Airline Collective Bargaining: Reform or Reframe?

Joshua M. Javits

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The airline industry is bleeding. It is facing $30 billion in losses since "9/11." For 2003, $10 billion in losses is estimated, and the losses could be higher depending on SARS, the economy and the war on terrorism. More than 100,000 employees have been furloughed, and 70,000 more furloughs are expected. Two airlines (United Airlines and Hawaiian Airlines) are in bankruptcy, one is just out of bankruptcy (US Airways), and several others are on the verge of bankruptcy. Many carriers assert that cost cutting, especially labor cost cutting, is the top priority. If cutting labor costs is the cure, are high labor costs the cause? Several carriers are encouraging Congress to ask this question and explore what to do about the worst industry conditions in decades.

During the last congressional session, Senator John McCain (R-Ariz.) introduced a bill (S. 1327) to change the way airline labor disputes on major carriers are resolved. McCain's bill would replace the right to strike with baseball-style interest arbitration under which neutral arbitrators would choose the best final offer from labor or management. Could this work? Would the public and industry be served best by such legislation? The bill presumes that airline labor has too much leverage at the bargaining table and that this imbalance has contributed significantly to the present crisis.

Industry Decline

The airlines' "relentless [economic] downward spiral," as characterized by Delta CEO Leo Mullin, has many causes. There is the obvious impact of September 11, the continuing threat of terrorism, the war in Iraq, the downturn in the economy, the added security costs, the spike in jet fuel prices, the easy access to Internet pricing, and business travelers' unwillingness to pay premium prices.

The current structure of the major network carriers dictates that they absorb enormous capital and labors costs as well as maintain expensive hub-and-spoke systems and global operations. This has meant that while they can make large profits in good times, they can lose even more in poor times. Many analysts see the future as even worse, with fewer booms and chronic busts on top of more bankruptcies, more liquidations, and continued insecurity for the industry's remaining 700,00 employees.

Most of the major airlines not only made it through deregulation in 1978 but also prospered. The industry made $22 billion in profits during a five-year golden era spanning from 1995 through 2000. Yet the debt buildup from the bust periods (1979–82, 1989–93, and 2000–present), coupled with the high cost of labor, aircraft, insurance, and jet fuel, finally sank the majors in a sea of red ink after 9/11. Industry debt load has risen from $55 billion to $90 billion since 1999. The market capitalization of the largest six carriers has fallen to one tenth of what it was in 1998. The continuing sour economy, the war in Iraq, competitive Internet pricing, and business travelers' parsimoniousness were the final nails in the coffin. Despite significant reductions in capacity and costs, the network carriers still find it hard to sell seats at a price they can make a profit.

With this background, it is inevitable that labor is the focus of intense cost cutting because most view it as the airlines' only significant variable cost. For example, United and US Airways achieved about two thirds of their cost savings from labor during their bankruptcies. American's non-bankruptcy labor cost savings represented about half of its total cost reductions. Nonetheless, airlines can build in some degree of cost flexibility through jet fuel hedging strategies**,** passenger service levels and aircraft lease terms.

However, these do not provide the immediate substantial savings achieved through furloughs, compensation reductions and work-rule changes.

Current Labor Law

Current labor law allows for free collective bargaining and the right to strike, rights held dear by labor organizations. Historically, public interest permitted collective activity by unions to advance employee security and economic welfare while balancing corporate power in an imperfect labor market.

These principles are enshrined in the nation's labor laws. The Railway Labor Act (RLA), which governs airline and railroad labor relations, was enacted in 1926 through a consensual process. Significantly, representatives of railway labor and management drafted the RLA, and Congress made few changes. The act's coverage was extended to airlines in the 1936 amendments. Neither labor nor management has desired to significantly modify the law until very recently.

What has changed? Certainly the recent airline nadir has forced the carriers to seek greater control over their cost structures to mitigate the bust periods in their business cycles. Compensation and benefit levels may be unsustainable in a significant downturn. In addition, the rigidity of labor costs flow in part from job security provisions and various other compensation guarantees in the collective bargaining agreements (CBAs). Nonetheless, labor costs are collectively bargained in this heavily unionized industry; it takes two to tango. So why have the carriers historically agreed to labor costs they now believe are unsustainable?

