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OUT OF THE ASHES: OPTIONS FOR REBUILDING AIRLINE LABOR RELATIONS¹

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Out of the Ashes: Options for Rebuilding Airline Labor Relations¹

Thomas Kochan, Andrew von Nordenflycht, Robert McKersie, and Jody Hoffer Gittel
March, 2003

Abstract

The crisis in the airline industry and its labor relations system creates a window of opportunity to introduce changes that are essential to successful industry recovery. This paper summarizes the results of our research on labor relations conducted as part of the MIT Global Airline Industry Project and proposes a set of improvement initiatives. We recommend that (1) companies negotiate a “recovery compact” with its employees that includes plans for improving the workplace culture and climate and for expediting and resolving collective bargaining contract negotiations, (2) government leaders specify a window of time for industry and labor leaders to agree on changes needed in the Railway Labor Act, (2) the National Mediation Board engage industry and labor leaders in a process of transforming the agency’s role to support the changes needed in the industry, and (4) industry, labor, and government leaders create a forum to support mutual learning and improvement.

¹ Prepared for presentation at the 2nd Annual MIT Airline Industry Conference, Washington, D.C., April 8, 2003. Funds for this research are provided by a grant from the Alfred P. Sloan Foundation to the MIT Global Airline Industry Program. The views expressed are solely those of the authors.

Crisis or Opportunity?

By all accounts, labor relations in the airline industry are in crisis. Some would argue that the system is broken and in need of major overhaul. The short-term signs of distress are obvious. Two major carriers are struggling to cope with bankruptcy by negotiating deep concessions with their unions while others are seeking similar concessions to avoid bankruptcy. The entire industry is searching for a business model that works in the post September 11, 2001 marketplace. Whatever changes in business strategies are implemented will very likely require significant changes in both the structural and qualitative features of the current labor relations system. Thus, the industry faces both a crisis and perhaps an unprecedented window of opportunity to introduce changes to its labor relations system.

Even prior to September 11th, signs of a distressed labor relations system were growing:

- Contracts were taking longer to negotiate,
- Inter-union competition and representation challenges increased uncertainty and made negotiations and problem solving more difficult,
- The structure of bargaining appeared to be breaking down; what was once pattern bargaining turned into a continuous process of each settlement leapfrogging the previous one in its occupation,
- The tradition of firm-specific seniority led to the furlough of many experienced pilots by hub and spoke carriers while new pilot recruits were being hired to fly expanding regional services. The result: underutilization of the skills available for this crucial segment of the industry,
- Rank and file rejections of tentative contracts were increasing,
- Slowdowns and strikes led some employers to call for limits on the right to strike,
- The President signaled a new determination to invoke the Railway Labor Act procedures to avoid work stoppages, and
- Industry, labor, and government leaders expressed increasing concerns over the ability of the National Mediation Board to address the range and depth of problems facing the industry.

As these problems were building, the performance of the airline industry was deteriorating. Customer satisfaction was low to begin with and declining. The industry collectively lost \$8 billion in 2001 and losses have continued ever since. The dramatic post 9-11 traffic and revenue declines have led many to argue the industry is facing a long term structural change in demand requiring new business and labor relations models capable of competing with low cost carriers in a price sensitive market.

One theory has been that labor law is at least partially to blame for these industry troubles. An influential Senator and some industry leaders called for reforms of the Railway Labor Act (RLA) to give the Secretary of Transportation the power to impose

final offer arbitration in situations where a work stoppage would either threaten national security or impose significant economic costs on a city or region of the country.

Given the visibility of these problems and calls for legislative reform, leaders in Congress or the White House are likely to take action of some sort. However, there has yet to be a serious look at the evidence on the state of labor relations, its effects on industry performance, workers, customers, or the economy, or a discussion of alternatives for addressing these problems. ***Therefore, we believe it is essential that management, labor, and government leaders who share responsibilities for labor relations in the industry begin to discuss what needs to be done, informed by concrete evidence. By doing so, perhaps this crisis can be turned into an opportunity for innovation and improvement.***

This paper is designed to provide a framework for such an effort. We have been studying the airline labor relations system and its effects on industry performance for the past three years as part of the MIT Global Airline Industry Program. Over this time we have collected and analyzed historical and quantitative data on the effects of labor relations on firm performance and customer service, analyzed data on length of time required to reach settlements, tracked the responses of the major carriers to the September 11th crisis, interviewed management, labor, and government leaders, and brought these leaders together to discuss the state of labor relations in the industry.

The analysis and options discussed here are not presented as final conclusions or recommendations. Instead we expect to treat this paper as a “*living document*” subject to revision after further comment and discussion.

Substantive Issues and Challenges

Labor Costs

Labor costs are the biggest variable cost in airline operations. Given their magnitude, it is not surprising that labor costs become a focal point when companies need to reduce costs. Ever since industry deregulation in 1978, companies facing an imminent threat of bankruptcy or liquidation have sought or imposed deep wage cuts. This is the case in the present crisis as well. However, there is another dimension to the debate over wages and labor costs involved in the current situation that was not present in prior industry downturns and/or firm financial crises. Today there is a widespread view that the basic business model that supported the wage structure of the past cannot be sustained in light of revenue declines and shifts in the business environment in the industry.

