FAIRNESS, MINIMUM WAGE LAW, AND EMPLOYEE BENEFITS

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Often employers will agree to pay their employees more than the minimum the employees would accept for performing the job in question. One reason for this behavior is that such "fair" treatment by employers may encourage better job performance by employees. In her contribution to the Symposium, Professor Christine Jolls examines some of the legal implications of this "fairness dynamic." Empirical evidence strongly supports the idea that some employers will offer to pay employees more than the minimum amount the employees would accept in order to induce them to exert more effort, and that employees respond in turn by working harder. Fairness behavior is of special relevance to employers when monitoring and punishment for inadequate performance would prove difficult. Once the fairness dynamic described here is taken into account, the argument for the minimum wage requirement imposed by the Fair Labor Standards Act is undercut in situations where employees are relatively difficult to monitor, as fairness considerations will tend to drive the wage up regardless. This legal conclusion is a reminder that while behavioral law and economics may sometimes be more likely than traditional law and economics to support legal intervention, in other cases the opposite is true.

"My partner and I recently hired a half-time babysitter and are very happy to have found her, but we're feeling frustrated by the amount we agreed to pay," someone recently told me in a backyard conversation. "Well, why did you settle on that pay level?" I asked. "I suppose because the sitter is going to be in our house alone caring for our children for a significant amount of time, and we just didn't feel we should negotiate for a lower level of pay even though we believe we could have gotten one."

Why did these parents agree to pay the babysitter more than they "needed" to? Should they have? And what are the consequences of this dynamic for the desirability of legal regulation of employment relationships?

Behavioral economics can help to answer these questions. Behavioral economics arises out of three "bounds" on human behavior: bounded rationality, bounded will power, and bounded self-interest.[1]

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[1] Christine Jolls, Cass R. Sunstein & Richard Thaler, A Behavioral Approach to Law and Economics, 50 Stan. L. Rev. 1471, 1476 (1998).

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Bounded rationality, an idea originally due to Herbert Simon, refers to the limits that exist on individuals' cognitive functions.[2] Bounded will power involves limits on individuals' ability to exercise self-control.[3] Bounded self-interest reflects the idea that people care about being treated fairly and want to treat others fairly in certain settings.[4] One important component of bounded self-interest is that people who are the beneficiaries of fair behavior tend to reciprocate such behavior even when doing so imposes a financial or other cost on them.[5] Together these three bounds define behavioral economics as an alternative to traditional economic analysis.[6]

The legal literature already contains significant discussions of both bounded rationality and bounded will power in the specific context of the employment relationship—the context on which this Symposium focuses.[7] The existing legal literature, however, contains surprisingly little discussion of the aspect of bounded self-interest noted just above—in which people reciprocate fair behavior—insofar as the employment relationship and its regulation by the law are concerned. My contribution to the Symposium attempts to fill the gap.

Part I below describes empirical findings from the economics literature that point to the significant role of this aspect of fairness behavior in the employment relationship. As described below, the empirical evidence suggests that some employers choose to pay employees more than the minimum amount those employees would accept in order to induce them to exert effort, and that employees respond to such "fair" behavior by working harder. I shall refer to this behavior as the "fairness dynamic." Also as described below, fairness may intervene in a variety of other ways in the employment relationship, but my focus here is on the specific instance of fairness behavior reflected in the fairness dynamic.

The babysitting example from above illustrates the basic point. The parents decided to pay more than the minimum amount they believed the babysitter would accept because the babysitter would be

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[2] See Herbert A. Simon, A Behavioral Model of Rational Choice, 69 Q.J. Econ. 99, 99-100, 103-10 (1955).

[3] See Richard H. Thaler & H.M. Shefrin, An Economic Theory of Self-Control, 89 J. Pol. Econ. 392, 392-93 (1981).

[4] See Matthew Rabin, Incorporating Fairness into Game Theory and Economics, 83 Am. Econ. Rev. 1281, 1281-82 (1993).

[5] E.g., Ernst Fehr, Georg Kirchsteiger & Arno Riedl, Does Fairness Prevent Market Clearing? An Experimental Investigation, 108 Q.J. Econ. 437, 437-39 (1993).

[6] Jolls, Sunstein & Thaler, supra note 1, at 1476-77.

[7] See, e.g., Cass R. Sunstein, Human Behavior and the Law of Work, 87 Va. L. Rev. 205 (2001) (bounded rationality); Deborah M. Weiss, Paternalistic Pension Policy: Psychological Evidence and Economic Theory, 58 U. Chi. L. Rev. 1275 (1991) (bounded will power).

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caring for their children alone for significant amounts of time, and the parents wanted to ensure the right level of "effort" (to use the economic term) from the babysitter. Hopefully, the babysitter is reciprocating as anticipated by the fairness dynamic. As this example suggests, a driving force behind the fairness dynamic is the difficulty of inducing high effort through direct monitoring and punishment for low effort. Where high effort cannot be ensured through monitoring and punishment (as for instance in the babysitting example, where the parents are not present), a fair wage provides an alternative means by which an employer may be able to encourage an employee to work hard.

Part II below describes some implications of the fairness dynamic for the coverage and enforcement of the minimum wage requirement imposed by the Fair Labor Standards Act (FLSA).[8] Part III turns to the context of legal regulation of employee benefits and offers a few brief remarks on the implications of the fairness dynamic for the regulation of such benefits. My central conclusions are as follows:

First, once fairness is taken into account, a minimum wage requirement is less necessary to raise wages, all else equal, in situations in which employees are difficult to monitor than in situations in which they are relatively easy to monitor. (A minimum wage may still be important in setting expectations of what counts as a "fair" wage, however.) If employees are difficult to monitor, then fairness considerations may push toward a higher wage wholly apart from legal regulation, as employers strive to pay employees "fairly" in order to encourage diligence and hard work on the employees' part. If, by contrast, monitoring is relatively easy, then fairness considerations do not create any upward pressure on wages, as employees can simply be fired if monitoring discloses that they have not performed well. Minimum wage laws are more necessary to raise wages, all else equal, in the latter context.

Second, the argument offered here provides a new way to understand the FLSA's familiar exemption of "executive, administrative, and professional employees" from the minimum wage requirement.[9] At an obvious level, these employees "need" the protection of wage regulation less than other employees because they are likely to earn more in the first instance. Also, though, and more subtly, they "need" the protection of the law less because the nature of their work makes

[8] 29 U.S.C. §§ 201-219 (1994 & Supp. V 2000), amended by Worker Economic Opportunity Act, Pub. L. No. 106-202, 114 Stat. 308 (2000).

[9] 29 U.S.C. § 213(a)(1) (1994).

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monitoring difficult and thus the fairness dynamic produces upward pressure on their wages regardless of the existence of legal regulation.

Third, and more controversially, the monitoring argument may help to make at least partial sense of one of the largest and most debated historical exemptions from the FLSA, that for domestic service employees. Until 1974, such employees were not covered by the FLSA at all, as described below. But to the extent that such employees are involved in child care (as, for instance, in the babysitting example above), the quality of their performance will often be difficult to monitor, and thus minimum wage regulation may again be less necessary to raise wages for these employees than for otherwise similar employees whose performance is easier to monitor.