Bargaining Leverage

Many carriers argue that the airline unions maintain unfair leverage over the carriers. Since the early 1980s, the major carriers assert that they have accepted the uneconomic demands of labor to avoid potentially disastrous strikes of significant duration.

Management's capitulation is understandable given what is at stake. A single employee group can shut down an entire airline system. Unlike manufactured goods, airplane seats cannot be inventoried and sold at a later date. In response to the threat of a strike, which can be a month or more before an actual strike, passengers and travel agents heavily book away from the troubled airline. The shutdown period before an imminent strike and the startup period after a strike, which involve complex logistics and positioning of crews and aircraft, can easily take a week or more in addition to the strike period. In addition to the loss of revenue, carriers fear the loss of market share.

Carriers view pilot strike threats as especially costly. Pilots are virtually impossible to replace. Training alone takes months and is very expensive—about $40,000 per pilot. And training the thousands of pilots that a major airline needs to operate during a strike is logistically impossible.

A strike's impact is far from one-sided, however. Striking employees do not receive a paycheck and union strike benefits are usually small.

Yet the expectation that unions will demonstrate enlightened self-interest and use self-restraint in bargaining has lost credibility. Employees of United Airlines, which was employee-owned until its bankruptcy, led the charge in 2000 by demanding and receiving wage hikes of between 22 percent and 28 percent and engaging in slowdowns just as the industry was beginning to lose steam. The pilots at Delta Airlines followed suit, believing that unless it matched United pilot rates, the airline would be subject to strikes. The other carriers would have fallen into line with these pattern settlements if the 9/11 terrorist attacks had not occurred. Typically, generous deals are agreed to at the end of the up part of the business cycle so airlines are left with high costs and fewer passengers in the low part of the business cycle; conversely, concessions are given at the end of the low part of the business cycle. Currently, other major network carriers (Delta and Northwest) are seeking the pattern concessionary agreements that United and US Airways made during their bankruptcies and American obtained from its unions to avoid bankruptcy.

Carriers are concerned that the cycle will repeat itself; much like it did following the last round of concessions, bankruptcies, and liquidations in the early 1990s. They fear that the unions will demand significant benefits, compensation, and work rule improvements to make up for the current round of major concessions wrought with the hammer of bankruptcy, just as soon as the carriers begin to eke a profit.

The hard times are providing ample opportunity for union leadership to take a responsible direction in collective bargaining. The crisis is not only a carrier crisis, but also one for the entire airline industry. Unions may need to reexamine their bargaining assumptions and approaches to restrain expectations and demands in good times in order to avoid furloughs, concessions, and work reductions in bad times. Union membership ratification requirements should also be examined. An agreement rejected by the IAM precipitated United's bankruptcy filing. The threatened second ratification votes at American after revelations of undisclosed executive pay might have scuttled those deals and lead to an American bankruptcy filing. In addition, non-stop side-line criticism by a non-incumbent union, AMFA, have undermined the IAM's ability to represent the best interest of its members in this time of crisis. The authority of union bargaining representatives to negotiate agreements at the bargaining table is in some cases being undercut by ratifications, dissident activities and a lack of bargaining confidentiality. Future negotiations will be hurt by a lack of attention to these issues.

Outlook

Is there no way for the parties to live under the current regime? Southwest Airlines' pilots are unionized, but its contracts are manageable, its work rules are comparatively flexible, and its relationship with its pilot union is healthy. But Southwest has a unique culture, history, and operating system. It also has an independent pilot union. Northwest Airlines endured a fourteen-day strike in 1997 and a settlement was eventually reached under the threat of government intervention from a presidential emergency board. Even that controlled strike caused Northwest to lose more than $1 billion, a cautionary tale for the other majors.