Figures 1-3 illustrate the nature of the problem facing the major carriers.² Figure 1 shows trends in labor costs as a percentage of revenues for these carriers from 1982 to 2002. These costs fluctuated between 36 and 40 percent of revenues from 1982 to 1999 but then rose to 44 percent and 47 percent respectively in 2001 and 2002. Figure 2

² The major carriers included in these calculations include: America West, American, Continental, Delta, Northwest, United, and US Airways.

provides a more complete picture of trends in several key measures of costs and revenues: (1) labor costs per available seat mile, (2) total costs per available seat mile, and (3) revenue per available seat mile. These numbers are adjusted for inflation and are expressed in 2001 dollars.

These data show three aspects of the current challenge facing labor and management. First, real unit labor costs, a function of both wage levels and labor productivity, are approximately 21 percent lower today than at the beginning of the 1980s. This is one of the reasons workers and their representatives argue that labor costs are not the sole, or perhaps even the primary, cause of the problems facing the industry. Second, over this same time period, real total unit costs also declined approximately 27 percent. Third, and herein lies the essence of the problem, in recent years revenues per seat mile have declined more than either unit labor costs or total costs. In 2002 real revenue per available seat mile were more than 33 percent below their 1982 level. Most importantly the revenue generated per seat mile was less than the total cost per seat mile by a sizeable margin. This translates into the large financial losses for these carriers.

Figure 3 illustrates the competitive challenge several lower cost carriers pose to the major carriers. It shows unit labor costs of each carrier relative to those of US Airways, the company with the highest labor costs per available seat mile. In 2002 United, American, and Northwest's labor costs were about 20 percent lower than US Airways,' Delta and Continental range between 30 to 35 percent lower, and carriers such as Southwest, America West, and ATA were more than 50 percent lower than US Airways and considerably lower than the other major carriers. This analysis by itself does not tell us to what extent these unit labor cost differentials are achieved through lower wages and to what extent they are achieved through higher labor productivity. In either case, however, these are the stark realities facing labor and management of the major carriers today.

Given these realities, it is not surprising that the Air Transportation Stabilization Board (ATSB) has required evidence of significant labor cost reductions as a condition for granting loan guarantees. As of this writing, major concessions are being negotiated or imposed as part of bankruptcy proceedings at U.S. Airways and United Airlines. Reductions achieved at these firms will in turn put pressure on their competitors to achieve similar concessions and cost reductions from their employees.

Thus, for most if not all of the major hub and spoke carriers, some lowering of unit labor costs appears to be a necessary condition for survival in the short term and development of a sustainable business model for the long run. Our analysis of prior experiences with wage concessions clearly shows that reductions in wages alone will not be a sufficient strategy for building either a new labor relations system or a sustainable business model. Indeed, as noted above, reducing wages is only one avenue for reducing unit labor costs. The other avenue for reducing unit labor costs is to increase productivity.

Specifically, our analysis of the relationships between wage costs and industry performance over the 1987-2001 time period showed that the net effects of wages on profit margins depended on how changes in wages affected other key variables such as productivity and service quality.³ Here wide variations across firms were observed. Some firms were able to offset wage increases with labor and/or aircraft productivity improvements while others were not. Reductions in wages were also associated with reductions in service quality, which in turn led to lower profitability. Thus while lowering wages clearly provides short term relief to firms, over the long term the effects of wage and other contract changes are determined in part by their effects on productivity and customer service and other aspects of airline operations. These operational performance outcomes were, in turn, heavily influenced by the quality of employee and labor relations, specifically by the culture of day to day workplace relationships and the amount of conflict experienced in collective bargaining negotiations. ***The major implication we draw from this work is that lowered labor costs may be necessary given the current and projected future business environment. However, a lower labor cost structure is at best only the starting point from which a new labor relations system will need to be built. The way that lower labor costs are achieved –i.e., entirely through wage reductions or offset by productivity increases – will determine in large part the long-term viability of individual carriers in this industry.***

Wage Criteria and Bargaining Structures

In addition to a one time adjustment of wage and employment terms, some discussion of the principles that should guide overall wage adjustments, and cross-occupational and cross-firm wage relativities, might help to reduce the uncertainty and delays associated with future negotiations.

Because wage movements are often delayed, they have been poorly matched to business conditions. Delayed negotiations are especially difficult if the economic environment changes dramatically over the course of negotiations. Figure 4, which shows data on pilot wage rate changes for several different aircraft as well as changes in revenues per employee, illustrates this point. From 1993 to 1997 pilot wages increased a total of approximately 4 percent.⁴ During this same time period, however, revenues per employee rose 18 percent, leading to strong calls from employees for catch-up wage increases. Then, from 1998-2001 wage agreements were signed that increased wages approximately 24 percent while revenues were declining by eight percent. Thus, in these negotiations employees looked backward and argued that catch-up increases were due while the companies looked forward and saw the need for labor cost control or reduction in the face of current or impending revenue declines.

