

## PROFESSOR RICHARD EPSTEIN AND THE NEW ZEALAND EMPLOYMENT CONTRACTS ACT: A CRITIQUE

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Penelope Brook, one of the major proponents of radical reform in the New Zealand labor law system, has characterized the New Zealand Employment Contracts Act (ECA) as an “incomplete revolution.”<sup>1</sup> She argues that this “incompleteness” stems from the retention of a specialist labor law jurisdiction and the failure to frame the Act around the principle of contract at will.<sup>2</sup> The emphasis placed on these two issues—specialist jurisdiction and contract at will—demonstrates the influence arguments made by Chicago Law Professor, Richard Epstein, have played on labor law reform in New Zealand. Despite reservations about its final form, Brook gives her support to the ECA, precisely because it operationalizes some of Epstein’s ideas.

It has been generally acknowledged that ideas like those of Epstein played a significant role in the introduction of the ECA in New Zealand. However, while critics of the ECA have acknowledged the importance of Epstein’s ideas in the debate which led up to the passing of the Act, few attempts have been made to outline clearly or critique Epstein’s views. This Paper attempts to fill this lacuna by providing a critique of the behavioral assumptions that Epstein brings to his analysis of labor law. The first sec-

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1. Penelope Brook, *New Zealand’s Employment Contracts Act: An Incomplete Revolution*, 7 POLICY 6 (1991); see also Penelope Brook-Cowen, *Labor Relations Reform in New Zealand; The Employment Contracts Act and Contractual Freedom*, 14 J. LAB. RES. 69 (1993) [hereinafter *Labor Law Reform in New Zealand*]; and Penelope Brook-Cowen, *Neoliberalism*, in NEW ZEALAND POLITICS IN TRANSITION (Ray Miller ed., 1997), in which she argues that the ECA fails to meet the standard of contractual freedom that is required. The case made by Brook for the adoption of a contractual labor law system in New Zealand can be found in Penelope Brook, *Reform the Labour Market*, in ROGERNOMICS: RESHAPING NEW ZEALAND’S ECONOMY (Simon Walker ed., 1989) and PENELOPE BROOK, *FREEDOM AT WORK: THE CASE FOR REFORMING LABOUR LAW IN NEW ZEALAND* (1990) [hereinafter *FREEDOM AT WORK*].

2. *Id.*

tion of this Paper briefly outlines the context within which Epstein's arguments were used to support the reform of labor law in New Zealand, in the period leading up to the introduction of the ECA, and in the subsequent criticisms by employer groups of the specialist jurisdiction. The second section reviews Epstein's attack on a specialist jurisdiction for labor law, his view that a simplified common law is an adequate basis for the regulation of the employment relationship, and his advocacy of contract at will as the basis for an efficient and equitable employment relationship. It demonstrates that these conclusions are linked to two behavioral assumptions that lie at the heart of Epstein's social and political philosophy—the theory of self-ownership and the theory of self-interest. The third section demonstrates how these behavioral assumptions have allowed Epstein to dismiss as ill founded criticisms made of his approach to labor relations by pluralist labor lawyers. The fourth section argues that Epstein's behavioral assumptions, and the subsequent conclusions he reaches about the employment relationship, constitute a problematic and flawed basis on which to frame labor legislation. The conclusion argues that empirical evidence concerning the impact of the ECA on social equity in New Zealand validates the criticisms of Epstein's behavioral assumptions.

#### EPSTEIN, THE ECA, AND THE SPECIALIST JURISDICTION DEBATE

The ECA represented a dramatic change in the legislative pattern of labor market regulation in New Zealand.<sup>3</sup> The origins of this dramatic change can be found in the economic problems facing New Zealand in the 1980s, and the particular response taken by policy makers to these economic problems. The New Zealand economy has been in a phase of long-term stagnation since the late 1960s. Dramatic falls in the terms of trade for traditional agricultural export products threatened the viability of the domestic defense model of economic development which had been developed in the 1930s.<sup>4</sup> Economic uncertainty and external shocks were met with increasingly interventionist state policies as the New Zealand government attempted to man-

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3. See Gordon Anderson, *The Employment Contracts Act 1991: An Employers Charter?*, 16 N.Z. J. INDUS. REL. 127 (1991); Kevin Hince & Martin Vranken, *A Controversial Reform of New Zealand Labour Laws; The Employment Contracts Act 1991*, 130 INT'L LAB. REV. 475; and Pat Walsh, *The Employment Contracts Act*, in *THE DECENT SOCIETY? ESSAYS IN RESPONSE TO NATIONAL'S ECONOMIC AND SOCIAL POLICIES* 64-69 (Jonathan Boston & Paul Daziel eds., 1992) [hereinafter *The Employment Contracts Act*] (overviews the ECA's provisions and consequences); see also Pat Walsh, *Employment Policy*, in *NEW ZEALAND POLITICS IN TRANSITION* (Ray Miller ed., 1997) [hereinafter *Employment Policy*] and Brook-Cowen, *Labor Relations Reform in New Zealand*, *supra* note 1, for differing accounts of the nature of the change in the pattern of labor market regulation associated with the introduction of the ECA.

4. BRIAN EASTON, IN *STORMY SEAS: THE NEW ZEALAND ECONOMY SINCE 1945* (1997); Brian Easton & Ralph Gerritsen, *Economic Reform: Parallels and Divergences*, in *THE GREAT EXPERIMENT: LABOR PARTIES AND PUBLIC POLICY TRANSFORMATION IN AUSTRALIA AND NEW ZEALAND* (Francis Castles et al. eds., 1996).

age its way through the economic crisis. By the early 1980s, the New Zealand economy was in a perilous position.<sup>5</sup>

In 1984, a newly elected Labour government set about dramatic reform of the New Zealand economy. The primary aim of these reforms was to restructure fundamentally the relationship between the state and the economy.<sup>6</sup> It did so by attempting to remove almost all government regulation and control of factor and product markets, and expanding the scope for market mechanisms to ensure efficient allocation of resources.<sup>7</sup> The adoption of this reform agenda reflected a number of factors. First, there was a widespread belief that there was no alternative, given the apparent failure of all forms of state regulation to resolve the economic problem in the Muldoon era. Second, the reform agenda stemmed from the influence of an increasingly powerful Treasury which had been fostering monetarist ideas since the early 1970s. Third, many in the Labour party leadership had an intellectual predisposition towards market-based solutions.<sup>8</sup> Finally, similar policy

