguably individual preferences are not morally sacrosanct here, as philosophical notions of dignity and the like may intervene, as Amartya Sen and others -- including Elizabeth Anderson -- have argued in other contexts. Fair enough, but let's emphasize that individual preferences probably are pushing fairly strongly in the direction of higher pay rather than higher perks, given the initial tax distortion.[4]

Anderson seems to regard it as obvious that a business should not have the right to fire a worker for Facebook postings or other forms of "outside the workplace" activity. But is this morally so clear? For a start, a lot of workers put racist, sexist, or otherwise discomforting comments and photos into their Facebook pages. When employers fire them, very often it is to protect some notion of *the freedom of the other workers*. As I read Anderson's text, conflicts are about the employer vs. the workers. But through markets, employers very often are internalizing the preferences of the workers as a whole. The question of workplace freedom often boils down to one set of the workers against another, and then allowing for a lot of apparently arbitrary firing decisions may support rather than oppose worker autonomy, at least along some dimensions.

Overall I find the perspective of the employer and also the perspective of the customer to be lacking in her essay, as employers are mostly viewed as controlling workers or at least trying to do so. There is a pretty simple law and economics story that employer discretion is required because a lot of employee transgressions and misbehaviors cannot be specified in easily contractible or legally enforceable ways. At the margins, that employer discretion leads to abuses, some of which are documented in Anderson's written remarks. But those abuses are relatively few in number, and *the gains for workers and customers from the firing discretion* -- not just the gains for bosses -- outweigh those costs. Maybe this perspective is too simple, but

[4] If Anderson really thinks more job perks is the way to go, she could argue for higher taxes on worker incomes to bring about that end. Furthermore she might wish to oppose the Earned Income Tax Credit and other policies which subsidize pecuniary wages and likely lower the quality of workplace perks (the employer may lower perks to capture more of the value of the subsidy for the firm, rather than it going to the worker).

Anderson never rebuts it. The proffered instances of employer abuse are presented as a *prima facie* argument against current arrangements, without much of a look at the offsetting benefits of that discretion. Furthermore we are never told how many such cases of arbitrary firings have occurred or how high their human costs have been. I do not see the evidence which suggests such events are a major concern of the American public.

I'm not trying to argue that current arrangements represent an ideal. But to evaluate such questions, we need to build the trade-offs into our moral theory at an earlier level than what I see Anderson doing.

Overall, corporate impositions on worker dignity aren't nearly as great as Anderson makes them out to be. Large numbers of employers go out of their way to make their companies *sources* of worker dignity, precisely because workers and potential workers value such freedoms and protections. The more your company is viewed positively, the easier it is to recruit talented workers. I don't see that perspective getting enough play in Anderson's piece. A lot of people don't like working at home because they receive too much pleasure and fulfillment from their workplaces, even though some conformity is expected. It is also well known that unemployment has major negative effects on happiness and health, far beyond what the lost income otherwise would induce. Does this not indicate that workplaces, overall, are significant sources of human dignity and fulfillment in today's capitalist world? I think so, yet Anderson never rebuts or considers this side of the ledger. The desire to attract and keep talent is the single biggest reason why companies try to create pleasant and tolerant atmospheres for their workers, and why it is rare for businesses to fire workers for their political views or their off-premises activities.

Several times in her essay, Anderson contrasts business governance over workers with the "rule of law." I would note that under today's American "rule of law," if interpreted literally, the average American commits about three felonies each day (for instance throwing out junk mail addressed to somebody else is a federal crime punishable with up to five years in prison; see Silvergate 2011). Of course most of us get off scot-free for these and many other crimes. I do think we should clear away many of these laws, but in the meantime they reflect a broader point: just about all workable systems rely on embedded incentives to make them tolerable. In this case there is very little incentive to prosecute each American for three felonies each day. I am thus uncomfortable seeing arbitrary corporate governance juxtaposed against a supposed objective or neutral ideal of the rule of law.

