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The Core Principle and Fundamental Theorem of Industrial Relations

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Abstract: This paper describes the original paradigm of industrial relations, as developed in the United States in the early part of the 20th century. The original paradigm had three faces: science-building, problem-solving, and ethical/ideological. It is argued that the core principle that spans and unites these three faces is rejection of the orthodox economic model of a competitive labour market. This proposition may also be stated as rejection of the proposition that labour is a commodity. Building on this core principle is the fundamental theorem of industrial relations. It states that a free market capitalist economic system cannot survive and efficiently perform without the practices and institutions of industrial relations that humanize, stabilize, professionalize, democratize and balance the employment relationship.

1. Introduction

The field of industrial relations is in decline across most nations of the world. Some leading scholars paint a dire picture. In his presidential remarks to the International Industrial Relations Association (IIRA), for example, John Niland offered this grim assessment: “It is not being overly dramatic to wonder whether the discipline will survive much beyond the year 2000.” Equally gloomy, IIRA president Thomas Kochan (1998) observes that: “the field of industrial relations is in a state of profound crisis.”¹

¹ John Niland, ‘Change and the International Exchange of Ideas,’ In J. Niland, R. Lansbury and C. Verevis, eds., *The Future of Industrial Relations: Global Change and Challenges*. London: Sage, 1994, pp. 451-72; and Thomas Kochan, ‘What is Distinctive about Industrial Relations Research,’ in K. Whitfield and G. Strauss, eds., *Researching the World of Work*. Ithaca: Cornell University Press, 1998, pp. 31-50.

The reasons for the pronounced decline of industrial relations as a field of study are numerous. Arguably the most important factor, however, is the steady and increasingly severe erosion in union density in most countries. To a large degree, most scholars regard trade unionism, collective bargaining and labor-management relations, and the national labour policy and labour law within which they are embedded, as the core subjects of the field. Admittedly, these subjects are examined from a variety of disciplinary perspectives, theoretical points of view and national experiences, giving industrial relations research a rich diversity. Also, one certainly must recognize that other subjects, such as contingent work, work-family balance, and dispute resolution, are also important parts of the intellectual dialogue in the field. Nonetheless, the indisputable fact remains that the study of trade unions and labour-management relations is the heart of industrial relations, as indicated by the remark of Berndt Keller that: “Discussions of the future of industrial relations always tend to turn into a debate on the future of trade unions.”² Since for several decades union density has declined in a slow but cumulatively significant way across nearly all regions of the world, the field of industrial relations has suffered its own long-term decline. Further, since no end is currently in sight for the decline of unions, the future for the field of industrial relations is likewise gloomy and fraught with crisis, as indicated in the quotations by Niland and Kochan.

Is there any way out for industrial relations? Can there be a brighter future for the field? We seem to face two possibilities and strategic choices. The first possibility is that the union movement (or some alternative form of collective worker voice) stages a resurgence, bringing with it renewed interest in all the traditional subjects of industrial

² Berndt Keller, ‘The German Approach to Industrial Relations: A Literature Review,’ *European Journal of Industrial Relations*, Vol. 2 No. 2, 1996, pp. 199-210.

relations, such as strikes, collective wage negotiations, national bargaining structures, and comparative labour law. Like a lake largely emptied from a severe drought but replenished by the unexpected return of rainy weather, a union resurgence would end the state of crisis in the field and replenish industrial relations with new scholars, a new set of current events for research and policy-making, and a new inflow of research-sustaining funding from governments and private foundations. If this scenario is a real possibility, then the best strategic choice for the field might well be to maintain its current union-related focus and wait out the drought for better times.

Adopting this strategic option represents, however, a real gamble with the future of the field. If the resurgence of the labor movement does not come, or only comes many years from now, the field of industrial relations may wither to insignificance. To avoid this fate, scholars in the field have a second strategic choice. This choice is to fundamentally restructure and reposition industrial relations in terms of subject matter, theories, and policy issues so that it occupies a larger and more prosperous intellectual place in the study of the work world and, at the same time, also decreases its dependence on the trade union movement. This repositioning cannot just take any form or direction for much of the territory of the world of work is already claimed by other disciplines and fields of study, such as management, labour economics, organizational sociology, and labour law. Likewise, such a repositioning cannot go so far so as to abandon certain fundamental intellectual and ethical principles that lie at the heart of industrial relations for then the field would lose its very identity and intellectual coherence. Nonetheless, if scholars, operating within these broad constraints, could successfully redefine the intellectual territory of industrial relations so it is more inclusive and relevant with

respect to labour issues and policy debates then the field might also have a brighter and more prosperous future. This repositioning, I should note, does not mean abandoning the subject of trade unions or taking on the full neo-liberal agenda, but it does imply that trade unions would move from the core subject of the field to only one of several equally important subjects and that unions would likewise be subjected to more objective and critical analysis than has heretofore been the norm.

In this paper I take up the challenge of developing the second strategic option – a broadened and reconfigured vision of the paradigm of industrial relations. My argument is that the contemporary union-centered version of industrial relations is not a faithful representation of the original industrial relations paradigm that first emerged in the late 1910s-early 1920s in the field’s birth country, the United States. To develop this argument, I provide a brief review of this original industrial relations paradigm and then describe in more detail what I have elsewhere called the “three faces of industrial relations.”³ These three faces collectively represent the field’s core subject matter and ideological value statement, at least as originally enunciated in the USA. I next examine the core intellectual and ethical principle that underlies these three faces and ties them together as a unified whole. This common denominator, I argue, is rejection of the competitive labour market model of demand and supply. This position can also be stated as the affirmative assertion that *labour is not a commodity*. In the next section of the paper, I use these core principles to develop a broader and more inclusive vision of the field of industrial relations, including a statement of what I believe is the field’s “fundamental theorem.” This vision reveals that the original paradigm of industrial

³ Bruce Kaufman, *The Global Evolution of Industrial Relations: Events, Ideas and the IIRA*, Geneva, ILO, 2004a; Bruce Kaufman, ‘Industrial Relations and Labor Institutionalism: A Century of Boom and Bust,’ *Labor History*, Vol. 47 (August) 2006, pp. 295-318.

relations includes trade unions and labour-management relations but also contains a number of other equally important subjects related to work and employment. The paper ends with conclusions and implications. Although written largely from an American perspective, the hope is that the general ideas and principles developed here are relevant to the study of industrial relations in all countries.

2. The Definition and Intellectual Boundaries of Industrial Relations

The original paradigm of industrial relations was born a century ago in England and the United States, but particularly the latter. Writers in these two countries drew inspiration, however, from a variety of European sources, including Marx, the German historical economists, sociologist such as Durkheim and Weber, and the advancing movement on the Continent for labour law and social insurance.

In England, the “mother and father” figures of industrial relations are Sidney and Beatrice Webb and their great intellectual contribution to the field is the book *Industrial Democracy*.⁴ The work of the Webbs built an important foundation for the future field of industrial relations, but they neither used the term “industrial relations” nor developed the concept. Indeed, as I shall argue below, the Webbs were in certain respects at odds with the original paradigm of industrial relations since they espoused replacing capitalism with socialism, while a core purpose of industrial relations (at least the original American version) is to preserve capitalism.

Industrial relations did not emerge as a consciously self-identified subject of research and practice until the late 1910s-early 1920s and its country of birth was the

⁴ Sidney and Beatrice Webb, *Industrial Democracy*, London: Longmans Green, 1897.

