Judicial Performance as A Worker Discipline Device

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1. Introduction

The shirking version of efficiency-wage theory postulates that the combination of high wages and tight monitoring induces workers to put forward their labor effort (Shapiro and Stiglitz, 1984). Later developments show that employment protection legislation (EPL) has a key role in this mechanism (Alvi, 1998; Gáldón-Sanchez and Güell; 2003; Chang et al., 2009). When EPL is poorly enforced, in fact, a firm facing a redundancy may use disciplinary dismissals to avoid firing costs. As the OECD Employment Outlook (2004: 66) puts forward, even if employers should be held responsible for disrespecting the EPL, "these provisions are subject to court interpretation and this may constitute a major […] source of variation in EPL strictness".[1] Marciano et al. (2019) show that even the most efficient rule will be ineffective if not properly enforced.

In this note, we analyze the effect of EPL enforcement on the wage level both theoretically and empirically. In section 2, we develop a shirking model to assess how judicial delay and the judges' political bias affect the efficiency-wage. In section 3, we test how such variables affect aggregate compensation levels using macro-data on French labor courts. Section 4 concludes.

[1] Gáldón-Sanchez and Güell (2003: 327) analyze French data over the period 1982–1998 and demonstrate that "almost 74% of all labour conflicts were declared unfair" that "individual dismissal conflicts represented on average 60% of total claims" and that "80% of the dismissals that arrived in court involved disciplinary disputes".

2. The model

We consider a modified version of Shapiro's and Stiglitz's (1984) shirking model to allow for variance in the "quantity" and "quality" of EPL enforcement. As usual, employees may either work and incur in the cost of effort $e > 0$ (strategy *N*) or shirk and supply no effort (strategy *S*). If employed, they receive a compensation $w > 0$; if unemployed, they receive their outside option V_U. While all workers face an exogenous probability $0 \leq b \leq 1$ of being terminated for economic reasons, shirkers are also fired for personal motives, which happens with the exogenous probability $0 \leq q \leq 1$.

We assume that the EPL requires firms to compensate the employees dismissed for economic reasons with a severance payment $g > 0$, while disciplinary dismissals are costless for the firm. Hence, firms may leverage on courts' imperfect information and declare redundancies as disciplinary dismissals to avoid firing costs. In this case, unjustly terminated workers may ask for compensation in court.[2] We assume that the expected returns of litigating are given by:

$$C = p(s)f(d) - c \tag{1}$$

where $c > 0$ measures litigation costs; $f(d) > 0$ is the present value of the compensation, $d \geq 0$ is the number of days needed by the court to handle the dispute – where we assume $f'(d) < 0$ and $f''(d) = 0$ – $0 < p < 1$ is the probability that the court will recognize a hidden redundancy and $0 < s < 1$ is the share of pro-labor judges in a given court – where we assume $p'(s) > 0, p''(s) = 0$ and $p(0) \geq 0$.

The assumption $f'(d) < 0$ specifies the expected compensation as a decreasing function of judicial delay (Djankov et al., 2003): the longer the labor trial, the smaller the present value

[2] In reality, EPL creates a "double moral hazard problem", as shirkers fired for personal motives may also claim unfair dismissal to get compensation—see Gáldón-Sanchez and Güell (2003). For an extended version of the model contemplating this possibility, see Appendix A.

of the compensation. The probability p that workers win the trial, in turn, may depend on the court's ideological bias, as pro-labor judges are more inclined to decide in favour of the plaintiffs (Spiller and Gely, 1992; Berger and Neugart, 2011). Hence the assumption $p'(s) > 0$. To simplify things, we impose the following restriction upon the set of parameters' values:

Assumption 1—$c/f(d) \leq p \leq g/f(d) \; \forall \; d \geq 0$.

According to assumption 1, it is a dominant strategy for workers to contest a hidden redundancy, while it is a dominant strategy for firms to declare redundancies as disciplinary dismissals.[3] Given the above, the workers' value functions are given by:

$$rV_E^N = w - e + b(V_U - V_E^N + C) \tag{2}$$

$$rV_E^S = w + (b + q)(V_U - V_E^S) \; + bC \tag{3}$$

where $r > 0$ is the discount rate. Solving equation (2) for V_E^N,(3) for V_E^S, and the payoff difference $V_E^N - V_E^S = 0$ for w, we derive what Shapiro and Stiglitz (1984) call the "no-shirking condition", that expresses the efficiency-wage level $\widehat{w}$ that make all workers just indifferent between shirking and non-shirking, which is given by:

$$w = rV_U + (r + b + q)e/q - bC \equiv \widehat{w} \tag{4}$$

From equation (4), we formulate two testable predictions, Hp1 and Hp2, concerning the effect of judicial performance on the wage rate, which are summarized in the following Proposition:

[3] Gáldón-Sanchez and Güell (2003) impose similar limitations. For a model contemplating the scenarios ruled out by Assumption 1, see Besancenot and Vranceanu (2009).

