The Effects Court Enforcement of Contracts has on Shirking

A Study of Contract Law in France

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I. Introduction

Once upon a time, when visiting Germany with my high school class, we stumbled upon a pizza shop in the center of town. We entered, expecting a succulent meal to be provided by this establishment. Perhaps our first clue was expecting pizza in Germany, but things did not go our way. We ordered our food and sat waiting for a few minutes. A few minutes turned into ten, turned to thirty, and then an hour. After enough time had passed, one member of our party decided to check the kitchen to ascertain the status of our order only to find that there was no pizza being made. The pizza maker had shirked on his obligations to provide us food. More importantly, he shirked his company's contractual requirements. As the good economic student that I ascribe to be, I asked: what institutional arrangements make shirking more likely than others?

While attempting to determine all institutional arrangements that incentivize shirking is too broad of a topic to cover in any one project, this paper will address one instance that generates such actions. In French labor law, it is increasingly difficult to fire an employee, and the court system in handing employment cases of illegal firing vary in their judgements. This paper will argue that the lack of contractual enforcement of firing in French permanent contracts leads to shirking among workers, and businesses adapt to this institutional framework by utilizing self-enforcing contracts that involve benefits for contractual compliance rather than costs for noncompliance.

II. Roadmap

The paper will begin by addressing how the broader economic literature understands shirking, and the framework that undergirds the topic. After this, it will address that

contractual enforcement is not only neglected because monitoring costs, but also because of a government's capacity to uphold the stated contractual agreement. Once this framework has been built, the French legal context on firing workers will be introduced, and the broader institution of permanent contracts and employment tribunals will be discussed. It is from this position that this paper will argue that there is variation in the judgements from these employment tribunals that leads to uncertainty by entrepreneurs and shirking among workers. Once this has been shown, the paper will present how French employers adapt to this institutional arrangement to keep workers most efficiently from shirking. To do this, a brief interlude will be done to address what self-enforcing contracts are, and then how the French contracts differ from the regular analysis.

III. Shirking in the Literature

The problem of shirking is defined very simply in the literature. When two parties desire a mutual exchange – such as an employer wanting a commodity produced and an employee desiring a wage – they write up a contract that stipulates rewards for both parties holding to their end of the bargain and disciplinary action for noncompliance. However, the terms of the contract are built on and require enforcement for both parties to uphold their end of the bargain. If contracts are not enforced, then the costs of violating the terms of the agreement are lowered, and the constraints binding each party do not hold. Because of this, infringing the terms of agreement are more likely to take place, *ceteris paribus*. These actions of contractual violation are defined as shirking.[1]

[1] Staten, M.. and Umbeck, J., "Information Costs and Incentives to Shirk: Disability Compensation of Air Traffic Controllers" *American Economic Association* 72, no. 5 (1995): 1023.

Let us say that a manager hires an employee to construct rubber ducks. Under the contract, the worker is required to produce so many ducks a day, and from this he receives a wage. The profitability of the rubber ducks is influenced by actions of the worker, but not all of these are clearly visible, and he can choose to either take the high action of performance or the low action of shirking.[2] Under the common model, our duck manufacturer is a utility-maximizer, and is motivated by two possible options: leisure and pecuniary compensation. The employee may choose to produce ducks and receive a wage for his action, or he may engage in leisurely activities – such as bathing with a rubber duck. He will allocate the tradeoff between making ducks and enjoying them accordingly. However, "if labor rewards are not perfectly correlated with productive effort, then the incentive to produce is diminished – shirking results."[3]

When are labor rewards not perfectly correlated with productive effort? One such example that the literature focuses on is when there are costs associated with monitoring performance. If principals could observe their agents without cost, then there would be no incentive to shirk because the full costs of shirking can be borne by the agent through the adjustment of contractual benefits. The worker would show that they marginally prefer more leisure over working, and they would receive a lower wage to compensate this. However, when there are costs to monitor agents, then the principals cannot perfectly adjust their contracts, and the workers are then not forced to bear the full costs of shirking. The agent can shirk without the principal knowing. "Monitoring will only be undertaken so long as the marginal gains from reduced shirking equal or exceed the

[2] Zhu, J., "Optimal Contracts with Shirking" *Review of Economic Studies* 80, no. 2 (2013): 812.
[3] Staten, M. and Umbeck, J., "Information Costs and Incentives to Shirk: Disability Compensation of Air Traffic Controllers": 1023.

marginal costs of detection. Less-than-perfect monitoring implies some shirking incentives remain."[4]

Let us return to our duck manufacturer for a moment. When our worker decides to spend time talking to the ducks rather than casting plastic polymers and placing them in rotational ovens – and the manager observes this – then they go back to the negotiation room. The worker explains that he desires more time playing with his artificially feathered friends, and the manager docks his pay. However, if for the manager to observe this contractual violation he must stay extra hours at the factory, then there is a margin that the costs of the manager observing the worker will outweigh the benefits of stopping him from playing with the product. The worker will make his ducks and play with them too; he will shirk undetected.

