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THE NEW DEAL AT WORK

PETER CAPPELLI*

INTRODUCTION

Most observers of the corporate world believe that the traditional relationship between employer and employee is gone. But why the change occurred is not well understood, and what is replacing it often seems like a mystery.

What ended the traditional employment relationship is a variety of new management practices, driven by a changing environment, that essentially has brought the market—both the market for a company's products and the labor market for its employees—directly inside the firm. And once inside, its logic quickly has become dominant, pushing out of its way the behavioral principles of reciprocity and long-term commitment, the internal promotion and development practices, and the concerns about equity that underlie the more traditional employment contract. The policies and practices that buffered the relationship with employees from outside pressures are gone. The end of employee loyalty to an organization, replaced by greater attachment to careers, is but one manifestation of this change.

Most attempts by companies to draw up a new contract represented wishful thinking as they sought simply to lower the expectations of employees by explicitly limiting the employer's obligations on job security and career development (the dreaded "employability" doctrine that pushes responsibility for careers onto employees), while assuming that most other aspects of the relationship, including high levels of employee performance, would continue. In fact, virtually every aspect of employment changes now that the market governs this relationship. From the difficulty that employers

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have in recouping training investments to the substitutes that must be found for employee motivation and commitment, the new relationship dramatically changes how firms must manage their employees.

If the new employment relationship is not defined unilaterally by employer attempts to dictate a new deal, then what is it? It is tempting to think of the new relationship as something like free agency where legal contracts can be used to govern all aspects of the relationship, much as they do for professional sports or temporary help. There are some jobs where this model fits well, especially those where performance is easy to specify in advance and monitor after the fact. Jobs that can be contracted out, such as many positions in the world of information technology, fall into this category.

But for a great many positions, especially those in management, contracts struck in the market cannot define an employment relationship. At least some of the skills are unique to the employer and developed on the job, the tasks are interdependent with others or with systems in the organization, and performance is difficult to monitor accurately, all of which make contracts imperfect at best. Nor are managers professionals. Their work is governed by standards inside the organization, not professional codes, and their success is inextricably linked to that of their employer. The most important rewards for managers are still associated with promotion inside a company hierarchy.

The contradiction inherent in the new relationship comes from the fact that the nature of the work that most managers in particular perform does not lend itself to market-based relationships and contracts. It is much more suited to open-ended relationships where the obligations can be adjusted, performance can be observed, and rewards allocated accordingly as situations change. Some level of mutual commitment and trust to facilitate changing needs is inevitable as is the need to develop some unique skills inside the organization and to retain them indefinitely.

At the same time, the pressures from markets and the need to change organizations means that truly open-ended, long-term employment relationships are largely dead. The pressures to shed obsolete skills (compounded by the uncertainty of knowing which ones will be obsolete) and the problem of poaching skills from other employers make it difficult to maintain commitment and trust, develop skills internally, and retain important skills. The defining problem of the new relationship, therefore, is how to graft the model of the market onto occupations for which it is poorly suited.

Observers sometimes refer to the traditional, lifetime employment relationship as something like a marriage. Using that analogy, the new employment relationship is a lifetime of divorces and remarriages. It is not simply dating because that suggests relationships that are too casual and short-term to facilitate the functions that need to be performed in most organizations. It is more like serial monogamy, a series of close relationships governed by the expectation going in that they need to be made to work and yet will inevitably not last. And the adaptations to a life of serial monogamy—always keeping your options open with other partners, avoiding long-term investments in each other with prenuptial agreements, and reducing the issues on which violations of trust matter (e.g., no big life insurance policies naming them as the beneficiaries)—are not unlike the career advice given to employees in the modern workplace.

The analogy of marriage and divorce is troublesome as a metaphor because it typically suggests a broken commitment and the violation of a trust. The trauma of workers who have been downsized is sometimes likened to divorce precisely to highlight the sense that the employer has broken a commitment.

Suppose for the moment, however, that both sides entered a relationship with the same expectation that it could be temporary. There are many successful relationships involving mutual commitments that each party knows going in will not last. The relationship between students and colleges is but one example: both parties go in not only knowing that the relationship will end but also, generally speaking, when it will end. What is different about the new employment relationship is that, while both parties know that the relationship is unlikely to last forever, it has no finite ending point but instead can be ended unilaterally by either side when they want.

So the new employment relationship is an uneasy dance between an open-ended relationship and the pull of the market. The parties are constantly negotiating their commitments in light of uncertain future needs and opportunities elsewhere. Pressures from outside the relationship, from the labor market in particular, are now the important forces shaping the nature of the relationship. When labor markets are slack and jobs are difficult to find, employees become more loyal to their employer and bear most of the costs of restructuring; when labor markets tighten, employee commitment falls and employers become more willing to make investments in their employees.

As with any change, the new employment relationship where the labor market dominates employee behavior is creating a new set of winners and losers. For most of the past two decades, it was easy to keep score: employers won and employees lost because, with this new, market-mediated relationship, slack labor markets allowed employers to push most of the costs of restructuring onto employees. The advice for employees was simple: try to develop other job options, just in case, and prepare psychologically to get whacked. For employers, the management of employees was such a simple matter that observers seriously questioned whether the human resource function was even necessary.

Once labor markets begin to tighten, however, the problems are no longer simple. When bargaining power becomes a bit more equal, then the problem of negotiating this open-ended relationship in the context of a market becomes very tricky indeed. Even though employers may not have all the power, the job of shaping the employment relationship in response to these negotiations and making it work falls to them because they control the mechanisms through which the relationship can adapt—how jobs are designed, compensation structured, training delivered, and the other aspects of employment. Which employers will come out on the winning side of this new relationship depends on how well they can adapt and whether they can find ways to manage employee commitment, develop the skills they need, and retain those workers in the context of a much more open and powerful labor market.