Thus critics assert that the overwhelming leverage of pilots and, to some extent, of machinists and flight attendants, justifies the legislation proposed by Senator McCain. Of course, the carriers are looking for other structural changes given their financial hardships and especially in light of the continued profitability and competitiveness of low cost carriers such as Southwest and Jet Blue whose success is only partially due to lower labor costs. But the network carriers' unit costs are still nearly 50% higher than the low cost carriers and labor costs are about 40% of revenues.

The major network carriers are cutting costs and capacity. Some are reviewing and revising their essential business models—route, fare, and operational structures. But the major carriers would still argue that any new business model and, eventually, the low cost airlines may well face the same problem—an imbalance in leverage with their unions. Longer term this imbalance may lead to similar unsustainable cost distortions. These carriers seek to change the Railway Labor Act to limit unions' understandable willingness to use the opportunities for employee gains that the law allows.

Laws governing private-sector collective bargaining are generally designed to level the playing field in the tug of war between labor and management. The carriers favoring S.1327's approach generally believe that labor has the upper hand under the RLA because of management's inability to sustain a strike. Yet, at least under current circumstances, with furloughs rampant, capacity cut back, and bankruptcy courts cutting pay and benefits, that leverage has shifted to the carriers. Whether this development is short term or long term remains to be seen.

Boom-and-bust cycles do exist in the airline industry and do affect each side's leverage. The unions argue that the expectation of these cycles leads them to seek improvements in good times to make up for the inevitable concessionary demands in bad times. Their demands are restrained not only by memories of the bad times, but also by the lack of mobility that results from pilot seniority, position, and aircraft qualifications—all factors that make them dependent on a single carrier for their careers. Similar geographic, seniority, and other non-perfect labor market factors influence the other employee groups. Avoiding future furloughs and gaining the benefits of carrier expansion also cause airline workers to modify their demands. Employees do not want to kill the goose that lays their golden egg. But as one pilot leader famously said, "[W]e don't want to kill the golden goose, we just want to choke it by the neck until it gives us every last egg."

Carriers argue that it is irrational to count on a union's memories of the disastrous eras of furloughs and concessions to restrain its use of leverage in better times. The carriers supporting S. 1327 argue that it is necessary to re-level the playing field given unions' unchecked power, which has enabled them to set high labor rates throughout the industry.

Regulation and Mutual Aid Pact

Leverage appeared more balanced before 1978 because of two other factors. First, airline regulation enabled carriers to pass along costs to passengers and competition was limited. Failing carriers were absorbed by competitors along with labor protection for all the affected employees. Second, the airlines maintained an almost industry-wide mutual aid pact under which a carrier subject to a strike was reimbursed for losses from the fund. Thus, allegedly, Northwest came out ahead financially despite enduring three successive pilot strikes in the 1970s.

No one is seeking the kind of price and route regulation of the pre-1978 regulation period. The airline's mutual aid pact was effectively outlawed in the 1978 Airline Deregulation Act. The alternative of bringing back the mutual aid pact to level the playing field is not credible because post-regulation the major airlines are very competitive with one another.

At least in good times, the large major carriers (e.g., Delta, United, and American) acted in a way that may have mimicked the regulatory period. Although high labor costs cut into profitability, they were seen as endurable so long as the airline unions forced the smaller major carriers to accept the pattern set by the largest majors; the smaller majors' acceptance of the pattern preserved the largest majors' a competitive advantage. This was part of the larger majors' focus on market share and control of captive hubs from which they could extract significantly higher ticket prices.

Carriers are now reexamining these and other long-standing strategic approaches. The smaller majors such as Continental and America West have reached and maintained agreements below the pattern set by the five largest majors, which still appear to abide by the power of the pattern. Moreover, the latest bankruptcy-created patterns should enable the big five to be more cost-competitive with the smaller majors. Still, the largest majors are encountering aggressive competition from low cost carriers on a great majority of their routes—even those in and out of hub airports. The current concessionary period has reduced several major carriers' high costs, but has not transformed them into "low-cost" carriers.