Fourth, and again controversially, the monitoring argument may also provide some support for the failure of the FLSA to cover independent contractors. Under the legal definition of an independent contractor, such individuals are more likely to be difficult to monitor than individuals who qualify as employees. Monitoring difficulties therefore again suggest upward pressure on wages without any need for legal regulation. The point here is not that independent contractors never require the protection of minimum wage regulation; it is just that, all else equal, they are less likely than those who qualify as employees to require such protection.

Fifth, compliance problems with the minimum wage requirement should be smaller in situations in which employees are difficult to monitor than in situations in which they are relatively easy to monitor. Again, if employees are difficult to monitor, then fairness considerations are more likely to exert upward pressure on wages wholly apart from any legal regulation. In this instance, the minimum wage requirement is more likely not to be binding and compliance will therefore not be a serious issue.

Sixth, fairness considerations are less relevant to policy decisions in the context of employee benefits than in the context of minimum wage regulation. This is so because market failures that are not relevant in the minimum wage context become relevant in the employee benefits context, as described below.

As many of the elements of the foregoing summary suggest, the policy implications of the fairness dynamic tend to be distinctly of the laissez-faire variety. If people will behave appropriately without legal regulation—as the fairness dynamic suggests they may—then perhaps the market should be left to function without legal regulation. This creates an intriguing political juxtaposition, as liberals are probably more open in general to the importance of a phenomenon like fairness, but then when one looks to implications for the law it turns out

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that, at least in this context, the conclusions are generally more apt to please conservatives. I elaborate on, as well as qualify, these claims about politics in the last section below.

I
THE FAIRNESS DYNAMIC IN EMPLOYER-EMPLOYEE RELATIONSHIPS

As Nobel Laureate Robert Solow has written, "[T]he fundamental reason for believing that fairness is a factor in labor markets is what we know about our own society and culture. . . . [W]age rates and employment are profoundly entwined with social status and self-esteem . . . ."[10] Albert Rees offers the following telling anecdote:

> Beginning in the mid-1970s, I began to find myself in a series of roles in which I participated in setting or controlling wages and salaries. . . . In none of those roles did I find the [neoclassical theory of wage determination] I had been teaching for so long to be of the slightest help. . . . The one factor that seemed to be of overwhelming importance in all these real-world situations was fairness.[11]

Fairness may play many important roles in wage setting and other aspects of the employment relationship. (Various conceptions of fairness probably also underlie many laws regulating the employment relationship.)[12] Studies by Alan Blinder and Don Choi, by Carl Campbell and Kunal Kamlani, and by Daniel Kahneman, Jack Knetsch, and Richard Thaler, for example, examine perceptions of the fairness or unfairness of wage adjustments in response to various demand- or supply-side shifts in the economy and find that such perceptions have significant effects—just as Solow's 1979 article, "Another Possible Source of Wage Stickiness," suggested they would.[13] Fairness also appears to play a major role in the determination of the relative

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[10] Robert M. Solow, The Labor Market as a Social Institution 9-10 (1990).

[11] Albert Rees, The Role of Fairness in Wage Determination, 11 J. Lab. Econ. 243, 243-44 (1993).

[12] See, e.g., Seth D. Harris, Conceptions of Fairness and the Fair Labor Standards Act, 18 Hofstra Lab. & Emp. L.J. 19 (2000).

[13] See Alan S. Blinder & Don H. Choi, A Shred of Evidence on Theories of Wage Stickiness, 105 Q.J. Econ. 1003, 1008-09 (1990); Carl M. Campbell III & Kunal S. Kamlani, The Reasons for Wage Rigidity: Evidence from a Survey of Firms, 112 Q.J. Econ. 759, 759, 765-80 (1997); Daniel Kahneman, Jack L. Knetsch & Richard Thaler, Fairness as a Constraint on Profit-Seeking: Entitlements in the Market, 76 Am. Econ. Rev. 728, 730-33 (1986); Robert M. Solow, Another Possible Source of Wage Stickiness, 1 J. Macroecon. 79, 80 (1979).

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wages of various groups of employees within a firm, as Truman Bewley and David Levine, among others, have emphasized.[14]

The discussion to follow, however, focuses not on this whole range of fairness behavior in the employment relationship but rather on one specific form of such behavior. The behavior on which I focus has its theoretical basis in the efficiency wage model of George Akerlof and Janet Yellen.[15] In this model, employers pay wages above employees' "reservation wage"—the minimum level they would demand for their services—in order to induce reciprocation in the form of high levels of effort.[16] On a macroeconomic level, this fairness dynamic can explain the otherwise puzzling existence of involuntary unemployment in the economy.[17]

Fairness, of course, is not the only explanation for efficiency wages; for instance, such wages may also be explained by employers' desire to increase the wage loss to employees fired for poor performance (or "shirking") and thus to increase employees' incentive not to engage in such shirking.[18] Akerlof and Yellen have summarized a variety of explanations for efficiency wages.[19] The discussion to follow, however, focuses on the fairness version of the efficiency wage model and the empirical evidence that supports it.

As long ago as 1929, Sumner Slichter emphasized the role of fair treatment in spurring high levels of effort by employees.[20] Slichter noted that the poor state of the economy beginning in 1920 had not led to a reversion to the harsh labor practices that prevailed in the "buyers' market" for labor before the first World War, and he concluded that "[p]ossibly the most important determinant of post-war labor policies . . . has been the growing realization by managers of the close relationship between industrial morale and efficiency."[21] As discussed by, among others, Gary Charness and David Levine, setting what is thought to be a fair wage may spur not only more exertion of

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14 See Truman F. Bewley, Why Wages Don't Fall During a Recession 75-82 (1999); David I. Levine, Fairness, Markets, and Ability to Pay: Evidence from Compensation Executives, 83 Am. Econ. Rev. 1241, 1252-57 (1993).

15 George A. Akerlof & Janet L. Yellen, The Fair Wage-Effort Hypothesis and Unemployment, 105 Q.J. Econ. 255 (1990); George A. Akerlof, Labor Contracts as Partial Gift Exchange, 97 Q.J. Econ. 543 (1982).

16 E.g., Akerlof & Yellen, supra note 15, at 255-56.

17 Id. at 256.

18 See Carl Shapiro & Joseph E. Stiglitz, Equilibrium Unemployment as a Worker Discipline Device, 74 Am. Econ. Rev. 433 (1984).

19 George A. Akerlof & Janet L. Yellen, Introduction to Efficiency Wage Models of the Labor Market 1, 4-8 (George A. Akerlof & Janet L. Yellen eds., 1986).