5. See Herman Schwartz, *Can Orthodox Stabilisation and Adjustment Work? Lessons from New Zealand 1984-1990*, 45 INT'L ORG. 221, 235-38 (1991), for a detailed account of the economic problems facing the New Zealand government during the early 1980s; see Brian Easton, *From Run to Float: The Making of Rogernomics Exchange Rate Policy*, in THE MAKING OF ROGERNOMICS (Brian Easton ed., 1989), for details of the current crisis facing the newly elected Labour government in 1984. See also Robert Castle & Nigel Haworth, *The Economic Imperative for Restructuring in Australia and New Zealand*, in ECONOMIC RESTRUCTURING AND INDUSTRIAL RELATIONS IN AUSTRALIA AND NEW ZEALAND: A COMPARATIVE ANALYSIS (Mark Bray & Nigel Haworth eds., 1993), and Easton & Gerritsen, *supra* note 3, for a more general overview.

6. This issue has received considerable attention in the literature. See, as examples of the best work in relation to this issue, Brian Easton, *The Commercialisation of the New Zealand Economy: From Think Big to Privatisation*, in THE MAKING OF ROGERNOMICS (Brian Easton ed., 1989) [hereinafter *Commercialisation of the New Zealand Economy*]; BRIAN EASTON, THE COMMERCIALISATION OF NEW ZEALAND (1997); JANE KELSEY, ROLLING BACK THE STATE: PRIVATISATION OF POWER IN AOTEAROA/NEW ZEALAND (1993); JANE KELSEY, THE NEW ZEALAND EXPERIMENT: A WORLD MODEL FOR STRUCTURAL ADJUSTMENT? [hereinafter THE NEW ZEALAND EXPERIMENT]; Conrad Blyth, *The Economists' Perspective of Economic Restructuring*, in ECONOMIC LIBERALISATION IN NEW ZEALAND (Allan Bollard & Robert Buckle eds., 1987); Jonathan Boston, *The Theoretical Underpinnings of Public Sector Restructuring in New Zealand*, in RESHAPING THE STATE: NEW ZEALAND'S BUREAUCRATIC REVOLUTION (Jonathan Boston et al. eds., 1991); Paul Daziel, *The Reserve Bank Act: Reflecting Changing Relationships between State and Economy in the Twentieth Century*, in STATE AND ECONOMY IN NEW ZEALAND (Brian Roper & Chris Rudd eds., 1993).

7. For an overview of the changes introduced, see chapters in ECONOMIC LIBERALISATION IN NEW ZEALAND (Allan Bollard & Robert Buckle eds., 1987); see also Schwartz, *supra* note 5, at 240-43.

8. In relation to the apparent failure of Keynesian economic policy, see Easton, *The Commercialisation of the New Zealand Economy*, *supra* note 6; and Geoff Bertram, *Keynesianism, Neoclassicism and the State*, in STATE AND ECONOMY IN NEW ZEALAND (Brian Roper & Chris Rudd eds., 1993). On the rise of monetarism and the power of the Treasury, see Jonathan Boston, *The Treasury and the Organisation of Economic Advice: Some International Comparisons*, in THE MAKING OF ROGERNOMICS (Brian Easton ed., 1989); and Shaun Goldfinch & Brian Roper, *Treasury's Role in State Policy Formation during the Post War Era*, in STATE AND ECONOMY IN NEW ZEALAND (Brian Roper & Chris Rudd eds., 1993). On the predisposition of the leadership of the Labour Party for market-based reform, see Colin

agendas adopted by Reagan and Thatcher in the early 1980s had been apparently successful. However, the character of the New Zealand state, and in particular the almost unconstrained power of the executive concentrated in the Parliamentary cabinet to make legislative change, ensured that the reform program that followed the election of the Labour government was of a character unmatched in scale and scope in any developed market economy.<sup>9</sup>

Despite substantial reform of almost all aspects of the economy and attempts to foster the scope of market forces in most aspects of economic life, the New Zealand economy continued to perform poorly in the second half of the 1980s.<sup>10</sup> While some economists attributed this poor economic performance to the excessive focus on price stability at the expense of economic growth, attention increasingly focused on continued state intervention in the labor market as the final remaining impediment to the improved economic performance promised by the reforms.<sup>11</sup>

Labour had set about reforming most aspects of the economy during its first term in office, but labor market reform was delayed until its second term in office beginning in 1987. The 1987 Labour Relations Act was an attempt to increase the level of labor market flexibility but at the same time retain some of the protections of the traditional New Zealand industrial relations system. The changes introduced include forcing amalgamations of unions, removing reference to fixed relativities in the determination of award wages, and allowing unions to opt out of award coverage and negotiate workplace agreements with employers.<sup>12</sup> Walsh argues that the variance between the Labour Relations Act and the radical deregulation agenda in

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James, *The Policy Revolution: 1984-1993*, in *NEW ZEALAND POLITICS IN TRANSITION* (Ray Miller ed., 1997). Probably the best account for the origins of the post-1984 reform agenda is W. Hugh Oliver, *The Labour Caucus and Economic Policy Formation: 1981-1984*, in *THE MAKING OF ROGERNOMICS* (Brian Easton ed., 1989), which stresses the interaction of all these forces.

9. For these reasons, former Labour Prime Minister, Sir Geoffrey Palmer, characterized the New Zealand political system as one of "unbridled power." See GEOFFREY PALMER, *UNBRIDLED POWER: AN INTERPRETATION OF THE NEW ZEALAND'S CONSTITUTION AND GOVERNMENT* (2d ed. 1987).