Railroad Experience

In the railroad industry, which is also subject to the RLA, there is no interest in S. 1327. The large Class I railroads engage in multi-employer bargaining. All large American Class I railroads customarily negotiate with one voice with each of their 14 unions. In the 1970s, the airline industry attempted something short of multi-employer bargaining, "coordinated" bargaining, under which a entity composed of the major carriers would establish binding guidelines on its member carriers' bargaining positions, such as a maximum pay rate for each employee group. However, after deregulation in 1978, the carriers breached the guidelines and the effort ended. The reason is that airlines have a greater diversity of interests than do the railroads and are far more competitive with one another. This makes multi-employer bargaining or even coordination, much more difficult. Moreover, the rate of change in the airline industry is incessant. Changes in routes, markets, prices, aircraft types, code-shares, international treaties, and federal aviation regulations necessitate operational and strategic changes and therefore negotiations with union groups on issues that affect individual carriers and their employees.

In addition, there is a strong railroad union tradition of honoring one another's picket lines. Thus a strike by a single rail union shuts down the freight railroads throughout the country and a national crisis results. More than half the rail shipments are interlined between railroads and a strike at one carrier soon obstructs the flow of freight throughout the entire rail system –This is because the Class I carriers carry about 95 percent of the rail freight in the United States and because much of the vital bulk and heavy goods (coal, oil, agricultural commodities, and building and other raw materials) transported by rail cannot feasibly be carried by trucks.

Presidential Emergency Boards and Interest Arbitration

There is still another tradition in rail bargaining—presidential emergency boards (PEBs). PEBs are inevitably created when the parties are unable to reach an agreement and a strike or lockout is imminent. An emergency board investigates and reports on the dispute within a 30-day period, often leading the parties to settle on the basis of its recommendations during the following 30-day cooling-off period. The board's recommendations constitute a face-saver and lay the groundwork for possible congressional involvement to prevent an economically damaging shutdown. Historically, Congress has ordered interest arbitration or has imposed the recommendations of the presidential emergency board on the parties to avoid such a shutdown. There have been only six (6) days lost to railroad strikes in the last thirty (30) years.

If airlines also bargained jointly they would be even more likely to produce presidential emergency boards or to invoke congressional involvement in the face of shutdowns. At least since 1997, government intervention has not been uncommon, even absent multi-employer bargaining. By the mid-1990s, passenger enplanements had grown to more than 1.5 million per day. The shutdown of a major carrier would disrupt the lives of 250,000 passengers per day, double the number only 10 years earlier. Disruption to the public and economy by a major carrier shutdown has thus been seen as warranting some kind of government intervention. Although government intervention is more likely under the present legal and political realities, it is not inevitable.

The problem is the impact of potential intervention on collective bargaining. In anticipating intervention, the parties in the railroad industry have conducted less in the way of constructive bargaining. Fewer issues are discussed when the parties know that an emergency board or congressional intervention is virtually inevitable should they not reach an agreement. Often the parties fail to achieve voluntary agreements and the hard decisions are left to the post-collective bargaining process.

Interest arbitration, as well as emergency boards, is blunt instruments for dispute resolution. Nonetheless, such third-party intervention can achieve things the parties need done but cannot accomplish, often for internal political reasons. In the railroad industry, emergency boards have resolved long-standing intractable issues to the ultimate benefit of both parties.

Unlike interest arbitration, which resolves the dispute with finality, presidential emergency boards facilitate settlement by proposing or recommending a basis for settlement. The parties must still sit down and negotiate a resolution. At the end of the process, the parties may still employ self-help rights—the union to withhold labor (e.g., through a strike) and the carriers to lock out employees or unilaterally impose new contract provisions. Congressional intervention following an emergency board is similar to interest arbitration in that it normally ends the dispute with finality.

Public-Sector Analogy

In many respects S. 1327 mimics state laws that prohibit public employees, especially public safety employees such as police officers and firefighters, from striking. Those laws require arbitration of unresolved disputes. Their arbitration provisions usually set forth criteria for the arbitrators to apply, including comparability with similarly situated employees in other jurisdictions and public concerns about funding sources and the potential for tax or fee increases. S. 1327 sets forth similar factors for neutrals to apply.