I find the discussion of the alternatives to current arrangements comes as an afterthought whereas I would put it at the center of the analysis. I would ask for a closer look at company bargains with labor unions, co-ops owned and run by their workers, and worker-managed firms. Overall the literature shows that these structures do not offer significantly greater freedom for workers, at least not in the sense that Anderson describes. One reason is that these organizational structures often are less efficient, and that interferes with their ability to give workers a better deal. Another mechanism is that when workers can get a better deal, they often prefer to take cash rather than extra freedoms or perks. Different organizational forms therefore do not seem to be a significant answer to the problems of workplace freedom, nor are unions.

In fact there are some reasons why labor-managed firms may give their workers *less* personal freedom. The old-style investment banking and legal partnerships expected their owner-members to adhere to some fairly strict social and professional codes, even outside the workplace. More generally, when workers are motivated to monitor each other, through the holding of equity shares, monitoring becomes easier and so corporations engage in more of it. Again, the main issue is not controlling bosses vs. freedom-seeking workers.[5]

If there is a major problem which firms impose on workers, it is when they prematurely or mistakenly "liberate" them from the oppression of the workplace. Of course I am talking about unemployment. Most economists agree that, from a social point of view, firms are too willing to lay workers off and too reluctant to cut their nominal wages as a way of keeping workers on board and making ends meet. And if you look at labor-managed firms, the evidence bears this hypothesis out. When workers have a say in governance, employment tends to be more stable and wages tend to be more volatile.[6] In other words, the real problem with bosses is that they are too willing to give up "control" over their workers.

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[5] On some of these mechanisms, see Freeman, Kruse, and Blasi (2004).

[6] See for instance Craig and Pencavel (1992).

Anderson mentions the German codetermination model, whereby workers sit on the boards of corporations. The best study I know indicates that this organizational form costs about 26% of shareholder value because of lower productivity (Gorton and Schmid 2002), and furthermore a lot of that burden is born by consumers, who of course are mostly workers in another guise. And that result is for Germany, the country where this organizational model probably has been most successful. Furthermore the codetermination model works best for mid-level manufacturing firms -- which are prevalent in Germany -- but does not generalize as easily to the service sector, where most workers may have less of a stake in the long-run interests of the firm.

In the text there are many small points I wish to differ with, but here are just a few. First, I think economists have a pretty good but not perfect explanation of why employers often have so much discretionary authority over workers. The employers (often, not always) have a more unique contribution to the value of the capital goods, and thus they own the property rights to that capital, as outlined by Sanford Grossman, Oliver Hart, and John Moore in a series of papers.[7] Ultimately most workers benefit from this arrangement, if only in their role as consumers; most people don't want their co-workers in charge of the ultimate disposition of the capital goods. There is plenty of evidence that workers require some degree of external control, and often themselves recognize as such.[8]

That said, I do participate in a worker-owned firm myself, namely my blog with Alex Tabarrok, which is owned by the two of us. As the main writers, we're the ones who add the value, and capital costs are very low, and so this organizational form makes sense and indeed is predicted by economics. Otherwise I let my university pay me and, at the same time, tell me I cannot have obscene material on my computer, or perhaps I cannot blog or tweet very offensive remarks (as defined by them), as a condition of continued employment. I'm happy with that mix, and in return I don't have to wear a suit and tie to work.

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[7] See for instance Grossman and Hart (1986) and also Hart and Moore (1990).
[8] A starting point here is Kaur, Kremer, and Mullainathan (2012).

I get nervous when I read sentences such as "The pro-market egalitarian dream failed in part due to economies of scale." There is plenty of evidence, from numerous countries I might add, that increasing returns to scale industries in manufacturing have historically built sizable middle classes (Felipe, Mehta, and Rhee 2014), and in fact such economies of scale have been required for inclusive economic growth.

It is not mentioned that the United States is currently in the midst of a major shift to more freelance work, a trend which perhaps Anderson welcomes. Yet a lot of discrimination and bad treatment comes from customers, not employers, and freelance workers still suffer under those problems, albeit without the buffer of an employer to advance the capital and bear a lot of the risk.

In sum, I think Anderson's portrait is too negative toward business, too negative toward individual freedom as enjoyed in corporate workplaces, and too unwilling to confront the relevant trade-offs square on. The good news is that even the non-academics amongst us do not toil under the supervision of communist dictators.

Tyler Cowen

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