

## **INSTITUTIONAL WAGE STANDARDS IN PUBLIC SECTOR INTEREST ARBITRATION**

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### **ABSTRACT**

For negotiations that are at impasse most public sector collective bargaining laws require interest arbitration. Typically, the only issue remaining at impasse in public sector negotiations is the economic package, and the most common economic issue is that of wages. Because the strike is proscribed in most jurisdictions, and the labor market is imperfect, a theory of second bets has emerged in settlement of these matters. Rather than relying on market forces, the parties must rely on interest arbitrators and their applications of the institutional wage standards to the record of evidence to determine what the appropriate wage shall be. This article reviews these institutional wage standards and some of the difficulties in providing evidence concerning these matters.

It is generally true that public sector contract negotiations are often more controversial and more closely watched by the general public than private sector collective bargaining activities. The reason for this is that the negotiations generally involve important public services, and the public's tax dollars. If General Motors and the United Auto Workers fail to reach an agreement, you can always take your business to Ford, Chrysler, or one of the foreign car manufacturers. However, public safety employees and the city have no alternatives available. Garbage

collectors on strike can make for unpleasant environs; however, they are not as critical as police and fire. The end result is that most jurisdictions outlaw strike activity for public employees and substitute statutory impasse procedures to resolve impasses between the parties [1].

The beginning point for any analysis of interest arbitration is the impasse. Impasses arise in negotiations when continued bargaining is unlikely to result in an agreement. Most state collective bargaining statutes define impasses or set a date when, if no agreement is reached, for purposes of the law impasse procedures must be applied [1].

This article examines the standards applied by interest arbitrators in resolving disputes concerning wages. Elkouri and Elkouri identified three standards routinely applied in public sector wage disputes: 1) ability to pay, 2) prevailing practice or comparative norm, and 3) cost of living or living wage [2]. The Elkouri's also identified what they refer to as minor standards, which include 1) productivity, 2) past practice and bargaining history, 3) geographic differentials, and 4) steadiness of employment. It is these standards that shape how interest arbitrators make awards.

### **Preliminary Matters**

The standards identified for the resolution of wage impasses are not applied in a vacuum. These standards are applied in the context of the jurisdiction's statutory requirements, if any; the parties' negotiations; and the standards the parties themselves have used in their negotiations over time. Interest arbitration in this context is, in one important respect, a simple extension of the parties' own negotiations. The literature seems to support the conclusion that the impasse procedures have had an impact on the parties negotiations [3].

However, impasse procedures have been criticized as having adverse effects on the parties bargaining behaviors. Hoyt Wheeler suggested that there was a "narcotic effect" associated with the parties becoming increasingly reliant upon statutory impasse procedures [4]. In other words, the parties engage in bargaining designed merely result in impasse, and they let the neutral take the heat from their constituents for the arbitration award. Hence the parties become addicted to arbitration. There is also an alleged "chilling effect" on negotiations that lead up to impasse procedures being invoked [5]. The chilling effect is defined as an impasse brought to interest arbitration, in which an arbitrator will consider the parties' offers, but the parties negotiate not to reach agreement, rather, to optimize their result in the impasse procedures—hence a chilling effect on collective bargaining. There is also some evidence to suggest that police unions, in particular, have politicized negotiations by taking their demands and evidence off the bargaining table and taking those items to the public [6].

Most state collective bargaining statutes provide for an impasse procedure, should the parties be unable to negotiate their contract without outside

intervention. For example, the Kansas Public Employment Relations Act provides for factfinding should mediation fail to resolve the parties' dispute [1]. Kansas has no provision for interest arbitration. Iowa, on the other hand, provides for interest arbitration after factfinding, but limits the arbitrator to selecting the last offer of either party or the factfinder's recommendation [1]. State statutes also define the relationship between governing bodies (school boards, city councils, etc.) and their obligation to collectively bargain. The majority of the states bar settlements that result in deficit financing for the government entity [1]. The budgetary matters in federal law are also not subject to collective bargaining, budgets are fixed by the United States Congress, and therefore matters such as budget or wages in federal negotiations are illegal issues of collective bargaining [7].