³ Jody Hoffer Gittel, Andrew von Nordenflycht, and Thomas A. Kochan, “Mutual Gains or Zero Sum: Labor Relations and Firm Performance in the Airline Industry,” *Industrial and Labor Relations Review*, forthcoming. All of the “quantitative” findings we discuss in the text are drawn from this paper.

⁴ These analyses are based on data provided by the Airline Industry Labor Relations Conference (AIRCON). They include the 21 largest carriers in the industry and are weighted averages of pay rates for the most senior captain averaged across four different aircraft: Boeing 767/757; Boeing 727/MD80, Airbus 310-321, and Boeing 737-DC9.

Negotiations are difficult in any industry characterized by boom and bust cycles. They are made more difficult if the negotiations drag on through a transition from boom to bust or bust to boom. This problem is then compounded when a tradition of pattern bargaining gives way to pressures on union and management negotiators to constantly do better or leapfrog prior settlements as seems to have been the case in pilot and mechanic bargaining in recent years across carriers such as Northwest, United, and Delta.

One approach to this problem (in addition to shortening the time required to reach agreements, a point we will discuss in detail below) would be for industry and labor leaders to agree on the principles or criteria that should guide wage levels and adjustments. An important part of these discussions might focus on alternative ways (e.g., profit sharing, gains sharing, performance bonuses, stock ownership, etc.) for employees and firms to share fairly in whatever progress toward economic recovery and profitability is achieved. Failure to do so will risk repeating the same battles experienced in prior bust and boom cycles.

Another dimension to this problem lies in the need for firm-wide principles for wage adjustments that will follow the current round of concessions and employment cutbacks. As will be suggested below, firm and industry recovery will depend heavily on the degree of cooperation and cross-functional coordination achieved within firms. ***Development of firm-wide structures and processes in an industry with a strong craft-structure tradition is a challenge that current conditions require be met.***

Pilot Seniority and Scope Clause Issues

The emerging business models suggest that, in the short run at least, job opportunities will continue to shift from major hub and spoke carriers to lower cost point-to-point carriers or regional and feeder airlines. The longstanding firm-specific seniority rules and associated scope clauses in pilot contracts make this adjustment difficult and lead to the unfortunately and perhaps unsafe result that experienced pilots are furloughed while less experienced pilots are being recruited. This could be a lose-lose outcome for all parties, and especially for the safety and security of customers. ***Some creative solutions have been negotiated to address this problem such as the jets for jobs agreement at US Airways and similar “family-wide” adjustment and transfer plans. Perhaps, with appropriate grandfathering, this could be viewed as a first phase of a longer term process of shifting to more of an industry-wide seniority and transfer plan that makes best use of the nation’s pool of experienced and skilled pilots.***

The Quality of Labor Relations

Addressing these substantive issues may be necessary but will not be sufficient for labor relations to contribute positively to industry recovery. The quality of the underlying labor relations system needs significant change and improvement as well.

We see the labor relations system as functioning at three interrelated levels of activity.⁵

(1) **The workplace.** This is where employees interact with each other, with supervisors and managers, and with customers on a daily basis. These interactions both reflect and then reinforce the basic culture (level of trust, cooperation, coordination and problem solving, etc.) in the firm's employee and labor-management relationship.

(2) **The negotiations and dispute resolution process.** This is the most visible part of the labor relations system since it is where the basic terms of employment are determined and adjusted. Negotiations are governed by the RLA and, in special circumstances such as the present moment, may be subject to oversight by other entities such as the bankruptcy court, the government's loan guarantee board, and/or outside creditors and investors.

(3) **The strategic or governance level of the firm.** This is where basic business strategies are established and corporate governance processes occur. In some firms employees and/or union representatives have a direct role in these processes but in all cases there is a close interrelationship between the strategic business decisions and the rest of the labor relations system.

We believe all three of these levels of activity need to be addressed as part of a comprehensive reform. We take each up in turn below.

Workplace Relations

Our case study research suggested that at least three airlines have been able to build a positive workplace culture with employees at different points in time over the past twenty years: (1) Delta, from at least the early 1980s up until it began imposing wage cuts and layoffs in 1992; (2) Continental, from 1994 to the present, and (3) Southwest, from its startup to the present.⁶ Our quantitative analysis confirmed that having a positive workplace culture was associated with higher productivity, service quality, and profits. That is, Southwest, and during their "positive culture years," Delta and Continental, outperformed other firms on these performance metrics. Thus, we believe that efforts to develop a positive workplace culture pay off for employees, firms, and customers.

We have also studied intensively how this general term "culture" translates into productivity and customer service benefits. This analysis is presented in some detail in Jody Hoffer Gittell's recent book *The Southwest Airlines Way*.⁷ Her case study and

⁵ Thomas A. Kochan, Harry Katz and Robert McKersie, *The Transformation of U.S. Industrial Relations*. New York: Basic Books, 1986.