I. WHAT CAUSED THE CHANGE?

One place to start this discussion is to recall that as late as the second decade of the twentieth century, employment relationships were more like a free market than perhaps even today. The “inside contractor” model was the dominant system for manufacturing, essentially a model of virtual organizations where owners outsourced even production operations to contractors operating in the owner’s facility. Professional agents handled the marketing, sales, and distribution of companies on a fee or contingent contract basis. Employees in some industries, such as tapestries, moved routinely from company to company, facilitating knowledge transfer in the

process. The turnover of key talent was managed carefully, but turnover of other employees was often remarkably high.¹

The history of U.S. employer paternalism has been explored elsewhere at length.² A summary suggests that efforts to protect production workers from market forces were common but perhaps never ran very deep.³ Even in this golden age of employee protections, from World War II until the 1981 recession, workers were constantly being laid off with the business cycle. They had stable jobs in the sense that they would return to the same employer, but layoffs were typical. Employer support for collective bargaining never meant any widespread acceptance of unions, and it may never really have been very deep. By the 1970s, for example, sophisticated union avoidance campaigns were common, and many employers—perhaps a majority—were taking actions to undermine the unions, some of which included violations of labor law.⁴

The story for white-collar workers was always different. There the model for managing employees was not welfare capitalism, which was directed at production workers, but managerial capitalism, where the managers of the company acted to pursue their own goals as distinct from those of the owners. White-collar and managerial employees *were* the organization, at least in the eyes of the executives. What most people think of as career jobs—good prospects for steady, predictable advancement, lifetime security subject to minimum performance levels, as well as good wages and benefits—was more or less in place with the formation of large, multi-divisional corporations, expanding in scope and scale as the management structures expanded. In this model, employees were hired based on general skills and attributes, received elaborate initial

1. See Peter Cappelli, *Contemporary Employment Practices in Historical Perspective*, in *CORPORATE RESPONSIBILITY AND HUMAN CAPITAL* (Margaret Blair & Thomas A. Kochan eds., forthcoming).

2. See generally STUART D. BRANDES, *AMERICAN WELFARE CAPITALISM, 1880–1940* (1976); SANFORD M. JACOBY, *MODERN MANORS: WELFARE CAPITALISM SINCE THE NEW DEAL* (1997); DANIEL NELSON, *MANAGERS AND WORKERS: ORIGINS OF THE TWENTIETH-CENTURY FACTORY SYSTEM IN THE UNITED STATES, 1880–1920* (2d ed. 1995).

3. Not everyone thought that these arrangements were necessarily better for employees than the previous more market-driven era because employees gave up control for security. In the former system, the argument goes, at least employees had more autonomy. See Stephen A. Marglin, *What Do Bosses Do? The Origins and Functions of Hierarchy in Capitalist Production*, *REV. RADICAL POL. ECON.*, Summer 1974, at 60.

4. For a detailed guide to these practices, which remained accurate until the early 1980s, see SUMNER H. SLICHTER ET AL., *THE IMPACT OF COLLECTIVE BARGAINING ON MANAGEMENT* (1960). For an analysis of the decline of that system, see THOMAS A. KOCHAN ET AL., *THE TRANSFORMATION OF AMERICAN INDUSTRIAL RELATIONS* (1986).

training, and had a career that was internal to the firm. The systems for managing employees, such as wage and benefit policies, training and development systems, promotion ladders, and other practices of internal labor markets, were part of the elaborate internal administration of the firm.⁵

What is easy to forget now is the rather obvious dark side of these arrangements, especially for managers. Internal labor markets with outside hiring only at the entry level and all promotions internal to the company meant that employees were stuck with their current employer. If they did not fit, they had no choice but to suffer or adapt, and fitting in had as much to do with altering one's politics, social attitudes, and values as it did with performance. William H. Whyte's classic *The Organization Man*⁶ is perhaps the best known critique of this system, but other observers like C. Wright Mills,⁷ and two decades later, Rosabeth Moss Kanter,⁸ helped document the often coercive effects it had on employees.

Both the operating environment and the nature of companies were different in that period in ways that made it substantially easier to provide stable employment and career paths. Especially for large companies, product markets were stable and much more predictable because many industries were explicitly regulated by the government to ensure stability. Foreign competition was very limited, and domestic competition often operated as an oligopoly where unions effectively took labor costs out of competition with standardized union contracts.

Large companies like IBM made ten- and fifteen-year business plans that proved accurate. In the context of such plans, it was sensible and realistic to lay out equivalent human resource plans and to say to individual employees: This is our career plan for you until you retire, and here is how we are going to manage you to ensure that it happens. Whatever economic instability these large companies experienced was mainly the temporary kind associated with business cycles. Companies like IBM argued, with some justification, that the employment security they offered employees facilitated what by contemporary standards was low-level restructuring of operations

5. For the classic study of managerial capitalism, see ADOLF A. BERLE, JR. & GARDINER C. MEANS, *THE MODERN CORPORATION AND PRIVATE PROPERTY* (1932).

6. WILLIAM H. WHYTE, JR., *THE ORGANIZATION MAN* (1956).

7. See C. WRIGHT MILLS, *WHITE COLLAR: THE AMERICAN MIDDLE CLASSES* (1956).

8. See ROSABETH MOSS KANTER, *MEN AND WOMEN OF THE CORPORATION* (1977).

brought on by unforeseen market changes.⁹ But there was relatively little pressure to maximize shareholder value, at least by contemporary standards, and executives had much greater discretion to devote resources to such goals.

The world began to change for employers with the 1981–82 recession, the worst economic period since the Great Depression, which brought with it structural changes that went well beyond the usual cyclical downturn in product demand. A number of important changes in the economy and in the way business was conducted got underway in that period. They include the following:

- A. Pressures to Increase Shareholder Value: The rising influence of institutional investors and legal decisions made maximizing shareholder value not only the singular goal for directors of public companies and the executives they managed, but also made shareholders the only stakeholder to whom companies were legally accountable. New financial institutions such as junk bonds made possible hostile takeovers of companies that were not maximizing shareholder value. Any resources that companies may have devoted to other causes, such as protecting employees from business risks, were quickly transferred to the goal of shareholder value.¹⁰ More important, investors and analysts seem to be persuaded that cutting jobs raises shareholder value even though the hard evidence on that point is decidedly mixed. New accounting techniques, such as economic value added to maximize shareholder value, punish fixed costs, including the fixed investments in employees.¹¹
- B. Changes in the Boundaries of the Firm: Companies were persuaded that divesting unrelated businesses and acquiring new ones with appropriate synergies could raise shareholder value, and mergers and acquisitions rose to record levels

9. For a persuasive argument of this case, see D. QUINN MILLS, *THE IBM LESSON: THE PROFITABLE ART OF FULL EMPLOYMENT* (1988).