Proposition 1—*The efficiency wage is increasing in judicial delay* (Hp1) *and decreasing in the share of pro-labor judges* (Hp2)*.*

Proof: $\partial \widehat{w}/\partial d = -bp(s)f'(d) > 0$ since $f'(d) < 0$ by assumption and $\partial \widehat{w}/\partial s = -bp'(s)f(d) < 0$ since $p'(s) > 0$ by assumption ■

The intuition behind Proposition 1 is as follows: when workers can rely on quick and just labor trials in case of unfair termination, they have greater incentives to put forward their labor effort. Hence, poor EPL enforcement increases the efficiency-wage, as firms must raise the compensation to attract labor effort.

3. Empirical Analysis

We test the two hypotheses highlighted in Proposition 1 using data from French labor courts (*Conseils des Prud'hommes – CPHs*). Labor justice in France represents a harshly debated topics in the political agenda. While French EPL is itself very rigid compared to other developed countries (OECD, 2016), it has been shown that an ineffective enforcement of such regulation may hinder labor market's dynamism (Fraisse et al., 2015). Especially in the aftermath of the 2008 financial crisis and the consequent increase in the number of labor contracts' terminations, one of the critiques usually ascribed to *CPHs* is their lack of performance in terms of lengthy delays and excessive polarization among their judges. A unique institutional feature of *CHPs*, in fact, is that judges are elected via multi-party proportional elections as to equally represent both workers and employers. Ideology plays a relevant role in the election of judges representing workers, with moderate and confrontational unions competing for employees' consensus. Ideology thus reflects also on judges' performance, with more adversarial courts being relatively more supportive of labor litigation.

Because of data availability (wages measured only every 5 years) we employ a cross-section of the 203 *CPHs*' districts, averaging all other variables, that are measured between 2012 and 2016.

Table 1

	(1)	(2)	(3)	(4)
Judicial_delay	0.150***	0.105**	0.0487*	0.0664**
	(0.0541)	(0.0507)	(0.0283)	(0.0335)
Legal controls		Y		Y
Economic controls			Y	Y
Obs	203	203	203	203

Robust standard errors in parentheses. *** p<0.01, ** p<0.05, * p<0.1

Hp 1, that wages increase in judicial delay, is tested by an OLS model in which we regress (observed average) wages against judicial delay and various "economic" (gdp per capita, unemployment rates and the share of temporary workers) and "legal" (lawyers' density and litigation rates) controls. Results are displayed in Table 1. Our estimates predict that a 1 month increase in judicial enforcement is correlated to an increase in yearly wage that, depending on the specification, ranges between €50 to €150. We are aware that we cannot exclude *ex ante* the existence of reverse causality. However, to a more rigorous scrutiny, it is reasonable to claim that a richer district characterized by higher wages is much likely also characterized by better functioning institutions (Djankov et al., 2003) and thus lower judicial delays. If this is true, this means that even if biased, our results underestimate the true coefficients.

For Hp 2, that wages decline in the share of pro-labor judges, we employ an IV strategy. Recently, Nizza (2021) showed how the *Phylloxera* crisis[4] in the nineteenth century can be used as an exogenous source of the current variation in the geographical distribution of

[4] This event has already been used to test the impact of economic shocks on health conditions (Banerjee et al., 2010) or crime rates (Bignon et al., 2015).

confrontational unions [5]. The *Phylloxera* had an impact on unions' creation, which still predicts today electoral local support for confrontational unions in *CPHs*' elections and thus the share of pro-labor judges in courts. We construct our IV as a dummy equal to 1 if the district was hit by the blight, and 0 otherwise. As for the former estimation, we include a number of "legal" (judicial delay, litigation rates, lawyers' density) and "economic" (gdp, unemployment, the share of temporary workers and a dummy accounting for "agricultural" departments) controls.

Table 2

	(1)	(2)	(3)	(4)
	Panel A – second stage (dependent variable: wage)			
%_Confr_judges	-9.398***	-12.63***	-10.16***	-10.40***
	(3.070)	(4.666)	(2.947)	(3.830)
	Panel B – first stage (dependent variable: %_confr_judges)			
Phylloxera	.0703***	.0532***	.0765***	.0588***
	(0.000)	(0.001)	(0.000)	(0.000)
Legal controls			Y	Y
Economic controls		Y		Y
Obs.	203	203	203	203

Robust standard errors in parentheses. *** p<0.01, ** p<0.05, * p<0.1

All first-stage statistics (see Appendix B) suggest that our IV appears to be a relevant and possibly exogenous instrumental variable. Depending on the specification, a judicial district facing the *Phylloxera* crisis in the '800 is associated with around a 6% increase in the share of confrontational judges in today's *CPHs*. In our second stage this translates, assuming the validity of our identification strategy, in a reduction of about €100 of yearly salary for every additional percentage of pro-labor representation in *CPHs*.

[5] We adopt the classification by Desrieux and Espinosa (2019) considering judges elected with CGT and FO as pro-labor.

4. Conclusions

In this work, we developed a shirking model to analyze the effect of judicial delay and judges' ideology on the efficiency-wage. We find that wages increase with the lengthiness of trial and decrease with the share of confrontational judges. Our empirical estimates support these theoretical findings. However, we are aware that we cannot identify the underlying mechanisms with the data at hand. Hence, we mean this contribution as a preliminary exploration of the issue and leave further refinements for future research.

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