It is also the state administrative law agency that maintains lists of interest arbitrators for the parties to select or who are assigned to particular impasses. The selection of interest arbitrators has been widely analyzed, and it is generally their experience and decisions in previous cases that determines their acceptability to parties in future cases [8-10]. The interest arbitrators who hear these cases are often the very same people who serve as factfinders, and they often serve in several states [11]. It is this group of people who apply the standards for wage determination and operationalize the jurisdictions' impasse procedures contained in the collective bargaining statutes.

### MAJOR INSTITUTIONAL WAGE STANDARDS

Interest arbitrators are sometimes obliged by the jurisdiction's collective bargaining statute to apply specific standards in framing their awards. For example, the Indiana Educational Employment Relations Act specifies the standards to be employed by factfinders operating under that law:

. . . The fact-finder shall make a recommendation as to the settlement of the disputes over which he has jurisdiction. In conducting such hearing and investigations, . . . ; he shall, however, take into consideration the following factors:

- (1) Past memoranda of agreements and contracts between the parties.
- (2) Comparisons of wage and hours of the employees involved, with wages of other employees working for other public agencies and private concerns doing comparable work, giving consideration to factors peculiar to the school corporation.
- (3) The public interest.
- (4) The financial impact upon the school corporation and whether any settlement will cause such school corporation to engage in deficit financing [12, §20-7.5-1-13, et seq.].

Where the statute prohibits an arbitrator from making an award that would result in deficit financing the ability to pay becomes the threshold issue before other standards can be employed [1]. Even where the statutory proscriptions of deficit financing do not exist, interest arbitrators still tend to use this standard as a threshold requirement for wage awards [13, 14]. Otherwise, the arbitrator typically has no other statutory obligation with respect to which standards will be applied in which order. Customarily, however, interest arbitrators will apply the standards the parties themselves used in their negotiations when statutory obligations do not specify otherwise.

### **Ability to Pay**

An ability to pay for a public employer is not an easily determined financial situation. An ability to pay for a union wage demand can be met by deficit financing. However, the wisdom of requiring such payments and the ability to make those payments are not the same thing [15]. What is clear is that much of this standard is involved in the budgetary process and the accounting practiced by the public agency [16]. The applicability of generally accepted accounting principles (GAAP) in collective bargaining, in general, and in the public sector specifically has been the subject of controversy [17-19]. While there are those who advocate reliance on the GAAP [16], this approach has been criticized:

. . . These GAAP promote conservatism and objectivity and an historical record view of accounting. We submit that GAAP-inspired, conventionally prepared accounting data should not be sanctified: there is a strong case that such data are inherently unserviceable (i.e., not technically fit) for the purposes of collective bargaining. This thesis was propounded by Clarke and Craig [20]. . . . These authors claimed that much data emerging from the accounting process are not "true and fair" as purported, but rather are idiosyncratic artifacts of an inherently creative process: they provide poor indications of financial wealth, define assets to include other things that have no monetary existence, violate the law of additivity by regarding every dollar appearing in a financial statement as representing identical purchasing power, equate 'cold hard cash' with the figures in financial statements preceded by dollar signs, and focus on past financial performance rather than on future financial viability. . . . [19, pp. 281-282].

In the public sector the budgetary process is often complicated and specified by statute in its form and presentation. The end result is that the fixed data of the public sector budget may not portray images that are readily recognizable for their implications for the parties' negotiations. There are many difficulties in interpreting these data. Contingency planning, account transfers, annual carry-over, and overbudgeted accounts are methods by which an ability to pay may be difficult to extract from the data.

It is also true that an ability to pay and deficit financing are not necessarily the same thing. Deficits are not new to the public sector, and recurring expenditures are sometimes funded by deficit expenditures. However, the initiation of new expenditures or wage increases is not often taken lightly by neutrals faced with arbitrating wage issues [14]. Interest arbitrators have also awarded pay increases where the inability to pay is of a temporary nature or when the current financial difficulties are a one-time occurrence [2].