USA. In the academic world, the American “father” of industrial relations is institutional labour economist John R. Commons, who along with colleagues of what is called the “Wisconsin School” largely defined and developed the early model of industrial relations. In an earlier book, I have claimed that industrialist John D. Rockefeller Jr. also deserves to be considered a “father” of industrial relations, given his great influence in spreading the study and practice of industrial relations in American corporations and universities and through the International Labour Organization.⁵

The original paradigm of industrial relations (IR) cannot be found in any one article or book. I nonetheless claim it is possible to canvas this early work and distill from it a synthetic portrait of the key ideas and principles that collectively define the original vision of industrial relations.

The place to start in describing the original IR paradigm is to first define what is the subject matter and intellectual boundaries of industrial relations. The most authoritative source on this matter is a 1928 report prepared by the Social Science Research Council (US) entitled *Survey of Research in the Field of Industrial Relations*. It states (p. 19, emphasis added): “the focal point of the field is *the employer-employee relationship*.” Also relevant is a report by the National Industrial Conference Board a few years later that states (p. 31): “the term ‘industrial relations’ comprises every incident that grows out of employment.”⁶

Based on this and other evidence, I conclude that the core subject of the original industrial relations paradigm is the employer-employee relationship and, in particular, all

⁵ Kaufman, 2004a, op. cit.

⁶ Social Science Research Council, *Survey of Research in the Field of Industrial Relations*, New York, 1928; National Industrial Conference Board, *Industrial Relations: Administration of Policies and Programs*, New York, 1931.

the behaviors, outcomes, practices and institutions that emanate from or impinge on the employment relationship. Viewed from this perspective, industrial relations could more accurately be called *employment relations*. It is also evident from this definition that the subject area of industrial relations, as early defined and conceived, is much broader than the study of trade unions, labour law or any other such topic. Rather, the original paradigm of industrial relations covers all aspects of the employment relationship, thus including within the field employment relationships of all types (e.g., union and non-union, private and public, formal and informal) and a large number of related subject areas, such as labour economics, human resource management, industrial psychology, industrial sociology, labour law, labour history, and political science.

Although the original industrial relations paradigm was centered on the employment relationship, it was not a unitary construct in terms of research and practice. Rather, industrial relations was part an intellectual project, part an applied program of problem-solving and labour reform, and part a moral and ideological commitment. I call these three dimensions of the original industrial relations paradigm the “three faces” of industrial relations.⁷ Each is described below.

3. Science-Building

The first face of industrial relations is “science-building.” Science-building is largely an academic and intellectual endeavor aimed at expanding the frontiers of knowledge. The tools of science-building are theory and research methods, such as abstract models and

⁷ Kaufman, 2004a, op.cit.

mathematics, and the goal is to derive useful generalizations and insights about the employment relationship.

In its science-building mode early American industrial relations was largely coterminous with the institutional school of economics, particularly the Wisconsin School stream of institutionalism pioneered by Commons and colleagues. At a broad level of generalization, institutional economics is a marriage of economics, sociology, psychology, history and law. It is an inductive approach to theory-development that advocates an historical-based, “go and see” empiricism; seeks to substitute for “economic man” a model of the human agent that incorporates bounded rationality and ethical and social (interpersonal) relations; views the economy as a mix of institutions structured by property rights and coordinated not only by price but also command and custom (e.g., as in firms and families); regards imperfect competition as the norm in markets; and holds that the appropriate social welfare objective for an economy includes not only efficiency and satisfying consumer wants but also considerations of justice, human self-development, and the welfare of people as workers. All of these ideas Commons attempted to explicate, with only very limited success, in his theoretical treatise *Institutional Economics*.⁸

Industrial relations is essentially the labor branch of institutional economics and, as such, largely mirrors the latter’s characteristics and strengths and weaknesses. The subject domain of industrial relations, as noted above, is the employment relationship. In neoclassical economics, the employment relationship is modeled as a species of market exchange between buyers and sellers of labor, with emphasis on the equilibrium price and

⁸ Bruce Kaufman, ‘The Institutional Economics of John R. Commons: Complement and Substitute for Neoclassical Economic Theory,’ *Socio-Economic Review*, forthcoming, 2007; John Commons, *Institutional Economics: Its Place in Political Economy*, New York: Macmillan, 1934a.

quantity and efficiency properties thereof. The base-line assumption is that markets are competitive, giving rise to well-defined demand and supply curves, a going market price, and welfare-maximizing wages and other terms and conditions. As various “new institutional” writers such as Ronald Coase and Oliver Williamson have shown, also implicit in this core theory are two other important assumptions – zero transaction cost and complete contracts.⁹ In a competitive zero transaction cost world, workers and employers face each other with equal bargaining power, both sides honor their commitments, and workers are protected from exploitation and unjust treatment by competitive forces and, in particular, the threat of quitting. The very concept of *labour problems*, so central to industrial relations (as described in the next section), becomes a foreign concept in this theory and conditions of efficiency are separable, via the neoclassical fundamental welfare theorem, from considerations of distribution and equity.

The labour theory of industrial relations looks at the employment relationship in quite different terms. The employment relationship is not solely a species of market exchange but involves a web of legal, political, social and economic relations and must, therefore, be examined from an interdisciplinary perspective. One reason is that labour contracts are necessarily incomplete (due to positive transaction cost) and thus price and market contracting are incapable of fully specifying and enforcing the terms and conditions of the labour sale. These contractual holes and gaps are necessarily filled by other means, such as social custom, ethical precepts concerning right and wrong, bilaterally negotiated rules and understandings, and judicial interpretations. A second reason is that labour, unlike other factor inputs, is embodied in human beings and thus a

⁹ Ronald Coase, ‘The Nature of the Firm,’ *Economica* Vol. 4 (November), pp. 386-405; Oliver Williamson, *The Economic Institutions of Capitalism*, New York: Free Press, 1984.

range of uniquely human concerns and considerations enter into the employment relationship.¹⁰ Capital equipment, for example, does not care about the social relations at work, does not feel emotions of jealousy, anger, or love, and the manner of its usage carries no higher moral significance. Labour is quite different on all these counts and this fact is the fundamental reason why the subject of industrial relations is separate from orthodox economics and, similarly, why there is a distinct field of industrial relations but not a similar field of “capital relations” or “land relations.” Likewise, unlike orthodox economics industrial relations recognizes that efficiency depends on fairness and social justice for, in the absence of these, people consciously withhold part of their labour supply.

A second and equally fundamental theoretical divergence between industrial relations and orthodox economics concerns the operation of markets. Neoclassical economics is able to banish the theoretical and practical importance of labour problems only by constructing a theory of the labour market that is utopian. It does so in its core version by assuming perfect people, perfect markets, and a perfect legal order. In such a world, exemplified by Arrow-Debreu general equilibrium theory, the invisible hand of Adam Smith can successfully take a situation of scarcity and conflicting interests and create a “best of all possible” outcomes. Institutional economics and industrial relations insists, however, that theory maintain a fidelity to the most important aspects of reality, which in this case means a recognition that people, markets, and the legal regime are all highly imperfect and, correlatively, that transaction cost is positive and contracts are incomplete. People are imperfect, Commons argues, because their use of reasoning and

¹⁰ John Budd, *Employment with a Human Face: Balancing Efficiency, Equity and Voice*, Ithaca: Cornell University Press, 2004.

logic is heavily constrained by “stupidity, ignorance, and passion” – factors Herbert Simon later made famous as bounded rationality.¹¹ Likewise, markets work imperfectly because positive transaction cost and incomplete contracts lead to a host of market failures and coordination problems. Examples include externalities, public goods, principal-agent problems, moral hazard, opportunism, and – according to the institutionalists – the single gravest defect of capitalism, persistent involuntary unemployment.¹² And, finally, the legal regime is also inherently imperfect since bounded rationality, limited judicial resources, and corruption of the legal process by vested interests prevents complete and unbiased enforcement of contracts. For all of these reasons, markets are not self-regulating, do not lead to efficient “best of all worlds” outcomes, and generate a large host of labour problems.

