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Age Discrimination and Employment Law

The topic of discrimination in the law of employment is one of the growth industries of our time. The issue covers the gamut from race, to sex, to disability and to age. This last category is in its own way perhaps the most important because the dogged insistence that age be disregarded or de-emphasised in employment decisions cuts against the grain of the employment policy of virtually every well managed private firm. With a statute prohibiting mandatory retirement policies recently taking effect in New Zealand, the whole subject of age discrimination and employment law is even more topical than usual. As an outsider, I will not dwell in detail on the New Zealand statute, but will instead try to place the overarching issues in a wider international context. The problems surrounding anti-discrimination laws are far from unique to New Zealand and afflict many other countries, including the United States.

Contrasting philosophies in the labour market

On my first visit to New Zealand in 1990, I had a debate with trade unionist Martha Coleman over alternative employment regimes. One regime was the pay equity legislation, which had just been passed by the Labour government. The other was a liberal, free-contracting approach to employment law, which the New Zealand Business Roundtable and others were then promoting. This latter philosophy was soon to be seen reflected, albeit imperfectly, in the Employment Contracts Act 1991

(ECA). I was then, and still remain, a very strong proponent of that statute, at least by comparison with the regime it replaced, because it incorporated a much better framework for establishing employment relationships. By contrast, initiatives such as anti-discrimination legislation, including the prohibition of mandatory retirement provisions in contracts, should be seen as derogating from the general provisions and philosophy of the ECA.

My support for the Employment Contracts Act 1991 is based on the first principles of the most appropriate form of regulation to govern the employment relationship. It should be stressed that this is not advocating some anarcho-capitalist system in which the law takes absolutely no interest in employment contracts. The serious debate has always been between those who believe that the primary function of employment law is to respect the contractual terms emerging from a market transaction and to enforce those terms with the aim of providing contracts with greater stability, and those who believe that some of the contractual terms emerging from negotiations will be distorted or biased in ways that call for legal redress.

The pay equity legislation, happily repealed before it came into effect, represented a massive victory for the second philosophy which stressed the need for comprehensive government regulation. Its ambition was no less than to calculate every wage, in every contract, in every industry, in terms of some contemplated sense of the 'value' of one job relative to another. It was a bureaucratic nightmare that would have collapsed under its own weight had it been allowed to proceed.

While measures such as pay equity are clearly misconceived, it does not follow that we should proceed automatically to a system of completely free contracting in the labour market. We might still wish to impose some specific limitations on contractual freedom. Indeed there are reasons rooted in the common law not to enforce certain contracts, although most are relatively unimportant in the context of labour law. For instance, we need not concern ourselves with contracts designed to kill or maim third persons. Nor are we troubled by violations of antitrust or competition policy, which almost by definition cannot arise in individual contracts between employers and employees. Thus we face no problems arising from the external effects of contracts that might lead a legal system to deny their enforcement.

We might also choose not to enforce a contract if there has been some defect in the bargaining process. But a striking feature of employment contracts is that they are typically not tainted by fraud or duress. There are rarely any hidden or surprising conditions associated with them, and certainly none that requires a system-wide public response. On the contrary, employment contracts are designed to facilitate long-term relationships. People undertake their jobs day in and day out. At least after a while, they have good knowledge of their working conditions. In these settings with fairly full information, wages and other key terms of employment contracts are not likely to cause unfair surprise.

To the extent that sudden and unpleasant surprises do occur and alter the expectations on which a contract is based, the typical reaction is readily anticipated. Workers who find themselves short-changed in one job will simply leave for greener pastures elsewhere. It is this ability to quit – and the consequent cost to a firm of finding and training a replacement – which constrains employers in the labour market so efficiently. That is very clear from the history of New Zealand labour relations after the passage of the ECA – at least before its partial destruction by the Employment Court. The basic idea that contracts work for the mutual benefit of both parties (which I have sometimes called the Eleventh Commandment) has been borne out by experience under the Act.

Open markets penalise irrational discrimination

Adherents to the interventionist philosophical tradition have attempted to counter the movement towards a more liberal labour market. One part of their tradition is the legislation known as human rights laws in New Zealand and anti-discrimination laws in the United States. These laws are based on the assumption that employers are so irrational, so prejudiced and so unwise that they will turn down well-qualified applicants simply because they are blinded by some antiquated prejudice. In considering applications, employers find there are a wide variety of grounds that they are simply forbidden to take into account. Criteria such as race or sex have long been favourites for legislators in this tradition, while more recently grounds such as sexual orientation, disability and age have been added to the list.