The public-sector model may not lead to the cost rationalization many carriers seek. The real question is whether the benefits of interest arbitration—avoiding the threat and reality of airline shutdowns and eliminating labor's perceived advantage—makes up for the costs—including the certainty that important contract terms will be imposed by a third party, regardless of the parties' deepest interests.

Scope Clauses

Underlying S. 1327 is the idea of joining it with another legislative initiative, one to limit or outlaw scope clauses in collective bargaining agreements. Scope clauses generally restrict an airline from contracting out or shifting current work to another carrier or provider. They offer a way for airline pilot unions to protect the volume and type of work they perform. The issue has taken on great importance to airlines and their unions since the introduction of regional jets, generally small 50-seat jet aircraft. Regional airlines traditionally used propeller-driven aircraft and fed major airlines' hubs with passengers from smaller markets. Regionals have considerably lower overall costs and labor costs than major airlines, and they are now rapidly acquiring these smaller jet aircraft. Whether regional jets add to or take away from the volume of work of major airline employees is hotly debated.

Unions and management last faced and negotiated scope when the major airlines developed various relationships—some based on partial ownership such as with Northwest and KLM and some based on alliances with foreign airlines. More recently, domestic alliances have begun to emerge (e.g., between Continental and Northwest). In the mechanics craft or class scope clauses limit the carriers' ability to subcontract work outside the company or to reassign it to other groups of employees.

Scope is a substance issue; it is typically negotiated alongside benefits, compensation, and work rules and is part of collective bargaining in numerous industries. In this respect it is unlike S.1327, which alters the procedures rather than the subject matter of bargaining. However, scope may also be seen as something more—an anticompetitive provision that detracts from the ability of smaller cities and towns to be serviced by airlines, because major carriers serve major markets and only the regionals have the cost structure to serve the smaller markets. In cases where regional airlines have relationships with major carriers, Scope provisions can limit their ability to acquire and use jet aircraft to support the major carriers in those smaller markets. From the perspective of the small markets the scope clauses link up with the current financial climate to focus service on the major markets.

Thus, with the industry in such a state of flux, a radical change in the law is both a danger and an opportunity, depending on one's perspective. But long-term benefits may be lost if that change comes about unilaterally.

Collective Bargaining

Collective bargaining allows the parties to work out their problems rather than looking to third-party outsiders to decide the way they operate. Third parties do not have to live with the outcome. Accountability affects people's behavior. If third parties rather than the interested parties make key decisions in labor-management relations, then neither of the interested parties will take ownership of the outcome. During the contract term, the parties are more likely to undermine the agreement or regard it with contempt, leading to strained relationships and even more difficult bargaining the next round. Another problem is that third parties, especially governmental bodies, can often go astray and impose a nonsensical or unacceptable compromise instead of a workable solution.

Paeans to collective bargaining at this critical phase in the airlines' existence may appear to be an unaffordable luxury, the proverbial orchestra playing on the deck of the sinking Titanic. Nonetheless, employees are being furloughed en masse, are being asked to accept enormous cuts in pay and benefits, and are being told they must give up beneficial work rules. These sacrifices and trade-offs often take years of bargaining to attain. Carriers must work together with their employee-selected representatives during this dire period so the parties together can find a reasonable resolution that maintains their working relationship.

Two Divergent Approaches

There are two extreme views with regard to the role of government in the broader airline crisis. One is that Congress should do nothing and let the market take its course, including liquidations. For example, if United or US Airlines stops flying, the public may ultimately be served by Jet Blue, which has more than 100 aircraft on order. Passengers unwilling to pay top dollar for airline travel probably do not care whether their plane carries a historic brand name.

The opposite view is that it is time for government to save the industry, financially and otherwise. Some have even mentioned nationalization of the airline industry if conditions become much worse. This interventionist school believes that matters traditionally the subject of collective bargaining should be taken out of the hands of labor and management and given to a government surrogate or third party. In some cases, this might be a bankruptcy court. In the long term, government intervention could mimic the public-sector model.