The literature addresses this problem through efficiency wage models, and there are many papers on this methodology. T. Barmby, J. Sessions and J. Treble attempt to address the effect of health on absenteeism (a type of shirking), and their approach is a good example of the literature more broadly. In their paper, workers are supposed to be risk-neutral utility maximizers, and their utility is a function of their income and leisure. Furthermore, they attach a weight to each good that depends on their overall health where they value leisure more as their health decreases. There is a threshold that the company sets where sick leave is acceptable, and workers receive sick pay if they meet it.[5] However, due to asymmetric information, where it is assumed that workers still prefer to

[4] Staten, M. and Umbeck, J., "Information Costs and Incentives to Shirk: Disability Compensation of Air Traffic Controllers": 1023.
[5] Barmby, T., Sessions, J., and Treble J., "Absenteeism, Efficiency Wages, and Shirking" *The Scandinavian Journal of Economics* 96, no. 4 (1994): 562

be absent from work for all sickness that is under the minimum threshold, there is the incentive for them to overstate their level of sickness – and this is the cause of shirking. Because shirking is costly, firms may choose to monitor the true health status of their workers at some average cost.[6] However, when the costs of monitoring rise, there is incentive for firms to find alternative ways to diminish shirking. After calculating out company costs, expenditures from monitoring shirkers, and the equilibrium wage rate, they determine that "The firm's optimal response to an increase in the cost of monitoring, assuming that monitoring remains the efficient option, is to reduce costly shirking by raising wages."[7]

At the backbone of the argument is the proposition that raising wages increases worker productivity and reduces the incentive to shirk. It is true that raising a worker's wage increases the potential costs of shirking on the margin, and there will be less shirking, *ceteris paribus*. This is where they assume that increasing wages increases productivity – and these authors are not the only ones to do so. William Encinosa, Martin Gaynor, and James Rebitzer, in their paper on the effect of pay practices on incentives, note that,

> Economic models of compensation treat pay practices as a solution to an incentive problem. High levels of performance require high levels of effort and, beyond some minimal point, providing this effort is costly. Firms desiring high levels of performance from employees should therefore link economic rewards closely to an individual's productive contribution.[8]

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[6] Barmby, J. Sessions and J. Treble, "Absenteeism, Efficiency Wages, and Shirking" (1994): 563.
[7] Barmby, J. Sessions and J. Treble, "Absenteeism, Efficiency Wages, and Shirking" (1994): 565.
[8] Encinosa W., Gaynor M., and Rebitzer J., "The Sociology of Groups and the Economics of Incentives: Theory and Evidence on Compensation Systems" *Institute of Labor Economics Discussion Papers* 1851 (Bonn: IZA Institute of Labour Economics, 2005), 2.

While it is true that raising wages provides raises the opportunity cost for potential shirkers, the literature too often focuses on monitoring costs as the main cause of shirking. At its heart, the way that the economic profession addresses the inefficiency shirking generates is to structure contracts so that they incentivize performance over nonperformance. Addressing possible ways to improve contracts is not an unadmirable goal, but it is also not the only way that shirking can be understood. If we revisit our definition, we stated shirking occurs when contracts are not perfectly enforced, and while monitoring costs undermine the enforcement of contracts, they are not the only means of doing so.

III. Contractual Enforcement

Another mechanism that affects contractual enforcement is the willingness for courts to uphold the stated terms of agreements. To address how the state enforces contracts, either efficiently or inefficiently, it is important to first understand what makes a contract perfect. Robert Cooter and Thomas Ullen, in their textbook *Law and Economics*, give a very concise definition of what a perfect contract is.

> According to the Coase Theorem, given zero transaction costs, rational parties will allocate legal entitlements efficiently. This proposition applies to contracts. When transaction costs are zero, the contract is a perfect instrument for exchange. Every contingency is anticipated; every risk is internalized; all relevant information is communicated; no gaps remain for courts to fill; no one needs the court's protection from deceit or abuse; nothing can go wrong. Perfect contracts pose no conundrums of interpretation. The parties need the state to enforce a perfect contract according to its plain meaning, but nothing more is required.[9]

[9] Cooter, R. and Ullen, T., *Law & Economics*, 6th Edition (London: Pearson Education, Inc, 2012), 291-292.