10. See Paul Daziel, *National's Macroeconomic Policy*, in *THE DECENT SOCIETY? ESSAYS IN RESPONSE TO NATIONAL'S ECONOMIC AND SOCIAL POLICIES 20-31* (Jonathan Boston & Paul Daziel eds., 1992), for an overview of the New Zealand economy 1984-1990 and the financial crisis facing the incoming National government in 1990, respectively. See also Brian Easton, *Has Recent Economic Policy Succeeded?*, Address to the 1996 Biennial National Conference of the New Zealand Engineering, Printing and Manufacturing Union (Aug. 8, 1996) (on file with author), and *THE NEW ZEALAND EXPERIMENT*, *supra* note 6, at 243-70, for an overview of the reform process which questions the extent to which it has delivered economic benefits.

11. See, in particular, Daziel, *supra* note 10, at 23, for the view that excessive focus on price stability had undermined the prospects for economic growth; see Brook, *Reform the Labour Market* and *FREEDOM AT WORK*, *supra* note 1, for the argument that lack of flexibility in the labor market was preventing the realization of improved economic performance promised by reforms in other sectors of the economy.

12. See JOHN DEEKS & PETER BOXALL, *LABOUR RELATIONS IN NEW ZEALAND* 41-56 (1989), for an overview of the changes introduced in the 1987 Labour Relations Act.

other factor and product markets can be understood as a rear guard action by unions, members of the New Zealand Labour Party, and the bureaucracy concerned with the effects of deregulation in other areas of the economy.<sup>13</sup>

Immediately after the Labour Relations Act was passed, the New Zealand Business Roundtable (BRT) began a public campaign for more radical reform of the labor market.<sup>14</sup> Penelope Brook's work represents the most sophisticated of the arguments put forward by those associated with the BRT in this period. She argued that the failure of the economic reforms introduced by Labour during the second half of the 1980s could be largely attributed to the failure to reform the labor relations system. In particular, she argued that "there is little evidence that the new legislation [the Labour Relations Act] is a means to the kind of rapid evolutions in employment relationships made necessary by fundamental restructuring in other areas of the economy."<sup>15</sup> This, she argued, was because "the essentials of the system remained . . . largely untouched. [T]he assumption that monopoly unionism, supported by the state, was the way to go about promoting the interests of workers in the employment relationships went largely unchanged."<sup>16</sup>

On the basis of a sustained critique of the effects of state-sponsored union monopoly status on equity and economic efficiency, Brook proposed an alternative labor statute based on freedom of contract as a "philosophically and theoretically consistent alternative to New Zealand's current labor market arrangements."<sup>17</sup> Brook's alternative contractual labor market order drew almost exclusively from Epstein's writings on labor relations.<sup>18</sup> Brook argued that the adoption of a contractual labor market order

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13. Pat Walsh, *A Family Fight? Industrial Relations Reform Under the Fourth Labour Government*, in *THE MAKING OF ROGERNOMICS* (Brian Easton ed., 1989).

14. Walsh, *The Employment Contracts Act*, *supra* note 3, at 62. The BRT's objectives for reform were first expressed in New Zealand Business Roundtable, *NEW ZEALAND LABOUR MARKET REFORM: A SUBMISSION IN RESPONSE TO THE GREEN PAPER* (1986). The BRT is an organization consisting of the chief executive officers of New Zealand's largest companies. It was formed in response to the perceived lack of big business influence on policy development. See John Wanna, *Centralisation without Corporatism: the Politics of New Zealand Business in the Recession*, 14 N.Z.J. INDUS. REL. 1, 6 (1989). By 1986, the BRT had appointed a full-time executive director who had previously been an Assistant Secretary of the Treasury and was able to use the extensive resources of its member companies to fund and promote a neo-liberal policy agenda. See Brian Roper, *A Level Playing Field? Business Political Activism and State Policy Formation*, in *STATE AND ECONOMY IN NEW ZEALAND* 163 (Brian Roper & Chris Rudd eds., 1993). Penelope Brook was a senior policy adviser to the BRT from 1987-1990. She played a leading role in the development of the BRT's case for labor market deregulation in New Zealand during this period, and her book, *FREEDOM AT WORK*, *supra* note 1, represents the culmination of theoretical cases put forward by the BRT in this period.

15. *FREEDOM AT WORK*, *supra* note 1, at 82.

16. *Id.* at 27.

17. *Id.* at 129.

18. *Id.* at 94-129. The contractual order proposed by Brook is drawn almost exclusively from Richard Epstein, *A Common Law for Labor Relations: A Critique of the New Deal Labor Legislation*, 92 YALE L.J. 1357 (1983) [hereinafter *A Common Law for Labor Relations*], and Richard Epstein, *In Defense of Contract at Will*, 51 U. CHI. L. REV. 947 (1984)

would both improve economic performance and ensure better standards of equity.<sup>19</sup> It was this analysis, shaped heavily by a reading of Epstein's ideas, which formed the basis of the policy statements made by BRT representatives in the media and in policy forum.<sup>20</sup>

The BRT provided the National government, elected in 1990, with an explanation of why the previous reforms had not worked and a clear policy agenda for further reform. Faced with a serious financial crisis and continued poor economic performance, the National government was responsive to these ideas. It was in this particular context that Epstein's views on labor law came to dominate labor market policy formation.<sup>21</sup> Based on this view that a contractual order in the labor market could achieve economic efficiency, National introduced the ECA—"an Act designed to promote an efficient labor market and in particular, (a) to allow for freedom of association; (b) to allow employees to determine who should represent their interests in relation to employment issues."<sup>22</sup>

While the BRT was able to influence the general thrust of the ECA, it was not successful in gaining all of the changes it wanted. In particular, the ECA retained a specialist jurisdiction for labor law. As Walsh and Ryan argue, this provision reflected the outcome of alterations made to the initial policy proposals in the process of moving from Bill to Act.<sup>23</sup> In the face of defeat over the retention of the specialist institutions and the perceived failure of the Employment Court to interpret the statute in line with parliament's intention, employer groups, and especially the BRT, have led an almost continuous attack on the specialist jurisdiction.<sup>24</sup> Criticisms of both the existence of the Employment Court, as a specialist body, and the nature of its decisions, in particular in relation to its failure to allow freedom of con-

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[hereinafter *In Defense of Contract at Will*].

19. FREEDOM AT WORK, *supra* note 1, at 129-60. For a replication of these arguments by members of the BRT, see references given in Ellen Dannin, *Consummating Market Based Labor Law Reform in New Zealand: Context and Reconfiguration*, 14 B.U. INT'L L.J. 267, at 303, n.180.