20 Sumner H. Slichter, The Current Labor Policies of American Industries, 43 Q.J. Econ. 393, 401-04 (1929).

21 Id. at 396-97, 401.

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effort in an employee's specifically designated responsibilities but also higher levels of "organizational citizenship behavior" outside those designated responsibilities.[22] Truman Bewley's survey of managers suggests that setting what is perceived to be a fair wage plays a major role in inducing appropriate employee behavior (although, as noted above, Bewley gives particular attention, in the determination of what is a "fair" wage, to the role of coworkers' wages, whereas the empirical evidence emphasized in what follows is more focused on the absolute level of the wage).[23]

In a 1993 article published in the *Quarterly Journal of Economics*, Ernst Fehr, Georg Kirchsteiger, and Arno Riedl provide strong empirical support for the Akerlof and Yellen version of the efficiency wage model.[24] The authors' experimental results, using subjects who were students at the University of Vienna or the University of Technology in Vienna,[25] have been replicated in numerous subsequent studies, including one in which the stakes were two to three times participants' monthly incomes.[26]

To provide the strongest possible test of the fairness hypothesis, Fehr, Kirchsteiger, and Riedl used the labels "buyer" and "seller" for subjects assigned (respectively) to the "employer" and "employee" groups.[27] This is likely to provide the strongest possible test because fairness considerations seem more likely to be present in employer-employee relationships, which usually involve social interaction, than in the relationship between the buyer and the seller of a type of good other than labor.[28] If fairness is important even when the labels of employer and employee are not used, then it is even more likely to be important (or at a minimum is no less likely to be important) in a setting in which those labels are used. Consistent with this conclusion, a subsequent article by Fehr, Erich Kirchler, Andreas Weichbold, and

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22 Gary Charness & David I. Levine, When Are Layoffs Acceptable? Evidence from a Quasi-Experiment, 53 Indus. & Lab. Rel. Rev. 381, 383 (2000).

23 Bewley, supra note 14, at 415.

24 Fehr, Kirchsteiger & Riedl, supra note 5, at 438-39, 446-53.

25 Id. at 440 n.5.

26 See Armin Falk, Simon Gächter & Judit Kovács, Intrinsic Motivation and Extrinsic Incentives in a Repeated Game with Incomplete Contracts, 20 J. Econ. Psych. 251, 266, 269-71, 273-74 (1999); Ernst Fehr & Armin Falk, Wage Rigidity in a Competitive Incomplete Contract Market, 107 J. Pol. Econ. 106, 111, 117-28 (1999); Ernst Fehr, Erich Kirchler, Andreas Weichbold & Simon Gächter, When Social Norms Overpower Competition: Gift Exchange in Experimental Labor Markets, 16 J. Lab. Econ. 324, 327-28, 333-37 (1998); Ernst Fehr, Georg Kirchsteiger & Arno Riedl, Gift Exchange and Reciprocity in Competitive Experimental Markets, 42 Eur. Econ. Rev. 1, 3, 11-16, 19-20 (1998); Ernst Fehr & Elena Tougareva, Do High Monetary Stakes Remove Reciprocal Fairness? 11-17 (June 1996) (unpublished manuscript, on file with the *New York University Law Review*).

27 Fehr, Kirchsteiger & Riedl, supra note 5, at 439 n.2.

28 Id.

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Simon Gächter that replicates the original test using employer and employee labels finds strong effects of fairness.[29]

In the first stage of the original Fehr, Kirchsteiger, and Riedl experiment, "employers" are given a specified period of time in which to bid for the services of a single, unknown "employee."[30] Bids consist of the wage that the employer will pay the employee.[31] In the second stage, those employees who have accepted offers of employment at the specified wages are able to set an effort level at which they will perform.[32] Higher effort levels are associated with increases in employers' payoffs, as employers earn higher profits, but with decreases in employees' payoffs, as effort is costly.[33] Wages may not be made contingent upon effort levels, and employers have no ability to retaliate for low effort levels in future periods because they do not know the identity of their particular employee.[34] Thus, it is impossible for employers to induce high effort levels by a strategy of monitoring employees and punishing them for poor performance.

According to the traditional model, the results of this experiment are quite predictable. Employees will always choose the minimum effort level in the second period so as to maximize their payoffs; their wage has been fixed in the first period, punishment for low effort is not feasible, and effort is costly. Employers, aware of this incentive, should assume low employee effort and offer a wage that puts employees just above their "reservation level" (the minimum level they would demand for their services). Employees should accept the offered wage since it is above the reservation level. The result is a low-wage, low-effort equilibrium.[35] Does this simple prediction square with the experimental results?

No. Employers in the above setting typically choose wage levels above the level predicted by the analysis just described, and employees respond by choosing effort levels significantly in excess of the minimum feasible level.[36] Figure 1 below demonstrates the relationship graphically. As the figure shows, only one employer offered a wage of thirty, the lowest feasible level above the reservation level assuming the minimum level of effort.[37] For most employer-employee pairs, by contrast, an equilibrium with a higher wage and a correspondingly

[29] Fehr, Kirchler, Weichbold & Gächter, supra note 26, at 327-28, 333-37.
[30] Fehr, Kirchsteiger & Riedl, supra note 5, at 439.
[31] Id.
[32] Id. at 440.
[33] Id. at 441.
[34] Id. at 439-41.
[35] Id. at 443.
[36] Id. at 446.
[37] See id. at 443 (explaining why lowest feasible wage is thirty).

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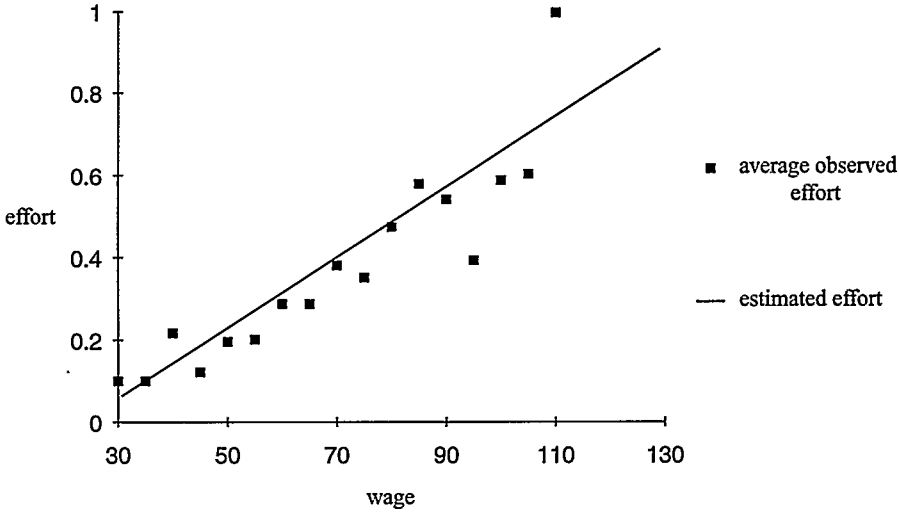
higher level of effort replaces the low-wage, low-effort equilibrium predicted by the traditional economic account.