⁶ Andrew vonNodenflycht, "Alternative Approaches to Airline Labor Relations: Lessons for the Future," Paper presented to the annual meetings of the Industrial Relations Research Association, January, 2003.

⁷ Jody Hoffer Gittell, *The Southwest Airlines Way: Using the Power of Relationships to Achieve High Performance*. New York: McGraw Hill, 2003.

quantitative analysis demonstrate that Southwest has been able to build and sustain a high level of trust, cooperation and cross-occupational coordination that results in both high levels of customer service and productivity (measured by employee productivity and aircraft turnaround times).

An important insight in this research is that high levels of productivity and customer service require coordination and cooperation *across* employee groups that in other parts of the labor relations system are separated into different bargaining groups (customer service agents and other ground personnel, flight attendants, pilots, etc) or into supervisory/non-supervisory distinctions. Minimizing work rules and focusing on coordination, cooperation and conflict resolution across these groups are all critical to building and sustaining a positive culture and achieving high levels of performance.

We recognize, as some representatives of other airlines often point out, that Southwest has many features that make it unique or at least different from other carriers. Yet we also believe that when combined with the evidence at Continental and Delta, the benefits of building and maintaining a flexible and positive workplace culture cannot be ignored. ***The major implication we take from this work is that efforts to build this type of workplace culture and coordinated effort are an essential component of an effective labor relations system and a sustainable business model.***

For existing firms the challenge lies in how to transform a low trust and occupationally specialized employment relationship into a flexible and coordinated organizational effort needed to achieve and sustain high levels of trust, performance, and customer service. Clearly, this cannot happen overnight. Evidence from other industries suggests it requires a high level of commitment and effort from both management and labor leaders. One challenge in airlines is its history of craft/occupational division of labor and negotiations structure. ***Special efforts may be needed to unify and coordinate the efforts of different employee groups and unions and to resolve conflicts that may occur from time to time.***

Negotiations and the Resolution of Contract Disputes

Contract Negotiations: Options for Improvements

Figure 5 presents summary statistics on 202 negotiations processes from 1984 to 2000.⁸ Overall, the data show a relatively low level of strikes (6 out of 211 negotiations or just under 3 percent), a similarly infrequent use of Presidential Emergency Boards (3 or less than 2 percent of the cases). The number of contract rejections has been high relative to other private sector standards (39 or 18 percent).

The time required to reach agreement across all carriers over this time period is long by comparison to experience under the National Labor Relations Act. Figure 6 provides

⁸ Andrew von Nordenflycht and Thomas A. Kochan, "Length of Negotiations in the Airline Industry, 1984-2000," Working Paper, MIT Institute for Work and Employment Relations, 2003. The data for this paper were drawn from the files of the Airline Industry Labor Relations Conference (AIRCON).

a comparison using data on 122 airline contract renewals negotiated between 1984 and 2000 under the Railway Labor Act and two national samples of private sector contracts negotiated under the National Labor Relations Act between 1993 and 1999.⁹ While differences in the time period and other characteristics caution against making too much of these direct comparisons, the differences are too stark to dismiss. Under the NLRA, 74 percent of contracts are settled before or within one month after the contract expiration date. In contrast only 21 percent of airline contracts are settled before or within a month following their amendable date. So on average it takes considerably longer to reach agreements under the RLA than the NLRA.

But a closer look within the airline sample demonstrates that long contact negotiations are not preordained. Differences exist both over time and across carriers and unions. Over the 1984-2000 time frame it took an average of 15.9 months from the start of negotiations and 13.8 months from the amendable date of the contract. The time required was larger for the ten major carriers (16.5 months). The average duration has increased over time, most notably among the major carriers. But the main finding from these analyses is that there is wide variation across carriers and across unions in the length of time required to reach agreement. Moreover, these differences are not related to the economic conditions facing either the carrier or the industry at the time of negotiations (measured by profitability, employment or revenue growth, or changes in profitability during the time of negotiations). These results suggest that the length of negotiations is not totally preordained by the RLA or by the economic environment. Instead, the wide variations in experiences across carriers (ranging from and average of over 20 months at U.S. Air, TWA, United, and Northwest to 9 months or less at Southwest and Continental; or from over 20 months with the IBT to 10 months or less with the ALPA and the TWU), suggest that the length of negotiations has more to do with the quality of the labor-management relationship than with the nature of the labor law itself.

Our quantitative analysis found that conflict in labor negotiations (measured by whether or not a strike, mediation, release, or arbitration occurred in the negotiations) was negatively related to productivity, service quality, and profitability. All these indicators of conflict are also associated with longer contract negotiations. Thus, efforts to improve the effectiveness of the negotiations and dispute resolution process are clearly warranted.