10. One might argue that such practices might actually benefit shareholders by improving company performance. The problem is that there is no solid evidence for this position, and every anecdote of a company that appears to succeed in this fashion can be countered by another anecdote about companies that do not.

11. The rise of these pressures from the investor community is perhaps the most important development in the world of business in a generation. See MICHAEL USEEM, *INVESTOR CAPITALISM: HOW MONEY MANAGERS ARE CHANGING THE FACE OF CORPORATE AMERICA* (1996).

year after year. Companies concerned about focusing on their core competencies learned to outsource functions that were not central to their capabilities and to pursue joint ventures as an alternative to internal development of capabilities. The consequence for employment was to disrupt long-term career paths and, more fundamentally, to make the security of all functions and jobs uncertain. Any operation could be divested if changing markets and changing patterns of competition align themselves, and all functions could be outsourced if a low-cost vendor comes along. One might say that the number of good jobs stays the same in this model and just moves around from company to company, but such movement and the constant uncertainty about movement undermines job security and any attempt to develop long-term careers.

- C. Changes in the Speed of Competition: Shorter production cycles and more rapid change in business strategies associated with faster-paced competition makes skills obsolete more quickly. The examples here are like the change from physical chemistry to biotechnology in pharmaceuticals or from one market segment in insurance to another, where the skills needed are completely different. Employers simply do not have time to develop the new skills they need internally where dramatic changes in products and strategies happen quickly. So they turn to outside hiring to get those new skills. They also turn to outside hiring to get the managerial skills and experience to facilitate changes in their administrative operations. One way to think about these developments is that product life cycles have now become shorter than the expected career of an employee, as explained below.
- D. Changes in Management Systems: Work systems that empower employees, such as cross-functional teams, break down traditional job ladders, eliminate supervisory positions, and widen spans of control. Information systems eliminate many of the internal control functions of middle management positions, and decentralizing operations through the creation of profit centers and similar arrangements further reduce the need for central administration. Flatter hierarchies and the sharp reduction in central administration reduces promotion prospects.

- E. **Policy Pressure:** Public policy in the 1980s contributed to the pressures to unbundle employee protection provisions inside firms. The Reagan Administration explicitly argued for increasing employer discretion in employment decisions in an attempt to link economic competitiveness to the ability to shed redundant employees, a position that arguably had more influence on management than the decision to fire the striking Professional Air Traffic Controllers Organization workers. Various reports gave guidance as to the best ways to cut workforces. Even under a democratic administration, the U.S. Department of Labor had by 1995 accepted that companies would continue to restructure their operations in ways that cut jobs. It argued not for preventing such changes but for minimizing the damage to employees.¹²

Coercive pressures from leaders in the employer community also reversed. IBM's announcement of its decision to abandon employment security and lay off employees was followed shortly thereafter by a wave of layoffs among other large employers. The business community organized itself to press for greater flexibility in employment. For example, the Labor Policy Association, an employer group concerned with public policy, produced a widely circulated study arguing that the key to improved corporate performance is greater management discretion in employment decisions, in other words, the end of administrative practices to protect jobs.

The requirements of employment legislation also created incentives to unravel the internalized employment structure, incentives that built as regulations increased. The vast array of federal legislation directed at employment has largely been tied to the traditional, internalized model of employment. Alternative arrangements, such as contracting out or contingent work, can mean that "employers" are no longer covered by the legislation, freeing them from its obligations.

- F. **Market Alternatives:** An enormous market has developed to respond to these developments. Vendors who will take in every function that could be outsourced now exist. Staffing agencies will lease employees with any set of skills, even

12. See OFFICE OF THE AM. WORKPLACE, U.S. DEP'T OF LABOR, GUIDE TO RESPONSIBLE RESTRUCTURING (1995).

CEOs, so that labor costs can be transformed from fixed to variable costs. And, as noted below, corporate recruiters now offer a rich menu of available applicants to any employer willing to pursue outside hiring.

White-collar and managerial employees have experienced the most fundamental changes because they are the ones with the most protections to lose. First, they now face much the same increased insecurity and instability as production workers, a profound change as it undermines what has been the very basis of the distinction between white collar and blue collar. That distinction stems from the New Deal Era's Fair Labor Standards Act which was based on the assumption that production workers needed legislative protections that white-collar workers did not because the latter were already protected by the firm. Second, white-collar employees have seen internal careers evaporate as job ladders shrink, restructuring disrupts the promotion tracks that remain, and external hiring blocks advancement by filling more senior positions. To argue that there has been no significant change in employment relationships requires asserting either that the above changes in the employer's world are not very significant or that somehow they never got down to the employees.

II. EVIDENCE OF A CHANGING RELATIONSHIP

Some labor market evidence is available that relates to the decline in internal labor markets and secure careers. Some care is necessary in interpreting this evidence, however, because a large percentage of the workforce never had anything like the traditional relationships in the first place.¹³ So a finding that there is only a

13. Even if we focus just on the private sector and leave out the roughly 11% of the workforce who are self-employed, in farming, or in other jobs that do not fit the model of working for an "employer," organizations still have to be a certain size before it is efficient to have systems of internal development and training, job ladders, and other arrangements associated with long-term commitments. Seven percent of private sector employees work in establishments with fewer than five employees, and 44% are in establishments with fewer than one hundred employees. William Wiatrowski, *Small Businesses and Their Employees*, 117 MONTHLY LAB. REV. 29, 30-31 (1994). One researcher calculated that organizations need a minimum of five hundred employees to make formal compensation systems feasible. See Robert S. Smith, *Comparable Worth: Limited Coverage and the Exacerbation of Inequality*, 41 INDUS. & LAB. REL. REV. 227, 232 (1988).