FIGURE 1[38]
THE WAGE-EFFORT RELATION



These results may reflect concerns with fairness. Workers who receive wages above the low level predicted by the traditional analysis may offer high levels of effort in response based on their perceptions of the fairness of the employers' behavior, and employers, aware of this result, can maximize their profits by offering such generous wages. This is the basic mechanism contemplated by the Akerlof and Yellen theory.[39] Subsequent work by Fehr, Kirchler, Weichbold, and Gächter confirms the fit between the Akerlof and Yellen model and the behavior we observe in the experiments by showing that employers' offers of high wages do not reflect an unwillingness by employees to work for less but instead, as envisioned by the efficiency wage model, reflect a desire by employers to encourage high levels of effort by paying employees more than the reservation level they would demand for their services.[40] Lawrence Mitchell, in a recent article, of-

[38] This figure is reprinted with permission from id. at 447.

[39] See sources cited supra note 15.

[40] See Fehr, Kirchler, Weichbold & Gächter, supra note 26, at 327-29. The mechanism used to test apart the two explanations is ingenious. Fehr, Kirchler, Weichbold, and Gächter compare the results from the original experiment (described in the text) to the results from an alternative experiment in which effort levels are specified in advance by the experimenter rather than being subject to the choice of the employee. Wages are substantially higher in the original set-up than in the alternative. This shows that what is driving the high wages is the desire by employers to encourage high effort, as contemplated by the

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fers a wonderful anecdote suggesting a related dynamic, although with reverse timing: A contractor he had hired put in an extraordinary level of effort, after which Mitchell paid him more than twice what he had agreed to work for.[41]

As the discussion here suggests, employers in the model posited by the fairness dynamic are not necessarily motivated by an affirmative desire to behave fairly toward employees (although they might be so motivated). Employers may simply be responding in a profit-maximizing manner to employees' reactions to behavior perceived by them to be fair. In this respect the empirical findings described here are similar to the findings from the well-known "ultimatum game." In that game, the "proposing" player suggests an allocation of a sum of money between herself and another player, and the "responding" player may then either accept or decline this offer. If the latter course is taken, both players get nothing. When this game is played in experimental settings, responding players typically decline offers of less than twenty to thirty percent of the sum to be divided even though this means they get nothing, and proposing players rationally anticipate such behavior by offering shares closer to forty or fifty percent.[42] As in the Fehr, Kirchsteiger, and Riedl context, this behavior by the first-moving player may well reflect not affirmative concerns about fairness on this player's part but instead simple profit maximization in light of fairness behavior by the second-moving player.[43] The ultimatum game differs from the present setting, however, in that in the ultimatum game the second-moving party's response to behavior thought to be fair is to do what standard economic theory would predict (accept the offer), while in the present setting the employee's response to behavior thought to be fair is to do the opposite of what standard economic theory would predict (exert significant rather than minimal effort). In this sense the behavior of the second-moving party in the Fehr, Kirchsteiger, and Riedl setting might be said to reflect affirmative concerns for fairness.[44]

An interesting extension of the model described here suggests that employers may actually gain by *intentionally* structuring the

efficiency wage model, rather than the unwillingness of the employee to work for a smaller sum. See id. at 327-29 (summarizing two sets of experiments and their results).

41 Lawrence F. Mitchell, The Importance of Being Trusted, 81 B.U. L. Rev. 591, 593-95 (2001).

42 See Werner Güth, Rolf Schmittberger & Bernd Schwarze, An Experimental Analysis of Ultimatum Bargaining, 3 J. Econ. Behav. & Org. 367, 371-72, 375 tbls.4 & 5 (1982); Daniel Kahneman, Jack L. Knetsch & Richard H. Thaler, Fairness and the Assumptions of Economics, 59 J. Bus. S285, S291 tbl.2 (1986).

43 See Jolls, Sunstein & Thaler, supra note 1, at 1492.

44 See id.

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workplace in a participatory manner, so that employees must be self-directed and self-motivated rather than being subjected to monitoring of performance and punishment for poor performance; this is so because the higher effort that may result from work in a self-directed setting produces efficiency gains for both parties.[45] This analysis points to a rejection of a Taylorist model under which employees should be given highly discrete and specialized tasks and then closely monitored in their performance of those tasks.[46] Robert Cooter and Melvin Eisenberg have discussed other steps firms can take to increase their employees' propensity to engage in "fair" behavior.[47]

More broadly, the fairness dynamic described here is consistent with economics and political science literatures suggesting the efficiency aspects of "trust" relationships.[48] Empirically, higher levels of trust are correlated across regions and across countries with better economic performance.[49] These results suggest that the opportunity to build upon trust relationships enhances efficiency.[50] Considerations of trust arise in the fairness dynamic between employers and employees because when employers cannot directly monitor their employees' effort, they must trust them to perform well in response to being offered "fair" wages.

The discussion to follow briefly describes the implications of the fairness dynamic for the legal regulation of wages and employee benefits.

II
IMPLICATIONS OF THE FAIRNESS DYNAMIC FOR THE FLSA'S MINIMUM WAGE REQUIREMENT

At the most basic level, the fairness dynamic suggests that a minimum wage requirement may be less necessary to raise wages than might otherwise be thought, for the essential idea behind the dynamic

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[45] See, e.g., David I. Levine & Laura D'Andrea Tyson, Participation, Productivity, and the Firm's Environment, in Paying for Productivity: A Look at the Evidence 183, 187-88 (Alan S. Blinder ed., 1990).

[46] See, e.g., Frederick Winslow Taylor, The Principles of Scientific Management 36-48 (1911).

[47] Robert Cooter & Melvin A. Eisenberg, Fairness, Character, and Efficiency in Firms, 149 U. Pa. L. Rev. 1717, 1726-28 (2001).

[48] See generally Rafael La Porta, Florencio Lopez-de-Silanes, Andrei Shleifer & Robert W. Vishny, Trust in Large Organizations, 87 Am. Econ. Rev. (Papers & Proceedings), May 1997, at 333 (summarizing these literatures).

[49] Id. at 333-36.

[50] Margaret Blair and Lynn Stout, among others, have discussed this point in the legal literature. Margaret M. Blair & Lynn A. Stout, Trust, Trustworthiness, and the Behavioral Foundations of Corporate Law, 149 U. Pa. L. Rev. 1735, 1753-58 (2001).

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is that employers and employees may find their way to an equilibrium with higher wages entirely on their own. But at some level this observation is too simple, for a premise of the fairness dynamic is that high effort cannot be ensured by the direct mechanism of monitoring effort and then punishing employees who fail to perform up to par. Such monitoring and punishment are obviously possible in some settings; for instance, in the telemarketing sector studied by Daniel Nagin, James Rebitzer, Seth Sanders, and Lowell Taylor—a setting in which employee misbehavior takes the form of reporting successful solicitations when in fact the solicitee responded negatively—misbehavior can be checked by calling back a certain fraction of the solicitees to confirm their responses.[51] Because monitoring and punishment are possible in some settings, a more refined set of conclusions from the fairness dynamic focuses on settings in which a minimum wage requirement is likely to be *more or less* necessary to raise wages.