Under perfect contracts, all possible contingencies can be anticipated and accounted for, and there will be no deceit, abuse, or shirking of contractual duties. In this knowledge experiment, all parties observe perfect information and perfect monitoring of performance – and because of this both parties are forced to bear the full costs of their actions and there is efficiency where wages are perfectly correlated with the productive effort of workers.

Contracts that we observe in the real world are not perfect, and there are many reasons for this. Let us return to our duck manufacturer for a moment to address some of these imperfections. When our manager and duck constructor write out their contract, they attempt to list as many contingencies in their contract as they can reasonably expect. If the worker slips on a rubber duck in the workplace and injures his back, he is allowed paid leave for seven days; or if he becomes sick from inhaling plastic fumes, he is allowed four days of paid leave. Even though both parties list as many contingencies they can think of, how do they interact when an unforeseen event happens? Let us say that our manufacturer assumes that melted rubber ducks would make an adequate substitute for the rising prices of gas, because both contain petroleum. However, this substitution ends up overheating his engine and he becomes stranded on the side of the road and unable to attend work. Under the terms of their contract, is the manufacturer allowed to skip work?

This is where the court system steps in to fill the gap. If the employer docks the duck manufacturer's pay for missing work, and he believes this to be against the contract, then he may sue the company. When this case is brought to court, the judge has three possible resolutions to this problem. First, he may judge as if the contract were perfect, and state that all possible reasons for absence were listed and thus upholding the

employer's docking of pay. Secondly, the judge may fill in the gaps of the contract and attempt to come to a solution that does not go against the stated terms of the contract. He could assume that, if both parties had anticipated a car malfunction, that the manufacturer would have been allowed to arrive late to work – and so he judges that the docking of pay was unjust. Lastly, he may override the explicit terms of the contract, and judge on his own decisions. He may say that it is unjust docking pay for the worker being late for any reason, and rule against the employer and force them to pay damages.[10]

It is with this last option that the problem of contractual enforcement enters the analysis. In the case that two parties write a contract with explicit terms, and the court refuses to abide by the arrangement made, then there is a margin where the contract is not enforced. If two parties write into their contract that a worker cannot become absent from work for car problems, and the courts refuse to uphold this agreement when the contingency takes place, then the costs of not complying with this are lowered. This will display to current workers that, legally, employers cannot uphold this portion of the contract. As a result of this verdict, marginally more employees would take less care of their vehicles, and when they experience a car malfunction would be absent from work. The court's willingness to uphold the explicit terms of contracts affects incentives, and when they do not enforce them shirking results on the margin.

IV. French Labor Contracts

It is from this background of contractual enforcement being a function of a government's willingness to uphold the explicit terms that leads us to France. In French

[10] Cooter, R. and Ullen, T., *Law & Economics,* 292.

Labor Code, there are two types of contracts that employers may offer potential employees: contrat de travail à durée déterminée (CDD) and contrat de travail à durée indéterminée (CDI). In the simplest sense, the contracts differ where CDD are fixed labor contracts, with a *determined* period of employment; and the CDI are permanent labor contracts, with an *indetermined* period of employment. While this paper's analysis of French contract law will only focus on CDI, it is important to address both types – as to understand the limitations of permanent contracts.

Contrat de travail à durée indéterminée are the standard type of contract that French businesses may offer to potential employees. These CDI do not have a specified end date written into the contractual agreement and do not require renewal for continual employment. Permanent contracts are the norm in French firms, which is a circumstance that has been heavily influenced by French law. Firstly, these contracts are supported because they are required to have a minimum of rights that are provided by the company – which includes a minimum wage – and cannot include clauses that are deemed "against French values and law." Secondly, French courts heavily favor permanent contracts because of the proposed benefits to general workers and regulate when employers are allowed to terminate an employee's contract. A French publisher notes this, saying that:

> This form of contract may be broken at any time by a unilateral decision; such as a decision by the employee to resign, or by the employer should they feel there are grounds for the dismissal of the employee. The contract may even be brought to an end by factors beyond either party's control (such as an 'Act of God', e.g. the entire business premises is destroyed in a natural disaster)[11]

[11] Campbell, E., "Types of Employment Contract in France", *Tironem.com*, Tironem, Accessed December 2021. https://www.tironem.com/employment-contracts-france/