A third fundamental theoretical divergence between orthodox economics and industrial relations concerns the issue of power in the employment relationship. According to Commons, economic power comes from the ownership of scarce resources and, in particular, the ability to deny other people the use of these resources. Neoclassical economics abstracts from the issue of power by taking as a “given” the distribution of wealth and property rights in society, assuming markets are competitive so all firms and workers are powerless “wage takers,” and modeling the firm as a technological construct synonymous with the production function. The reality of the early 20th century employment relationship, however, was that workers faced a marked inequality of power

¹¹ Commons, *Institutional Economics*, 1934a, p. 874; Herbert Simon, *Models of Bounded Rationality*, Vol. 2, Cambridge, MIT Press, 1982.

¹² John Commons, ‘Industrial Relations,’ in Commons, ed., *Trade Unions and Labor Problems*, 2nd ed., New York: Augustus Kelly, pp. 1-16; Bruce Kaufman, ‘Labor Markets and Employment Regulation: The View of the ‘Old’ Institutionalists,’ in B. Kaufman, ed., *Government Regulation of the Employment Relationship*, Madison: Industrial Relations Research Association, 1997, pp. 11-55..

in three fundamental areas of life: in the internal governance of firms, wage bargaining in external labour markets, and in political influence in the government.¹³

In its science-building mode, therefore, industrial relations is an interdisciplinary, social science enterprise that endeavors to build a theory of the employment relationship centered on economics but with contributions from other disciplines such as law, political science, psychology, sociology, and organizational science. This theory is also intended to be more realistic by incorporating the imperfect nature of people, markets, and the legal regime, and bringing into the picture the interaction between economics, law, and society. In accord with the inductive “go and see” methodology of institutional economics, industrial relations scholars also abjure deductive “armchair” theorizing for an empirical-based form of theorizing in which assumptions, laws, and causal relationships are adduced from field investigation, case studies, and participant observer techniques. As actually practiced by early scholars in industrial relations, theory-building remained shallow and largely under-developed, in part because their focus and emphasis was on the second face of industrial relations – problem-solving.

4. Problem-Solving

The second face of early industrial relations is problem-solving – the application of knowledge and expertise to solving practical problems in the work world. Although the institutional founders of industrial relations were interested in the intellectual aspects of employment, practical concerns bulked far larger in drawing them to the field. Looking

¹³ John Commons, *The Legal Foundations of Capitalism*, New York, Macmillan, 1924; Kaufman, 2004a, op. cit..

back on his career, for example, Commons remarked, “What I was trying to do, in my academic way, was to save Wisconsin and the nation from politics, socialism, or anarchism, in dealing with the momentous conflict of capital and labor.”¹⁴ They also espoused a relatively pragmatic and non-ideological form of problem-solving, an orientation that made them deeply distrustful of left-wing intellectuals and Marxist/radical solutions to labor problems.¹⁵ In this respect, the American institutionalists were considerably more conservative than the Webbs and many other early 20th century European labour intellectuals who espoused some form of socialist transformation of society.¹⁶

The problem-solving mode of industrial relations was intimately connected with the concept of labour problems. Writing in 1931, for example, Dale Yoder declares, “The most widely accepted approach to the study of industrial relations is one which involves an examination of the phenomena that are usually described as Labor Problems.”¹⁷ This approach to the study of industrial relations arguably found its earliest formalized expression in the work of two Wisconsin economists, Thomas Adams and Helen Sumner. In 1905 they published the first text written in the United States devoted to the study of labour, entitled *Labor Problems*.¹⁸

Although their text appeared fifteen years before the birth of the industrial relations field, it nonetheless had an important influence on the development of the problem-solving face of the field. The first part of the text was devoted to a list of labour

¹⁴ John Commons, *Myself*, Madison: University of Wisconsin Press, 1934b, p. 170.

¹⁵ Selig Perlman, *A Theory of the Labor Movement*, New York: Macmillan, 1928.

¹⁶ Royden. Harrison, *The Life and Times of Sidney and Beatrice Webb, 1858-1905: The Formative Years*, London: Palgrave, 2000; Kaufman, 2004a, op. cit.

¹⁷ Dale Yoder, ‘Introductory Courses in Industrial Relations,’ *Personnel*, Vol. 7 (February), 1931, p. 123.

¹⁸ Thomas Adams and Helen Sumner, *Labor Problems*, New York, Macmillan, 1905.

problems or “evils.” These evils, including poverty wages, child labour, and sweatshop conditions were the labour problems of the employment relationship that demanded attention and resolution. The second part of the book was then devoted to solutions or “remedies.” Among these were trade unions, factory legislation, and profit sharing.

The focus of the early labour reformers was initially on trade unionism and collective bargaining. But over time they broadened their research and portfolio of problem-solving tools and fleshed-out an overall policy strategy. With regard to strategy, the institutional labour economists worked-out a three-prong reform program.¹⁹ The first prong was the *stabilization of product and labour markets*. The aim here is to smooth disruptive fluctuations in production and employment, prevent excess supply conditions from dragging down labour standards, and provide workers with secure, full-time jobs. The second prong was to promote *equality of bargaining power between employers and workers*. Viewing the wage determination process as seriously tipped in favor of employers, the institutionalists sought to bring wages and labour conditions up to a more competitive and fair level by augmenting the bargaining power of workers so the two parties would compete on a more level playing field. The third prong was *constitutional government in industry*, or what the Webbs and many others refer to as industrial democracy.²⁰ The aim here is to bring into the industrial sphere basic democratic practices enjoyed by citizens in the political sphere, such as a written agreement or “constitution” to ensure that “rule of law” replaces “rule by men,” opportunities for participation and representation (“voice”) in the determination and enforcement of

¹⁹ Bruce Kaufman, ‘John R. Commons and the Wisconsin School on Industrial Relations and Strategy,’ *Industrial and Labor Relations Review*, Vol. 57, No. 1, 2003a, pp. 3-30.

²⁰ Sidney and Beatrice Webb, 1897, op. cit; Milton Derber, *The American Idea of Industrial Democracy*, Urbana-Champaign: University of Illinois Press, 1970.

workplace rules, and the protection of due process in the resolution of workplace disputes and administration of justice. Collectively, they thought, accomplishment of these goals would substantially reduce labour problems and improve the efficiency, fairness, and human satisfaction of the employment relationship.