This debate is unlikely to be resolved soon. Meanwhile, the current process has shown surprising vitality. US Airways and its unions has worked hard and successfully to reach voluntary agreements even in bankruptcy. American reached agreements to avoid bankruptcy. These efforts have had short-term results and may provide long-term dividends in terms of improved labor-management relationships. For other major carriers in financial *extremis* that cannot obtain voluntary concessions but want to avoid bankruptcy, interest arbitration on a voluntary basis may be the only realistic approach.

Pain, Politics and Policy

Airline unions are not the cause of the airlines' financial crisis. In fact, airline employees have suffered the most of all stakeholders as a result of furloughs, recurrent give-backs, unexpected and constant changes in airline practices and undermined career expectations. One of the reasons the industry is so heavily unionized is because unions strive to obtain a measure of stability, predictability and protection for airline employees in this topsy-turvy environment. Airline unions bargain for the best terms they can obtain under the existing rules for collective barging. Nonetheless, the airlines and their unionized employees share an essential common interest in creating a stable and predictable future: only carriers' sustained growth can create the fertile airline goose who's golden eggs can be shared by its employees.

S.1327 suffers not only from the requirement that both sides abandon their ultimate control over their most fundamental interests to a governmental or neutral third party, but that the last best offer approach itself is flawed. The most important bargaining issues are complex scheduling, hours of service, scope of work and pay matters for which the last best offer approach is ill suited. The theory that the process induces the parties to submit a reasonable offer because that is the essential selection criteria is often subsumed to subjective and "political" concerns. Last best offer arbitration may well result in the selection of an extreme, or at least one-sided offer, which is impractical, unworkable or unreasonable. Furthermore, the loser will likely resent the process and poison the parties' subsequent relationship.

Furthermore, an interest arbitration regime, with an approach and elements that unions perceive as one-sided, would not be viewed as fair. The parties' relationship, bargaining and otherwise, could become bitter, while the opposite is needed: the airline business calls for teamwork, professionalism, and mutual respect.

Labor now faces an administration that has a proclivity to intervene in airline disputes by creating emergency boards. Congressional intervention is also a possibility in the current climate. The industry economics and the political environment make it probable that interest arbitration or emergency boards will be used more frequently in major carrier negotiations than in the past. The threats of terrorism and the airlines' financial crisis will prompt both Republican and Democratic administrations to continue the intervention that began in the mid-1990s. This means that the nature of airline collective bargaining has already changed.

Clearly, the carriers that favor S. 1327 perceive the crisis as an incentive for change. Yet this bill does not appear to be a priority for the Bush administration or for many members of Congress who sense the headwinds of strong union opposition. In addition, the carriers recognize that their advocacy of S. 1327, while they are seeking voluntary and even involuntary (bankruptcy court) concessions from their employee groups, is hurting their immediate critical interests.

No one really expects S. 1327 to resolve the current crisis. But the current crisis is bringing a much-needed and long-overdue focus on the collective bargaining process. Although a crisis mentality should not lead to a precipitous long-term remedy, it can produce a candid and open reevaluation of the strengths and weaknesses of the customary approaches to solving collective bargaining disputes. Such an evaluation should consider the values of collective bargaining, the need for a healthy airline industry, and the public interest in safe, convenient, and reliable travel.

Airline labor and management have an interest in the long-term economic health of the industry and the public has the same interest. Union members and stockholders share this interest. Before Congress grapples with the labor-management issues troubling the airline industry, the National Mediation Board, the agency responsible for administering the Railway Labor Act, should lead a constructive discussion on the issues and needed changes to the collective bargaining process. The senior-level focus groups that the NMB managed in the mid-1990s could provide a way to facilitate honest dialogue and produce useful results.

All the parties—labor, management, and government—need to recognize and actively shape the changes that are occurring in approaches to industry dispute resolution. Unless they engage themselves and make the political investments necessary to improve collective bargaining, it will evolve without their participation, quite likely in a less constructive manner.

Mr. Javits is President of Dispute Resolution Services, which provides neutral arbitration, mediation, and training services. Mr. Javits is a member of the National Academy of Arbitrators and was Chairman and member of the National Mediation Board from 1988 to 1993.