The major implication we draw from these data is that efforts to reduce the time required to reach negotiated agreements must start with joint company-union efforts to improve their own negotiating processes. Case study evidence from some of the carriers and unions that have been able to reach agreements in a timely fashion suggest that such

⁹ The data for contracts negotiated under the National Labor Relations Act are drawn from the second National Customer Survey conducted by the Federal Mediation and Conciliation Service. For a report on this survey see Joel Cutcher Gershenfeld, Thomas A. Kochan, and John Calhoun Wells, "How Do Labor and Management View Collective Bargaining?" *Monthly Labor Review*, vol. 121, no. 10, October 1998, 23-31.

efforts might include reaching an agreement on a timeline for (1) when negotiations will start, (2) when NMB assistance will be requested if no agreement is reached, (3) how long to engage in NMB-assisted mediation, (4) when to move the next stage of the process, if necessary, and (5) what the final stage of the process will be—an agreement to arbitrate, NMB release to strike/lockout, or some other process for completing the negotiations. Some parties have also used the NMB or outside services to train for and engage in interest based bargaining (IBB) and found this helpful. Others have agreed to cooperate on how to use the internet to communicate progress in negotiations and tentative agreements to rank and file members. In the absence of a proactive communications’ strategy and set of tools, some unions (and companies) have found that opponents of tentative agreements have used the internet to urge rejection of agreements before the bargaining teams have presented the agreement to the membership.

One additional finding stands out in our case studies and review of differences in average contract length across companies. Firms with more positive workplace cultures reach agreements in a more timely fashion than others. As several industry representatives have stressed, it is difficult to address problems in negotiations in a credible and effective way if there is a lack of trust between the workforce and management at the workplace on a day to day basis.

Dispute Resolution under the RLA: Options for Improvement

What could be done to improve the performance of the RLA as a dispute resolution system? There is a tremendous wealth of experience with dispute resolution systems from other industries and sectors that can inform discussion of this question. We will draw on this body of knowledge here.¹⁰

Dispute resolution systems mix various combinations of mediation, fact-finding, and arbitration. Moreover, there are various ways to design arbitration procedures, as illustrated in Figure 7. The first design decision is whether arbitration is *voluntary* or *mandatory*. Another option involves the structure of the arbitration process. Here the choices involve using a *single neutral* arbitrator, an *all neutral panel*, or a *tripartite panel* or arbitrators. A third design parameter involves a choice between *conventional* arbitration wherein the arbitrator has discretion to fashion whatever settlement he or she deems appropriate (subject to the criteria specified in the law or agreement to arbitrate) and *final offer* arbitration. Under final offer arbitration the arbitrator is required to choose either the employer or the union’s final offer. Finally within final offer arbitration

¹⁰ For two reviews of the evidence on with dispute resolution procedures in the public sector since the 1960s see, Thomas A. Kochan, “Dynamics of Dispute Resolution in the Public Sector,” in Benjamin Aaron, Joseph R. Grodin and James L. Stern (eds), *Public Sector Bargaining*. Madison: Industrial Relations Research Association, 1979, 150-190 and Craig A. Olson, “Dispute Resolution in the Public Sector,” in Aaron, et al, *Public Sector Bargaining* (2nd Edition), Madison: Industrial Relations Research Association, 1988, 160-188. For an analysis of more than twenty years experience of the dispute resolution system governing police and firefighter negotiations in Massachusetts see John T. Dunlop, “The Joint Labor Management Committee Approach to Dispute Resolution,” *Perspectives on Work*, 1, 3, 1998, 59-61. For a more comprehensive historical treatment of alternative approaches to resolving labor disputes, see John T. Dunlop, *Dispute Resolution*. Dover, MA: Auburn House, 1984.

one can allow for final offer on either an *issue by issue* basis or on the *total package* of outstanding issues.

Long experience with dispute resolution systems in the private sector and, since the 1960s in the public sector, has produced a general consensus among researchers and practitioners on several points:

1. There is no one ideal best system for achieving all the performance objectives a dispute resolution system must serve. These objectives include avoiding work stoppages, encouraging the parties to reach agreements on their own without becoming dependent on using the procedures, encouraging problem solving and adaptation to changing circumstances and needs of the parties, and reaching substantive agreements that are equitable and well tailored to the needs of the parties and the public.
2. Given the above point, most experienced professionals argue that the full range of tools and procedures should be available to the neutrals who administer a dispute resolution system so that (a) they can match the use of different tools to fit the types of disputes and situations that they encounter, and (b) retain sufficient discretion over their use to maximize the uncertainty under which the parties negotiate and thereby keep maximum pressure on the parties to reach timely and effective agreements.
3. A final point follows from the above two: For any dispute resolution system to function effectively, the parties must have confidence in it, share a commitment to it, and respect the individuals who administer and staff it.

How might these principles be applied to improve the effectiveness of negotiations and dispute resolution in the airline industry? A number of ideas for doing so are listed below:

1. Individual companies and unions should be encouraged to negotiate their own protocols and timetables for negotiations, mediation, releases, and final steps for resolving disputes should an agreement not be reached within this time frame. Such a protocol should be required part of an overall recovery compact and business plan if or when the government, courts, or private investors are called on to decide whether to provide financial resources or approve recovery plans.
2. The NMB should be empowered to use a broad range of dispute resolution options while retaining discretion over the form and structure of the final resolution step so that it can better fit the process to the specific features of the dispute and needs of the parties and public.
3. The NMB should continue to encourage and support use of interest-based negotiations and mediation techniques and ensure its staff members are prepared to facilitate these processes.