Having identified a strategy and set of objectives, the next issue is how to implement and achieve them. The institutionalists did not immediately arrive at a complete answer to this question but incrementally and pragmatically worked their way to it over the first three decades of the century. By the late 1920s their labour reform program was relatively rounded-out and revolved around four basic institutional revisions to the disorganized and unregulated labour market of that period. This four-part program defined, in turn, the problem-solving face of early industrial relations.²¹

The first institutional fix they advocated to promote market stabilization, equality of bargaining power, and constitutional government in industry was trade unionism and collective bargaining. Early in the twentieth century Commons became a vocal supporter of trade unions and, in particular, unions organized along industry (rather than craft) lines. He saw such unions as greatly facilitating all three objectives. For example, by organizing all firms in the product market a union can take labour cost out of competition and help stabilize wages, conditions, and employment. At a macroeconomic level, Commons in these early years also believed that by raising wages unions promoted macroeconomic stability by offsetting tendencies to under-consumption. Evidently, unions also increase workers' leverage in wage determination by replacing individual bargaining with collective bargaining, while they also give workers an organized and independent form of voice and representation. Commons described this collective

²¹ Kaufman, 2003a, op. cit.

bargaining arrangement, with reference to the government of England, as “an industrial House of Commons and House of Lords, but without a king.”²²

As the prospects for industry-wide unionism in the U.S. waned in the latter part of the first decade of the century, Commons and colleagues turned their attention to a second method to promote these industrial relations goals. This was the method of legal enactment in the form of protective labour law and social insurance programs. Protective labour law takes various forms, such as a minimum wage, maximum hour, child labour, accident prevention statutes, and civil service reform in the public sector. Like collective bargaining, these laws also set a floor of minimum standards in the labour market and increase labour’s bargaining power, and in the case of civil service reform also promote greater due process and voice for workers. Social insurance programs, in turn, seek to protect workers from various work-related risks and hardships, such as through workmen’s compensation, unemployment insurance, old age pensions, and health insurance. These programs also help shift the costs of these negative byproducts of employment from workers, their families, and their communities to where the institutionalists thought these costs properly resided: the employers, consumers, and society.²³ The involvement of the institutionalists in legal enactment was first revealed in Ely and Commons’s role as founders of the American Association for Labor Legislation (AALL) in 1906.²⁴ A second visible sign of their growing interest and advocacy of labour law was the publication in 1916 of Commons and Andrew’s text, *Principles of Labor*

²² Commons, 1934b, p. 72.

²³ Donald Stabile, *Activist Unionism: The Institutional Economics of Solomon Barkin*, Armonk: M.E. Sharpe, 1993.

²⁴ David Moss, *Socializing Security: Progressive-era Economists and the Origins of American Social Policy*, Cambridge: Harvard University Press, 1996.

*Legislation.*²⁵ Many of their ideas for labour law and social insurance came from Continental Europe and, in particular, Germany.

The third prong of the early institutionalists' labour reform program was progressive labour management. This component did not appear until shortly after the World War I years when leading employers began to experiment with new methods of personnel management and "welfare capitalism."²⁶ Under the traditional employment system, labour was treated as a commodity to be bought for as little as possible, worked to the maximum, and then discharged when no longer needed. Personnel departments were largely non-existent, procedures were very informal and decentralized, and foremen ruled with an iron hand. Needless to say, this approach to managing the workforce led to considerable waste, dissatisfaction, and conflict. But progressive and forward-looking employers began to wake up to the fact, as Commons first expounded in his book *Industrial Goodwill*, that often greater profit can be made by treating labour as a partner and human being rather than a servant and commodity.²⁷ Out of this idea was born the 1920s movement of Welfare Capitalism that sought to achieve greater efficiency and profit by eliciting labour's cooperation through above-market wages, job security, various welfare benefits (pensions, vacations, etc.), humanized supervision, and formal employee voice through a shop council or employee representation plan. The practitioners of Welfare Capitalism, particularly among the Rockefeller network of companies and consultants, consciously adopted the term "industrial relations" as their label for a more

²⁵ John Commons and John Andrews, *Principles of Labor Legislation*, New York: Harper, 1916.

²⁶ Sanford Jacoby, *Employing Bureaucracy: Managers, Unions and the Transformation of Work in American Industry, 1900-1945*, New York: Columbia University Press, 1985.

²⁷ John Commons, *Industrial Goodwill*, New York: McGraw-Hill, 1919.

strategic and progressive form of labour management.²⁸ Although some of the Wisconsin institutionalists were initially skeptical, by the end of the 1920s most were convinced that employers' personnel programs and representation plans had become an important and praiseworthy way to help stabilize markets, equalize bargaining power, and provide for greater worker voice.²⁹

The fourth prong of the institutionalist's labor reform program was countercyclical macroeconomic policies aimed at smoothing out the business cycle and preventing ruinous booms and busts in production and employment. Commons was the leading person from Wisconsin in promoting these new macroeconomic policies, but other economists such as Sumner Slichter and Paul Douglas also wrote on these topics. Commons stated that "The fluctuation of the currency is the greatest of all the labor problems.... The first great method of importance in bringing about industrial peace is the stabilizing of the dollar."³⁰ He devoted much of the 1920s to studying monetary policy and became one of the nation's leading experts, counseling the Federal Reserve to use open market operations to stabilize the aggregate price level.³¹ Commons also advocated incorporating an experience rating feature in unemployment insurance to induce employers to avoid layoffs, and co-authored a book *Can Business Prevent Unemployment?* that examined various other ways firms can stabilize employment.³² Various articles in the *American Labor Legislation Review* were also published over the 1920s advocating countercyclical spending on public works. Not only would all of these

²⁸ Bruce Kaufman, Richard Beaumont, and Roy Helfgott, *Industrial Relations to Human Resources and Beyond: The Evolving Practice of Employee Relations Management*, Armonk: M.E. Sharpe, 2003.

²⁹ Kaufman, 2003a, op. cit.

³⁰ Commons, 1921, op. cit. p. 4.

³¹ Charles Whalen, 'Saving Capitalism by Making It Good: The Monetary Economics of John R. Commons,' *Journal of Economic Issues* Vol. 27 No. 4, 1991, pp. 1155-79.

³² John Commons, Sam Lewisohn, Ernest Draper, and Don Lescohier, *Can Business Prevent Unemployment?*, New York: Alfred Knopf, 1925.

programs help stabilize product and labour markets, but by maintaining full employment conditions and increasing the potency of the worker's "quit threat" they also helped increase labour's bargaining power and induced employers to provide greater opportunities for voice and participation.

At the end of the 1920s these four prongs of labour market policy represented the core parts of the early industrial relations approach to problem-solving. Progressive employers using a "unitarist" welfare capitalist model of labour management chart the leading edge of employment practice. The appropriate role for trade unions and protective labour law is to set minimum employment standards, act as policemen for workplace conditions, and provide workers with protection against exploitation and injustice among employers in the lower-to-middle rungs of the labour market. In addition to protective labour legislation, government also has an important role in establishing social insurance programs for workers in all firms, given that problems of externalities, moral hazard and public goods cause pensions, accident compensation, and health care to be under-provided in a free market system. Finally, the government also takes a responsibility for maintaining full employment and macroeconomic stability through countercyclical fiscal and monetary policies.

5. Ethics and Ideology

Early industrial relations in America also had a third face, defined in terms of ethical values and ideological positions with respect to the performance of work, the structure of

the employment relationship, and the solution of labour problems. Slichter expressly acknowledges this dimension of industrial relations when he observed:

“There are two ways of looking at labor problems. One is the scientific point of view.... It is aspired to by the scientist who studies trade unions, child labor, unemployment, in order to find out what *is* or what *might be*, without speculating about what *should be*.....To the vast majority of people, however, even to the economists and sociologists, the labor problem is more than this. It is also a matter of ethics, a matter not simply of what is or what might be, but of what should be.... From the ethical point of view, therefore, the labor problem is concerned with two principal things: with the effect of the prevailing institutions.... Upon the conflict between life and work, and with the institutional change needed to harmonize men’s activities as laborers with their interests as men.”³³

The ethical/ideological face of early industrial relations has several components.³⁴ The first and most fundamental element is the normative proposition that labour is embodied in human beings and therefore should not be treated like a commodity. That is, labour – unlike capital, land and other inputs – is inseparable from the person supplying it and the conditions and outcomes of work experienced by human beings thus carry a much higher moral significance. Society does not care, for example, whether steel is stored in a hot place or a machine is worked twenty-four hours a day. But society does

³³ Sumner Slichter, ‘What is the Labor Problem?’, in J. Hardman, ed., *American Labor Dynamics in Light of Postwar Developments*, New York: Harcourt Brace, 1928, p. 287 (emphasis in original).