In reality, the basic argument for freedom of contract is so strong that it leaves no role for human rights laws. While such a view is easily defended, it is regarded as very radical in some quarters. On my most recent visit to New Zealand, I defended the free contracting position in a debate with the chief human rights commissioner, Pamela Jefferies, in a way that she found rather shocking. But when analysing prejudice in employment markets, people such as Ms Jefferies make the mistake of assuming that markets are like politics. In politics there is one outcome that applies to everyone, and it tends to be determined by the attitudes and behaviour of the median voter. But the sentiments of a market are not uniformly determined by some 'average' or 'median' participant. There may be a market in which large numbers of people harbour all sorts of irrational and offensive prejudices. Yet as long as there is some segment of that market where people can be hired on the strength of their qualifications and ability to do a job, wages will not be lower in that sector. Provided there is open entry, any good worker who is temporarily neglected in one section of the market will find alternative employment elsewhere.

Of course, it may take some time before individual firms respond to competitive pressures. But ultimately a firm's prejudices will rebound to harm the firm more than the people it refused to hire. After all, it is simply not good business to refrain from hiring women or blacks on the basis of some irrational dislike of these groups. Once firms appreciate that fact, prejudices do not last very long. Thus if we observe persistent discrimination in some form, we should not automatically assume it is bad. Rather than banning it, we should ask ourselves why such discrimination might make sense in terms of the specific employment relationship. And before considering the legislative alternative, we should recognise that the rigidities that banning discrimination will produce in the end will increase the employer's search costs and the switching time for workers and employers alike. The positive search costs that discrimination may create are not simply eliminated by an anti-discrimination law, even one that is responsibly administered. Any 'for cause' requirement for hiring and firing will necessarily slow the time for hiring and force qualified applicants to jump over another set of hurdles that they cannot escape.

Given these general observations, I think it would be a mistake to assume all anti-discrimination laws have an equal impact on the day-to-day operation of the market. It is worth stressing that the most dangerous of all the human rights laws is potentially the prohibition on age discrimination. The reason hearkens back to my opening observations. In the absence of any human rights law, very few firms would have an explicit policy of saying 'no women welcome here', or 'no blacks welcome here', or 'no Jews welcome here'. That is not a clever way to attract business: in attracting a few people, the firm would guarantee that hundreds more would stay away. It would have worked a public relations wonder in reverse. Underneath the sign 'No Maori welcome here', a firm might as well hang the sign 'Liquidation in progress'.

But the practice regarding age discrimination is very different. Before the introduction of the anti-discrimination statutes in the United States, chief executives in their mid-50s were putting in place mandatory retirement policies for themselves and everybody else on their staff, including the senior staff with the greatest economic influence and power. If this practice was widespread, why should we assume collective irrationality in this part of the market? The answer is not that these business people were stupid and failed to understand the consequences of their decisions. The only parties that failed to understand the consequences were the legislatures that passed these statutes.

Ironically, it is the defenders of anti-discrimination laws who often accuse me of being out of touch. Time and again I am told: 'You cannot talk intelligently about labour relationships, Professor Epstein, because you have never been in business or managed a workforce. You are only a university professor, locked away in your ivory tower'. I fully accept the charge that I am ignorant about how many individual business people run their firms. But that is precisely the point. Suppose somebody in a legislature has actually worked in one job, at one place, at one time prior to taking public office. They now have (or, perhaps, had) an intimate knowledge of perhaps a handful of people in a particular business, whether in Christchurch or Chicago. What makes that person so confident about how to figure out the best employment policies for everybody else in New Zealand, the United States, or anywhere else?

The whole point about markets is that each of us has knowledge that only encompasses a very small part of the world around us. Whenever I hear politicians speak about universities, I take a deep breath. Indeed my knowledge of the University of Chicago does not translate easily into a working knowledge of its peer institutions. Similarly, if business people heard me pontificating about how they should organise their production lines or computer systems, they would breathe just as deeply. The point is that neither my views nor those of anyone else should rule absolutely in all New Zealand's factories and offices. If business people decide that a mandatory retirement age is not appropriate in their own business, they can eliminate it voluntarily. If they believe some extremely talented person should be exempt from a mandatory retirement rule, they can make that case to their chief executive. The fact that mandatory retirement rules have been in place over long periods of time suggests not that these policies are silly, but rather that they have a rationale sufficiently powerful to command broad support among businesses operating in a wide range of industries. Our job is to understand what that rationale is.