The discussion to follow emphasizes the ease of monitoring rather than the ease of punishment for low effort by an employee because the former seems easier to theorize about a priori. This emphasis marks a contrast with the original Akerlof article, which takes as its motivation a situation in which employees—young women in the first part of the twentieth century—were not difficult to monitor (indeed their output was known with exactitude) but were difficult to punish because their attachment to the labor force was quite limited (as most left the job within a short time to marry).[52]

The following discussion uses differences in the likely ease of monitoring to try to make sense of the scope of coverage of the FLSA's minimum wage requirement and to predict variations in the degree of compliance with this requirement within covered sectors. In terms of the FLSA's coverage, the claim will not be that the fairness dynamic provides a comprehensive framework to make sense of the overall statutory structure of the FLSA's minimum wage requirement. That requirement is subject to a number of rather random-sounding exemptions, including for various employees working in the fishing and agricultural industries, employees working in summer camps and similar recreational establishments, and employees employed by small newspapers or telephone companies.[53] The analysis offered here does

[51] Daniel Nagin, James Rebitzer, Seth Sanders & Lowell Taylor, Monitoring, Motivation and Management: The Determinants of Opportunistic Behavior in a Field Experiment 1-2 (Aug. 14, 2000) (unpublished manuscript, on file with the *New York University Law Review*).

[52] See Akerlof, supra note 15, at 546-48.

[53] 29 U.S.C. § 213(a)(3), (5)-(6), (8), (10) (1994).

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not purport to explain all of these exemptions, just to make some sense of the particular ones discussed below.

A. Coverage

1. The Exemption for "Executive, Administrative, or Professional" Employees

One of the most important exemptions from the coverage of the FLSA's minimum wage requirement is the exemption for bona fide "executive, administrative, or professional" employees.[54] Of course the most transparent explanation for this exemption is that such employees do not need the protection of a minimum wage law to ensure that they receive a decent wage, as they are performing reasonably high-level work. This is probably true in most instances, but, as Marc Linder has emphasized, there are important circumstances in which employees who fall within the "executive, administrative, or professional" category as the law defines it are in fact earning in the range of the minimum wage, so that a minimum wage requirement might become relevant to them; he emphasizes the example of fast-food restaurant managers.[55]

To be sure, the Secretary of Labor imposes a "salary test" as part of the inquiry into whether an employee is employed in an "executive, administrative, or professional" capacity.[56] Under this test, an employee must be paid a salary of at least a specific level to fall within the "executive, administrative, or professional" category.[57] But the Secretary has not revised the salary test over the past twenty-six years.[58] (The actual history is more complicated, with various twists and turns that Linder has engagingly described.)[59] Thus, at present, an executive or administrative employee who earns $155 per week, and a professional employee who earns $170 per week, may meet the salary test,[60] yet the pay rate reflected in those salaries is less than the minimum wage of $5.15 an hour for a full-time worker.[61] Thus, it is

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54 § 213(a)(1).

55 Marc Linder, Closing the Gap Between Reich and Poor: Which Side Is the Department of Labor On?, 21 N.Y.U. Rev. L. & Soc. Change 1, 1-3, 23 (1993-1994).

56 See 29 C.F.R. § 541.1(f) (2000) ("executive" employees); id. § 541.2(e) ("administrative" employees); id. § 541.3(e) ("professional" employees).

57 See id. §§ 541.1(f), 541.2(e), 541.3(e).

58 See Berne C. Kluber, FLSA Exemptions and the Computing Workforce, 33 Hous. L. Rev. 859, 869 (1996) (describing last revision in 1975).

59 Linder, supra note 55, at 12-19.

60 29 C.F.R. §§ 541.1(f), 541.2(e), 541.3(e) (2000).

61 See Elissa Gootman, Hempstead Takes Back New Minimum Wage Law, Officials Fear Measure Might Deter Business, N.Y. Times, Dec. 6, 2001, at D5 (stating current hourly minimum wage).

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quite possible that someone employed in an "executive, administrative, or professional" capacity as that category is legally defined would be earning at a sub-minimum-wage level. A fortiori, a person employed in an "executive, administrative, or professional" capacity could be earning just above the minimum wage. The point is that even an "executive, administrative, or professional" employee may be earning in a range such that the minimum wage requirement might become relevant, and thus it is interesting to ask whether nonetheless there are grounds for exempting such an employee from coverage.

This is where the fairness dynamic comes in. The effort levels of most individuals employed in an "executive, administrative, or professional" capacity are likely to be difficult to monitor because of the relative complexity and multidimensionality of at least a substantial portion of their work. In such a setting, fairness considerations may exert an upward force on wages and thus make a minimum wage requirement less necessary than it would otherwise be, as described above.

Note that the point is not that Congress drafted the exemption for "executive, administrative, or professional" employees based on this motivation. My point here is not to describe the intent or goals of Congress.[62] Instead, the fairness dynamic provides a possible rationalization, or way to make sense, of the statutory exemption of "executive, administrative, or professional" employees. The same point about distinguishing Congress's motivation from rationalizing or making sense of the statutory structure applies even more forcefully to the discussion just below of the historical exemption for domestic service employees, whose exclusion from the FLSA Linder and Laurence Norton have forcefully argued resulted from racism on the part of New Deal lawmakers.[63]

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[62] For a rich description of the legislative process leading to the passage of the exemption for "executive, administrative, or professional" employees, see Deborah C. Malamud, Engineering the Middle Classes: Class Line-Drawing in New Deal Hours Legislation, 96 Mich. L. Rev. 2212, 2286-89 (1998).

[63] See Marc Linder, Migrant Workers and Minimum Wages: Regulating the Exploitation of Agricultural Labor in the United States 154-55 (1992); Marc Linder, Farm Workers and the Fair Labor Standards Act: Racial Discrimination in the New Deal, 65 Tex. L. Rev. 1335, 1373-75 (1987); Laurence E. Norton II & Marc Linder, Down and Out in Weslaco, Texas and Washington, D.C.: Race-Based Discrimination Against Farm Workers Under Federal Unemployment Insurance, 29 U. Mich. J.L. Reform 177, 196-97 (1995-1996).

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2. *The Now-Abandoned Exemption for Domestic Service Employees*

Until 1974, all domestic service employees were exempt from the FLSA.[64] The exemption has now been largely abandoned, although the statutory path leading to this result and the precise scope of the exemption's abandonment turn out to be rather complex.