20. This issue is addressed in more detail in Nick Wailes, *The (Re)discovery of the Individual Contract of Employment in Australia and New Zealand*, in *INDIVIDUAL CONTRACTS AND WORKPLACE RELATIONS* (Andrew Frazer et al. eds., 1997).

21. Dannin, *supra* note 19, at 303, goes further to argue that "the main intellectual source of the ECA can be traced back directly to the United States and almost exclusively to one article by Richard Epstein," namely *In Defense of Contract at Will*.

22. Employment Contracts Act, 1991 (N.Z.).

23. Pat Walsh & Rose Ryan, *The Making of the Employment Contracts Act*, in *EMPLOYMENT CONTRACTS: NEW ZEALAND EXPERIENCES 23-28* (Raymond Harbridge ed., 1993); Rose Ryan & Pat Walsh, *Common Law v. Labour Law: the New Zealand Debate*, 6 AUSTL J. LAB. L. 230, 243-51 (1993).

24. See, e.g., *THE LABOUR EMPLOYMENT COURT: AN ANALYSIS OF THE LABOUR/EMPLOYMENT'S COURT APPROACH TO THE INTERPRETATION AND APPLICATION OF EMPLOYMENT LEGISLATION* (N.Z. Business Roundtable & Employers' Federation, 1992); Colin Howard, *THE INTERPRETATION OF THE EMPLOYMENT CONTRACTS ACT 1991* (N.Z. Business Roundtable & Employers' Federation, 1995); and Bernard Robertson, *The Arguments for a Specialist Employment Court in New Zealand*, 21 N.Z.J. INDUS. REL. 34 (1997).

tract or permit enforcement of contract at will, reflect the continued influence of Epstein's theories on the labor law debate in New Zealand.

### EPSTEIN'S COMMON LAW FOR LABOR RELATIONS

The previous section has argued that Epstein's ideas on labor relations came to play such an important role in policy development because of the particular economic and political context in New Zealand at the end of the 1980s. His ideas have also continued to play a dominant role in the ongoing criticisms by business groups of the institutions created by the ECA. This implies that an effective critique of the ECA needs to be based on a critique of Epstein's "common law for labor relations."<sup>25</sup> The following section briefly outlines the key features of Epstein's approach to labor relations.

Epstein argues that efforts to regulate the employment relationship through specialist institutions have produced perverse, suboptimal, and discriminatory outcomes in the labor market.<sup>26</sup> He advocates the replacement of all interventionist labor statutes by a minimal code which merely states the common law principles that ought to apply to the employment relationship and the abandonment of all specialist jurisdictions for labor law.<sup>27</sup>

Central to Epstein's argument is his particular definition of common law. He defines the common law as the best set of private law principles that can be devised to handle the problems of labor relations.<sup>28</sup> He is not referring to common law as it is understood in its technical legal sense. Rather his argument for "a" common law for labor relations is based on his view of how the common law ought to function and the principles on which it ought to be founded. Epstein's claim that, apart from an "unfortunate early flirtation with the law of criminal conspiracy," the common law proper took a very sound position in regulating the employment relationship in the last quarter of the nineteenth century, reflects his belief that the decisions made by courts in this period most closely approximated his view of how the common law ought to function.<sup>29</sup>

Epstein's advocacy of a common law for labor relations stems from his view that common law principles are based on a sound understanding of human behavior and can effectively deal with a broad range of possible outcomes in the labor market.<sup>30</sup> First, common law principles, as he defines

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25. Epstein, *A Common Law for Labor Relations*, *supra* note 18; see also Richard Epstein, *Unconscionability: A Critical Appraisal*, 19 J.L. & ECON. 293 (1975), for the development of similar ideas in relation to torts.

26. Epstein, *A Common Law for Labor Relations*, *supra* note 18, at 1362-63, 1402; for Epstein's detailed assessment of the detrimental consequences of specific unfair labor practices in U.S. labor law, see *supra*, at 1386-1402.

27. *Id.* at 1403; see also RICHARD A. EPSTEIN, *SIMPLE RULES FOR A COMPLEX WORLD* 151-69 (1995).

28. Epstein, *A Common Law for Labor Relations*, *supra* note 18, at 1359.

29. *Id.* at 1364.

30. *Id.* at 1359. In particular he attempts to show that unions can be accommodated

them, are based on the assumption that “every person owns his own person and can possess, use and dispose of his labor on whatever terms he sees fit.”<sup>31</sup> The application of the law of property and the law of torts to employment relationships allows the establishment of a set of original entitlements which provide the basis for voluntary transactions between workers and employers.<sup>32</sup> Second, he argues that, in employment relationships, humans act to maximize their self-interest.<sup>33</sup> He argues that the law of contract—with its acceptance of the mutual benefits of voluntary transactions, its ability to define the legality of contracts, and to determine the capacity of individuals to enter a contract—is well suited to regulating relationships between self-interested individuals.<sup>34</sup>

On the basis of these assumptions, Epstein argues that a common law statute can create a set of original entitlements and framework within which private transactions between self-interested individuals can make mutually beneficial transactions.<sup>35</sup> He argues that because the decision to become an employer or an employee is a private act, based on preferences for risk, the identity of the parties to voluntary transactions in the labor market should be of no special concern to the state and ought not to be the occasion for an increase of state regulation of private transactions.<sup>36</sup> This implies that the role of the state ought to be limited to the faithful enforcement of voluntary transactions reached between self-interested and self-owning individuals. The extension of this argument is that there is no need for a specialist labor law or specialist institutions with expertise in labor matters.

Therefore, it can be argued that Epstein’s approach to labor relations, which has been so influential in policy debates about labor market reform in New Zealand, stems from a particular definition of how the common law ought to function. Epstein’s view of how the common law ought to function

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within such a framework and that both the closed shop and “yellow dog” contracts can be concluded within such a framework. However, he argues that such a system implies no right to strike, being simply breach of contract, and in most circumstances picketing ought not be tolerated because of the inextricable mixture of speech and violence in such situations. *Id.* at 1367-79 & at 1382-86.

31. *Id.* at 1364.