Naive assumptions by the regulators

The proponent of an anti-discrimination statute typically comes forward with a smooth and reassuring speech. 'We are eliminating arbitrariness in business', it goes. 'Arbitrariness is of course bad, and we are replacing it with a principle with which everybody agrees. We are simply requiring all employers to assess individual workers solely on their ability to do their job at any given time. Outmoded employment policies are replaced with merit assessments. Who is against merit?' Strangely enough, at this point nobody raises a hand. It is like asking whether anyone is against motherhood. The proposal is made to sound so reasonable that anyone who has been doing something different is by implication too ignorant to understand the strength of this progressive new idea.

However, the argument can only take this form if we make a particularly naive assumption about social behaviour: that one change in a legal rule leads to only one change in social consequences. Thus if we eliminate the mandatory retirement policy by legislation, everything else in the firm is expected to continue exactly as before. There will simply be splendid new merit-based assessments in place of the old policies, which were arbitrary and worthless. Businesses will be better off (despite having opposed the statute) and nobody will be worse off. Who can resist such an alluring outcome?

Unfortunately, similar arguments have been made in other contexts and have always been proved wrong. For instance, the attention of legislators too often falls on the minimum wage law. For them, raising the minimum wage can only have one consequence: it will raise to a new minimum level the wages of workers who were below that level, and nothing else will change. In reality, we know there will be other consequences. If the price of labour (ie the wage rate) rises, the quantity of labour employed by firms will fall, leading to a rise in unemployment. While the empirical studies show that the employment losses from the minimum wage are not quite as high as simple theory would predict, this does not mean that the negative consequences are not as great as claimed. It merely shows that the simple theory failed to incorporate all the other ways for firms to adjust their behaviour at the margin.

For instance, a firm might continue to employ the same number of workers after a rise in the minimum wage, but no longer provide free training. Instead it might require workers to enrol in training classes at their own expense before being hired. Or a firm that had given its workers the convenience of single shifts might now demand split shifts. Or it might now require its workers to purchase their own equipment, rather than pay for that equipment itself. There are hundreds of different ways in which the employment relationship can change. The idea that altering a single variable like the minimum wage will leave all other variables unchanged simply defies the laws of economics. It is like a physical scientist saying that salt can be added to a solution without changing the concentration of sodium and chlorine ions. Everything is elaborately interconnected. Any important perturbation to the system will have powerful consequences in many directions over the long term.

Exactly the same logic operates in the case of age-discrimination laws. We must ask ourselves: 'If we push here, where will the bulge appear? What changes will take place, and why?'. To answer those questions we need to consider why many firms had mandatory retirement rules in the first place. There are a variety of reasons. Some concern the relationship between the individual employee and the firm. Others concern the overall composition of a firm's workforce and its desire to keep its stock of human capital deployed over time in a reasonably coherent fashion.

Younger workers learn faster

Let us consider first individual workers. An ongoing problem for any firm is how to train its workers for tasks they will be performing in the future. It is a great illusion, to which academics are not immune, to imagine that only schools and universities provide education. Firms in fact supply huge amounts of training to their workers in various ways. Sometimes they take their workers for a weekend retreat where they teach them new computer systems. Other times it can be on-the-job instruction. When a firm makes investments in education and training, two features associated with the return from those investments are of obvious concern.

One is how quickly the new knowledge is absorbed by the relevant employees. My sons Benjamin and Elliot are aged 14 and 17. By comparison with them, I am a person with ten thumbs when it comes to learning new computer skills. They are simply much more adept at picking up modern technology than I am. They spend much of their lives surfing the Internet, whereas I spent most of my childhood with a manual typewriter, which is not a formula for acquiring quite the same set of skills. Thus when it comes to assimilating new types of information, people should recognise that younger employees can have very powerful advantages.

When investing in its workers, a firm faces certain decisions. It wants its older workers to keep performing those tasks that they do well. But it will probably not select those workers for training and development when new ventures and promising lines of innovation are involved. It is one of those truths that everyone knows but few people are prepared to acknowledge: flexibility and plasticity diminish with age, not in all cases, but surely on average; a large percentage of older workers are set in ways that are not easily altered or undone. New Zealand employers may need to speak to a local psychologist or physiologist to understand just why this is true. But they know from practical experience that it is true, and the fact that some politician dares them to state the obvious should not justify their remaining silent. They should plainly point out that the ability to learn new tricks is different at different age levels. This means that the responses of older persons will at some stage, and for some roles, be inferior.