³⁴ Kaufman, 2004a; Bruce Kaufman, ‘The Social Welfare Objectives and Ethical Principles of Industrial Relations,’ in John Budd and James Scoville, eds., *The Ethics of Human Resources and Industrial Relations*, Champaign: Labor and Employment Relations Association, 2005, pp. 23-60.

care that the employees are given reasonable terms and conditions of employment because they are human beings and possess human rights that inanimate inputs do not. In this spirit, Commons observes that in neoclassical theory workers are treated “as commodities to be bought and sold according to demand and supply; while in the institutional perspective “they are treated as citizens with rights against others on account of their value to the nation as a whole.” Similarly, Slichter remarks, “it is vitally important that the methods of production shall be planned not only to turn out goods at low costs but to provide the kind of jobs which develop the desirable capacities of the workers.”³⁵

Also comprising the ethical/ideological face of industrial relations are a set of broad social welfare objectives. The social welfare objective of neoclassical economics may be summarized as maximum *efficiency*, meaning the allocation and usage of resources to produce at minimum cost the array of goods and services that maximizes the satisfaction of people as consumers. Industrial relations also believes that efficiency is important since without an adequate supply of material goods human life is stunted and eventually perishes. But the field also takes seriously the *Bible*’s dictum that “man does not live by bread alone” and therefore adds to efficiency two other distinctly humanistic welfare goals. The first is that the procedures and outcomes of the employment relationship should also be *equitable*, the second is that they should also promote opportunities for greater *human self-actualization and self-development*.

Lying behind these latter two social welfare goals is the institutional proposition that human welfare is advanced not only by providing people in their role as consumers

³⁵ Commons, 1919, op. cit, p. 33; Sumner Slichter, *Modern Economic Society*, 2nd ed., New York: Henry Holt, 1931, pp. 651-2.

with a plentiful supply of goods and services but also by providing them in their role as workers with an employment experience that is procedurally and distributively just and extrinsically and intrinsically rewarding. From an industrial relations perspective, therefore, the objective of social policy should thus be to use social engineering and institutional design to structure the employment relationship in a way that maximizes the sum of efficiency, equity, and human self-actualization/development.³⁶ While neoclassical economics generally portrays efficiency and equity as *substitutes* -- implying more equity comes at the expense of efficiency, institutional economics and industrial relations holds that over a significant range of situations equity and efficiency are *complements* so that more equity enhances rather than subtracts from efficiency.³⁷ The reason, in turn, is that while inanimate inputs such as coal and steel provide the same BTUs and tensile strength regardless of how they are treated by the employer the same is not true of humans. Instead, humans provide greater labour services when they are justly treated and provided a satisfying work experience.

6. The Core Principle of Industrial Relations

Having described the three faces of the original industrial relations paradigm, the question emerges: is there any common principle that unites these three faces and ties them together? I believe the answer is Yes. This core principle provides, I assert, the intellectual and normative common denominator that unites all scholars and practitioners

³⁶ Kaufman, 2005, op. cit., Budd, 2004, op. cit..

³⁷ Noah Meltz, 'Industrial Relations, Balancing Efficiency and Equity,' in J. Barbash and K. Barbash, eds., *Theories and Concepts in Comparative Industrial Relations*, Columbia: University of South Carolina Press, 1989, pp. 109-14.

of industrial relations and gives industrial relations its unique reason for being as a social science field of study and practice. Stated another way, without this core principle a separate and intellectually/socially relevant field of industrial relations cannot exist.

The core principle of industrial relations can be stated two ways. They perfectly match, like opposite sides of the same coin.

The first version of the core principle is *rejection of the orthodox competitive demand/supply labour market model* as the appropriate framework for analyzing and understanding the key features and outcomes of the employment relationship. This model is depicted in Figure 1. It shows the demand curve for labor (D_L), the supply curve (S_L), and the determination of the equilibrium wage and quantity of labour (W_E, L_E). It is fair to say that this diagram is the single most important theoretical construct in neoclassical labour economics, provides the starting point and frame of reference for practically all analyses of labour and employment issues by orthodox economists, and is the core idea behind the neoclassical/neo-liberal attack on labour market institutions and regulation. It is also the model of the labour market and employment relationship that the founders of industrial relations rejected – or, more correctly, wished to substantially revise. As described below, this diagram and the theory it represents may well describe certain specific, broad, or long-run tendencies regarding labour, but must nonetheless be rejected by industrial relationists as an appropriate theoretical foundation for the field.

[Insert Figure 1 about here]

The second version of the core principle is the proposition that *labour is not a commodity*. This statement applies to both the positive and normative sides of industrial relations. As a positive statement, this proposition maintains that in the scientific study of

industrial relations it is essential for proper understanding and explanation of employment-related phenomena to recognize that labour is embodied in living human beings. The implication of this proposition is that models and theories that treat labour similar to inanimate factor inputs, such as capital and land, are likely to be very biased and incomplete tools for industrial relations research. As a normative statement, the proposition that labour is not a commodity asserts the fundamental moral/ethical belief that since labour is embodied in human beings the terms, conditions and treatment of labour cannot be evaluated by the same efficiency criterion used for inanimate inputs (e.g., maximum productivity, minimum cost). The implication of this normative proposition is that society has a legitimate and compelling rationale for using laws and institutions to modify or replace terms and conditions of employment that are inhumane, anti-social or in violation of basic human rights.

These two versions of the core principle of industrial relations, I maintain, are mirror images of each other. That is, the competitive demand/supply model only maintains theoretical coherence if labour is treated as akin to a commodity. The essence of a commodity is that it is a homogeneous good and each unit is identical. Neoclassical theory recognizes in a very limited way that labour is embodied in human beings, since workers are modeled as maximizing agents with a set of preferences. Nonetheless, this theory necessarily treats workers as commodities for purposes of deriving the demand/supply model and the determination of equilibrium wages and employment. It must also make the same assumption to reach the conclusion that a perfectly competitive

labour market maximizes efficiency. Elucidating these points requires a brief foray into basic economic theory.³⁸

If workers are not treated as commodities, several crucial aspects of the competitive labour demand/supply model collapse. One, for example, is a well-defined downward sloping labour demand curve. The labour demand curve is equivalent to the competitive firm's marginal product of labour schedule, derived by adding homogeneous units of labour to the production function. For the labour demand curve to take the form of a unique one-to-one mapping between the wage rate and quantity demanded of labour it is crucial that labour be a commodity, such as a ton of coal, since then the marginal product of each unit of labour is entirely technologically determined by the production function. But if labour is not a commodity, then the marginal product schedule and labour demand curve in Figure 1 transform from a line to an ill-defined band of values that is consistent with a number of alternative wage/labour combinations. The reason is that the amount of productive services supplied by inanimate inputs is fixed by nature, but the amount of labour services (or "labour power" in Marxian terminology) provided by workers is volitionally supplied and can take a very large range of values (from zero when the worker sleeps on the job to the maximum amount the person is capable of performing) depending on a host of non-technological variables, such as morale, perceived fairness of pay, and treatment by the employer. Thus, any given wage rate is consistent with a large range of possible marginal products coming out of the production

³⁸ This section is based on Bruce Kaufman, 'The Institutional and Neoclassical Schools in Labor Economics,' in D. Champlin and J. Knoedler, eds., *The Institutional Tradition in Labor Economics*, Armonk: M.E. Sharpe, 2004b, pp. 13-38; and Bruce Kaufman, 'The Impossibility of a Perfectly Competitive Labor Market,' unpublished paper, Atlanta: Georgia State University, 2006.

function, making it impossible to draw the determinate, well-defined labour demand curve in Figure 1.