32. *Id.* at 1359.

33. *Id.* at 1407.

34. In fact, Epstein is a strong advocate for the return to the contract at will doctrine in the employment relationship in the absence of a specific agreement. Epstein, *In Defense of Contract at Will*, *supra* note 18, at 951-53, 979-82. He rejects the notion that the contract at will leaves employees open to exploitation and coercion. *Id.* at 948-51. He argues that the contract at will respects the freedom of individuals to bargain on whatever terms they see fit. Furthermore, Epstein argues, the power of either party to end the contract at any time prevents abuse of the relationship. This reflects Epstein’s view that the notion of unequal bargaining power confuses economic inequality with economic duress. He argues that such a view is tantamount to arguing that all bargains involve duress. See Epstein, *A Common Law for Labor Relations*, *supra* note 18, at 1367-69.

35. *Id.* at 1365-56.

36. *Id.* at 1366; see also Richard Epstein, *The Varieties of Self Interest*, 8 SOC. PHIL. & POL’Y 102, 104, 112 (1990) [hereinafter *The Varieties of Self Interest*].



is based on two assumptions about the nature of human action- that individuals are self-owning and that in employment relationships individuals act to maximize their self-interest. It is the derivation of "a common law for labor relations" from these behavioral assumptions which Epstein believes renders criticisms of his approach by pluralist labor lawyers meaningless.

### EPSTEIN AND THE PLURALIST CRITIQUE

Epstein has been the subject of a number of criticisms from industrial lawyers in the United States.<sup>37</sup> Broadly, these critiques have focused on two issues. First, they have argued that Epstein's presentation of the common law as if it is unchanging is a major flaw in his argument. Getman and Kohler argue that this presentation masks the limited time period in which contract doctrine governed the employment relationship.<sup>38</sup> They argue that the labor relations legislation that Epstein is so hostile to represents a reapplication of the traditional master and servant legal forms that dominated employment law before the intellectual experiment of using contract law.<sup>39</sup> Verkuil puts forward a second, and related, criticism, arguing that Epstein misrepresents the way in which the common law has dealt with employment relationships in the period when the contract doctrine operated and, therefore, fails to understand the reason that the employment relationship was taken away from the jurisdiction of the common law courts.<sup>40</sup>

However, Epstein dismisses these objections as misguided.<sup>41</sup> He characterizes the weakness of the pluralist position as essentially empirical and without a clear theoretical base. More importantly, in this context, he rejects the view that how the common law has functioned in the past is of any relevance to what he advocates. Epstein is not only interested in repealing the Wagner Act (and by extension specialist jurisdiction for labor law generally), but also in purifying the common law itself of intrusions that do not

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37. The following discussion deals specifically with the responses made directly to *A Common Law for Labor Relations*, *supra* note 18, in the same issue of the journal in which it first appeared. Epstein has been criticized by others, most notably Paul Weiler, GOVERNING THE WORKPLACE: THE FUTURE OF LABOR AND EMPLOYMENT LAW 56-63, 119-24 (1990). The aim of the following discussion is not to deny the validity of the criticisms made by these authors, but rather to demonstrate the extent to which assumptions made by Epstein allow him to dismiss these criticisms. My position is that a defense of specialist labor legislation and jurisdiction needs to be based first and foremost on an assessment of the acceptability of the assumptions from which Epstein proceeds.

38. Julius Getman & Thomas Kohler, *The Common Law, Labor Law and Reality: A Response to Professor Epstein*, 92 YALE L. REV. 8, 1409-14 (1983); see also Walsh & Ryan, *Common Law v. Labour Law*, *supra* note 23.

39. *Id.* at 1417-26.

40. Paul Verkuil, *Whose Common Law for Labor Relations? Comment on Epstein*, 92 YALE L. REV. 8, 1409-14 (1983); see also Walsh & Ryan, *Common Law vs. Labour Law*, *supra* note 23, for a presentation of these criticisms in the New Zealand context.

41. Richard Epstein, *A Common Law for Labor Relations and Reality: A Rejoinder to Professors Getman and Kohler*, 92 YALE L.J. 1435 (1983).

directly relate to the theory of entitlements outlined above. Therefore, the way in which the common law proper has dealt with the employment relationship prior to the development of contract is not his concern. Rather, he argues that these features of the common law ought to be done away with because they are not linked to the theory of entitlements.<sup>42</sup> Epstein argues that one of the specific impurities in the common law is the view that there is a need for a separate body of law or separate institutions to deal with what are essentially matters of property relations, like employment.<sup>43</sup>

The second criticism leveled at him—that he fails to take account of the historical circumstances under which the jurisdiction of labor law was taken away from the common law courts—he believes is also wide of the mark. Epstein sees the actions of the courts in the period leading up to Wagner as demonstrating the need to reduce judicial activism and a reflection of the rapid pace of social change.<sup>44</sup> It was not, he argues, a demonstration of any inherent failing of common law principles to deal with the employment relationship. Epstein's argument is that it is this mistaken assumption—that the common law cannot effectively deal with employment relationships—which is the source of the failure of modern industrial relations systems to promote efficient employment relationships.<sup>45</sup> On this basis, Epstein is opposed to any notion of change or development in the common law itself. This can be seen in the way he defines the common law. He does not view it as a body of law based on precedent but the best (single) set of principles derived from the "libertarian and utilitarian traditions of Locke, Bentham and Mill."<sup>46</sup> Furthermore, in line with his view that contract law is closely related to human nature, Epstein does in fact argue that the common law should be static around the theory of entitlements, therefore rejecting the importance of accounts of how the common law has functioned.<sup>47</sup> Epstein is not interested in how the common law has functioned, but rather in how it should function. Much of the confusion caused by Epstein's argument about labor relations revolves around this point. In fact, he is not talking about the common law proper, but rather a common law based on libertarian principles of human action.

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42. Epstein, *A Common Law for Labor Relations*, *supra* note 18, at 1360; and Richard A. Epstein, *The Static Conception of the Common Law*, 9 J. LEGAL STUD. 253, 254-56 (1980).