There is a line of cases in the United States involving airline pilots who had been forced to retire as pilots at age 60 by the Federal Aviation Authority. When the time for retirement arrived, the pilots insisted on their right to be trained as flight engineers. So these 60-year-olds, who had been pilots all their lives, were put on the same training courses as navigation engineers in their mid-20s. It was as though these 60-year-olds simply could not learn. They slowed up the classes, but they could not handle the procedures; they were absolutely hopeless students. Yet they had been fine pilots, which demonstrates just how specific certain skills can be. In this case employees were simply moved from one seat in the cockpit to another, yet as a group they went from being excellent performers, albeit on a downward slide, to being totally inept. That sort of problem can occur in training situations: employers know it, workers know it, and businesses adapt to it. Only the government remains resolutely ignorant of it.

Different investment pay-offs and the problem of cross-subsidies

Even if we assumed that the performance level of different age groups was identical, we would still be confronted with the problem of the anticipated pay-off to a firm for investing in a worker. When a competent company hires a young worker, it knows how to structure its compensation arrangements to maximise its chances of keeping that person for a lengthy period. If a firm does the job properly, today's investment in human resources might be paid back over a period of three or five or seven or 10 years. But if a company hires a 65-year-old and makes the same investment, the risk that the person will suffer a health problem soon after and leave the workforce is obviously greater. The rate of return could fall considerably if the period during which the investment is repaid were to be suddenly truncated. This is a major problem for firms.

It is also a problem constantly faced by universities now that mandatory retirement has been removed. No PhD student wants to sign on with a thesis supervisor who is 75 years old. At best, four or five years down the track that person will be 79 or 80, while at worst they will be retired in Miami or perhaps dead. The student will be left high and dry with a thesis that cannot be completed if another supervisor cannot be found. Of course there are risks with a younger thesis adviser (such as their moving to another university), but they are much smaller. The same situation occurs in any other business. If management has any foresight, it will attempt to plan for the long term. Managers must take into account the likelihood of workers quitting or becoming disabled, and that will increase sharply with age. Here, then, is one area where the new law leads to either irrational investments or to costly attempts to circumvent them.

There are other problems. Wages are typically only part of the total compensation package that a firm provides to a worker. There is also a range of formal and informal benefits, which can often include health insurance as a major component. Nobody would claim that the costs of these benefit packages are invariant to the age of workers. And if companies must pay the same benefit package to somebody aged 70 that they pay to somebody aged 40, and if insurance companies are permitted to discriminate, those insurance companies will charge differential rates. If they cannot discriminate, they may be forced to abandon the entire line of business. It just becomes too risky to accept people at rates that do not allow the companies to cover their costs. Even if insurance companies seek to raise rates uniformly across the board, they will face a serious adverse selection problem because the lower risks will abandon the system, so that the stated premium will not cover the more substantial risks that remain.

This jostling over rate structures leads to the question of what counts as discrimination, and here the statutes are enormously, and perhaps deliberately, ambiguous. I would prefer to define discrimination as differences in wage levels that do not reflect differences in performance or risk levels. But according to the government's definition of discrimination, one cannot take risk levels into account. All people are entitled to the same formal benefit for the same work. Thus, the age-discrimination statute effectively leads to enormous and complicated cross-subsidies within a firm. We know what happens when we create internal subsidies. Those people receiving the subsidies will remain with the firm for a long time, while those paying the subsidies will quickly leave. This has serious implications for the firm's long-term viability, not to mention the morale of its workers.

Disrupting the orderly transition between generations

A coherent firm organises itself by planning what we might call an internal firm inheritance. It plans for the transmission of knowledge, skill and managerial talent from one generation to another. One of the great merits of a mandatory retirement rule is that everybody knows roughly when a transition will take place. Younger workers do not sit around restlessly, waiting for arbitrary decisions to be made by senior executives.

The senior people know they are leaving. Because they have pride in their business, they apply themselves to training their successors, so that the business can continue over time in an orderly manner. Mandatory retirement rules effectively solve the succession problem for businesses in the way elections solve it for democracies. They ensure an orderly turnover.

Suppose that we now interrupt this transition cycle. We say to somebody who is 68 years of age: 'You do not have to retire. If you stay, you will not be engaged in turning this business over to somebody who in two years will be 44'. The training of the younger generation will cease in consequence, because there is no longer any reason for it. The 42-year-old will say: 'Why should I stay around indefinitely in a subordinate role? I will chance my luck somewhere else'. Typically, established firms will be handicapped relative to new entrants. New firms will be created by younger people opting out, frustrated at waiting behind their more senior colleagues.