Contrat de travail à durée déterminée are instead a rarer type of contract in French business. As the name suggests, CDD are labor contracts where the duration of employment is fixed and has a set date for its termination. While these types of contracts have many purposes, when and where they can be offered to laborers is narrowed to specific cases. Under these specific cases, there are two broad categories that allow for firms to use fixed contracts. The first category where employers are allowed to hire temporary workers is if the work itself is temporary. Let us assume for a moment that our Rubber Duck Manufacturing Company manager is assumed to be shirking and not paying workers their due, and so the board of directors wants to audit his specific branch. The work required to audit is not indefinite, as an audit has a completion date in and of itself. So, these board of directors may use a fixed contract to hire an auditor, to ensure their workers are being compensated fairly. The second category is if a company desires to increase their activity and production temporarily. If, for example, our Rubber Duck Company expects that in summertime, people on average purchase more ducks to enjoy in the bath or pool. Our managers may hire employees to increase the production necessary for the summer by use of fixed labor contracts, and their termination will naturally come at the end of the agreed upon period.[12]

While fixed term contracts may be used in specific cases, French law regulates the length of potential contracts. If a seasonal worker was to be hired, they may only be given a contract for less than nine months. If a worker is absent for sick leave, then a fixed contract may be given for up to eighteen months. In addition to the length of fixed term contracts, the courts also specify how many times certain uses can be renewed. In most

[12] Campbell, E., “Types of Employment Contract in France”

cases, these contracts are nonrenewable, except if the employee is over 57 years old – in which it may be renewed once and may last at a max of 36 months.[13] While fixed term contracts are important, because they constitute a proportion of the working class in France, there are different rules and consequently different incentive structures. It is because these contracts face different incentive structures that this paper will only focus on the CDI permanent contracts.

As briefly mentioned above, courts regulate when firms are allowed to terminate contracts with employees. The French Labor Code – the *Code Du Travail* – is recorded to consistently favor employees over their employers, and this can be observed from many angles. Firstly, Article L1232-1 of the code states that an employee's dismissal is only justified if it is backed by a *réelle et sérieuse* cause and if it adheres to dismissal procedures outlined. The list of real and serious causes for firing are broken into two broader categories: personal reasons and economic reasons.[14]

Personal reasons consist of those relating to the employee specifically. The most justified reason that an employer may terminate a permanent contract that relates to the employee is for disciplinary action. Under this category, there are three stages of seriousness that permit an employee to be terminated. The first order cause of dismissal is for "simple faults." Simple faults consist of those having to do with error or malicious actions that negatively impact the business' profitability. The second order is for "grave faults," where the employee either intentionally or unintentionally behaves in a manner that creates a toxic work environment – such as sexual harassment – where the employee

[13] Campbell, E., "Types of Employment Contract in France"
[14] "Terminating an employee in France", *safeguardglobal.com,* Safeguard Global, September 2021, https://www.safeguardglobal.com/resources/blog/terminating-an-employee-in-france.

can be terminated immediately without compensation. The third order is for "gross faults," where an employee intentionally attempts to cause harm to other employees or their employer – and they may be dismissed immediately without compensation.[15]

Economic reasons for dismissal must relate to the hardship that the company faces from a profit or loss perspective. Firms are legally allowed to fire employees if they perceive it to be beneficial or necessary to keep profit or avoid losses. However, an economic reason must satisfy one or more of four conditions. The first condition is that the dismissal must not be inherently tied to the employee, because those reasons for dismissal fall under the personal category. Secondly, the company may let go of employees if they are experiencing economic hardships, such as losses, where they must reallocate their funds. Thirdly, a company may let go of workers if they are introducing technology that makes the worker obsolete, such as self-checkout counters. Lastly, a company may let go of employees if they must do so to maintain competitiveness in their market.[16]

V. French Employment Tribunals

Even in the case that an employee is dismissed for either an economic or personal reason, the company must back their assertions and claims with documentation and proof. If the dismissed employee believes that either the reasons for firing are unfair or there is not adequate proof for their claims, then they may dispute it before an employment tribunal.[17] These tribunals, named *conseils de prud'hommes*, were created in 1806 to

[15] "Terminating an employee in France", September 2021.
[16] Ibid.
[17] Ibid.

settle disputes between employers and workers headed by lay *conseillers* rather than professional judges. There are 210 courts dispersed across France, and each one is headed by a team of two lay judges, who work together to bring both parties to conciliation. If the two groups cannot come to a mutually agreed upon resolution to the proposed unfair dismissal, then the case is pushed further to a public hearing where one of four *conseillers* must preside over and adjudicate based on evidence presented. However, while stated goal of the tribunal is to bring parties to mutual agreement, in 2013 only 5.5% of them successfully did so.[18]