The labour supply curve also changes shape (or form) if labour is not a commodity-like entity. A crucial assumption in deriving the market labour supply curve in Figure 1 is that each individual firm faces a perfectly elastic (horizontal) labour supply curve, indicating it is a “wage taker.” But a firm is a wage taker only if labour is a homogeneous commodity, for otherwise labour is differentiated and with differentiated labour the firm’s supply curve becomes upward sloping (just as a firm’s product demand curve becomes downward sloping when the good is differentiated). One factor that differentiates labour is when the employer and employee have a personal relationship, which is almost universal since the labour services are embodied in the worker and the worker must therefore have personal contact with the employer (or management representatives). For whatever reason, when the labour supply curve of individual firms is upward sloping then the labour market is no longer perfectly competitive but transforms into some version of monopsony. A monopsony labour market, in turn, does not resemble Figure 1 since it has three curves (marginal product, supply curve and marginal cost of labour), yields an equilibrium wage below the competitive wage, results in some measure of labour exploitation, and does not have a well-defined labor demand schedule.³⁹

Labour must also be a commodity-like entity for the model depicted in Figure 1 to determine a unique equilibrium wage and clear the labour market in the case of excess supply. Neither are likely to happen if labour is embodied in a human being. Demand and supply do not yield a competitive equilibrium wage, for example, because the wage rate

³⁹ Bruce Kaufman and Julie Hotchkiss, *The Economics of Labor Markets*, 7th ed., Cincinnati: Thompson-Southwestern, Chapter 6.

performs two functions – it allocates labor but is also used by firms to motivate labour -- and the wage rate that meets one objective will most likely not meet the other (a condition in macroeconomic theory of more “targets” than “instruments”). In commodity markets, by way of contrast, demand/supply are able to determine a unique equilibrium since price performs only the allocative function and not the motivational function (e.g., a barrel of oil does not have to be motivated to supply a certain amount of energy). Likewise, wage rates seldom fall in situations of excess labour supply (i.e., generalized unemployment) because firms consciously avoid imposing wage cuts, knowing that wage cuts can actually raise labour cost through the negative effect on employee morale, cooperation and productivity. But if wage rates do not fall in response to excess labour supply, the labour market will remain out of equilibrium and involuntary unemployment may persist for a long period.

In response, a neoclassical economist could argue that the model of perfect competition assumes a world of perfect information and complete contracts and with complete contracts all of the above-cited anomalies disappear. For example, with a complete contract (i.e., a contract negotiated prior to the exchange that specifies in perfect detail every aspect of the good/service to be delivered) the firm knows the exact value of the worker’s marginal product; the amount of work effort of the employee is locked-in by a contractual agreement prior to any personal contact in the workplace; and the issues of motivation is moot since the contract stipulates in advance how much labour is to be supplied.

But this argument fails because of its own internal contradiction. As Ronald Coase first argued, complete labour contracts can only exist in a world of zero transaction

cost (i.e., zero costs of transferring property rights). But, as Coase and other “new institutional” economists show, in an environment of zero transaction cost firms have no reason to hire employees but instead obtain labour services from independent contractors (since *control* of labour – the principal legal criterion defining the status of employee – has no economic value in a world of perfect information and zero transaction cost).⁴⁰

The net outcome, argued Coase, is that all firms dissolve into single person proprietorships, obtain labour from independent contractors through buying and selling labour services in product markets, and the labour market and employment relationship disappear. The contradiction, therefore, is that the neoclassical demand/supply model in Figure 1 can only be saved by assuming labour services are traded in complete contracts but this very assumption logically implies that the labour market and employment relationship do not exist. One invalidates the other. Conversely, if labour contracts are incomplete (which real world labour contracts most surely are) then all the anomalies cited above that arise from the human essence of labor reappear, again causing the competitive demand/supply model in Figure 1 to deconstruct.

Although perhaps not obvious at first, these conclusions are of fundamental importance to industrial relations and, indeed, in my opinion provide the foundation for the field. To appreciate why, we must return to the three faces of industrial relations described in the previous section. The essential point to establish is that each of the three faces gains intellectual power and moral credibility in direct proportion to the extent the

⁴⁰ Coase, 1937, op. cit.; Erik Furubotn and Rudolf Richter, *Institutions and Economic Theory*, Ann Arbor: University of Michigan Press, 1997; Bruce Kaufman, ‘The Organization of Economic Activity: Insights from the Institutional Theory of John R. Commons,’ *Journal of Economic Behavior and Organization*, Vol. 52 No. 1, 2003b, pp. 71-96.

demand/supply model in Figure 1, and the commodity theory of labour underlying it, are shown to be false.

I earlier argued that the science-building face of industrial relations is centered on explaining the existence and principal characteristics and outcomes of the *employment relationship*. The insight of institutional economics is that the neoclassical competitive labour market model of demand/supply by its very assumptions precludes the existence of an employment relationship. As described above, the demand/supply diagram in Figure 1 can exist only in a world of zero transaction cost, but in such a world economic theory predicts all firms are single-person proprietorships and buy labour services in the product market from independent contractors, not from employees in the labour market. As an illustration, to build its cars the Ford Motor Company does not hire from the labour market several hundred thousand people working as employees for a wage but goes to the product market and hires for a price the business services of several hundred thousand people who work for the company as independent contractors and do all the jobs otherwise performed by employees. But note that in this zero transaction cost (complete contract) world since all labour services come from independent contractors no employees or employment relationship exist, precluding by the logic of the model a place for the field of industrial relations since its object of study -- the employment relationship -- disappears. The study of labour, in this case, might be called “commercial relations” rather than industrial (employment) relations.⁴¹

Even if an employment relationship exists in a competitive labour market, the demand/supply model is still fatally flawed as a foundation for science-building. The

⁴¹ Bruce Kaufman, ‘Employment Relations and the Employment Relations System: A Guide to Theorizing,’ in B. Kaufman, ed., *Theoretical Perspectives on Work and the Employment Relationship*, Champaign: Industrial Relations Research Association, 2004c, pp. 41-75.

reason is that it eliminates most of the interesting things to study in industrial relations. In this model, for example, all terms and conditions of employment are entirely market determined, obviating the possibility of negotiation and bargaining. Also obviated is the existence of internal labour markets, and all the human resource practices and institutional rules that accompany internal labour markets (e.g., training programs, promotion by seniority). Since a competitive labour market presumes zero transaction cost, all labour contracts are complete and terms and conditions of employment, once agreed upon, are fully and faithfully executed. This feature also eliminates numerous important subjects in industrial relations having to do with principal-agent problems and moral hazard (e.g., harassment by supervisors, employee shirking on the job). And, finally, the perfect information assumption in the model eliminates yet other important IR subjects, such as strikes. A strike would never occur in a perfectly competitive labour market since both parties to the dispute could foresee the eventual wage outcome and would rationally agree to this settlement beforehand, thus saving both sides the costs of striking.

Given this reasoning, the conclusion stated above seems inescapable. That is, scholars doing science-building cannot rely on the competitive/commodity model of labour markets as the foundation for theorizing since this model eliminates most, if not all, of the core subjects that are central to the field. In reaching this conclusion, I am *not* saying that the competitive demand/supply model is completely useless and should be abandoned, as it is my opinion that for textbook exposition of basic market forces and empirical investigation of certain trends and developments of an aggregated or long-run nature (e.g., changes in the skilled/unskilled wage differential over two or three decades)

the model provides useful insights and predictions. What I do claim is that for the study of most issues relevant to industrial relations, particularly in the short-run and at the level of the firm, a substantially revised and reconfigured model that takes into full account the human essence of labour and the imperfect nature of labour markets is an undoubted necessity.