Another researcher argued that only about 40% of U.S. employees were in firms large enough and old enough to even have a reputation in their community, something that he saw as necessary to make the implicit contracts that were behind internalized employment practices operate. See Walter Y. Oi, *The Fixed Costs of Specialized Labor*, in THE MEASUREMENT OF LABOR COST 63, 105-06 (Jack E. Triplett ed., 1983). Even within those organizations, the

modest change for the workforce as a whole might mask a considerable breakdown in relationships for that segment of the economy that truly had career jobs, such as managers. This may help explain why observers who focus on labor market data are the least likely to believe that there are important changes in employment, while those who study organizations, especially managers, are perhaps the most likely.¹⁴

One important piece of the evidence is the sharp rise in unemployment for white-collar employees, especially relative to other groups.¹⁵ This is certainly among the strongest evidence that whatever special protection this employee group had in the past is gone. A second and more general trend has been the systematic shifting of business risk onto employees accompanying the restructuring of companies, a point that my colleagues and I have documented at length.¹⁶ This shift in risk is consistent with the view that buffers against the market have broken down. Some of the more important evidence concerning the change in the employment relationship is examined below.

A. Employee Tenure

Much of the argument suggesting that not much is new in employee relationships turns on research about job tenure—how long an employee stays with their employer. Because so much is based on these findings, it is important to understand what they can and cannot tell us. First and perhaps most important, it is a mistake to confuse stable jobs with secure jobs. For example, an employee does not have a secure relationship if the employer threatens to have her terminated—literally—every night if her job performance fell. The distinction is perhaps easiest to see in firm-level studies like Steven Allen and Richard Clark's interesting finding that tenure rose in

lifetime commitment model was generally a phenomenon for managerial workers who typically constituted about one-fifth of a company's workforce. If we define the workforce that ever had the lifetime, career-based employment system as managerial employees in firms large enough to have reputations, a rough estimate would be about 10% of the private sector workforce.

14. The focus of the business press on these issues, then, might not be because they are necessarily sensationalist but because the issues are especially pertinent to their readers—namely, middle-class, managerial employees.

15. For an explicit comparison, see Peter Cappelli, *Examining Managerial Displacement*, 35 ACAD. MGMT. J. 203 (1992).

16. See PETER CAPPELLI ET AL., *CHANGE AT WORK* (1997).

large, stable firms during the 1990s while 16% of the jobs in those firms were cut.¹⁷

Tenure can be a difficult concept to interpret because it is driven by two quite distinct components: voluntary quits and terminations. From the perspective of employees, only terminations drive job insecurity. We also know that these two components move in opposite directions with the business cycle. Quits fall and dismissals rise during downturns, visa versa during expansions. Because the two components move in opposite directions, stability is built into the overall tenure measure, which makes any changes in tenure meaningful. The more important findings concern trends in quits and in terminations examined separately. Here the results suggest, based on three different sets of data, that permanent dismissals rose through the 1980s and early 1990s while quit rates were falling.¹⁸ One study in particular found that the rate of dismissals increased sharply for older workers with more tenure, doubling for workers ages 45 to 54.¹⁹

It is probably fair to say that the inconsistent results about changes in overall tenure rates, sometimes even using the same data, does not make one especially sanguine about the robustness of labor economics.²⁰ It may nevertheless be instructive to review the results. As noted above, it is important to remember that not all workers had long-term, stable relationships even in earlier periods. For example, now as in the past, roughly 40% of the workforce has been with their current employer less than two years. And, as noted above, average stability can mask considerable variance for subgroups in the workforce.

The above qualifications aside, while studies found reasonable stability comparing the 1980s with earlier periods, more recent results using data from the mid-1990s find declines in average tenure especially for managerial employees but even for the workforce as a

17. Steven G. Allen et al., *Have Jobs Become Less Stable in the 1990s? Evidence from Employer Data*, in ON THE JOB: IS LONG-TERM EMPLOYMENT A THING OF THE PAST? (David Neumark ed., forthcoming).

18. See Annette D. Bernhardt et al., *Job Instability and Wages for Young Adult Men*, J. LAB. ECON. (forthcoming); Daniel Polsky, *Changing Consequences of Job Separations in the United States*, 52 INDUS. & LAB. REL. REV. 565 (1999); Robert G. Valetta, *Has Job Security in the U.S. Declined?*, FED. RESERVE BANK OF SAN FRANCISCO WKLY. LETTER, Feb. 16, 1996.

19. See Polsky, *supra* note 18, at 571-73, for this result.

20. There are perhaps a dozen recent studies using at least four major data sets to assess employee tenure. For a review of these studies, see PETER CAPPELLI, *THE NEW DEAL AT WORK: MANAGING THE MARKET-DRIVEN WORKFORCE* 113-57 (1999). For a discussion of even more recent studies, see ON THE JOB: IS LONG-TERM EMPLOYMENT A THING OF THE PAST? (David Neumark ed., forthcoming).

whole. These include studies that compare cohorts over time which seem to find the biggest changes, such as a 10% increase in the rate of job changes for younger workers now as compared to earlier decades.²¹ They also find large declines in tenure for older, white men in particular—the group most protected by internal labor markets. For example, for men approaching retirement age (58 to 63) only 29% had been with the same employer for ten years or more as compared to a figure of 47% in 1969.²² The most recent studies find that the percentage of the workforce with long tenure jobs, ten years or more, declined slightly from the late 1970s through 1993, and then fell sharply through the current period and are now at the lowest level in twenty years.²³ The finding that tenure declined for managerial jobs is especially supportive of the arguments for the erosion of internal career systems.²⁴