Under the basic provision currently exempting certain categories of employees from the FLSA's minimum wage requirement, employees employed in "domestic service employment to provide companionship services for individuals who (because of age or infirmity) are unable to care for themselves" are excluded from coverage.[65] But, at the same time, a separate provision within the section of the statute affirmatively setting forth the minimum wage requirement specifically provides that domestic service employees "shall be paid wages at a rate not less than the wage rate in effect under [the minimum wage provision] unless such employee's compensation for such service would not because of section 209(a)(6) of the Social Security Act . . . constitute wages for the purposes of title II of such Act."[66] Section 209(a)(6) of the Social Security Act sets forth an exemption from the definition of "wages" remuneration paid to domestic service employees if such remuneration is paid in a medium other than cash or if such remuneration is below a specified threshold (set at $1000 in 1994).[67] At a minimum, the effect of these provisions taken together is that domestic service employees *not* providing "companionship services" for the aged or infirm (and not employed on a casual basis to provide babysitting services, as discussed just below) must be paid the minimum wage as long as they meet the minimal annual cash earnings threshold specified in the Social Security Act.

The same section of the FLSA that sets forth an exemption from the coverage of the minimum wage requirement for those providing "companionship services" for the aged or infirm also sets forth an exemption for those employed "on a casual basis in domestic service employment to provide babysitting services."[68] "Casual basis," however, has been defined by the Secretary of Labor as "employment

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[64] E.g., Peggie R. Smith, Organizing the Unorganizable: Private Paid Household Workers and Approaches to Employee Representation, 79 N.C. L. Rev. 45, 57 & n.54 (2000).

[65] 29 U.S.C. § 213(a)(15) (1994).

[66] § 206(f)(1).

[67] 42 U.S.C. § 409(a)(6) (1994) (referencing I.R.C. § 3121(x) (1994)). Section 3121(x) of Title 26 was initially enacted in 1994. Pub. L. No. 103-387, § 2(a)(1)(B), 108 Stat. 4071, 4071 (1994).

[68] 29 U.S.C. § 213(a)(15) (1994).

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which is irregular or intermittent, and which is not performed by an individual whose vocation is babysitting."[69] Thus, those employed on a regular or steady basis to provide babysitting services are not exempted from the coverage of the minimum wage requirement. Those providing regular or steady babysitting services are also affirmatively covered under the provision quoted above applying the minimum wage requirement to domestic service employees who meet the annual cash earnings threshold specified by the Social Security Act.[70]

But what of the historical exemption of domestic service employees from the minimum wage requirement? At one level, the exemption seems quite surprising. While high-level professional "nannies" are often paid well above the minimum wage (more than $40,000 annually, plus benefits, in large cities),[71] and thus these individuals would not be affected by an exemption from the minimum wage requirement, other domestic service employees are, and presumably were, among the most vulnerable in the economy.[72] Why should these employees have been excluded from the coverage of the minimum wage requirement?

One rationale that has been offered for the exemption of domestic service employees is the privacy concerns of the households employing these individuals.[73] (Other accounts emphasize racist aspects, as noted earlier.)[74] In the words of Jane Addams, a turn-of-the-century social reformer, "[The domestic's] position is peculiar. She is in the family, but not of it . . . ."[75] Households "do not see themselves as employers," as one member of Congress put it in a discussion of the treatment of domestic service employees.[76]

The fairness dynamic, however, provides an interesting variation on this theme of household "privacy." Some forms of household work—particularly care for children—are difficult to monitor. While one knows whether the employee is present for work, the *quality* of

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69 29 C.F.R. § 552.5 (2000).

70 29 U.S.C. § 206(f)(1) (1994); supra notes 66-67 and accompanying text.

71 See Leslie Eaton, Show Nanny the Money: As Economy Booms, Pay Rise for Child-Care Workers, N.Y. Times, July 26, 1998, at 27 (noting nanny salary of $800 per week plus benefits).

72 See, e.g., Smith, supra note 64, at 53-54.

73 See generally Peggie R. Smith, Regulating Paid Household Work: Class, Gender, Race and Agendas of Reform, 48 Am. U. L. Rev. 851, 906-15 (1999).

74 See supra note 63 and accompanying text.

75 Jane Addams, Social Conditions in Domestic Service, 13 Mass. Lab. Bull. 1, 1-2 (1900), quoted in Smith, supra note 73, at 852.

76 Proposals to Simplify and Streamline the Payment of Employment Taxes for Domestic Workers: Hearings Before the Subcomm. on Social Security and the Subcomm. on Human Resources of the House Comm. on Ways and Means, 103d Cong. 4, 18 (1993) (statement of Rep. Meek), quoted in Smith, supra note 64, at 57 n.55.

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the work is, or can be, extremely subtle in its variations, in ways that cannot be monitored well unless the employer hovers over the employee, which of course would tend to defeat the purpose of hiring the employee in the first place. The fairness dynamic suggests that employers and employees may end up at an equilibrium with a higher-than-expected wage, and a correspondingly higher level of effort, without the intervention of a minimum wage requirement. If this analysis carries some truth, then a minimum wage requirement may be less necessary to raise the wages of certain domestic service employees than to raise the wages of otherwise similar employees working in different settings.

Of course, many domestic service employees perform tasks—such as various housework duties—that may not involve the sort of discretion associated with child care, and much of the literature on domestic service employees and their abuse at their employers' hands focuses directly on such employees, who are not the subject of the fairness argument here and who may very well desperately need the protection of a minimum wage requirement.[77] Moreover, at the other end of the spectrum, certain domestic service employees—such as high-level professional nannies—are in a wholly different category from those domestic service employees who could conceivably stand to gain from the application of a minimum wage requirement; as already noted, professional nannies earn dramatically in excess of the minimum wage. However, some in-home child care workers do earn relatively low wages[78] (and presumably also did in the past, although it is hard to get access to good data for the pre-1974 period for child care workers as distinguished from other domestic service employees); and thus it remains an interesting question whether it makes sense for the minimum wage requirement to apply to these child care workers.

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[77] See, e.g., Mary Romero, Unraveling Privilege: Workers' Children and the Hidden Costs of Paid Childcare, 76 Chi.-Kent L. Rev. 1651, 1670 n.110 (2001) (describing employer advantage-taking against employee who provided housecleaning services); Smith, supra note 64, at 46-58 & n.3 (defining "domestic service employees" as those who perform housework duties including "cleaning, laundering, and cooking" and detailing vulnerabilities of such employees).

[78] The Bureau of Labor Statistics states that earnings of "private household workers," including child care workers, "vary from about $10 an hour . . . to less than . . . $5.15 an hour . . . ." Bureau of Labor Statistics, U.S. Dep't of Labor, Occupational Outlook Handbook 355, 357 (2000-01 ed. 2000). The Bureau reports that the average weekly pay of child care workers in 1998 was $204, which translates to $5.10 an hour with a forty-hour work week (although many child care workers work less than that, so the hourly rate would be somewhat higher). Id. at 357. Because, as noted previously, professional nannies may earn more than $40,000 annually, or more than $19 per hour assuming a forty-hour work week, other in-home child care workers must earn at or near the minimum wage.