Most jurisdictions require that the parties negotiate in good faith. As part of this obligation, the majority of jurisdictions have adopted the stance taken by the National Labor Relations Board in its decision in the case of *Truitt Manufacturing* [21]. Upon appeal, the Supreme Court sustained the N.L.R.B.'s prescription concerning claims of an inability to pay. If an employer claims it has an inability to pay economic demands by a union, the employer must be prepared to prove that claim of an inability with specific and reliable evidence. In the private sector, as well as in most public sector jurisdictions, employers do not claim an inability to pay to avoid the evidential difficulties resulting from such claims. In cases of claimed inability to pay, interest arbitrators are sometimes left unpersuaded by budget and tax revenue information [22]. Without limitations on debt or simply no ability to transfer funds between budget lines, public employers engage in a risky strategy in claiming an inability to pay. Even so, there are times when the record of evidence shows that an employer is struggling financially and does not have the resources to meet the economic demands of the union, hence truncating the need for an arbitrator to apply the following standards; otherwise, the ability to pay will be weighed against the remaining standards.

### **Prevailing Practice**

The prevailing practice standard is also sometimes called the comparative norm. This standard is commonly relied on by interest arbitrators if the threshold of ability to pay has been met [23-25]. In fact, it is reported that this standard is the most commonly relied upon standard by interest arbitrators:

This standard is the one most widely used, though it is not used as the sole standard in most cases. The reasons for its use are multiple: Valid, reliable evidence is available; it carries connotations of fairness; and it may reflect market forces as well. Even its reputation as an acceptable standard enhances its acceptability to parties at impasse. As the name implies, this standard is concerned with what other similarly situated bargaining relations or similar employer-employee contracts have used for solutions to common problems [26, p. 127].

The key to this standard is the existence of comparable jurisdictions and occupations that are similarly situated. Similarly situated means that the demands placed on the occupation in the jurisdictions are essentially the same, that the taxing units are similar in size and tax base, and that in most important respects

the comparables are similar to the parties' own situation. Proof of the comparability data must be offered, unless the parties stipulate to a group of comparable jurisdictions, which is relatively common throughout the country.

If proof must be adduced to show that one comparability group is better than another, that evidence must be reliable and credible. Telephone surveys by business agents or city managers hardly constitute material for winning cases. The data should be gathered by professional, if not independent, entities, with clear descriptions as to the methodology employed in gathering the data and when the data were gathered. If one party must err in the gathering of comparability data, it is clearly preferable to err on the side of credibility and clarity. It is the quality of the evidence, not its convenience, that wins cases [25, 26].

There are also other comparisons that the parties to wage disputes will often proffer into the record of interest arbitration hearings. Public safety employees have some common risk factors and often pay close attention to their relative compensation levels. For example, police and firefighters often cite one another's settlements as support for their own proposals because they are both public safety employees [26, 27].

Therefore, both vertical [26] (among occupations, generally within the same jurisdiction) and horizontal [24] comparability groups are commonly on the bargaining table. The parties' own negotiations typically focus on both the fairness and the market considerations of these groups. If comparable occupations within a jurisdiction suffer pay inequities, this is normally a source of divisiveness and dissatisfaction [28]. The horizontal comparisons are with similarly situated employers, and pay differentials among similar jurisdictions, especially if geographic proximity may lead to high turnover rates for the jurisdiction whose pay schedule is at a disadvantage—much the same as functioning markets would predict [29].

### **Cost of Living**

The cost-of-living standard is a reflection of the principle of microeconomic theory, which suggests that workers do not offer their services for a nominal wage, but they offer their services for what that wage will buy for them—their standard of living [30]. As a result, the effects of inflation on the purchasing power of public employees' wages can produce impasses due to catch-up demands, i.e., the restoration of lost purchasing power. Public sector negotiations have rarely resulted in cost-of-living or escalator clauses, as has been the case in private sector negotiations [31]. In school contracts and most city employee agreements, the parties have settled either for single-year contracts, wage re-openers for multiple-year contracts, or occasionally, wage increases negotiated for the current year coupled with reliance on a forecast for annual increases in subsequent years, with the obvious problems as a result of forecast errors.