Next, consider the implications of the competitive/commodity labour model for the second face of industrial relations, problem-solving. Just as the competitive model eliminates most of the subjects central to the analytical study of industrial relations, so too does the model eliminate most of the employment problems that provide the focus for practice and policy-making. As noted earlier, the concept of *labour problems* is central to industrial relations. The essence of a labour problem is some maladjustment, defect or shortcoming that emanates from the labour market and employment relationship and the *raison d'être* of industrial relations is to provide a solution to the labour problem. Note, however, that with a competitive model of the labour market not only does an employment relationship not exist but neither do labour problems. The second face of industrial relations also disappears!

The competitive model banishes labour problems by the assumptions it makes. At its core level, the theory is a model of perfect people exchanging goods and services in perfect markets operating within a web of seamless contract laws enacted and enforced by a perfect government. As enshrined in the fundamental welfare theorem of neoclassical microeconomics, the operation of this perfect people/market/government economy leads to a “best of all possible worlds” in which the invisible hand of free markets leads to a production and allocation of resources that is Pareto optimal – that is,

the most efficient possible. In this efficient world, all resources are fully utilized so no labour problem known as “unemployment” (or at least involuntary unemployment) exists. Likewise, in a competitive labour market all workers are paid the value of labour’s marginal product so labour problems of exploitation and discrimination are also non-existent. As another example, labour problems such as excessive work hours, inadequate workplace safety and sexual harassment cannot persist in a competitive labour market because workers can easily quit and find a job elsewhere.

Based on this reasoning, I again conclude that the competitive/commodity model of labour markets must be rejected, in this case since it eliminates most, if not all, of the real world labour problems that provide the focus for applied problem-solving in industrial relations.

The argument is equally strong for the third dimension of industrial relations, the ethical/ideological face. On ethical/ideological grounds, proponents of industrial relations maintain that labour should not be treated like a commodity. In practice, this means that the terms and conditions of employment should meet reasonable social and ethical standards with regard to humanly satisfying work conditions, workplace fairness, social justice and fundamental human rights. The competitive demand/supply model eliminates all of these ethical/ideological propositions. In the competitive model, the only social criterion used to evaluate the terms and conditions of labour is efficiency. Efficiency, in turn, is promoted by unrestricted trading of labour in free markets where competition sets all terms and conditions of employment. If efficiency is enhanced by child labour, twelve hour workdays, or poverty-level wages, the demand/supply model gives no room to object on social or ethical grounds. Indeed, in this model any institutional intervention to

change market-determined outcomes, say by a trade union or protective labour law, is an unwise interference that disturbs an otherwise optimal allocation of resources.

The competitive demand/supply model is claimed to be ideologically neutral. Yet, in practice, this model is constructed with a set of assumptions that promotes the interests of consumers and employers over workers. Workers are, after all, treated as a commodity input and factor cost in this theory that have no higher purpose than creating the most goods possible for consumers (and firms) at the lowest possible cost. The ethical/ideological proposition of industrial relations is that workers are human beings, not commodities, and social welfare is promoted by not only producing goods cheaply and in quantity but also having them produced in a way that promotes a satisfying and rewarding work experience.

The third face of industrial relations also requires, therefore, rejection of the competitive/commodity model of labour. This model is intrinsically and inherently antagonistic to the core ethical and moral principles that guide research, practice and policy-making in industrial relations. Adherence to the competitive/commodity model of labour would not only eliminate the rationale for the field of industrial relation, so too would it eliminate the rationale for government bodies such as the International Labour Organization (ILO).

In summary, I claim the field of industrial relations and the competitive demand/supply model are mutually incompatible and cannot logically or ethically co-exist. The core principle that forms the foundation of industrial relations as a field of study and practice, therefore, must be rejection of the demand/supply (commodity) labour model.

Interestingly, this statement is not only my opinion but is the fundamental proposition enunciated by people who helped found the field of industrial relations in the early 20th century. These people do not say that it is collective bargaining, protective labour law, or any other institution or practice that provides the core principle of industrial relations. Rather, this core principle is what I have earlier stated – *labour is not a commodity*. As evidence, note that the ILO constitution, adopted in 1919 when the IR field was formed, contains nine principles and the first of these states “labour should not be regarded as a commodity or article of commerce.” With regard to science-building in industrial relations, Commons -- the American father of industrial relations – did not recommend rejecting the demand/supply model completely, but he did claim in his book *Industrial Goodwill* that it is fundamentally incomplete and misleading and therefore needs to be broadened and reconstructed. In this spirit, he states “the commodity theory of labor...is not false, it is incomplete.” A third example comes from *Report on Industrial Relations* published in 1919 by the Merchant’s Association of New York. It claims there are “three features of our industrial system, which are not compatible with satisfactory industrial relations.” The third of these principles is (p. 6), “The law of supply and demand as the determining factor in fixing wages and conditions of employment.”⁴²

7. The Fundamental Theorem of Industrial Relations

The core principle of industrial relations states what the field rejects. To be against something is not enough, however. The field of industrial relations must also make a

⁴² International Labour Organization, *The International Labour Organization: The First Decade*, London: Allen & Unwin, 1931; Commons, 1919, op. cit., p. 17; Merchants’ Association of New York, *Report on Industrial Relations*, 1919, p. 6.

positive statement about what it stands for. This statement is contained, I argue, in what I have elsewhere called the *fundamental theorem of industrial relations*.⁴³

The fundamental theorem of industrial relations states the basic premise that guides the science-building, problem-solving, and the ethical/ideological faces of the field. This theorem contains two parts. The first part asserts that:

“free labour markets – without the balance, fairness social protection and macroeconomic guidance offered by the institutions of industrial relations and the visible hand of state management – will necessarily create or perpetuate conditions that undermine their own effectiveness and survival. That is, free markets will heighten insecurity, lead to growing inequality, fail to automatically eliminate unemployment through flexible price movements, create sub-standard working conditions, fail to give workers adequate voice and protection against arbitrary and discriminatory treatment, and contribute to a variety of other evils that collectively imperil efficiency, social justice and human development and call into question the very legitimacy of the market system and capitalist order.”

The second part provides the positive statement of the field’s purpose and *raison d’être*. It asserts that:

“[The] purpose of industrial relations is to make the market system and capitalism work better. To accomplish this goal, industrial relations seeks to humanize, stabilize, professionalize, democratize, and balance the market system through new, expanded and reformed institutions.”⁴⁴

⁴³ Kaufman, 2004a, op.cit., p. 631.

⁴⁴ I have added the word “reformed” to the original sentence.

The fundamental theorem is meant to provide an intellectual and ethical compass for the field of industrial relations that gives it direction and purpose. The theorem does this for each of the three faces of the field.

The core principle of industrial rejects the commodity demand/supply model of labour as a useful for tool for science-building, at least if not revised and broadened for many applications. To make progress in science-building, industrial relations needs an alternative theoretical model. The fundamental theorem points the field in the direction it needs to go when it highlights the role of *institutions*.