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In considering the application of the fairness dynamic to such workers, it is illuminating to contrast these workers with another category of relatively low-paid employees, the category of fast-food preparer or server. As wonderfully documented in the video *Fast Food Women*,[79] the trend in at least some sections of the fast-food business has been toward increased routinization of tasks to the point that employees have absolutely no discretion in performing their tasks. In my favorite example, employees are instructed with great precision and with the use of numerous large color charts on the proper order in which to stack the elements of a hamburger sandwich (lettuce, tomato, cheese, hamburger, etc.); thus even the most trivial details about performing the work are pinned down in advance by management rather than being left to the employee's judgment. It is hard to imagine a more Taylorist workplace.

In light of the absence of discretion and multidimensionality in at least some sectors of the fast-food industry, employee performance in these settings is likely to be fairly easy to monitor, and thus it is not surprising to learn that nearly all of the employees in *Fast Food Women* earned the minimum wage. As Truman Bewley has noted, if work requires little of "employees' imagination or general cooperation" and is "mechanical" in its nature, then "supervision is easy" and "there is almost no need to foster good morale" by offering higher wages.[80] In such settings, Bewley writes, "[t]he tendency is . . . to speak of maintaining 'the right level of terror' rather than of encouraging positive attitudes."[81]

By contrast, "maintaining 'the right level of terror'" clearly would be the wrong model for most child care work. This is so, I want to suggest, because of the degree of freedom and discretion enjoyed by such employees in performing their work. In such settings, a more likely way to encourage desired performance from employees is to pay a wage higher than what the traditional economic analysis would suggest.

Of course, the notion of a "higher wage" equilibrium as a result of the fairness dynamic does not necessarily ensure that the employees in question were earning—prior to the elimination in 1974 of the FLSA exemption—a "living wage," one capable of sustaining them at

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[79] Fast Food Women (Appalshop 1991).

[80] Truman F. Bewley, A Quest for an Explanation of Downward Wage Rigidity Through Conversations with Decision Makers 16 (Apr. 2001) (unpublished manuscript, on file with the *New York University Law Review*).

[81] Id. at 5.

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reasonable standards.[82] Even a wage above the minimum required by the FLSA might well not be a living wage. Whether it is depends, of course, on the gap between the legally required minimum and the level required for a living wage—a gap that has varied over time with the level of the minimum wage in real terms.[83] As an interesting point of comparison, in the Fehr, Kirchsteiger, and Riedl study, the result of fairness behavior is an average wage that is more than twice the wage predicted by the traditional economic analysis.[84]

3. *The Failure to Cover Independent Contractors*

The FLSA's minimum wage requirement applies to "employees" but not to "independent contractors."[85] Unlike the limit pertaining to domestic service employees, this limit on the coverage of the FLSA continues in effect today. As with the aspects of the FLSA discussed above, it may be possible to make some sense of this feature of the law by reference to the fairness dynamic and the relative difficulty of monitoring independent contractors versus employees.

Under the FLSA, whether an individual is an independent contractor or an employee turns on the following factors:

1. the nature and degree of the employer's control as to the manner in which the work is to be performed;
2. the individual's opportunity for profit or loss depending upon his managerial skill;
3. the individual's investment in equipment or materials required for his task, or his employment of workers;
4. whether the service rendered requires a special skill;
5. the degree of permanency and duration of the working relationship;
6. the extent to which the service rendered is an integral part of the employer's business.[86]

The first, fourth, and fifth of these factors are likely to correlate with the difficulty of monitoring an individual's work. The less control an employer has as to the manner in which the work is to be performed (the first factor), the more difficult it is likely to be for the employer to monitor that work. Similarly, the more skilled the individual's work (the fourth factor), the more difficult it is likely to be for

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[82] See generally Lawrence B. Glickman, A Living Wage: American Workers and the Making of Consumer Society 61-77 (1997) (defining "living wage").

[83] See William P. Quigley, The Right to Work and Earn a Living Wage: A Proposed Constitutional Amendment, 2 N.Y. City L. Rev. 139, 167, 169-70 (1998) (giving minimum wage value in real terms at various points in time).

[84] See Fehr, Kirchsteiger & Riedl, supra note 5, at 443, 446.

[85] E.g., Sec'y of Labor v. Lauritzen, 835 F.2d 1529, 1531 (7th Cir. 1987).

[86] Id. at 1535.

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the employer to monitor the work. And finally, the lesser the degree of permanency and duration of the working relationship (the fifth factor), the greater the difficulty of (successful) monitoring of the individual's work, as there will not be a long horizon over which the employer can look for poor performance. Based upon these factors, the work of independent contractors is likely to be more difficult, all else equal, to monitor than that of employees, and thus, according to the fairness dynamic, the application of a minimum wage requirement will be less necessary, all else equal, to raise the wages of independent contractors than to raise the wages of employees.

The fairness dynamic thus provides some assistance in making sense of the oft-criticized failure of the FLSA to cover independent contractors. This is not to say, though, that every exclusion accomplished by that coverage failure makes sense; some exclusions—such as that by some courts of migrant farm workers—seem hard to make sense of, as Judge Frank Easterbrook (among others) has recognized.[87]

4. Costs of FLSA Coverage

The central implication of the fairness dynamic is that the minimum wage requirement of the FLSA is less necessary, all else equal, to raise wages in settings in which monitoring is difficult than in settings in which monitoring is less difficult. But perhaps this argument implies nothing more than that a minimum wage requirement would simply be irrelevant in settings in which, because of monitoring difficulties, fairness pushes up wages without the need for legal intervention. What are the *costs*, if any, of imposing a minimum wage requirement? Why bother exempting certain employees if the law would simply be irrelevant to them given the operation of the fairness dynamic?

From a law and economics perspective, it may seem obvious that any form of legal regulation is likely to carry with it costs, so that a regulation that is believed to produce no or few positive effects obviously should not be imposed. But it is worth pausing briefly to consider what exactly these costs might be insofar as minimum wage regulation is concerned.

First, like any legal regulation, a minimum wage requirement imposes administrative costs, for even an employer who has conformed substantively to the requirement may always be haled into court and asked to prove to the court's satisfaction that it has done so. The point here is parallel to Richard Epstein's point that a "good cause"

[87] Id. at 1543-45.

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standard for discharging employees will impose administrative costs even on employers who obey the substantive standard.[88]

Second, a related point is that if an employer must be able to prove in court that it has met the minimum wage requirement, the employer will have to track and maintain records of the specific number of hours worked by each employee in exchange for the pay received by the employee. This practice obviously entails costs.

Third, and in a somewhat different vein, it might be argued that the imposition of a minimum wage requirement in a given setting has the effect of contributing undesirably to the commodification of work in that setting. This point may bear particularly on the context of domestic service employees, who, as noted above, were exempted from the FLSA's minimum wage requirement prior to 1974. As Katharine Silbaugh has noted, "remov[ing] paid domestic workers from the formal economy" by exempting them from various forms of employment regulation may result from a strong anticommodification perspective on domestic labor.[89]

Fourth, and most linked to the central ideas explored in this work, it may be the case that minimum wage regulation in a particular setting would serve as a signal to market participants that employers were not sufficiently trustworthy to be left on their own in setting wages. As Tamar Frankel and Wendy Gordon succinctly put it in discussing the general idea that legal regulation may signal a lack of trust, "trust begets trust, while mistrust begets mistrust."[90] On this view, minimum wage regulation might disrupt the operation of the fairness dynamic. Of course, another, perhaps more optimistic perspective—advanced by (among others) Dan Kahan—is that legal regulation, with its expressive aspects, may help to encourage rather than undermine trust relationships; Kahan, however, appears to view this possibility as more applicable to areas such as drunk driving than to the employment setting.[91]

B. Compliance

The fairness dynamic has implications not only for the appropriate coverage of the FLSA's minimum wage requirement but also for

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[88] Richard A. Epstein, In Defense of the Contract at Will, 51 U. Chi. L. Rev. 947, 970 (1984).