4. The equivalent of the NLRA's "contract bar" doctrine should be adopted in airlines to limit challenges to a union's representation status while a new contract is being negotiated.
5. Industry and labor representatives should be convened to discuss the criteria or standards that should guide wage setting and adjustment in collective bargaining and by any third party process. This is one of the keys to public sector bargaining statutes. The criteria normally include comparisons with comparable workers, ability to pay, cost of living, and "other factors normally considered" relevant to the occupation and industry. One might add other factors unique to this industry such as quality of service, and the safety and security of passengers and employees. These criteria should be discussed and given operational meaning by people closest to the industry and then applied rigorously in negotiations and any dispute resolution proceedings.
6. Should Congress act to eliminate or further limit the right to strike and provide some form of mandatory arbitration? This is ultimately the toughest question. While the right to strike has never been an unconditional right for American workers, it is a deeply held principle in any democratic society. Limiting it is therefore a very serious matter. Moreover, taking it away in an unilateral fashion from employees who have had it in the past risks making this issue the focal point of debate for years to come. Each time political power shifts one side or the other will try to change the law. Such an environment does not promote effective labor relations. Thus efforts to engage the parties in the process of designing and managing a new dispute resolution system would be highly desirable.

One approach for doing so would be for individual companies and their unions to voluntarily negotiate a compact as part of a recovery plan in which they put in place their own dispute resolution system and agree not to resort to either strikes or lockouts for a specified period of time. Such an approach is not unprecedented. Project agreements in the construction industry have been negotiated voluntarily to provide for the orderly resolution of disputes for the duration of the project. Similar provisions were put in place in the 1960s to cover operations at Cape Canaveral. In the 1970s the steel industry and the United Steelworkers established a voluntary arbitration process that continued for about a decade. Currently, a growing number of firms in other parts of the private sector are essentially doing this by signing contracts of four, five, or more years' duration. Some of these contain provisions for periodic wage adjustments based on a negotiated formula or set of criteria. Others provide for means for on-going employee and union-management consultation, problem solving, and if necessary negotiations and dispute resolution.

Another option would be for bankruptcy court judges, outside investors, or the Congress to give the parties a limited period of time to negotiate such a plan or impose one of their own design if the parties do not do so.

Another option would be to reform the RLA Act to allow the NMB or some other entity to impose a final resolution strategy as the default option if the parties do not have one of their own in place.

But if we are to heed the consensus drawn from prior experiences summarized above, in no event should a single predetermined form of arbitration or final resolution be mandated by the law. To do so artificially constrains problem solving and local innovation.

7. Regardless of the specific procedures governing the resolution of disputes, it is clear that the role and capabilities of the NMB or whatever public or private entity is charged with overseeing dispute resolution in the industry will need to be transformed. It will need to be active in facilitating the changes in labor relations in the industry and supporting the types of company level compacts called for here. It may need to expand the training and technical services it provides to the parties. To ensure the agency enjoys maximum credibility, industry and labor leaders should be actively involved in the redesign and implementation of these changes. Experience from other sectors which have built labor and management representation into the leadership or advisory structures of dispute resolution agencies may be particularly relevant to this effort.

Strategic Interactions and Corporate Governance

Since deregulation five large carriers (Eastern, Western, TWA, Northwest, and United) experimented with a form of shared governance in which, in return for wage concessions, employees gained an ownership stake in the company and one or more seats on the board of directors. U.S. Airways recently negotiated agreements with its unions to become the sixth company to negotiate this type of agreement. United has been the most visible example in this group since its unions have held a majority (55 percent) of the company's shares since its ESOP agreement took effect in 1994. Our analysis of these arrangements in this industry to date showed that while each had the short term effect of lowering wage costs and thereby increasing margins and most had a limited period of time in which relationships improved, none of the companies experienced sustained performance (customer service, productivity, or profitability) benefits. Employees in turn experienced lower wages. Does this mean that shared governance arrangements are inherently flawed and/or of little sustainable value? The evidence from other industries suggests that ESOP programs are most likely to add value to a firm when accompanied by changes in the quality of the labor management relationship and the culture of the workplace. This has not been achieved in any of the airline examples, despite some initial attempts at companies such as Eastern and United. Standing alone, share ownership and representation on the board are not likely to return significant benefits to either a firm or its employees. ***The major implication we draw from the experiences with ESOPS and/or shared governance in this industry and others is that any further expansion of ESOPS and shared governance arrangements need to be accompanied by a plan to***

improve workplace and labor-management relations as part of the firm's short and long range business model and recovery plan.

