ABILITY TO PAY AS AN ISSUE

IN PUBLIC SECTOR INTEREST ARBITRATION

A Study of the Experience in Six Jurisdictions:
Iowa, Minnesota, Wisconsin, Michigan,
New York City and New York State

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May, 1981

Ability to Pay as an Issue in Interest Arbitration

There is an often quoted Latin proverb which states, "Nemo dat quod non habet," which freely translated is "No one gives what he does not have." It is quite unlikely that this proverb is part of the legislative history providing for the criterion of ability to pay in statutes authorizing arbitration as a means of resolving impasses in negotiations. Nevertheless, the concept embodied in the proverb would appear to be the basis for including ability to pay as a factor that an arbitrator must deal with in making a determination.

It would seem, even absent such a criterion in the statute, that an arbitrator would of necessity have to deal with this issue if raised by a public employer or if raised by the employee organization. Yet its inclusion in the legislation would seem desirable for two reasons: First, the legislature, in delegating to an arbitrator the authority to fix to a degree the costs of government, should provide explicit and reasonable standards to be used by the arbitrators in making a determination. Secondly, public employers when confronted with the prospect of having some "outside person" deciding wages and other economic benefits to be paid the employees, would understandably be apprehensive because it would be left to the public employer to fund the award made by the arbitrator. Thus, the inclusion of the criterion ability to pay does as least assure the public employer that the financial condition of the governmental entity will be considered by the arbiter and in a rational manner.

This, of course, is not to say that unions or employee organizations do not share a sense of apprehension in having terms of a bargaining agreement finally determined by a neutral rather than in the negotiating process. But such organizations are not as concerned about ability to pay at least in the sense that the public employer is. Rather, their concern about ability to pay is that it may be used, over emphasized or indeed manipulated to defeat the attainment of a fair and equitable settlement, a settlement clearly justified on comparability and other factors such as increases in the cost of living.

The term ability to pay as used in most statutes is not defined or explicated.1/ Its application, therefore, raises many and serious questions. For example, (a) should the arbitrator simply consider the budget as prepared and presented by the public employer and, if the budget does not permit

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1/ Recent legislation in New York State affecting New York City did define ability to pay, and that will be considered in the section infra dealing with New York City.

the granting of benefits sought by the union, then the arbitrator may conclude that the employer lacks ability to pay; (b) to what extent do arbitrators question the priorities in the budget and to what extent does the award directly or indirectly result in the reordering of such priorities; (c) if the funds necessary to implement requested benefits would be available only through borrowing (a source available to an employer) or by an increase in taxes, do arbitrators directly or indirectly require the employer to borrow or to increase taxes; (d) is ability to pay accorded greater weight than other statutory criteria; (e) what evidence have arbitrators relied upon to find ability or inability to pay; (f) do arbitrators consider the employer's ability to pay simply in the light of the demands of the bargaining unit in arbitration or do they consider the ability to pay in the light of the employer's funding of increases to its other employees?

The factor "Interest and Welfare of the Public" is frequently joined with the criterion ability to pay in statutory formulation. This phrase, "Interest and Welfare of the Public," is, however, not defined in the statutes and perhaps does not permit a definition, for it will mean different things to different people depending upon their perspectives. To some undoubtedly it would mean the avoidance of onerous tax burdens; to others it would mean fair and reasonable compensation for public employees.

Though it is a broad term and not precise in meaning, it would seem that the purpose of its inclusion among statutory criteria is to make arbitrators ever mindful that the very purpose of government is to serve the public in providing those services deemed necessary for the community which comprises the government.

As will appear infra, some arbitrators use "Interest and Welfare of the Public" as a crutch or "catchall" to support an otherwise unsupported conclusion such as denying an increase on the ground that it would not be in the public interest without ever explaining the basis for such a finding. However, it would seem that a proper construction of "Interest and Welfare of the Public" is that it should strike a balance between the competing positions of the public employer and public employees, namely that it is in the public interest to have a work force that is efficient and reasonably compensated.

A study was made of arbitrators' awards in six jurisdictions: Iowa, Minnesota, Wisconsin, Michigan, New York City and New York State, in order to determine how arbitrators have dealt with these and similar questions.