So, if the statutory prohibition on mandatory retirement is retained in New Zealand, I confidently predict that it will shift the balance of advantage between firms. An established business, which once had an edge through its ability to transmit information, will now be at an enormous disadvantage because it will no longer be able to do so efficiently. Most of the people to whom it would have otherwise transferred the information will simply go out on their own. New firms will have an undeserved advantage. It will not result from anything in their human capital or firm culture, but from the peculiar disruption of succession planning in their more-established rivals, another unintended consequence induced by the statute.

We can now see that statutes banning mandatory retirement suffer from two major disadvantages. First, they adversely affect how a firm deals with individual employees. But perhaps more importantly, they change the distribution of age, the transmission of information, and the transmission of control inside the firm in ways that could threaten its very stability. And rational business people will clearly take some counter-measures in response to this legislative intrusion.

A newspaper article written by a thoughtful commentator recently described the new dynamics operating in his business with performance reviews. Under mandatory retirement, if an employee was a year or two within the age of retirement, deterioration in performance was generally overlooked because all parties knew that person would soon be leaving. At present if a manager finds a slight deficiency in performance that enables them to dismiss somebody approaching normal retiring age, that manager will take advantage of it, because the dignified exit afforded by mandatory retirement is no longer available. The statute has given employers a new inducement to find fault with their employees. With automatic retirement, it was not necessary to build up a specific dossier for requiring an employee to leave. But with the mandatory retirement option closed off, an employer has incentives to gather all the dirt on a person in a big folder, and use it to justify a dismissal. Undignified and inhumane procedures substitute for a graceful exit.

All of this must be regarded as an industrial relations catastrophe in the making. And there is no reason for it: that is why we had mandatory retirement policies in the first place. Companies did not have individual case-by-case reviews because everybody understood that the politics involved in deciding exactly how long one person stayed and when another person would go are very ugly. A company would rather see both people go at the same age. Then if one of them was competent while the other wasn't, that person could be rehired after retirement. If a firm had a policy of not rehiring its former employees, some other firm would seize the opportunity. And the firm that released these employees could hire people who were released under mandatory retirement by some other firm.

A firm's mandatory retirement rule is simply a contractual policy. It is not an industry-wide ban on certain individuals. Paradoxically, that rule prolonged the useful working life of people. If workers approaching retirement wanted to continue working, they had a powerful incentive to perform well in their last years at the firm. They were anticipating going back to the market, which meant keeping their skills high. Now that situation is completely reversed.

In universities, the market for older academics has been very important. After the second world war, the University of California essentially built its reputation as a first-rate institution by hiring staff from eastern universities who were in their early sixties and who faced retirement. They chose the best people they could obtain, gave them five-year contracts, and asked them to start a department and hire the next generation of academic staff. These days, if universities employ somebody for a year they may be forced to keep that person for a lifetime. The market for older academics is now dead. This obviously means that universities have to sack non-performers, and that firing people is often fraught with litigation.

Courtroom follies and escape routes

In the United States it is extremely difficult for an employer to win age-discrimination cases. Generally they must demonstrate some incompetence in the employee. But an employer typically has two factors in mind when assessing a specific worker's future. One factor is overt instances of incompetence. The other, which the employer knows but is not permitted to articulate, is the tendency for a person's skills to ebb slowly as they age. It happens to baseball players, to computer programmers and even to law professors. If this is indeed a general tendency, the attitude of an employer will simply be to dismiss an employee, perhaps with a pension or an elaborate send-off, before their skills deteriorate too far. They would rather obviate the problem through an orderly transition.

But when such a dismissal case ends up in court, and the employer offers evidence that on average the productivity of a 72-year-old male is only, say, 84 percent of that of a 66-year-old male, the employer will lose. All evidence must relate to the specific individual in question, and this requirement leaves employers with a huge problem. Typically it is not spectacular under-performance that leads an employer to want to release a worker. It is the employer's general understanding of the path on which that person is travelling. The courts and statutes essentially say that not everything that is known about the situation can be used. For example, the general trends in employment markets are deemed irrelevant. Only facts about aging with respect to a specific worker are legally relevant. Reliance on general trends is assumed to indicate irrational prejudice.