Summary

Labor relations in the airline industry are at a critical juncture. The confluence of pressures coming from bankruptcy court proceedings, government loan guarantees, proposed changes in the RLA, and the uncertainties of a struggling economy and potential war all create the pressure and offer a limited window of opportunity to introduce significant changes in practices and policies. We believe that it is in the best interest of all those with a stake in the industry—firms, employees, customers, and government officials—to begin discussing and putting in place the types of comprehensive reforms needed to rebuild an effective labor relations system in this industry. ***We would therefore encourage the courts, members of Congress, and private investors/creditors to insist that a reform plan be included in any business plan to come before them or as part of any proposed changes in labor legislation.*** The elements of the reforms proposed in this paper are summarized below.

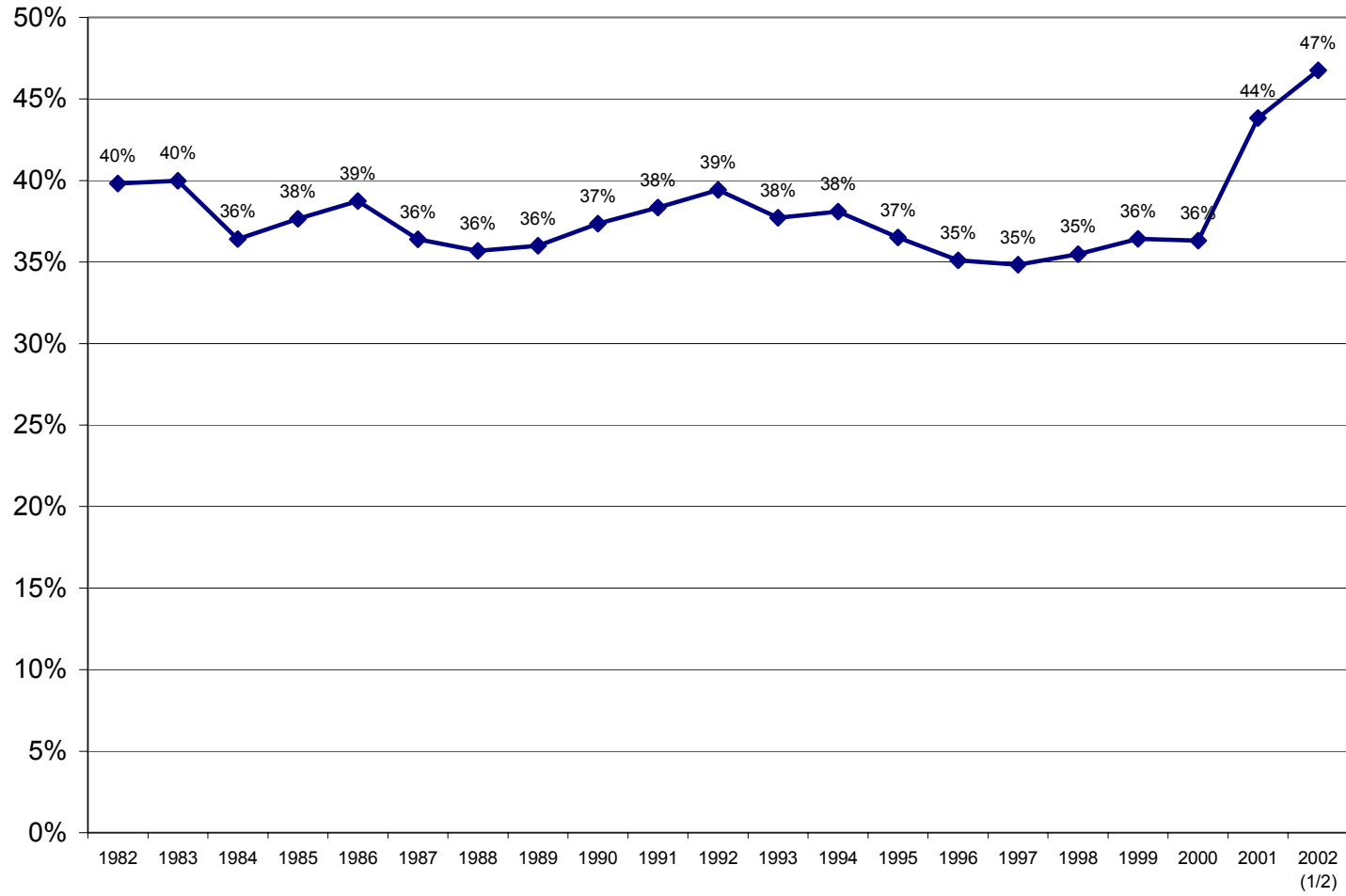
1. Companies and unions should be encouraged to negotiate a *recovery compact* of specified duration that contains a protocol for negotiating new agreements and adjusting the terms of their contracts. These should include clear timetables for moving through various steps of the process and agreement on the final steps to be followed in the event an agreement is not reached within the agreed upon timeline.
2. Recovery agreements should include a plan for improving the workplace culture and employee-management and cross-functional/cross-occupational coordination, flexibility, cooperation, and conflict resolution. This plan should include specific efforts to achieve the cross-occupational and worker-management coordination and cooperation needed to achieve and sustain high levels of performance in airline operations.
3. An industry wide conference should be called to seek consensus on the criteria to guide negotiators and third party neutrals or panels in making or recommending changes in wages, benefits, and other terms of employment. Parties should be encouraged to incorporate these criteria into their company-union recovery compacts.
4. The time periods when challenges to replace or withdraw recognition from duly certified bargaining representatives can be made should be specified so as to not interfere with the process of negotiating an agreement.
5. If the RLA dispute resolution system is to be revised, it should provide for a variety of options to be chosen by the NMB as the need arises rather than specify a single form of arbitration.