[89] Katharine Silbaugh, Commodification and Women's Household Labor, 9 Yale J.L. & Feminism 81, 113-15 (1997).

[90] Tamar Frankel & Wendy J. Gordon, Introduction to Symposium, Trust Relationships, 81 B.U. L. Rev. 321, 322 (2001).

[91] See Dan M. Kahan, Trust, Collective Action, and Law, 81 B.U. L. Rev. 333, 344-46 (2001).

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the likelihood that this requirement will be binding on employers. If it is not binding, then compliance will not be a concern. The issue of whether the requirement binds is of real significance because it seems clear that serious compliance problems with the minimum wage requirement exist in some sectors,[92] and thus it is important to know where it might be sensible to target enforcement efforts.

For the reasons given above, the fairness dynamic suggests that enforcement will be less necessary in circumstances in which workers are difficult to monitor than in circumstances in which they are relatively easy to monitor, for in difficult-to-monitor settings fairness concerns exert an upward pressure on wages wholly apart from any legal regulation. I do not offer this suggestion as a fundamental driver of enforcement behavior; instead I simply mean to make the ultimately commonsensical observation that if an employer is trusting an employee to work well using judgment and discretion and the employer cannot accurately monitor the degree to which this is occurring, we might not worry too much about the likelihood that the employer will decide to pay the employee less than $5.15 an hour.

III

SOME BRIEF REMARKS ON EMPLOYEE BENEFITS

As described above, the fairness dynamic suggests that minimum wage regulation is less necessary than it otherwise would be in settings in which employees are difficult to monitor, as in those situations fairness considerations may exert an upward pressure on wages wholly apart from legal regulation. A natural extension of this idea suggests that in situations in which employees are difficult to monitor, regulation of employee benefits may similarly be less necessary than it would otherwise be.

But in fact the fairness dynamic provides a far less convincing basis for a laissez-faire, nonregulatory approach in the case of regulation of employee benefits than in the case of a minimum wage requirement. Many benefits are presently mandated by law,[93] and the fairness dynamic does not provide much grounds for abandoning this approach. The reason for this is simple. Various market failures, such as imperfect information and adverse selection, may prevent the voluntary provision of employee benefits even if fairness considerations

[92] E.g., Orley Ashenfelter & Robert S. Smith, Compliance with the Minimum Wage Law, 87 J. Pol. Econ. 333, 338-47 (1979).

[93] See, e.g., Christine Jolls, Accommodation Mandates, 53 Stan. L. Rev. 223, 225-26 (2001) (providing examples of mandates).

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work in favor of their being offered.[94] By contrast, with the simple setting of the wage level, it is harder to tell comparable stories of traditional economic market failure. The theme of the relationship between the fairness dynamic and laissez-faire prescriptions is taken up again in the following section.

CONCLUSION

In the setup examined in the Fehr, Kirchsteiger, and Riedl study described in Part I above, the behavior predicted by the traditional economic analysis leads to a suboptimal solution from an overall efficiency standpoint.[95] "[I]f all agents are money maximizers, there is a conflict between individual and collective rationality," with individual rationality leading to a departure from collective rationality.[96] This departure is one of the classic justifications for legal intervention within the law and economics framework, with the Prisoner's Dilemma model being a canonical illustration.

But fairness concerns disrupt this otherwise compelling rationale for legal intervention. Fairness considerations suggest that parties may be able to resolve the conflict between individual and collective rationality on their own.[97] Fairness considerations thus complement other reasons, such as reputational factors, for thinking that legal intervention is less necessary than might otherwise be thought.[98]

An interesting feature of this conclusion is its political orientation. While some might naturally assume that behavioral economics (as compared to traditional economic analysis) is more rather than less likely to provide normative support for legal intervention—and while in some cases this may be true[99]—the case of fairness is an important counterexample. If we take seriously the idea that people care about fair treatment, they may be more likely than we would otherwise assume to resolve their conflicts on their own, and the role of the law will accordingly be reduced.

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94 See, e.g., Alan B. Krueger, Observations on Employment-Based Government Mandates, with Particular Reference to Health Insurance, in Labor Markets, Employment Policy, and Job Creation 297, 301 (Lewis C. Solmon & Alec R. Levenson eds., 1994) (imperfect information); Lawrence H. Summers, Some Simple Economics of Mandated Benefits, 79 Am. Econ. Rev. (Papers & Proceedings), May 1989, at 177, 179 (adverse selection).

95 Fehr, Kirchsteiger & Riedl, supra note 5, at 445.

96 Id.

97 Id.

98 See generally Robert C. Ellickson, Order Without Law: How Neighbors Settle Disputes (1991) (discussing nonlegal solutions among Shasta County farmers and ranchers); Elinor Ostrom, Governing the Commons: The Evolution of Institutions for Collective Action (1990) (describing nonlegal solutions in various contexts).

99 See, e.g., Jolls, Sunstein & Thaler, supra note 1, at 1541-43.

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In the specific context of wage-setting, however, an important assumption underlies the laissez-faire nature of this normative conclusion. That assumption is that the benefit of pushing up wages outweighs the cost of the reduced employment that is likely to come along with higher wages for those who remain employed. When a minimum wage is imposed by Congress, one might reasonably assume that the trade-off between higher wages and higher employment has been resolved by the polity in favor of higher wages (assuming that there is in fact such a trade-off).[100] But when the increase in wages occurs, as in the discussion above, through the operation of market forces rather than through legislation, it is, ironically, possible at least in theory that the resulting wage is too *high* relative to the social optimum, and thus that government intervention is needed to protect opportunities for employment from encroachment by *excessive* wage levels. So fairness, in this particular context, could conceivably argue *for* the necessity of market intervention rather than *against* the necessity of such intervention. The point, more generally, is that it is often more difficult than observers have realized to generalize about the political orientation of behavioral law and economics; this is true in the employment setting on which the present Symposium focuses and presumably in other settings as well.

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[100] For the leading defense of the idea that no wage-employment trade-off exists, see David Card & Alan B. Krueger, Myth and Measurement: The New Economics of the Minimum Wage (1995). For a response, see David Neumark & William Wascher, Minimum Wages and Employment: A Case Study of the Fast-Food Industry in New Jersey and Pennsylvania: Comment, 90 Am. Econ. Rev. 1362 (2000).

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