In other words, anybody who is a good probabilistic calculator, or who simply has learnt the lessons from long-term experience, must disregard this entire class of evidence. Instead, any evaluator must concentrate on a single employee in isolation on the grounds that every worker is potentially an exception to any general rule. But it will never be the case that the longshots will always come home, or that the exceptions will prove more important than the rule. Cognitive psychologists remind us constantly of the dangers of disregarding base rate evidence. The age discrimination laws, far from countering that bias, reinforce it.

Notwithstanding this bleak picture, there are three rays of hope, at least in some businesses, for offsetting the worst side-effects of the age-discrimination law. First, workers sometimes wish to retire early. To the extent that there is voluntary agreement on retirement, the problem is no longer the age-discrimination statute. Rather, it is the cost of the superannuation schemes that will be incurred, either publicly or privately, to fund an ever-longer retirement. If other things are held constant, any worker demand for early retirement should ease the pressures on the firm.

Secondly, in some countries anti-discrimination statutes contain exemptions for senior employees. In the United States, accruing a sufficiently large pension entitlement allows a person to be forced to leave the firm at a given age. The costs to the firm of the wrong person remaining in a position are much higher with top management than with ordinary employees. For that reason, a board of directors will be more eager to retain their capacity to replace their chief executive at age 65 than to remove other employees. This standard industry practice demonstrates the mythical nature of the idea that labour markets are characterised by inequality of bargaining power. In this case, a chief executive does not have the power to obtain in their contract an element that is possessed by the employee on the most lowly salary. The obvious explanation: efficiency motivations drive ordinary contractual negotiations at every level in the firm.

A third response is to buy off employees by paying their pensions twice. In the United States, employees are sometimes given large sums of money on the understanding that they will go quietly and waive any claims under the law for unjust dismissal. The legal validity of many of these agreements is unclear. If an employer wishes to avoid a charge of coercion, much will depend upon the correct handling of all the formalities, and the structure of these deals is now a major issue. Inevitably, a policy of providing a buy-out at the end of a person's working life will impact on a firm's ordinary pension scheme. Since employers cannot simply conjure up new funds out of thin air, the new level of bargaining will inject an element that could leave many employees with less income security than they would have had under the previous contractual regime.

Conclusion: do not tinker

Government tinkering with the employment relations system is fraught with pitfalls, no matter how benevolent the intentions of legislators are to improve the lot of working individuals. Legislators cannot change just one element of a system that they regard as irrational, leave all else untouched, and expect everything to go on as before. As with every other type of contract subject to government interference, quite the opposite occurs. Changing a single term that is central to a long-term employment relationship will lead to private adaptations that will change much else as well. The problem may be especially hard to see because the new changes could take place in dimensions that previously were regarded as settled: offices, training, trips, or perks of all sorts could be called into play for no apparent reason, as employers and employees seek to establish a new equilibrium while subject to the legislative command.

The basic moral is that people in all walks of life optimise subject to constraints, even when they are not consciously aware of what they are doing. If a constraint changes or disappears, then the patterns that result from the process of optimisation will also change. This is learnt in the workplace, as a reality confronting managers every day of their professional lives, and not just espoused by academic economists as an interesting theoretical possibility.

Regrettably, in today's climate of opinion, it takes courage to articulate this view publicly. It is senior executives who must fight this policy, yet they are the very people who in the short run are most likely to benefit from an age-discrimination law. That is a great irony. I hope New Zealand business people will prove stronger at opposing this law than their counterparts in the United States. The stakes are as high here, and, owing to the small size of the country, perhaps higher, than they are east across the Pacific.

Questions

An anti-discrimination law will result in a policy of paying people to retire. The market will establish a dollar amount that an employee will accept, and they will leave at that rate. People will bargain hard over the compensation level, and extract as much as they can. Is that how you see things?

The basic pattern appears to be as follows. An employer decides that the continued employment of a given employee, at their current wage and position, is bad for the company. The worker is not overly concerned to stay on, so a bargain is possible. The worker will claim that accrued pension rights are not on the table, because they cannot be touched. So the employer ends up paying an extra sum of money to compensate the worker for any loss of pension rights.

In structuring these deals, employers in the United States have learnt not to give people much time to reflect upon the offer made to them, because that can lead to strategic behaviour and various counter-offers. They tend to follow an inflexible procedure, with no exceptions for individual workers. This policy undoubtedly has costs. Not only are employers paying bad workers to leave but, in making the option accessible across the board, they are also paying good workers to leave, including those whom they might wish to retain. Frequently, the superior workers accept these offers, because they can be re-employed elsewhere, while the bad workers decide the money is not worth taking and remain on the payroll. Despite that, experience in the United States suggests that the moment a firm attempts individuation, the process goes off the rails.

