



Wages, performance and harassment[☆]



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ABSTRACT

Higher wages reduce workplace harassment directly by raising the cost for harassers, indirectly by attracting agent types who file complaint if harassed. I show that low wage-high harassment combinations are neither compatible with effort objectives nor collusion-proof. Better internal compliance structures (lower cost of filing complaint, accurate and speedy investigations) reduce the wage bill and/or the frequency of harassment but also narrow the range of feasible anti-harassment targets. Wages and harassment risks should be negatively correlated across organizations with similar and effective compliance structures, whereas organizations with less effective compliance structures must pay higher wages to induce the same harassment level.

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1. Introduction

Workplace harassment based on protected traits such as ethnic or national origin, religion, gender, race and disability is a form of discrimination under state and federal laws, Title VII of the Civil Rights Act in the United States. Member countries of the European Union have their special labor codes and anti-harassment laws.¹ Although sexual harassment attracts the largest attention in media and popular fora, some other forms of harassment are at least as common.²

The law in the United States has evolved with the Equal Employment Opportunity Commission's (EEOC) guidelines in 1980, the Organizational Sentencing Guidelines in 1991 and landmark Supreme Court decisions. Two broad categories of harassment are defined: in a *quid pro quo* type a supervisor harasses a subordinate under threat of adverse employment action. In *hostile environment* harassment, there is no tangible employment action; the act typically involves co-workers, is

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¹ The prevalent legal term for similar acts of workplace harassment differs from nation to nation: "mobbing" is used in Germany and Nordic countries, "bullying" in Britain and Ireland, whereas the French ("harcèlement moral"), Spanish ("maltrato psicológico") and Italian ("molestie psicologiche") terms literally overlap with the notion of harassment.

² 33 percent of the 109,472 charges filed with the EEOC during the 1990s were gender-based; 43 percent were race-based and 14 percent were national-origin based (Johnson, 2004).

unwelcome, severe and creates an abusive work environment. The majority of harassment litigation falls into the second category, where the liability regime is negligence-based. The law basically imposes minimal prevention and enforcement standards on employers in setting up their grievance procedures and contractual measures to deter employee conduct that contributes to a hostile work environment.³

The substantial literature on workplace harassment outlines a litany of costs to the organization from unwanted publicity, litigation and negative effects on recruitment outcomes as well as retention of existing workforce. We know that harassment is prevalent in many forms, creates a hostile and unpleasant workplace environment, reduces productivity and increases absenteeism and sick leaves. We have little understanding, however, as to whether and how contracts can be used to cope with co-worker harassment in conjunction with the internal compliance structures imposed by the law. Do employers face a conflict between inducing specific performance and anti-harassment targets? What modification in the wages encourages internal complaints and reduces the probability of co-worker harassment? What role do internal compliance structures play in this mechanism?

I address these questions in a moral hazard model where a principal hires two agents, X and Y. In the first stage of employment the agents choose their effort levels. The principal independently inspects effort levels using a stochastic technology which may or may not produce verifiable evidence. Following the effort-inspection stage, Y may harass X. If harassed, X may stay silent or file complaint internally. In line with the EEOC guidelines, confirmation of harassment has a contractual consequence for Y, which in the model is equivalent to termination. The quality of the internal compliance structure is captured by three parameters, the cost of filing complaint, the probability with which the victim prevails, and the remedial effects of procedural quality (such as the speed and accuracy of the investigation) on the victim. As such, the analysis applies to all forms of co-worker harassment that are actionable on the basis of gender, disability, religious, racial or ethnic discrimination.

The types of X and Y, the victim's harm and the harasser's benefit, are private information. The principal designs a single contract for the agent position, specifying a wage under each inspection outcome. Although this contract cannot screen out the unsavory high-benefit harassers, it can in part serve to attract the high-harm X types who resist and file complaint if harassed. The principal has two objectives: ensure that the agents exert high effort and induce a pair of target harassment probabilities (p_H, p_θ), in the presence and the absence of high effort evidence. I briefly explain the results and relate the paper to the literature below.

The two anti-harassment targets determine the agents' wages under high effort evidence and no effort evidence, w_A^H and w_A^θ . The lower the principal's targets p_H and p_θ , the higher are w_A^H and w_A^θ . Because the contractual consequence of confirmed harassment is termination, higher wages directly deter harassment by increasing the price for harassment. There is also an indirect reinforcing effect that works by raising the probability of complaint upon harassment, because higher wages imply a higher contractual utility and attract high-harm whistleblower types to the workplace. This mechanism operates only in the presence of an effective grievance procedure. Without the threat of an internal complaint, wages have no impact on workplace harassment.

The analysis identifies a range of anti-harassment targets that are not compatible with the effort objective—this holds even if co-worker harassment does not directly affect productivity. Roughly put, p_H should not be set too high relative to p_θ , for otherwise the wage under high effort evidence, w_A^H , falls below the critical level that prevents shirking primarily by Y types whose harassment benefits are large. This tension between effort and anti-harassment objectives increases at asymmetric targets: For low p_θ targets, the principal's target p_H must also be low to be compatible with the high effort objective. Because the probability of complaint is high when at least one of the two harassment probabilities is low, it is impossible to prevent shirking by the harasser types of Y by inducing a low p_θ with a high p_H (which corresponds to a relatively low wage under high effort evidence). If p_θ is low, p_H must also be low and the wages paid under high effort evidence, large enough. Combining high p_θ with low p_H is feasible, however. The possibility of collusion, studied in [Appendix A](#) by introducing a supervisor to collect performance evidence, does not qualitatively change this feasibility result.⁴ Effort incentive compatibility and collusion-proofness considerations both rule out high p_H targets, in particular when p_θ is low. To perform, the worker must expect a high wage when good performance is certified, and high wages are consistent only with low harassment probabilities.

These results shed light on the contractual mechanisms that support anti-harassment policies without sacrificing from effort objectives. The last set of results highlight the impact of an improvement in the internal compliance structures, be

³ Estimates of women who have experienced some form of sexual harassment in their workplace range between 40 and 75 percent ([Aggarwal and Gupta, 2000](#).) The employer is liable for co-worker harassment if it knew or should have known the incidence and was negligent in promptly taking the remedial steps. In practice negligence could be evidenced by the quality of internal anti-harassment compliance structures such as employee training, dissemination of the organization's policies designed to prevent harassment and formal grievance procedures. The extremely high potential costs of a workplace harassment action have led most employers to install grievance procedures by the late 1990s and comply with the EEOC standards.

⁴ Collusion cannot happen when inspection fails because hard evidence cannot be forged. It can happen when inspection succeeds, if the supervisor agrees to conceal evidence and submit an inconclusive report, in two occasions. A joint deviation to low effort for prospective collusion in case the supervisor obtains low effort evidence can be prevented by appropriately raising the supervisor's wage for reporting low effort evidence. This comes at no cost to the principal because low effort lies off the path induced by incentive-compatible and collusion-proof contracts. In the other occasion, when the supervisor obtains evidence of high effort, the surplus from collusion is positive if p_H is sufficiently higher than p_θ because the agent wage for a high effort report, w_A^H , is then relatively low. Though this type of collusion can be prevented by increasing the supervisor's wage for reporting the evidence, raising the wage bill to induce a high harassment probability p_H can hardly be justified in the presence of a lower collusion-proof p_H which can be induced at lower cost.

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