43. Epstein, *The Static Conception of the Common Law*, *supra* note 42, at 255; EPSTEIN, *SIMPLE RULES FOR A COMPLEX WORLD*, *supra* note 27, at 151-53; RICHARD EPSTEIN, *TAKINGS: PRIVATE PROPERTY AND THE POWER OF THE EMINENT DOMAIN* 279-81 (1985); Richard Epstein, *Towards a Revitalization of the Contracts Clause*, 51 U. CHI. L. REV. 703, 729 (1984).

44. Epstein, *A Common Law for Labor Relations*, *supra* note 18, at 1363-69.

45. *Id.* at 1360-63, 1400-03; Epstein, *A Common Law for Labor Relations and Reality*, *supra* note 41, at 1435-37, 1441; EPSTEIN, *SIMPLE RULES FOR A COMPLEX WORLD*, *supra* note 27, at 154 and 163-64.

46. *Id.* at 1435.

47. Richard A. Epstein, *The Static Conception of the Common Law*, 9 J. LEGAL STUD. 253 (1980).

Clearly, then, criticisms of the type put forward by Getman, Kohler, and Verkuil do not correctly identify what Epstein believes to be the source of his case for a common law for labor relations. They do not acknowledge the link that Epstein makes between an understanding of human behavior and the usefulness of common law principles. This is best understood in relation to the standard against which Epstein judges common law principles—individual freedom. “The protection of private contracts against government regulation is inseparably entwined with two elements—individual freedom . . . and the need to prevent legislative mis-behavior.”<sup>48</sup> He sees the “importance of contract as an end in itself . . . (because it implies) the respect of individual liberty. It is unjust to abridge the economic liberties of an individual.”<sup>49</sup> By not confronting this relationship, Getman, Kohler, and Verkuil fail to understand the nature of Epstein’s challenge to pluralism.

#### SELF-INTEREST AND SELF-OWNERSHIP

This section argues that Epstein’s behavioral assumptions are extremely problematic and that any analysis based on them is seriously flawed. How can Epstein claim that “the decision to become an employer or an employee is an entirely private one based on individual preference for risk?”<sup>50</sup> This statement disarms much of the pluralist critique because it denies the fundamental assumption that an imbalance of power exists in the employment relationship and that this imbalance is the source of conflict in the workplace. However, Epstein’s claim is not an unproblematic notion, but rather represents the summary of a complex set of behavioral assumptions which need to be examined further.

Epstein asserts that the most important features of human action, in most situations, are best understood by the theory of self-interest.<sup>51</sup> He argues that the normative basis of social and political philosophy ought to be derived from this positive (descriptive) observation.<sup>52</sup> Epstein’s self-interest thesis can be summarized as follows. In a wide variety of human activities, human action is best explained not by using social categories but rather by concentrating on biological factors. He argues that what is particular to humans, and therefore what constitutes their nature, is that they will maximize their self-interest within certain moral, legal, and social constraints.<sup>53</sup> This he believes follows from the selection of the genotypes which maximize self-interest as a means of survival. He moderates this “standard model of self-interest” with a number of devices, such as inclusive fitness and imperfect obligation, but argues that in a situation of voluntary exchange between

48. Epstein, *Towards a Revitalization of the Contract Clause*, *supra* note 43, at 717.

49. *In Defense of Contract at Will*, *supra* note 18, at 951.

50. *A Common Law for Labor Relations*, *supra* note 18, at 1366.

51. Epstein, *The Varieties of Self Interest*, *supra* note 36, at 102.

52. *Id.* at 102.

53. *Id.*

strangers, as in the employment relationship, a standard model of self-interest most accurately predicts behavior.<sup>54</sup> On the basis of this formulation, Epstein attempts to assess the normative implications of self-interest—distinguishing the constant and variable features of human nature to determine the social arrangements that hold the greatest long-term social advantage. This “requires an understanding of the interaction between the self interest constant and diverse natural endowments.”<sup>55</sup> He argues that the persistence of self-interest and variations in preferences is the strongest justification for the use of a decentralized system of property allocation, and therefore a common law regime based on these principles.<sup>56</sup>

Using the biological derivation of self-interest and the argument that (genetic) diversity produces differences in preferences and tastes for risk, he is able to argue that some individuals assume the nature of employees and others of employers depending on their initial (biological) endowments.<sup>57</sup> The fact that an employer has a higher taste for risk allows him/her to have a greater say over the decisions in the business. Unlike Nozick, Epstein acknowledges that voluntary exchanges generate negative externalities, but asserts that these are reduced as voluntary exchanges become routine for broad classes of transactions.<sup>58</sup> Therefore, a common law for labor relations allows for predictability and reduces externalities from exchange. Further, he argues that a system based on private property and individual liberty will generate the closest approximation to the Pareto optimal social contract, given natural differences in preferences that cannot be measured.<sup>59</sup>

A number of problems with Epstein’s theory of self-interest raise doubts about its usefulness. Epstein’s model stems from the application of socio-biology to his social and political philosophy.<sup>60</sup> Rosenberg argues that, for socio-biology to have any normative influence, it has to address two key issues.<sup>61</sup> First, it must show that the naturalistic fallacy can be overcome by demonstrating how a purely factual property of organisms can “underwrite their status as agents or loci of intrinsic value.”<sup>62</sup> Second, if this can be achieved, it must show that this property is common and peculiar to all hu-

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54. “Inclusive fitness holds that all organisms act to maximize not only their individual fitness, but the fitness of their entire genetic line as well.” *The Varieties of Self Interest*, *supra* note 36, at 102. Imperfect obligation refers to religious belief, caring activity, etc. This is a device that Epstein takes from socio-biology as a means of dealing with the difficulties that a simple egoistic assumption poses for his analysis.

55. *Id.* at 103.

56. *Id.* at 104-05.

57. *Id.* at 112-14.

58. *Id.* at 117; ROBERT NOZICK, *ANARCHY, STATE AND UTOPIA* (1974).

59. *The Varieties of Self Interest*, *supra* note 36, at 117.

60. *Id.*; EPSTEIN, *TAKINGS: PRIVATE PROPERTY AND THE POWER OF THE EMINENT DOMAIN*, *supra* note 43, at 1341, n.19.