The level of discord and confusion it introduces, and the impact on morale, are simply too large. Thus a firm is best advised to stick to an inflexible schedule and make it non-negotiable.

At the University of Chicago we were forced to confront exactly this problem with our tenured faculty. I was involved in designing the payment schedule, which is absolutely rigid. If a tenured faculty member leaves at age 65, they receive a payment equal to twice their final salary. If they leave at 66, the relevant ratio is 1.8; at 67 it is 1.4; at 68, 0.8; and at 69, 0.4. At 70 years of age we have each other for life. By 'front-loading' the compensation, the university increases the chances that somebody will leave at age 65. This is worth more to the university than having somebody at age 70 staying on with no extra payment, because it avoids five more years of possibly declining performance.

This policy has worked reasonably well. But its very existence underlines the fact that the anti-discrimination statute has nothing to do with correcting irrational behaviour by employees. If irrationality was the problem people would learn from the errors of their ways. They would say: 'The government told us to be rational. We have tried rationality and we love it. People over 65 are very productive. We will no longer buy people out'. In reality, buying people out reflects the fact that employers adopted the correct policy the first time around. The government took from employers something they had negotiated by contract, and now they have to buy it back a second time.

The buy-out schedules are very difficult to calculate. In the United States, I am told that Johns Hopkins University set the buy-out, on a trial run, at four times the final salary. It discovered that everybody took the money. Nobody was interested in working after age 65. Payment schedules have subsequently been scaled back to lower levels. But that in turn has some perverse effects on the labour market. We may have a 61-year-old colleague who is considering taking up employment at a rival institution. But with that double payment looming up, job mobility is suddenly reduced. We might be glad to see our colleague leave, but they may not want to do so, because the other university is not offering the double payment.

Thus a policy of providing a lump sum payment when a person reaches a certain age reduces the mobility of labour and hence the efficiency of the labour market. A buy-out schedule is not a perfect fix: the system will still produce some strange results. It cannot be stressed too often that we had the optimal contracting arrangement in the first place. When the government comes along and takes out one term – the mandatory retirement age – and universities try to correct the mistake, they can only partially compensate for the loss. They are worse off than if they had never been forced to go through this miserable exercise.

Personally, I have never met a single university administrator who believes that mandatory retirement is a bad policy for academic faculty. Yet I have never met one who will speak out publicly. That is a seriously disturbing state of affairs. If an organisation speaks out on this issue in the United States, it is subject to investigation by the Equal Opportunity Employment Commission – the equivalent of New Zealand's Human Rights Commission. For that reason, anti-discrimination laws tend to undercut free speech in ways that no court can reach. For the private sector, just to be investigated risks having such deadly consequences that most employers simply avoid it. It is unreasonable to expect one company to shoulder the burdens of the world by having bureaucratic wrath visited upon it. One of the advantages of being an academic is that the authorities cannot retaliate against anything I say.

There is thus a real reluctance on the part of businesses to speak out. They fear being targeted selectively by the enforcement authorities in a way that they can neither avoid nor expose. Giving government the power to investigate on its own initiative is the most effective way to silence free speech. It is far more effective than fines. When a company pays a fine, it does not need to go to court, or publicly justify its actions. It can bury the bad publicity and continue as before. The sheer timidity of large American businesses on these issues can seem amazing. But their explanation is always the same: 'They cannot investigate you, Professor Epstein. You are too small to count. But we have dozens of drugs before the Food and Drug Authority, awaiting approval. If we talk publicly about their incompetence, they will slow down every one of them, and we can do nothing. One single drug costs a quarter of a billion dollars a year to get to market. If the FDA drags out approval by weeks and months, our ability to recover our investment could be fatally compromised. You should by all means talk publicly. We will play the game more quietly'. They do not remain passive, but neither do they go public. This illustrates the corrosive effect that prior approval laws can have on freedom of speech. The greater the discretion, the greater the risk.

We are often told about the dangers of so-called retaliatory discharges, in which an employee who objects to an illegal or unethical practice within a company is sacked in consequence. That is a serious issue in the workplace and should not be minimised. But the problem is equally great in the opposite direction. There is retaliatory enforcement on the part of the authorities, for which the remedies are exceptionally weak.

Often in the United States, universities will not hire their own graduates, and there may be many good reasons for such a policy. But your argument about mandatory retirement might easily be extended, in a sense, to mandatory fixed-term contracts. Having a finite term contract, rather than tenure forever, will often expedite efficient hiring. Is that consistent with your analysis?