Let us say that our worker is fired from his job at the French branch of Rubber Duck Manufacturing Company, where his manager claims that he has been stealing the product from the assembly lines. When the evidence is presented in a pre-dismissal meeting, the worker believes that there is not adequate proof for his dismissal. Instead, he argues that he has not been slipping his plastic friends into his pockets, but that they rather fell from the conveyor belts. When he appeals to the employment tribunal, and it naturally processes past the conciliation phase to a public hearing, the courts must listen to evidence produced on both sides. After both parties plead and bring forth their claims, the four *conseillers* retire to adjudicate based on the presentations of the case. If they cannot come to a majority decision, then a professional judge from a local district court is contacted to break the tie after a second hearing.[19] If, at the end of this process, the court has decided that the worker was wrongfully fired, then the company must pay him

[18] Burgess, P., et al., "The roles, resources and competencies of employee lay judges: A cross-national study of Germany, France and Great Britain" *Working Paper Forschungsförderung* 051 (Düsseldorf: Hans Böckler Foundation, 2017), 14.
[19] Desrieux, C. and Espinosa, R., "Case Selection and Judicial Decision-Making: Evidence from French Labor Courts" *European Journal of Law and Economics* 47, no. 1 (2019): 4.

damages in addition to severance pay "for the loss which he has suffered and the profit which he has been deprived of."[20]

VI. Shirking, a Result of French Employment Tribunals

We mentioned earlier that these tribunals only reconciled 5.5% of the cases that they received in 2013, and this raises two important questions. First, how efficient are tribunals at fulfilling their stated goal? Secondly, are their judgements consistent? Regarding the first question, the stated goal of the *conseille de prud'hommes* is to bring both parties together to aid them in reconciling their differences. To achieve this, the first step that the courts take is a mandatory conciliation period, where both parties formally convene with two *conseillers*, they present information on their cases, and are walked through the option of reconciliation.[21] However, Romain Espinosa and Claudine Desrieux note that in a period from 1998-2012 only 13.47% of cases ended in conciliation between employer and employee, and 24.75% ended with the employee withdrawing their claim. This shows that 61.78% of cases were brought into the second public hearing stage, where judges (either lay or professional) were forced to determine fault. While withdrawn cases may be made up of a portion of out-of-court settlements that are not documented as conciliation, there is still a strong majority that shows the courts fail to meet their stated goals.[22]

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[20] "Of Contracts and of Conventional Obligations in General," *Civil Code*, Chapter 3, Section 4, Article 1149, Translated by Rouhette, G. (Lisbon: University of Lisbon, accessed 2021): 149.
[21] Burgess, P., et al., "The roles, resources and competencies of employee lay judges: A cross-national study of Germany, France and Great Britain", 14.
[22] Desrieux, C. and Espinosa, R., "Case Selection and Judicial Decision-Making: Evidence from French Labor Courts," 9.

The second question comprises the main problem of this paper, as it relates to shirking: are the judgements that the *conseillers* give consistent? Because France is a civil law country, precedent does not guide much of their decisions – although rulings of higher courts often guide those of lower courts.[23] So while it would be important for a common law country to rule off how other courts have decided a law is applied to firing in a specific case, this does not take place in France. Further than this, the nature of the lay judges does not require a deep understanding of the law per say. Peter Burgess notes that in total there are 14,500 lay labor court judges, and they all come from separate backgrounds. Firstly, there are both *employee* lay judges – who are often union representatives – and *employer* lay judges – who are chosen by firm representatives. Secondly, among these many lay magistrates, only 41% of them have either an undergraduate or postgraduate degree, with 56% of employer *conseillers* and 27% of employee *conseillers* having one. What he then infers is that most of these judges are self-taught in matters of law and mostly learn the tools of the trade from participating in hearings.[24] While this does not immediately imply that the judgements made by *conseillers* is arbitrary, it does help to explain a possible reason why they might be – they are not required to be trained in law.

The main source for the argument that judges inconsistently adjudicate cases has to do with data presented by Espinosa and Desrieux in their paper, *Case Selection and Judicial Decision-Making: Evidence from French Labor Courts*, where they analyze whether union membership of judges affects the outcomes of court cases. While their

[23] Burgess, P., et al., "The roles, resources and competencies of employee lay judges: A cross-national study of Germany, France and Great Britain", 12.
[24] Ibid., 15.

findings are not discussed within the scope of this paper, they present main source of data for these courts. In an article presented to the Institut de Politique Publiques about their paper, they begin with a clear statement:

> The uncertainty about the outcomes of proceedings before France's employment tribunals ("les conseils de prud'hommes", also known as "les prud'hommes") is often pointed to as a possible damper on hiring of new staff. This uncertainty would appear to be generated in part by the fact that similar cases brought before them seem to be judged differently from one time to another or from one tribunal to another. After recalling the historic aim of the "institution prud'homale", the way it works, and recent changes to it, this policy brief shows that the decisions rendered by the French employment tribunals do indeed vary strongly from one tribunal to another. However, the source of this variability remains in doubt: it might equally well reflect the arbitrary nature of "prud'homale" justice as the fact that the cases judged by the various tribunals are of different natures and of different seriousness.[25]

They further continue to describe the sorts of variation that would seem to show that decisions between tribunals differ. They state that the overall variation in decisions that are favorable to the employee over the employer is one factor. While on average, 72% of all cases brought to hearing are judged in favor of the employee, this figure varies from as low as 8% to as high as 97%, and 80% of the observations fall between 60-80%. While they state that the variation is attributed across both tribunal and time, they continue to mention that time only accounts for 1% of the variation observed.[26]

If it is true that courts are likely to favor the employee 8% to 97% of the time on average, entrepreneurs will be unsure whether their decision to terminate a contract will be upheld. How do the authors address this problem of variation? As mentioned above,

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[25] Breda, T., Chevrot-Bianco, E., Desrieux, C., and Espinosa, R., "French employment tribunals: can the disparity of their decisions be explained?", *HAL-SHS Open Science* 02522702, (Lyon: Centre pour la Communication Scientifique Directe, 2020), 1

[26] Breda, T., Chevrot-Bianco, E., Desrieux, C., and Espinosa, R., "French employment tribunals: can the disparity of their decisions be explained?", 5-6

the conclusion of their paper is that union membership of lay judges does not affect the outcome of a court case. Instead, they argue that courts that are more polarized and seem to heavily favor one party over another face more difficult cases, where there is not clear evidence for one side or another. When cases are brought to public hearing, there is an average of 18.8 months for the panel of four *conseillers* to resolve the dispute, while this time increases to 32 months if they contact a professional judge to break the tie. The authors show that this presents a strong opportunity cost to both parties of going to court, because 15% of all cases that reach a public hearing are sent to a professional judge. [27] Let us say that our rubber duck maker knows there is clear evidence that he has indeed not been stealing product from assembly lines – and he presents this to his previous employer in the pre-trial conciliation meeting. Because of the opportunity cost of a possible 32-month trial, the employer has the incentive to settle – knowing it will be decided against his favor. Desrieux and Espinosa show that settlement is chosen for cases that have clear evidence in favor of one litigator or the other. Because of this, the cases that are brought to public hearing are those where the evidence for either side is not clear. They state that the variation observed in courts consistently favoring one party over another is a result of them judging more difficult cases.[28]

While the authors argue that easier cases reach conciliation because of the opportunity cost, only 13.47% of the cases in their data set were resolved via conciliation – and even if we include the cases that were withdrawn, 61.78% of all cases were brought

[27] Desrieux, C. and Espinosa, R., "Case Selection and Judicial Decision-Making: Evidence from French Labor Courts", 9.
[28] Desrieux, C. and Espinosa, R., "Case Selection and Judicial Decision-Making: Evidence from French Labor Courts", 23.

to public hearing.[29] If Desrieux and Espinosa are correct, then most cases brought before a tribunal involved cases that were harder to anticipate the outcome of. While these judges may not be adjudicating on values instilled by union representation, the absence of clear evidence for firing would present a lack of contractual enforcement for employers on the margin. If they did not have clear evidence in the onset of terminating a worker's contract, then they would not expect their decisions to be upheld and not terminate a contract. This would mean that employers who fire employees for contractual violations on the margin would experience a lack of contractual enforcement by the French Employment Tribunals.

If we revisit our definition of shirking, violations result when contracts are not perfectly enforced. In this case of France, we would theoretically expect that shirking would result when the explicit terms of a contract are not being enforced, even if it is for evidential reasons. Let us say that our rubber duck manufacturing company fires a second employee for stealing rubber ducks. Although they have employee testimony and a diminished output for the days the employee worked, the case is brought to court and the *conseillers* determine that there is not enough evidence to fire the employee. While the manager believed to be holding the employee to the explicit terms of the contract, instead he finds himself without legitimate backing by the courts. The courts and employers may have different expectations on what constitutes as legitimate evidence. What this judgement does for other workers to shirk on the margin because they recognize that the

[29] Desrieux, C. and Espinosa, R., "Case Selection and Judicial Decision-Making: Evidence from French Labor Courts", 9.

company can no longer hold them to their contracts. This company would experience more rubber ducks lost from assembly lines, and less product to sell.