SUMMARY

The Underlying Problem

The basic problem in the application of the ability to pay criterion is well-stated in an award wherein the arbitrator noted:

> On the one hand, employees are required to face continuing and inexorable increases in their costs of living; on the other hand, employers are beleaguered by economic and fiscal problems where their available revenue can no longer keep pace with the rising cost of operation. 1/

A. Issue Not Discussed by the Arbitrator

As is indicated by the summary of experience in the jurisdictions reviewed, there were many awards in which there was no discussion of the financial ability of the employer. A reasonable conclusion might be drawn from this, namely, that neither party raised the issue. However, where the statute mandates that it be considered, it would seem desirable for the arbitrator to inquire of either side as to whether either will raise the issue of ability to pay or, at the very least, note in the award that neither party has placed financial ability in issue.

If this were followed, it would seem to preclude a court reviewing the award from questioning it or overturning it for failure to deal with statutory criteria. The mere recital that the arbitrator has considered the statutory criteria, and makes a conclusory statement that they have been considered, would not be enough. If it is not discussed because it was not placed in issue, it should be so stated.

The Supreme Court in Michigan pointed out that the arbitration panel does not have the discretion to ignore any applicable factor, and that this is so even where the parties fail to introduce evidence or any such factor.2/ The Court stated that the panel has an obligation to direct the parties to submit evidence relating to applicable factors. Ability to pay would appear to be *prima facie* an applicable factor in any economic issue, unless the parties, or more particularly the employer, state that ability to pay is not an issue.

1/ City of Buffalo and Buffalo PBA, Case No. 1A-19 (New York) Slip Opinion, P. 7.

2/ City of Detroit v Police Officers Assoc.___ Mich.___ 105 LRRM 3083.

In some cases in which there was no discussion of the award, the arbitrator did adopt the employer's position. Perhaps it was reasoned that, if the award accepted the employer's proposal, it was obviously within its ability and there was therefore no need to discuss financial ability. However, if the award were based on comparability, it might be that those entities which formed the basis of comparison had fiscal constraints not shared by the subject employer. Thus, its financial ability might be a factor indicating that, in this instance, a higher award might be warranted.

The criterion ability to pay should be discussed for the following reasons:

(1) To assure each party that they have been heard and that the statutory criteria have been followed;

(2) So that nonparties could look to the award for some precedential value. Without discussion on the issue of ability to pay, such precedential value is reduced.

(3) To indicate to all who read the award that the system provided by the legislature is being followed.

B. Weight Given tothe Criterion Ability to Pay

Ability to pay is only one of several factors to be considered by the arbitrators in reaching a determination. Arbitrators do discuss the relative weight to be given to ability to pay vis-à-vis the other factors in the statute, such as comparability.

A majority of the decisions reviewed take the position that no one of the statutory criteria is controlling, and that ability to pay is just one of several factors to be considered. This view has found support in judicial review. In City of Buffalo (Renaldo),3/ the Court noted by way of dicta that, even if the statute mandated consideration of ability to pay, the arbitrators would still be vested with authority to determine priorities among all relevant factors in a balancing process.4/

3/ New York Court of Appeals, 41 N.Y.2d 764.

4/ Ibid., p. 768.

Yet, other arbitrators have taken a somewhat different approach, namely, that ability to pay will reduce an otherwise justified increase, i.e., justified under other criteria. Thus, while other criteria may support the union's economic proposals, the employer's inability to pay may reduce the proposal or, perhaps, negate it.

These two views may not be that disparate, for one is saying that ability to pay is not a dispositive factor and, indeed, it is not. For example, the fact that the employer has ability to pay for a benefit, not justified on another basis such as comparability, does not mean that it should be awarded. The other is saying that inability to pay, however, may be a dispositive factor in that the evidence on this point is so strong that on balance it is determinative. However, to be determinative, the financial inability should be irremedial, i.e., there are no alternatives available for the funding of the increase, such as borrowing, a tax increase or reallocation of resources.

C. Ability to Pay and Other Employee Groups

Frequently, in the course of arbitration, the public employer will, on the issue of financial ability, raise the question that the increase sought by the employee organization can not be considered in vacuo; rather, it must be considered in the light of demands of, or its responsibility to, other employee groups.

This, in turn, raises a basic question: to what extent should a panel in interest arbitration consider the fact that the employer is or may be faced with demands of other employee groups? The Michigan study discussed previously indicated that the panel should deal only with the particular bargaining unit before it, and should not consider matters beyond the unit before it. This would appear to bar from consideration the effects of its award on other employee groups employed by the same employer.

This approach does not appear to be realistic. Assume that:

(a) a police unit is before the panel, with firefighters still in negotiations;
(b) the public employer has a $100,000 surplus which is the only available source to fund an increase for both units;

(c) the cost of the increase sought by the police is $75,000.