With universities the usual rule is that an institution will eventually hire its own graduates. But most universities are reluctant to offer their own graduates their first teaching position. They prefer these students to go elsewhere for their first work experience. Concerns about cronyism lie behind this policy. At Chicago, for instance, we do not want graduate supervisors to give undue preference to their own students when hiring. But if the academic market establishes that a former Chicago student is worth having, we will take that person back. That is a sensible rule, but it cannot be a universal guide. There may be only one university specialising in a certain subject, in which case the university may hire one of its own graduates because there is nowhere else for that person to go. Egyptology has a rather different market from economics, for example, and sets different precedents.

On the wider question, the impact of age-discrimination laws – at least in the United States and New Zealand – is certainly not restricted to employment at or near the previously mandated retirement ages of, say, 65 or 70. That may be the most common problem resulting from these statutes, but it is not the only one. In the United States, whenever an employer dismisses any worker over the age of 40, an age-discrimination claim might be raised. The consequences of this law ripple right through the workforce. It raises the question as to whether a company can limit its liability by creating term contracts. Suppose somebody aged 39 joins a company, and the employer would like them to leave at age 65. Can the employer enter into a 26-year term contract with the employee? Nobody has enough courage to attempt that stratagem, because it will be regarded by the courts as a mere subterfuge to evade the statute.

Even contracts for shorter time periods will be similarly regarded, though they may not be shams. People will say: 'You only gave that 38-year-old a seven year contract, because you did not want to keep that employee after age 45. You are covered by the statute, and have therefore breached it'. In these circumstances employers must document the independent justification for the contract in question. Employers typically do not lose these cases, but they incur major costs in ensuring that they comply with the statute. Paradoxically, it reduces the age of people whom they are willing to hire.

In the United States labour markets there is now a very strong bias towards hiring people in their early twenties in many emerging industries, because they are not covered by the statute. They can effectively give prospective employers a guilt-edged warranty that if they are fired five years down the track, they will not be suing for age-discrimination. This tendency has been very pronounced in recent years. It is not simply a market phenomenon. It is in part a regulatory-driven phenomenon – a result of the risks associated with hiring people in their thirties. When employees reach their forties, they suddenly become protected citizens.

This leads to another bad consequence of these statutes. For some 42-year-olds, age-discrimination laws offer tremendous protection, and they have sinecures that run forever. But for a 42-year-old looking for a job, the statute can become a serious barrier. Thus two people whose prospects in the labour market should be relatively close suddenly find themselves in very different situations if one is employed and the other is not but is looking for a job. The former has a sinecure while the latter has far dimmer employment prospects. The statute has effectively created unnecessary tiers in labour markets.

Because the proponents of the anti-age discrimination laws always tell us that what is at stake is a moral or a fairness issue it is difficult to raise in public discussion their actual effects. In fact none of the economic analyses concerning consequences matter at all. However, bringing 'morality' into this debate is an attempt to stop discussion. In essence, the argument is that the unfairness of age discrimination always exceeds any unfairness that might arise from legislating against it. As long as this position is accepted, arguments based on economic considerations are to no effect and quickly become pointless.

The genius of labour markets – whether in the United States, New Zealand or anywhere else – lies in the decentralisation of employment decisions. Employers may come together to discuss industry issues, or for any other reason, but they must compete when hiring labour. It is very unlikely that all employers will get it wrong all of the time, and that one bureaucrat or legislator sitting in Washington or Wellington will get it right all the time. Those are the enormous odds against successful labour market outcomes created by a centralised labour statute. We are not talking here about telecommunications, where there are genuine problems over interconnection that are not obviously resolved by the market. Nor are we talking about collusion amongst firms, or a business using force or fraud. We are talking about employment relations in general – ordinary contracts between employers and employees – where markets have their strongest and most vital application. There is no area in which there is a stronger case for markets.

It is paradoxical that human rights legislation came in at the very time New Zealand was finally coming to a deeper appreciation of markets – for example in understanding the argument for free trade and the harm done by import protection. This particular area is like watching a mental regression taking place in legislative behaviour. Supposedly intelligent people manage to work themselves into such moral indignation that they become intellectually blinded, and claim protection under a new version of the old 'infant industries' argument for tariffs.

In sum, the age-discrimination statute is one that deserves nothing less than an early burial. The issue is not one on which we should be in the mood for compromise. The intellectual case for these statutes is as barren as any case has ever been. The legislation should be dismantled as soon as a government has the necessary intelligence and political will to do so.