While this only a theoretical claim that shirking results from the lack of enforcement of termination policies under the *conseils de prud'hommes,* there is evidence that supports the claim that shirking results from the inability for a firm to fire employees. Vincenzo Scoppa and Daniela Vuri, in their paper on regional shirking in Italy, analyze the relationship between unemployment rates and levels of absenteeism. In their conclusion, they find that there is a strong negative relationship between unemployment and the rate of absenteeism in a firm. To further back up this claim, they show that this effect is not present in public firms; and while there could be many explanations for this absence of a relationship, they attribute it to the probability of being fired for shirking being almost zero.[30] While this evidence is not directly related to French labor contracts, it backs up the assertion that the inability to fire employees has a positive effect on shirking.

VII. What are Self-Regulating Contracts?

This finding poses a strong threat to the efficiency of firms that operate in France, because they would experience lower productivity, less product produced, and lower profits as result of shirking. On the margin, this would put some firms out of business if they are unable to adapt to the new institutional framework. So, how do they mitigate shirking when governments do not uphold the stated terms of their contract? One method

[30] Scoppa, V., and Vuri, D., "Absenteeism, Unemployment and Employment Protection Legislation: Evidence from Italy" *Institute of Labor Economics Discussion Papers* 7091, (Bonn: IZA Institute of Labour Economics, 2012), 19.

that the economics literature points to solve this issue of government enforcement more broadly is self-enforcing contracts. Before we discuss how these are used by French firms, we must describe what self-enforcing contracts are.

When two parties write up a contract, there is always a possibility for one party to hold the other up. Let us say that a wealthy congressman hosts a party to celebrate his triumph in a local election. He contracts the Rubber Duck Manufacturing Company to bring 10,000 rubber ducks to join in the celebration – and writes in a clause that he may change the delivery date at any moment – and when the date of the anticipated festival arrives, he falls ill. He contacts the company and requests them to delay sending the rubber ducks a week. At this point, the manufacturer may attempt to hold-up the congressman, and force him hold to the original arrangement, thereby violating the contract – and he will do this if the short-run benefit of not changing the delivery date outweighs the long-run benefits of keeping the contract. While the general analysis is that the congressman may sue the manufacturer and the court would hold both parties to the original contracting paradigm, this is an explicit enforcement mechanism. The congressman could instead structure his contract to be implicitly enforced such that whenever he wins an election, he pays the company to deliver 10,000 ducks. However, if the manufacturer refuses to alter the delivery date on any occasion, then the contract is terminated, and no future exchanges take place. This contract would be self-enforcing if the manufacturer “expects to earn a future quasi-rent stream the present discounted value

of which is greater than the immediate short-run gain from breaching the contractual understanding."[31]

Contracts are self-enforcing when they do not require governments to demand compliance, but rather when the cost-benefit structure is such that neither party will be incentivized to violate the explicit terms of agreement. However, the problem for France comes in here: the literature discusses self-enforcing contracts with either party having the option of terminating the contract if the other shirks, and France does not consistently allow for employers to dismiss employees. So how can they structure contracts to have implicit enforcement?

If we revisit our definition, contracts are self-enforcing when the party facing termination "expects to earn a future quasi-rent stream… greater than the immediate short-run gain from breaching the contractual understanding."[32] Contracts can be self-enforcing by supplying benefits for compliance rather than costs for noncompliance, and there are multiple ways that businesses can demonstrate this. While the literature does not necessarily always talk about principal-agent problems in the context of self-enforcing contracts, there have been many proposed ways to overcome the incentive problems presented. Principals can offer certain benefits that transform such that the short-run leisure that is gained from shirking takes away an opportunity for greater monetary payment later.

[31] Klein, B., "Self-Enforcing Contracts" *Journal of Institutional and Theoretical Economics* 141, no. 4 (1985): 595.
[32] Klein, B., "Self-Enforcing Contracts", 595.

An example of this phenomenon would be stockholders giving golden parachutes to CEOs upon their termination in a merger. The principal-agent problem is presented as such: the CEO and the stockholders hold different incentives when a company is presented with a possibly beneficial merger. On the one hand, the merger could bring greater revenue and profits to the stockholders, but it could also mean that the CEO would be released and lose his job. So, the CEO may undermine the merger, which is in his benefit against the potential profits of the stockholders. To change the incentives of the executive, a business may introduce a "golden parachute" clause, which states that upon his termination in a merger, the CEO is given special compensation. This prevents the self-interest of the agent from negatively impacting a beneficial merger.[33] In short, golden parachutes offer a benefit to the employee that they lose if they choose to shirk instead of performing, rather than firing them for not choosing to merge.