In most cases, the findings of declines in tenure are modest, but these modest changes need to be assessed in the context of two caveats in addition to the general ones presented earlier. First, many of these studies are comparing tenure in the 1990s to the 1980s. The 1981–83 recession was the worst economic downturn since the Great Depression while the period after 1992 is quickly becoming the greatest economic expansion since the Depression. In this context, the finding that jobs are only slightly less stable in the 1990s than in the 1980s is hardly evidence of stable careers. Second, the declines in overall tenure for the workforce as a whole come despite the fact that tenure for women has been rising because they are now less likely to quit their jobs when they get married or have children.²⁵

B. Job Security

A better alternative for assessing changes in the employment relationship would be to look directly at job security rather than at proxies like tenure. It is difficult to measure job security directly except through changes in employer policies. As late as the end of

21. See Bernhardt et al., *supra* note 18.

22. See Christopher J. Ruhm, *Secular Changes in the Work and Retirement Patterns of Older Men*, 30 J. HUM. RESOURCES 362, 367-73 (1995).

23. See HENRY S. FARBER, *THE CHANGING FACE OF JOB LOSS IN THE UNITED STATES, 1981–1995*, at 3-5 (Princeton Univ. Indus. Relations Section Working Paper No. 382, 1997).

24. See David Neumark et al., *Has Job Stability Declined Yet? New Evidence for the 1990s*, J. LAB. ECON. (forthcoming).

25. See Alison J. Wellington, *Changes in the Male/Female Wage Gap, 1976–1985*, 28 J. HUM. RESOURCES 383 (1993).

the 1970s, survey evidence from the Conference Board indicated that management's priorities in setting employment practices were to build a loyal, stable workforce. But a decade later, by the end of the 1980s, that priority had clearly shifted to increasing organizational performance and reducing costs.²⁶ The most powerful evidence in this regard is another Conference Board survey which found more than two-thirds of the large employers in the sample reporting that they had changed their practice and no longer offered employment security; only 3% said that they still offered job security to employees.²⁷

Employer decisions to end job security through downsizing are another lens into the world of changing employment relationships. Cutting workers to reduce costs and improve financial performance—not just to respond to declines in business—is the essence of downsizing, a phenomenon that began in the 1980s. The American Management Association (the “AMA”) surveyed the downsizing of its member companies beginning in 1990. They found that the incidence of downsizing increased virtually every year—despite the economic expansion—until 1996 when 48.9% of companies reported it, a trivial decline from 50% the year before. Forty percent had downsizing in two or more separate years over the previous six.²⁸ Other surveys report roughly similar rates of downsizing. The scale of these job cuts is unprecedented in a period of economic expansion.

The causes of downsizing have also changed. A growing number of companies reported that downsizing now results from internal management decisions, such as restructuring (66%) and outsourcing (23%). Virtually none now cite overall economic conditions as an explanation, and most of the companies that cut are profitable in the year they are cutting. Further, downsizing is no longer necessarily about shrinking the size of the workforce. Thirty-one percent of those firms in the AMA surveys were actually adding and cutting workers at the same time in 1996, and the average firm that had a downsizing was in fact growing by 6%.²⁹ This development suggests

26. For a discussion of these surveys, see RICHARD S. BELOUS, NATIONAL PLANNING ASS'N, *THE CONTINGENT ECONOMY: THE GROWTH OF THE TEMPORARY, PART-TIME AND SUBCONTRACTED WORKFORCE* (1989).

27. Conference Board, *Implementing the New Employment Contract*, HUM. RESOURCES EXECUTIVE REV. 5 (1997).

28. See AMERICAN MANAGEMENT ASS'N, 1996 AMA SURVEY: CORPORATE DOWNSIZING, JOB ELIMINATION, AND JOB CREATION 4 (1996).

29. See *id.*

that firms are relying on the outside labor market to restructure, dropping skills that are no longer needed and bringing in new ones.

Data on workers who have been permanently displaced from their jobs confirms the fact that job security is declining and is now no longer dependent on business cycles. The overall rate at which workers have been permanently displaced backed down a bit in the late 1980s from the peak of the recession period (1981–83), but then rose again—despite the economic recovery—and jumped sharply through 1995. The rate at which workers were thrown out of their jobs was about the same from 1993–95, a period of significant economic expansion and prosperity in the economy as a whole, as compared to the 1981–83 recession.³⁰ It is difficult to think of more compelling evidence than this that the nature of the employment relationship has changed.

About 15% of the workforce saw their jobs permanently disappear during 1993–95. The cause of the job losses reported in these surveys mirrors the developments in the firm surveys: shifting away from economic or company-wide reasons such as downturns in business or plant closings toward eliminating particular positions associated with restructuring. Other manifestations of declining job security include the fact that job losses now are much more likely than in previous decades to be permanent; dismissals for cause, such as poor performance, have increased along with downsizing; and employees who were once largely immune from business cycle related layoffs—not only white-collar but also older and more educated workers—have seen their rate of job loss rise. Again, these reductions in security have occurred in a period of economic expansion.

C. Wages

Changes in the wage structure within organizations are another aspect of the change in employment relationships. One of the main functions of internal labor markets is to create distinctive wage profiles that differ from market rates in order to serve the internal goals of the organization. Job mobility within the same organization, which tended to produce greater benefits in the form of higher wages, was seen in part as the result of a better match between the attributes

30. See HENRY S. FARBER, HAS THE RATE OF JOB LOSS INCREASED IN THE NINETIES? 5 (Princeton Univ. Indus. Relations Section Working Paper No. 394, 1998).

of the employees and the requirements of the jobs as compared to job changes in the outside labor market, a testament to the advantages of the internal labor market in allocating labor. But by the early 1990s, there was no longer any advantage to the inside moves as compared to those across employers.³¹

The steady progression of wages based on seniority or tenure was one of the hallmarks of internal systems. The apparent decline in the return to tenure with the same employer is perhaps the most compelling evidence of the decline of more traditional pay and employment relationships. Researchers studying the semiconductor industry, for example, found a decline in the wage premium paid to more experienced workers. Among the explanations are that new technical skills are becoming more important, and those skills are learned not inside the firm but outside, typically in higher education.³²

In aggregate data, the returns to seniority—that is, tenure with the same employer—have collapsed in recent years.³³ Studies have shown a sharp decline in returns to seniority of about \$3000 annually between the 1970s and 1980s for workers with ten years of seniority. The costs of job changing dropped dramatically, and workers who changed jobs every other year saw almost the same earnings rise in the late 1980s as did those who kept the same job for ten years.³⁴

Further, this effect varies depending on why one changes jobs. The probability that employees who quit would find a job that offers a large pay raise has increased by 5%, while the probability that those who were dismissed would suffer a large decline in their pay has risen by 17% over the previous decade.³⁵ These results suggest that a good, lifetime match between an employee and a single employer is becoming less important in determining an employee's long-term success. By default, what must be becoming more important are factors outside of the relationship with an individual employer, factors associated with the outside market.