To say, upon the above assumptions, that the panel should consider the employer's ability to pay in the isolated circumstances of the police unit would tend to negate the purpose of the criterion.

Arbitrators have evinced a lack of unanimity on this question. Some arbitrators have expressly stated that they will not consider the effect of their award on increases sought by other employee groups. Other arbitrators, citing "Interest and Welfare of the Public", have tempered the award because of this consideration. I do not believe, however, that an award should be based solely on an allocation of available resources on an ex aequo basis because that would fail to take into consideration that a larger share should be allocated to a particular group on the basis of other criteria. For example, one panel limited its award to the employees' share of available funds based on such employees' share in the current budget. This approach, while it has a logical appeal, is not very persuasive, for it would seem to ignore other criteria which might support a larger increase for a particular group of employees.

One problem with the approach -- that the arbitration panel consider financial ability of the employer only in the light of the bargaining unit before it -- is best illustrated by the two City of Beloit cases considered in the Wisconsin discussion, supra. In the police case, a $30,000 surplus was mentioned and it was also cited in the firefighters' case. If each arbitrator were to act relying on the $30,000 surplus for the award in each case, an obvious problem would arise.

In sum, it would appear to be improper to fail to consider other demands upon the employer's resources, and it would seem equally improper in a mechanistic way that the other needs of the employer be a determinative factor in the panel's award; rather, it should be a balancing process.

In New York City, many decisions were based on prior settlements with other bargaining units in the City. Some panels there stated they would not go beyond such settlements even though the equities might have warranted a somewhat larger increase. Perhaps this was the result of the City's unique and serious fiscal problems.

In New York State, one arbitrator defined "Interest and Welfare of the Public" as maintaining a relationship as to benefits among all employees of an employer so as not to create unreasonable inequities.

Thus, apart from stated policy, it would seem in practice that an arbitrator does not always consider financial ability of an employer solely in the light of the demands of the employee group before him, but does give consideration to the other needs of the governmental entity, including its obligations to other employees.

D. The Arbitrator and the Employer's Budget

The arbitrators in Iowa, Minnesota and Wisconsin appear to take a far more activist role in the scrutiny and review of the public employer's budget than the arbitrators in the other jurisdictions studied herein.

Arbitrators, on the evidence before them, will find on comparability and increases in the cost of living that employees are entitled to a significant increase. Yet, the budget as submitted by the employer would seemingly preclude the funding of any increase and, thus, the employer has *prima facie* made out a case for financial inability.

If the arbitrator in these circumstances were to accept the budget as submitted, without subjecting it to scrutiny and review, the arbitral process would be rendered meaningless.

In the midwestern states, it is clear that the arbitrators do not accept the employer's budget as a document carved in stone. Arbitrators have considered the following:

(1) Whether under the Employer's budget and past practice, for example, the employer has underestimated its revenues in the past. If so, then less credence would be given to the projected deficit or the extent thereof.

(2) Whether the claim of poverty is self-imposed in that the employer could have obtained a tax increase by submitting the issue to the electorate, but declined to do so.

(3) Whether the fiscal problem is due in part to the budgeting of major repairs as a one year expenditure rather than amortizing it over a number of years.

(4) The questioning of priorities such as the paving of a teacher's parking lot or the subsidization of a sports arena rather than the provision of money for a warranted wage increase.

In Minnesota, a public employer claimed it was operating at a deficit and therefore could not fund any increase. An analysis of the budget confirmed this fact. However, the arbitrator considered some of the expenditures in the budget and questioned the priorities in the light of a proposed zero increase to teachers during a period of double digit inflation. The arbitrator awarded an increase. Here, the arbitrator was in effect reordering the priorities as determined by the officials of the governmental entity. Some may question the right of an arbitrator to do so; however, were the arbitrator to lack the authority to review the expenditures in the budget in the light of the demonstrated needs and entitlements under other statutory criteria, the arbitral process would lack credibility. For, any employer if it so desired could submit a budget which would limit any wage increase to an amount predetermined by the employer.

It must be pointed out that this scrutiny of the budget does not necessarily result in a finding contrary to the employer's position, for, as noted in the Minnesota discussion, such a review may sustain the employer's inability to fund the requested increase. This is true in cases where the employer had taken stringent measures to reduce expenditures, and where there were no "hidden" funds in the budget.

Also, such a review of the budget may lead to the conclusion that other obligations of the City (eg., recreational needs for the handicapped and upgrading the City's rolling stock) have as compelling a need to draw on available funds as do the subject employees, and thus there should be a balancing process.