61. A. Rosenberg, *The Biological Justification of Ethics: A Best Case Scenario*, 8 *SOC. PHIL. & POL’Y* 86 (1990).

62. *Id.* at 88. The naturalistic fallacy applies to any inference that purports to derive a normative conclusion from purely factual premises.

mans so that it will count as constituting our nature. This is exactly what Epstein tries to do. He deliberately ignores the critiques of Moore and Hume, and explicitly seeks to derive "ought" from "is." He uses the biological constant of self-interest to satisfy the second condition. However, Rosenberg argues that models that use socio-biology cannot satisfy this second condition because socio-biology's underlying tenet is that there is no such property common and peculiar to each member of the species; rather, they require variation both within and between species.<sup>63</sup> Therefore, it is not clear that the idea of a self-interest residual, which is so important in Epstein's argument, is consistent with a socio-biological methodology.

In the absence of being able to establish any direct normative importance, Rosenberg argues that the most that can be expected from these types of models is to tell a plausible story, but questions the value of such an exercise.<sup>64</sup> In effect, Epstein's model confronts the genetic fallacy—to infer that a particular normative conclusion is right or well grounded from a purely causal account of its origins. Epstein's model of self-interest, therefore, is severely limited in its ability to underpin normative conclusions.

Given the role biological foundations play in Epstein's work on labor relations, it is important to provide an alternative evaluation of self-interest. Lewontin argues that models like the one considered here reflect the need for bourgeois society to explain continued inequalities that exist in a market society.<sup>65</sup> Epstein's work on labor relations seeks to justify, or dismiss as unimportant, the inequalities that exist in employment relationships. Lewontin argues that "the ideology of equality has become a weapon for, rather than a weapon against, a society of inequality by relocating the cause of the inequality from the structure of society to the nature of individuals."<sup>66</sup> It is possible to situate this project in Epstein's work. He expresses the inequalities that exist between individuals in terms of the process of natural selection, but at the same time argues that the only basis for assessing the employment relationship is on the basis of equality and the common law principle of not considering the positions of the parties to a contract, independent of the functioning of that contract.

Epstein's self-interest thesis conforms to the three features of a biologically deterministic argument. He locates inequality in the genetic inheritance of the individual. Thus, he attributes an intrinsic merit and ability to those who are better off—in this case, employers. Second, because merit and ability are coded for in an individual's genes, they are passed from generation to generation. Lewontin argues that this construction confuses the two meanings of inheritance—monetary and genetic, legitimizing the pas-

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63. E. WILSON, *SOCIOBIOLOGY: THE NEW SYNTHESIS* (1975).

64. Rosenberg, *supra* note 61, at 89, 90.

65. Richard Lewontin et al., *Bourgeois Ideology and the Origins of Biological Determinism*, 8 *RACE & CLASS* 1, 5 (1982).

66. *Id.*

sage of social power from generation to generation.<sup>67</sup> Third, Epstein uses the presence of genetic differences to explain the development of hierarchical structures as natural. In doing so, Epstein falsely equates innate with unchanging and wrongly assumes that he can overcome the naturalistic fallacy.

The second behavioral assumption that Epstein relies on is that of self-ownership. The key to his argument that the common law, as he defines it, can effectively deal with the employment relationship is his ability to assume that all people own their own labor and can dispose of it as they see fit. In other words, he seeks to reduce employment to a matter of exchanges of property rights. This view runs counter to the pluralist position that labor is not simply a factor of production. Brook, who relies heavily on Epstein, argues that to say that labor is a commodity is simply to say that it has value.<sup>68</sup> This model can be characterized as one which is structured around a Lockean "person." Epstein, in relying on self-ownership, places the ideal-typical "person" developed by Locke at the heart of his argument. Levine argues that the profound changes associated with the development of a market society in the seventeenth century required the development of ideal-typical types to act as both a spur to acceptance of a market society and to justify the inequalities that a market society produced.<sup>69</sup> MacPherson argues that Locke's great achievement was to justify continued inequality in the face of a formal equality, and that the means by which he did this was in arguing that each individual owned his or her own labor.<sup>70</sup> Because self-ownership is not inconsistent with the right to alienate one's labor in return for a wage, MacPherson argues, unequal property is a natural feature that exists prior to the formation of civil society. To partake in a market society, individuals had to have initial endowments. Therefore, Locke's ideal typical type assigned (differential) initial endowments to the (pre-social) state of nature. Epstein uses socio-biology to construct these pre-social differences. Levine argues that this formulation excludes any notion of inequality from the analysis, because inequities are seen as a function of nature and not society.<sup>71</sup> Therefore, Epstein's use of self-ownership allows him to claim that there is no inequality in the employment relationship.

Furthermore, even given the general problems associated with using a Lockean person, there are a number of specific problems with the way Epstein uses and constructs this ideal typical type that undermine his behavioral assumptions. The first problem with Epstein's use of the Lockean person is that he employs this device on the basis of weak informational constraints about the slope of preferences, rather than on the basis of moral

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67. *Id.*

68. Brook, *FREEDOM AT WORK*, *supra* note 1, at 13.

69. A. Levine, *Capitalist Persons*, 6 *SOC. PHIL. & POL'Y* 39, 39-43 (1988).

70. C.B. MACPHERSON, *THE POLITICAL THEORY OF POSSESSIVE INDIVIDUALISM: HOBBS TO LOCKE* 198-262 (1962).

71. Levine, *supra* note 69, at 53-55.

*a priori*, as Nozick does.<sup>72</sup> This creates significant confusion in his argument. Epstein excludes the state from having a useful role in regulating the employment relationship because it lacks the necessary information about the slope of preferences of individuals, but does not exclude this possibility in theory. Therefore, his reversion to a Lockean formation is a secondary device. However, his analysis then proceeds from a position which assumes the existence of the individual prior to the social—thus assuming that the Lockean person is primary.<sup>73</sup>

A second, and related problem, is Epstein's reconstruction of the status of appropriation in the Lockean framework. Locke argued that individuals had the right to the product of their labor as long as there was as much and as good left for others. However, as Epstein notes, in a world of scarcity, this condition is impossible to satisfy.<sup>74</sup> He, therefore, uses a welfare constraint—normally known as a Lockean proviso. The appropriation of internal resources, generated through self-interest, does not affect the welfare of others because they are not accessible to others. However, external appropriation is more problematic, because as he has already acknowledged, scarcity prevents satisfaction of the sufficiency principle. He attempts to overcome this problem by arguing that the extension of voluntary transactions limits the welfare losses associated with external appropriation. However, it is not at all clear that self-ownership necessarily implies justifiable control over external resources, except where it is already assumed that a market society exists and that the outcomes of market exchange are just. Cohen demonstrates that, even where individuals are self-owning, joint control of external resources can result in an equal distribution.<sup>75</sup> This is contrary to Epstein's implicit assumption that self-ownership necessitates a hierarchical social structure. Broadly, the status of self-ownership in Epstein's model is uncertain and confused, and the logical consistency that he claims for his analysis of labor relations relies on poorly constructed behavioral assumptions.