31. See STEFFANIE L. WILK & ELIZABETH A. CRAIG, *SHOULD I STAY OR SHOULD I GO? OCCUPATIONAL MATCHING AND INTERNAL AND EXTERNAL MOBILITY* (Wharton Sch. Dep't of Management Working Paper, 1998).

32. See Benjamin A. Campbell & Vincent M. Valvano, *Wage Structures and Inequality, in THE COMPETITIVE SEMICONDUCTOR MANUFACTURING HUMAN RESOURCES PROJECT* 87, 87-116 (Claire Brown ed., 1997).

33. See Keith Chauvin, *Firm-Specific Wage Growth and Changes in the Labor Market for Managers*, 15 *MGMT. & DECISION ECON.* 21-37 (1994).

34. See DAVID MARCOTTE, *CENTER FOR GOV'T STUDIES, N. ILL. UNIV., EVIDENCE OF A FALL IN THE WAGE PREMIUM FOR JOB SECURITY* (1994).

35. See Polsky, *supra* note 18, at 573-76.

Another hallmark of internal labor markets was that pay was assigned to jobs rather than to individuals and that differences in pay were associated with differences in jobs. Research suggests greater risk and more variance in individual earnings over time that cannot be accounted for by the usual characteristics of jobs.³⁶ Some part of the greater variance may be because of a much stronger relationship between individual performance and pay. Hay Associates, the compensation firm, collects data from their clients on the pay increases associated with different levels of individual performance as measured by performance evaluation plans. In 1989, the increase associated with the highest level of performance was 2.5 times larger than the increase associated with the lowest level. By 1993, that ratio had risen to a factor of four.³⁷

A 1996 Towers Perrin survey found that 61% of responding firms were using variable pay and that 27% of firms were considering the elimination of base pay increases altogether so that the only increases in compensation would result from performance contingent pay.³⁸ The change in contingent compensation has been especially great for executives. Bonuses as a share of total compensation rose more than 20% from 1986 to 1992.³⁹ Contingent pay erodes the importance of internal, administrative pay systems by placing greater weight on factors that vary such as business and individual performance.

D. Pensions

Employee benefits end with employment, except pension plans which represent a continuing obligation to employees—even if employment ends (at least for vested employees)—and, as such, an indication of a more permanent obligation for employers. As Sanford Jacoby notes in his paper, pension plans have been on the decline.⁴⁰ Even more important than the decline in pension coverage has been the shift in the nature of pensions from defined benefit plans, where workers earn the right to predetermined benefit levels according to

36. See Peter Gottschalk & Robert Moffitt, *A Welfare Dependence: Concepts, Measures, and Trends*, 84 AM. ECON. REV. 38-42 (1994).

37. See CAPPELLI ET AL., *supra* note 16, at 190.

38. See Sandra O'Neal, Recent Trends in Compensation Practices, Presentation to the Board of Governors of the Federal Reserve System (Oct. 1997).

39. See K.C. O'SHAUGHNESSY ET AL., CHANGES IN MANAGEMENT PAY STRUCTURES, 1981-1992, AND RISING RETURNS TO SKILL 17 (University of Cal. at Berkeley Inst. of Indus. Relations Working Paper, 1998).

40. Sanford M. Jacoby, *Are Career Jobs Headed for Extinction?*, 42 CAL. MGMT. REV. 123, 132 (1999).

their years of service, toward defined contribution plans, where employers make fixed contributions to a retirement fund for each employee, especially 401(k) programs whereby employees contribute directly to their retirement fund.⁴¹ With this shift, the employer no longer bears the risk of guaranteeing a stream of benefits. That problem now falls to the employee. Thus, the employer's obligations to the employee end with employment, a move away from long-term relationships.

E. Contingent Work

Another aspect of changes in employment mentioned in Jacoby's article that is relevant to changes in career jobs, as opposed to good jobs, is the extent of contingent work which is made up of temporary, part-time, and self-employed work.⁴² Perhaps a better term for this category is nonstandard work because it emphasizes the common characteristic of being something other than full-time employment. Whether these jobs are good jobs as defined above is difficult to assess and may ultimately turn on whether employees take them by choice or because they cannot get full-time, permanent employment.

The rise of nonstandard work suggests something about the growing employer preference for variable as opposed to fixed employment costs. It is fair to say that nonstandard work may no longer be growing, but it is also worth recognizing that most estimates indicate that it already accounts for just under one-third of the jobs in the United States.⁴³ It might be reasonable to include contracting out and vendors in this category, at least from the perspective of the original firm, because they represent the movement of work that had been inside the firm at fixed cost to work now done outside the firm at variable cost. The outsourced jobs may still be good jobs, of course, although they often represent significantly reduced career opportunities.⁴⁴

41. See Richard A. Ippolito, *Toward Explaining the Growth of Defined Contribution Plans*, 34 INDUS. REL. 1 (1995).

42. Jacoby, *supra* note 40, at 130.

43. See Lewis M. Segal & Daniel G. Sullivan, *The Growth of Temporary Services Work*, J. ECON. PERSP., Spring 1997, at 117, 118-19. The estimates of temporary help in particular count only employees working for agencies, but estimates that include temps working directly for employers might double the total number of temps, from 2% to 4% of the workforce.