The model that is rejected is a theory that starts at its core with perfect people, markets and governments operating in an economy of zero transaction cost, zero frictions and no institutions. The alternative model for industrial relations is the opposite – a theory built at its core with imperfect people, imperfect markets and imperfect governments operating in an economy of positive transaction cost, positive frictions, and a variety of market and non-market institutions. Although modern neoclassical labour economics examines in considerable detail many of these imperfections (e.g., principal-agent problems, moral hazard, monopsony markets) with much insight, this theory nonetheless is grounded on a core model (e.g., as illustrated by Arrow-Debreu general equilibrium theory) that in the final analysis treats all of these imperfections as only minor modifications or small-scale blemishes to what is otherwise a competitive “invisible hand” world.⁴⁵ The better approach for industrial relations, therefore, is to take the paradigm of institutional economics as its theoretical framework since this paradigm is explicitly built on imperfect people, markets and governments. In particular,

⁴⁵ Kenneth Arrow and Frank Hahn, *General Competitive Analysis*, San Francisco: Holden-day, 1971; Gerard Debreu, *The Theory of Value*, New Haven: Yale University Press, 1959.

institutional economics is premised on positive transaction cost arising from real life people having bounded rationality and social preferences. In an economy of positive transaction cost, all the major features of industrial relations emerge and invite study, such as multi-person firms, an employment relationship and various labour market institutions (e.g., unions).⁴⁶ Bounded rationality, social preferences and non-market institutions also mean that industrial relations must necessarily go beyond pure economic analysis and include other disciplines, such as psychology, sociology, management, law, and history.

The fundamental theorem also provides an intellectual compass for applied problem-solving in industrial relations. The theorem highlights the fact that free, unregulated and non-institutionalized labour markets lead to a host of serious *labour problems*. Even in the perfect market schema of the competitive model, labour problems exist once it is recognized that labour is not a commodity. Real life human beings, for example, desire a secure job, fair wages, and voice at work yet competitive markets undersupply or provide none of these (e.g., a person's job is subject to loss every day, wage differentials between workers or firms determined by supply and demand may not be perceived as fair, the only "voice" offered by a competitive market is quitting). In the imperfect world of institutional economics, even more labour problems exist. Motivating workers, fostering cooperation, preventing discrimination, eliminating child labour, achieving work-family balance, and providing due process in employment termination all emerge as important issues once we move beyond a utopian world of competitive labour markets. And how are these problems to be solved? The fundamental theorem suggests it is through new, expanded, and reformed institutions that humanize, stabilize,

⁴⁶ Kaufman, 2004c, op. cit.

professionalize, democratize and balance the employment relationship. These institutions may take a variety of forms, such as works councils, trade unions, minimum wage laws, dismissal protection, human resource management departments, and unemployment insurance. Industrial relations also has to clearly keep in sight, however, that profit-making and job creation are crucial to a prosperous, humanized employment relationship in a capitalist economy and institution-building, therefore, has to be kept within reasonable limits and aligned to promote long-term growth. Also demanding attention is recognition that not only does market failure create a rationale for institutional intervention in labour markets but that “union failure” and “government failure” likewise create a reason to limit and constrain the extent of regulation of labour markets through collective bargaining and labour law. The hallmark of industrial relations, therefore, is *balance*.⁴⁷

The fundamental theorem also provides a compass for the ethical/ideological face of industrial relations. It states the key objectives are to *humanize, stabilize, professionalize, democratize and balance* the employment relationship. These are normative objectives that greatly expand and supplement the unitary neoclassical goal of maximum efficiency. Most clearly, efficiency is an extremely important goal since provision of abundant material goods is a central element for the “good life.” But industrial relations recognizes that advancing human welfare requires more than giving consumers additional low-priced goods and services. In particular, the fundamental theorem suggests that also crucial to the good life for the world’s people are good-paying, secure jobs with reasonable work conditions, an opportunity for voice, and protections

⁴⁷ Budd, 2004, op. cit.

from the major risks and abuses at work.⁴⁸ Also different, while neoclassical economics often presumes that greater equity and social justice come at the expense of efficiency, industrial relations recognizes that greater equity and social justice are often a complement to efficiency and without the former the latter often suffers.

8. Conclusion

In this paper I have outlined and described the original paradigm of industrial relations, as developed in the United States in the 1910s-1920s. I do not claim it is the only paradigm, as the conception and articulation of industrial relations differs across countries and all have merit and interest. The early American paradigm commands attention, however, because it was in the United States that industrial relations as a formal concept and institutionalized entity first appeared in the academic and business worlds.

As noted in the Introduction, the field of industrial relations has suffered a significant decline in many countries of the world in recent years. One reason, I allege, is that over time industrial relations has increasingly become associated (not exclusively but predominantly) with a relatively narrow set of subjects related to trade unions and collective bargaining, and the labour law and policy regimes that regulate them. As national labour movements have declined across most countries, the field of industrial relations has inevitably suffered the same fate. The message of this article is that one strategy available to cope with this problem is to go back to the broader conception of industrial relations contained in the original paradigm. That is, in this original paradigm

⁴⁸ This idea is the foundation for the ILO's recent program to promote "decent work" in the world's economies. See *Reducing the Decent Work Deficit: A Global Challenge*, Geneva: International Labour Organization, 2001.

the core topic of industrial relations is the employment relationship – a subject that certainly includes trade unions and labour law/policy but that also includes many other employment-related topics.

To say that industrial relations covers the broad subject of the employment relationship is not enough, however. The field also has to bring to the analysis of the employment relationship a unified, productive intellectual and normative framework in order to give the field coherence and value-added. Another contribution of this paper is to suggest an outline of such a framework. This framework begins with a core principle: rejection of the orthodox model of a competitive demand/supply labour market and its complementary proposition that labour is a commodity. In its place, industrial relations must substitute an alternative theory of the employment relationship. My suggestion is that a fruitful place to look is the theory of institutional economics, along with complementary theories (e.g., socio-economics, the French *régulation* school). This body of theory provides an insightful explanation for the existence of the employment relationship that neoclassical economics lacks and also explains the existence of numerous labour and employment problems that neoclassical economics denies or minimizes. Finally, institutional economics also provides a theoretical and policy rationale for a selective, balanced and cost effective regime of institutional regulation of the employment relationship, including collective bargaining and protective labour laws, in contrast to the neo-liberal policy of orthodox economics that views such regulation and institutions as undesirable impediments to efficiency. Most certainly labour market regulation and institutional interventions can be carried to excess (and in some cases have been), but the fundamental theorem of industrial relations predicts that capitalism and

free markets would nonetheless self-destruct without an institutional infrastructure that humanizes, stabilizes, professionalizes, democratizes and balances the marvelous but flawed operation of demand and supply. Industrial relations, therefore, is the study and practice of finding a balance between market forces and institutions and the social objectives of efficiency, fairness and human self-development in the employment relationship.

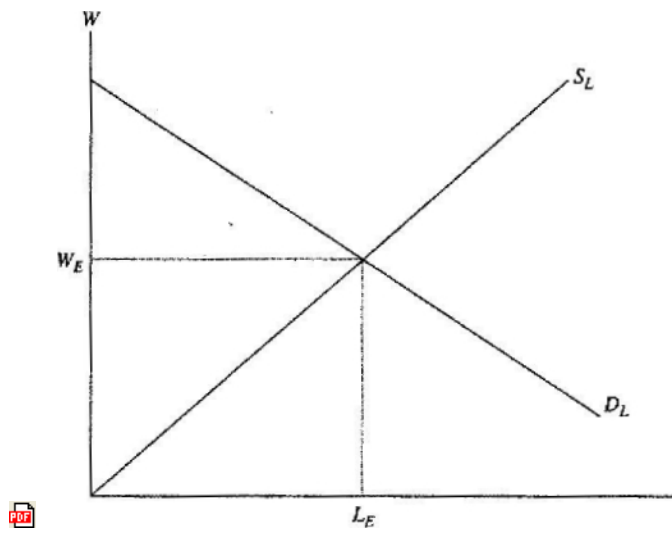


Figure 1: Competitive equilibrium in a labour-market.