VIII. Benefits for French Employees

How do French companies offer benefits in such a manner that incentivizes workers to choose performance rather than contractual noncompliance? While there are many that can be discussed, such as fuel cards, bonuses, meal vouchers, and stock grants, the most interesting example is the use of company cars as a bonus. ON Semiconductor Corporation is a manufacturer of semiconductor components used in a wide variety of industries, such as automotive, internet, and medical fields. Most importantly for this paper, they have offices in both France and the United States.[34] In the benefits summary provided by the company, ON Semiconductors provides company cars to employees

[33] Bress, R., "Golden Parachutes: Untangling the Ripcords" *Stanford Law Review* 39, no. 4 (1987): 955.
[34] "About Onsemi", *onsemi.com,* (Phoenix: ON Semiconductor Corporation), accessed December 2021, https://www.onsemi.com/company/about-onsemi

above salary grade 15 – and not all workers of this pay grade receive them. In short, company cars are offered based on performance, rather than a handout to all workers of that grade. This benefit is not offered to just one type of worker either, but rather is offered to engineers, sales managers, account managers, and directors as well.[35] While this offer is present in their French contracts, their United States benefits summary does not include this as an option.[36]

This is not an anomaly found in ON Semiconductors, but rather company cars make up 25% of all car purchases in France.[37] While in the United States, we may think of a plumber or electrician's van when we think of company cars, this is not how they are used in France. Company cars are often luxury cars that are offered for employees to use both on the job and off the job. So, instead of stating that they may only be used for transportation to and from work, company cars are used for personal use as well. Furthermore, all insurance, maintenance, and repairs are borne by the company. Offering cars as a benefit is so prolific in France that it has its own tax-status as a "benefit-in-kind" to workers as well.[38]

Let us say that our rubber duck company worker is considering shirking; he desires to sneak one of his little friends off the line and take him home without paying for one. However, he recognizes that if he is caught doing so – although he may not be fired

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[35] "2021 French Benefits Summary", *onsemi.com*, (Phoenix: ON Semiconductor Corporation), accessed December 2021, https://www.onsemi.com/site/pdf/Benefits-Summary-France.pdf
[36] "2021 USA Benefits Summary", *onsemi.com*, (Phoenix: ON Semiconductor Corporation), accessed December 2021, https://www.onsemi.com/site/pdf/Benefits-Summary-USA.pdf
[37]ITF, "Understanding Consumer Vehicle Choice: A New Car Fleet Model for France", *International Transport Forum Policy Papers* 72, (Paris: The International Transport Forum, 2019): 7.
[38] "Use of a Luxury Car as a Company Vehicle in France" *cabinet-roche.com*, Roche & Cie, November 2016, https://www.cabinet-roche.com/en/use-of-a-luxury-as-a-company-vehicle/

– he would lose out on the possibility of owning a Maserati once he is promoted from an assembly line worker to an engineer. If, in this case, he prefers the future benefit of driving a Maserati over the present satisfaction of a rubber duck, then he will choose to comply with the terms of his contract and not shirk. In this manner, French companies offer company cars to mitigate potential shirking when government enforcement cannot be relied on. Such contracts are self-enforcing because they incentivize workers to hold to their explicit terms of their contracts because the benefits of long-run compliance are greater than the short-run gains from violation: less rubber ducks shall be stolen.

IX. Conclusion

This paper shows that in France, companies offer benefits to workers to mitigate the potential for shirking that arises under the lack of contractual enforcement found in the French Employment Tribunals. This is done in contrast to terminating a contract, because employers cannot always expect their decision to terminate employment to be upheld. Car allowances may be an outlandish example, as other benefits such as stock grants may make up a greater proportion of company spending, but it helps illustrate the point clearly.

With this conclusion noted, this paper does fall short in a few aspects. Firstly, this is only a theoretical background and does not provide empirical support for the claims made. While it would have been more than beneficial to utilize statistics to back the claim that French workers shirk more on the margin because of the Employment Tribunals, the scope of this paper could not offer such analysis. Secondly, this paper only asserts one of many ways French companies offer benefits to workers. While this paper builds a background to understand shirking in French firms, there should be more research done

on the specifics of how great of an effect the tribunals have on shirking and what benefits are used most in their companies. Lastly, this paper only analyzes the effect of court enforcement in a specific civil law country, and cannot be extrapolated to analyze common law systems, where the method of adjudication is based in precedent. For this reason, more research should be done statistically on the Employment Tribunals, on specific benefits in French contracts, and on court enforcement in common law countries.

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