44. Consider, for example, a company that outsources janitorial or other lower-level jobs to a vendor. The janitors may still have full-time jobs, albeit now with a vendor. The likelihood of being able to advance to any position outside of janitorial work, however, may well be reduced.

F. Outside Hiring

The nail in the coffin of the traditional employment relationship is the greater use of outside hiring by employers. It is difficult to assess the extent of outside hiring, but one study that did so found a sizeable increase in the proportion of employers who sought experienced workers for entry-level jobs.⁴⁵ My examination of proprietary surveys of employers finds them reporting a greater interest in outside hiring to meet skill needs.⁴⁶ One interesting proxy for the growth of outside hiring is the fact that the revenues from corporate recruiting firms who perform outside searches for companies *tripled* just during the mid-1990s.⁴⁷ Not only is there no evidence that employers are making greater investments in their new hires, but the evidence that we have suggests that they are making substantially fewer investments, particularly in the extent of training to learn new jobs.⁴⁸

Movement away from internalized practices does not suggest that employers are necessarily headed toward free agency. Nevertheless, the set of industries that are well toward that model is more than just the margins of the economy. Silicon Valley is often held up as the example of open labor markets with high levels of mobility across firms and little planned internal development. It is not just a geographic location but a metaphor for much of the entire hi-tech sector of the country which operates on a similar model. Something close to free agency now dominates a range of industries such as movies and television, the investment industry, and increasingly professional service firms (accounting, consulting, and law firms in particular) where promotion to partner had meant a lifetime career at that firm. Now movement across firms is common even for associates. Moreover, "poaching" employees away from other employers is now a phenomenon for all jobs where labor is in short supply.

When employers switch from internal promotions to outside hires, they effectively shut down their own internal labor market by eliminating promotion prospects. They also eviscerate the internal

45. See Sara L. Rynes et al., *Experienced Hiring Versus College Recruiting: Practices and Emerging Trends*, 50 PERSONNEL PSYCHOL. 309, 321-30 (1997).

46. See CAPPELLI, *supra* note 20, at 181-220.

47. See *id.* at 215.

48. See Jill Constantine & David Neumark, *Training and the Growth of Wage Inequality*, 35 INDUS. REL. 491 (1996).

labor markets of competitors because employees leave after investments have been made. Finally, outside hiring shifts the attention of employers from inside the firm to the network of potential employers outside the firm where more—and quite likely better—career opportunities lie.

III. WILL EMPLOYEE PROTECTIONS MAKE A COMEBACK?

The return of tight labor markets clearly does shift bargaining power back toward the employees. There is no evidence, however, that employees are using this opportunity to demand anything like a return to the older model of employment relations. Employees understand that promises about career paths and long-term security are meaningless unless the changes in the business environment outlined above are rolled back. But there is no practical way for employees to bind their employers to the old model even if they wanted to, short of explicit employment contracts which employers loath to sign. Moreover, in tight labor markets, the last thing employees want is an arrangement that would buffer them from those markets and their benefits.

Evidence also seems to suggest that employees have already begun to adapt to the new model. Ninety-four percent of employees in a recent survey reported that they believed that they, and not their employer, were responsible for their own job security. In another survey, when asked what they wanted from employers, the top places went to development opportunities. Job security came out in the middle of the list. Surveys of MBA students find greater willingness to take risks and little interest in the large corporations that may still offer the best internal career paths.⁴⁹

There are some companies that continue to offer the old model—typically privately held companies not subject to the financial pressures of the investment community and often making products with some protection from fast-changing competition. But finding continuing examples of the old arrangements is no evidence of a *return* to those arrangements. There are also many examples in this tight labor market of companies trying to persuade their employees not to quit. But it is difficult to find any examples where companies are offering any concrete promises about future relationships.

49. For a review of this material, see CAPPELLI, *supra* note 20, at 181-220.

Every company that I have seen that wants to improve retention in fact is interested in retaining key talent, not necessarily all employees. Every one of these companies also says that they want to improve their ability to hire from the outside, a prospect that undermines their own internal labor market and cuts against the ability of other employers to retain employees. New work systems like team-based arrangements are on the rise, and one might expect them to require greater investments in employees and continuity. But there is no evidence that employers are making those investments.⁵⁰ Even where new work systems seem to require greater commitment from employees, commitment does not require lifetime or even permanent jobs as indicated by the studies showing that contingent workers are just as committed as full-time employees.⁵¹

CONCLUSION

The history of employment relationships in the United States makes clear that what we think of as the "traditional" model of long-term attachments, internal development, and mutual obligations may turn out to have existed for little more than a generation. The current move toward a more market-mediated employment relationship is in some ways a return to earlier arrangements. It is a particularly powerful transition in that markets represent especially elemental and resilient mechanisms for managing relationships.

Once these developments are underway, it is not within the power of an individual employer to return to the older arrangements. In order for an employer to successfully return to more traditional arrangements with long-term investments in employees, internal promotions, and lifetime careers would require that competitors agree not to poach away valuable talent and employees agree not to leave for what, at some point, would inevitably be better offers than they have internally. Neither is likely. It stretches the imagination to believe that even large companies will be able to offer employees better opportunities than the vast sea of possibilities in the outside market.

50. See Paul Osterman, *Skills, Training, and Work Organization in American Establishments*, 34 INDUS. REL. 125, 138-43 (1995).

51. There are now many studies reporting this result, but the first one appears to be Jone L. Pearce, *Toward an Organizational Behavior of Contract Laborers: Their Psychological Involvement and Effects on Employee Co-Workers*, 36 ACAD. MGMT. J. 1082, 1090 (1993).

These new arrangements create a new set of winners and losers. A great many of the practices in the more traditional employment relationship were designed to accommodate the equity concerns of employees. Compensation practices, for example, tried to reflect the view that seniority and responsibility should be rewarded, and that employees performing tasks of comparable value should be treated similarly. Markets, in contrast, are not good at equity. They reward scarcity and contributions, supply and demand. Market-based employment relationships reward skills that are in demand and in short supply, but only as long as that situation lasts. The results they generate may be fundamentally at odds with the perceptions of employees and the broader society about what is fair.