In Wisconsin, regarding the question of an arbitrator substituting his judgment for that of the City's elected officials, it was stated by the arbitrator that in providing for interest arbitration, the legislature authorized arbitrators to substitute their judgments for those of local officials in deciding which of the parties' final offers is the more reasonable.

E. The Arbitrator and the Funding of the Award

In dealing with a situation where the employer has shown that under existing fiscal conditions, it could not fund the increase otherwise found to be reasonable, an arbitrator has two alternatives. First, an arbitrator will state that it is not his function to set or to reorder priorities, but will award the increase found to be justified without any discussion as to how it might be funded. Second, the arbitrator, in such circumstances, may indicate that the funding will require the employer to borrow or to increase taxes even though he does not so direct such action, but will at least deal with and discuss the options available to the employer in the funding of the award.

Some arbitrators noted that the funding of the award "would probably require" the employer to eliminate positions but that the award was necessary so as to provide adequate compensation to the employees. In so doing, at least in the case of the teachers, the arbitrator was involving himself to some degree in a matter of educational policy relating to the faculty-student ratio. Of course, in these cases, the employer does not necessarily have to effect a reduction in force, but could decide to reduce expenditures elsewhere -- which again might prove to be a difficult choice.

This approach was vigorously resisted by the employer in the Minona case in Wisconsin where it was argued that it could fund an increase by a reduction in force, but that it chose not to do so and the choice should be that of the elected officials, and not that of an arbitrator. However, the City submitted no evidence that a reduction in force would have any meaningful adverse effect on the level of services. Further, there was another option available to the City; it could borrow the required funds. Thus, while the arbitrator stated he could not order the City to borrow, it was an available alternative to a reduction in force.

On the question of issuing an award that would require the employer to borrow, there is a diversity of opinion among the awards reviewed. One arbitrator in Minnesota refused to issue an award that would require borrowing to fund it; yet, other arbitrators in Minnesota and New York did not hesitate to issue awards that might require borrowing. It is interesting to note that the two seemingly conflicting decisions in Minnesota involved the same employer in the same period of time.

Most frequently, in discussing the funding of the award, arbitrators deal with the reallocation of resources or the reordering of priorities. Perhaps, the most forceful discussion in this study of such reallocation or reordering is found in Coleraine in Minnesota where the arbitrator clearly challenged the priorities as set by the local government. This is obviously a sensitive area because it does involve the substitution of the arbitrator's judgment for that of the local officials' judgment. Yet, as pointed out earlier, the questioning of priorities by the arbitrator is essential to the working of the process.

Ability to Pay as a Criterion

The criterion "ability to pay" as set forth in the statutory criteria appears to be a neutral factor, yet in practice it is not. Ability to pay has not been regarded in the positive sense; rather, it has been considered primarily as a negative factor. This latter statement perhaps requires clarification: for example, ability to pay as a positive factor. Assume a situation wherein the bargaining unit employees are paid at a rate that comparatively is one that is higher than the rate paid to employees - same job classification - in comparable communities. Assume, further, that the subject employer has a large surplus, so that it could easily meet the demand of the employee group even though that demand might not be justified on any other ground. There is no arbitral decision reviwed herein where an employee demand would be granted under these circumstances.

Then, we assume a situation where the employee group demonstrates on the basis of comparability, or on the rise in the cost of living, that it is entitled to a substantial increase. Yet, the financial constraints of the employer are such as to provide a basis for the arbitrator to reduce or deny such increase otherwise justified. Thus, an employer's "profitability" or financial ability may not be a se the basis

upon which an increase may be predicated; yet, financial inability may be a basis upon which a justified increase may be reduced or denied. Here, of course, we are assuming a situation where the employer's financial inability is an established fact, and not one where the alleged inability is predicated upon a budget that would not survive scrutiny.

It is important that the participants in interest arbitration understand that ability to pay has been regarded as such a negative factor.

The Significant Factors in Interest Arbitration

Although the various statutes set forth many criteria, the most significant criteria, as indicated by the above review, appear to be (1) wage comparisons; (2) cost of living; and (3) ability to pay. The cases reviewed indicate that where either of the first two factors are compelling, the arbitrator will generally not be dissuaded by claims of financial inability and will suggest other alternatives such as reallocation of priorities or reductions in force to fund the increase. Conversely, where the first two factors are not compelling, the arbitrator is usually more receptive to demonstrated financial inability.