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# Working Conditions and Regulation

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## Abstract

Do employers invest sufficiently in the working conditions of employees? We examine this question in a simple principal-agent model. We show that, even though investment is contractible, the principal underinvests whenever her agent's alternatives are rather poor. This provides a reason for regulation. The indirect regulatory approach of taking measures that improve the agent's bargaining power or outside option at least weakly enhances the agent's well-being and welfare. The direct regulatory approach of demanding a certain standard of working conditions increases the principal's investment, but may nonetheless leave the agent's well-being unaffected and deteriorate welfare.

*Keywords:* Principal-Agent Model, Working Conditions, Regulation, Standards

*JEL:* D82, J3, J81, J88, M52

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## 1. Introduction

The well-being of employees depends not only on their remunerations, but crucially also on the working conditions they experience. The issue is highly controversial.<sup>1</sup> While the debate on working conditions often relates to developing countries, working conditions, especially health and safety protection, are also an important issue in developed countries. Probably the best indicator for the quality of working conditions, which is comparable across time and widely available, is fatal work injuries. In the U.S., 4,821 fatal work injuries were recorded in the year 2014 (Bureau of Labor Statistics, U.S. Department of Labor 2016a). Interestingly, while the number of fatal work injuries was around 6,000 during the 1990s, the count for 2014 was lower, but the highest since 2008, see Figure 1.<sup>2</sup> For the rate of fatal work injuries per 100,000 workers, see Figure 2. Historically, the numbers were even more dramatic. In 1913, approximately 23,000 industrial workers suffered fatal work injuries among a workforce of 38 million, implying a rate of 61 deaths per 100,000 workers (Corn 1992). There are huge differences in the rate of fatal work injury between occupations. While the rate among all workers was 3.4 per 100,000 full-time equivalent workers in 2014, the rate was 110.9 for logging workers, 80.8 for fishers and related fishing workers, 64.0 for aircraft pilots and flight engineers, and 47.4 for roofers (Bureau of Labor Statistics, U.S. Department of Labor 2016b).

—Figures 1 and 2 go about here—

In the European Union, using a different method than the U.S., which in particular excludes road traffic accidents, the standardized incidence rate per 100,000 employees of fatal accidents at work for 2013 is .51 in the U.K., .81 in Germany, 1.24 in Italy, 1.55 in Spain, and 2.94 in France (see the Eurostat Database).

On a global level, around 2.3 million deaths occur annually for reasons attributed to work, 1.95 million linked to fatal work-related diseases and .36 million linked to fatal accidents,<sup>3</sup> causing direct and indirect economic costs of roughly 4% of the annual global GDP (ILO 2009a). Hämäläinen, Saarela, and Takala (2009) estimate fatal work-related accidents and diseases for various regions and countries worldwide and document enormous differences. They

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<sup>1</sup>For alternative views, see Krugman (1997), Miller (2003), and Brown, Deardorff, and Stern (2004).

<sup>2</sup>A similar time trend is documented for Great Britain, see Health and Safety Executive (2016). While the rate of fatal work injuries has been on a downward trend during the last 20 years, in recent years there are signs of leveling off.

<sup>3</sup>For slightly different estimates, see Concha-Barrientos et al. (2005) and Hämäläinen, Takala, and Saarela (2006, 2007).

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