In slack labor markets employers are able to push even more costs onto employees, while in tight labor markets employees are able to extract more rents from employers. Within the employee population, those with marketable skills and the ability to manage their own careers have made out very well; on the other hand, those without skills, with constraints on their mobility, and lacking career management skills have suffered even more than in the past. These developments may help account for rising inequality in outcomes, and they no doubt will exacerbate that trend. In particular, those who have the resources to invest in their own careers will have even greater advantages over those who do not.

The issue of skills and how they are developed is also central to the problems raised by these new arrangements. An important part of the skills that are valuable in society are developed at the workplace through investments made by organizations in their employees. When the ability of the employer to fund those investments declines, especially when the overall demand for skill begins to rise, then the search for alternatives becomes imperative.

Some employers will continue to invest in firm-specific skills and training where they can be reasonably certain that their employees will not leave. Other employers will become net exporters of skill, relying on the productive work of trainees who then move on to other organizations for their competitive edge. Firms that can find ways to combine work and learning, making it possible to support training, will have a competitive advantage in attracting employees. The prominent solution at the moment may be to push the problem of skill development off onto employees and, in turn, onto the market. Employer-generated skill standards are in effect credentials for skills and are currently being drafted by industry associations.

Individual workers now bear not only more of the responsibility for getting skills and managing their careers but also much more of the risks and uncertainty of doing business. Where employees themselves will get both the skills and the information to manage careers is another fundamental issue. They have been turning to post-secondary education for help. Community colleges have been particularly responsive with new course work offering some job skills, especially for nonmanagement work. But help in career management is not readily available yet. What kind of entrepreneurs will enter this market and what their products will look like remains to be seen.

The new relationship also creates new problems for managers as they try to address basic human resource issues. How organizations will function in the absence of employee commitment, where workers have a more individualistic and short-term orientation, is a far-reaching question that raises general issues for organizations and society as well. The new arrangements that are developing around more market-based relationships seem to be generating a number of internal contradictions. Organizations are demanding more from employees but offering them less. Bureaucratic control systems are replaced by systems with reduced supervision that require more commitment from employees at a time when employers are reducing their commitments to employees. More skills are required, including more knowledge and skills specific to an organization, when the employer's ability to fund those investments is decreasing.

These changes have important consequences for society as a whole. For example, employees with good skills, superior information about opportunities, and an overall high level of "marketability" may find that their job prospects are enhanced under the new market-oriented system; those who lack skills and information and are less marketable may find their prospects deteriorating. Together, these changes may further the trend toward increasing inequality in labor market outcomes that is already under way in the United States.

Much of contemporary American society has been built around stable employment relationships with predictable career advancement and steady growth in wages: long-term individual investments like home ownership and college educations for children, community ties and the stability they bring, and aspects of a quality life outside of work that are enhanced by reducing risk and uncertainty on the job. There is already at least anecdotal evidence that younger employees are more worried about getting a "nest egg" for financial security

sooner and may be willing to take more risk to get it. How these characteristics may change with the new employment relationship is an open question.

Both a high level of information and a series of contracts to enforce training agreements are needed to make the new employment arrangements function effectively. Meaningful credentials are needed as a signal to employers about skills and as a goal for employees. Potential employees need to be able to judge the quality of a training experience, just as employers need to judge the quality of a potential employee. Internalized systems of employment offered employers detailed and accurate information about the abilities of their employees which will be difficult to duplicate with the outside labor market. One consequence of these new arrangements, then, is that there may be more "slippage"—employees with the necessary abilities and talent are passed over because they lack the necessary credentials.

Increased importance of the labor market means more transactions and, in turn, more contracts to enforce them. With more hiring and presumably more dismissals, the labor law governing such actions will certainly get a workout that will make clear how its New Deal roots are out of step with the contemporary scene. Both employers and employees will need strong incentives not to cheat in these transactions, such as renegeing on training contracts.

Markets demand infrastructure to make them operate honestly and efficiently. As the labor market becomes more important, the need for information about jobs and workers, guidelines and enforcement of contracts, and other aspects of infrastructure will rise. Some industries have developed mechanisms for providing aspects of this infrastructure. But at present, the government is the only player in a position to deliver on a national scale the credential systems, remedial training programs, protection for the displaced, and other arrangements that could make the new system operate effectively.

It is difficult to envision policy options that would address the problems that are generated by this new deal. The traditional approach of prohibiting management decisions that hurt employees and communities, such as plant closings, lacks political support in the context of arguments linking competitiveness to flexibility. An alternative approach, which avoids that conflict, is to reduce the burdens associated with transitions between employers. These might include making employee benefits more portable so that employees do not lose health care coverage or pensions when they switch

employers; reforming unemployment insurance to accommodate temporary layoffs and to help assist employees who face permanent job loss (California, for example, allows companies to draw on unemployment insurance funds to retrain workers who are at risk of layoff); providing much more substantive assistance for retraining employees who are displaced from jobs, including greater access to education; and moving from economic assistance based on employment outcomes, such as the minimum wage, toward other forms of assistance such as earned income tax credits.

The rising power of markets is one of the most important developments of our generation, and the rise of labor market power is part of that trend. The effects have been profound in many segments of the economy and, I believe, are spreading to domains like professional service firms that were once home to lifetime careers. The extent to which these developments will come to permeate large corporations, where managerial work in particular seems most suited to internal labor markets, is a topic for speculation. There is little doubt that at least some aspects of the market-driven employment relationship are already in place even in these organizations. Its influence raises new challenges not only for employees but also for employers and society as well, with management challenges exacerbated by tight labor markets and, conversely, employee challenges worsened by slack labor markets. But the basic shift from internalized employment systems toward a more market-dominated relationship transcends the current state of the labor market and will continue to reveal new issues for many years to come.