The data for cost-of-living (Consumer Price Index, CPI) standards are gathered by the U.S. Department of Commerce and are published in several governmental sources [32]. These data are national, but they are also gathered and published for the largest cities in the United States, called Standard Metropolitan Statistical Areas. For smaller communities, the governmental sources are of little practical use. A private research organization, American Chamber of Commerce Research Association, Indianapolis, Indiana, publishes a cross-sectional index that covers a large number of small and intermediate-size cities [33].

There are difficulties in applying this standard and considerable debate concerning the accuracy of the CPI data. Naturally, the data are gathered assuming a particular market basket of goods, which may or may not be representative of any particular household. For households with paid-off mortgages, who live in temperate climates and have public transportation, the CPI may overestimate the costs of living. However, for households in cold climates, paying their mortgages, with car loans and several children, it is equally clear that the CPI may understate their costs of living. The CPI is therefore just a rough guide to what is happening to the cost of living for a relatively large group of persons.

### **Minor Standards**

Often the major standards of wage determination are not the only issues that the parties bring to the bargaining table. Among these additional standards are 1) productivity, 2) past practice and bargaining history, 3) geographic differentials, and 4) steadiness of employment. These standards are rarely standalone causes for an arbitrator's decision, but are often combined with the major standards, or serve as corroboration for the evidence concerning a major wage standard.

Greater productivity or increases in productivity, including increased expectations of employees, have been utilized by arbitrators in deciding that wage increases are appropriate [34]. A parallel standard to the productivity standard is where an increase in risk or responsibilities is in evidence [35]. The basic concept in applying this standard is fairness: since more productivity is required, more compensation should be paid.

Bargaining history and the practices of the parties with respect to the issues they have considered important when they negotiated their contracts without impasse are often given significant weight by interest arbitrators [2]. It is the parties' own negotiations and their solutions that are the best guides for the neutral about what the parties had been willing to accept previously. While this history may be part of the reason the parties are at impasse, one party or the other must convince the arbitrator that a move away from this history is supported by the record of evidence in that case [26].

Geographic differentials are also of importance in public sector negotiations. A state like Illinois provides an excellent example of how geography may

affect negotiations. Chicago is a far different place than downstate Illinois. The cost of living, the close proximity of a large number of comparable employers, and a strong union presence makes Chicago entirely different from Marion or Effingham, Illinois. To compare large urban areas with rural areas is inappropriate in most cases. What transpires in the Midwest may not be correlated with either coast. Further, this standard is also used in conjunction with the cost-of-living standard, and occasionally with the comparability standard because of worker mobility being limited by close proximity of other employers.

Steadiness of employment was historically a standard often argued by public employers because of the perception that governmental employment was less prone to job loss than private sector employment. This reasoning behind this standard was that because of the steadiness of the public employment, an employee would earn more (due to increased hours) than in the private sector, which experiences layoffs over periods of time and through the business cycle. During the past decade, this supposed steadiness of employment in the public sector has lost much of its luster, as governmental entities have laid employees off at rates unprecedented in public employment [2, 26].

## CONCLUSIONS

Collective bargaining typically arises because of market failures [36]. Because the markets do not function to allocate financial resources, collective bargaining has been substituted in the majority of public sector jurisdictions. Most negotiations end in a mutually acceptable contract between the employer and union. However, a few of these negotiations result in impasse. Some of these impasses are resolved in mediation, but many go to factfinding and interest arbitration.

When an impasse over wage issues goes to factfinding or interest arbitration, a neutral third party is asked to decide the issue for the parties. In deciding the issue, neutrals rely on what have become known as institutional wage standards. The three major standards: ability to pay, cost of living, and prevailing practice, together with several minor standards, are used to emulate a market solution to the impasse and to make the process more predictable than it might otherwise be.

Because these standards are applied to a record of evidence, it is the quality of evidence together with the standards that result in wage determination once impasse is reached. As imperfect as these standards are, they have proven serviceable and continue to be the basis for negotiations and impasse resolution in the public sector in the United States.

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