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72. EPSTEIN, TAKINGS: PRIVATE PROPERTY AND THE POWER OF THE EMINENT DOMAIN, *supra* note 43, at 334-48; Nozick, *supra* note 58, at 174-82.

73. The position adopted here is similar to that taken by Charles Fried: "Only by assuming that the preexisting common law system of property rights had some natural, pre-conventional status can the expropriatory thrust of the Wagner Act . . . be criticized. . . . What Epstein needs, but in my view does not provide, is an account of the relevant property rights that shows why they are pre-conventional and why they should be protected from government tampering." Charles Fried, *Individual and Collective Rights in Work Relations: Reflections on the Current State of Labor Law and its Prospects*, 51 U. CHI. L. REV. 1012, 1016-17 (1984).

74. RICHARD EPSTEIN, TAKINGS: PRIVATE PROPERTY AND THE POWER OF THE EMINENT DOMAIN (1984).

75. Gerry Cohen, *Nozick on Appropriation*, 150 NEW LEFT REV. 89 (1985); Gerry Cohen, *Self Ownership and Equality: Part II*, 3 SOC. PHIL. & POL'Y 77 (1986).

CONCLUSION: THE EFFECTS OF THE ECA AND EPSTEIN'S BEHAVIORAL  
ASSUMPTIONS

The consequences of a labor statute based on Epstein's ideas can be seen in the effects of the ECA in New Zealand since its introduction. The obvious effects of the ECA in New Zealand have been a dramatic decline in the level of trade union membership, a commensurate decline in the coverage of collective bargaining, and an almost total disappearance of multi-employer collective bargaining.<sup>76</sup> These outcomes were meant to result in an increase in economic efficiency.

The overall economic impacts of the ECA are less easy to identify, or to disentangle, from the effects of other policies or external factors.<sup>77</sup> Advocates of the ECA have been quick to argue that it has been largely responsible for recent improvements in the New Zealand economy by removing the remaining impediments to greater productivity.<sup>78</sup> Rejecting this view, Easton suggests that the major effect of the ECA has been to lower the shares of income going to labor and to suppress real wages, increasing profitability, not productivity.<sup>79</sup> Rasmussen finds in the period 1990-1994 productivity growth in New Zealand was 0.4 percent per annum on average.<sup>80</sup> This represented a deterioration of productivity performance in New Zealand from the 1984-1990 period, when it grew by 2.2 percent on average per annum. For Rasmussen, this poor productivity performance in New Zealand can be regarded as even more dismal than the raw figures suggest, because general recovery in the economy should have reinforced productivity growth.<sup>81</sup> Real wages over the period 1990 to 1996 have increased by only about 2 percent. When labor force composition effects and margins for error are taken into account, it is not possible to say whether real wages have increased at all.<sup>82</sup> Despite low productivity growth, Easton shows that real wages have not kept pace with this growth. Deflating real wages by productivity growth, he shows that this ratio has declined 4 percent since 1990, and concludes that it would not be unreasonable to attribute this decline to the ECA. Therefore, workers have not shared in the income they have helped to generate. This decline in the share of income going to labor can be regarded as contributing to the continued increase in income inequality in New Zealand during

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76. *Employment Policy*, *supra* note 3, at 282 (citing RAYMOND HARBRIDGE, *LABOUR MARKET REGULATION AND EMPLOYMENT: TRENDS IN NEW ZEALAND* (1994)).

77. *Id.* at 282-83.

78. See, in particular, WOLFGANG KASPER, *FREE TO WORK: THE LIBERALISATION OF NEW ZEALAND'S LABOUR MARKET STRUCTURES*, 51-52 (1996).

79. Brian Easton, *The Productivity Puzzle*, *THE LISTENER*, July 27, 1996, at 51.

80. Erling Rasmussen et al., *Industrial Relations and Labour Market Reforms in New Zealand*, in *HUMAN RESOURCE DEVELOPMENT OUTLOOK 1995-96: KEY HRD/ LABOUR MARKET ISSUES IN SELECTED ASIA-PACIFIC ECONOMIES* 157 (1995).

81. *Id.* at 158.

82. Brian Easton, *Does Free to Work Tell a True Story?* 2, 3 (unpublished paper, on file with author). This paper is a response to Kasper, *supra* note 78.



the 1990s.<sup>83</sup>

These adverse consequences of the ECA on social equity in New Zealand can be directly attributed to the way in which the ECA has been based on views like Epstein's. Epstein's case for the abolition of a specialist jurisdiction and the application of common law principles, as he defines them, to the employment relationship rest on a set of radical behavioral assumptions. This Paper has demonstrated a number of key features about Epstein's argument. It has shown that Epstein's case for the abolition of the specialist jurisdiction rests upon the thesis of self-interest and self-ownership, and that these behavioral assumptions cannot be sustained. Specifically, the theory of self-interest confronts the naturalistic fallacy. Without normative status, it simply operates in a deterministic fashion to exclude inequality from Epstein's analysis. Also, the use of the Lockean person is confused both in its status and its construction. The implication of this critique, which is confirmed by empirical evidence about the ECA, is that the application of the common law principles that Epstein advocates to employment relations are likely to have adverse effects on employees because they lack initial endowments.

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83. *Employment Policy*, *supra* note 3, at 282, 286; *see also* THE NEW ZEALAND EXPERIMENT, *supra* note 6, at 256-59.