6. The role of the NMB should be transformed to become a full service dispute resolution agency capable of supporting and facilitating the changes required in the industry and its labor management relationships. The transformation in the agency should proceed in close consultation with industry and labor representatives.
7. A forum should be created for airline labor, management, and government representatives to meet periodically to foster continuous improvement in industry labor management relations.

We welcome comments.

Figure 1

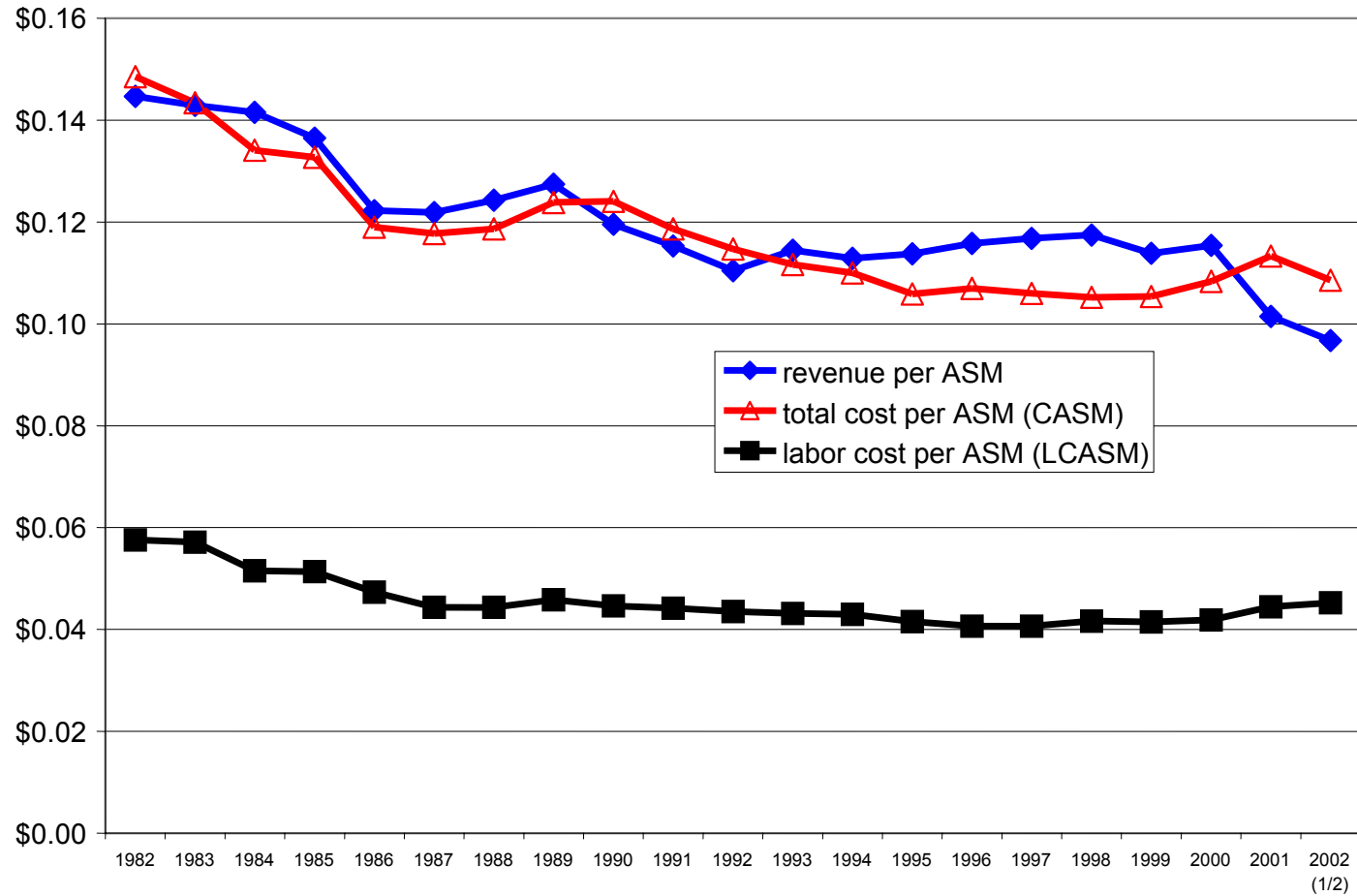
**Labor Costs as Percent of Revenue,
Major Carriers Weighted Average**



Source: Department of Transportation Form 41 (from Database Products, Inc.)

Figure 2

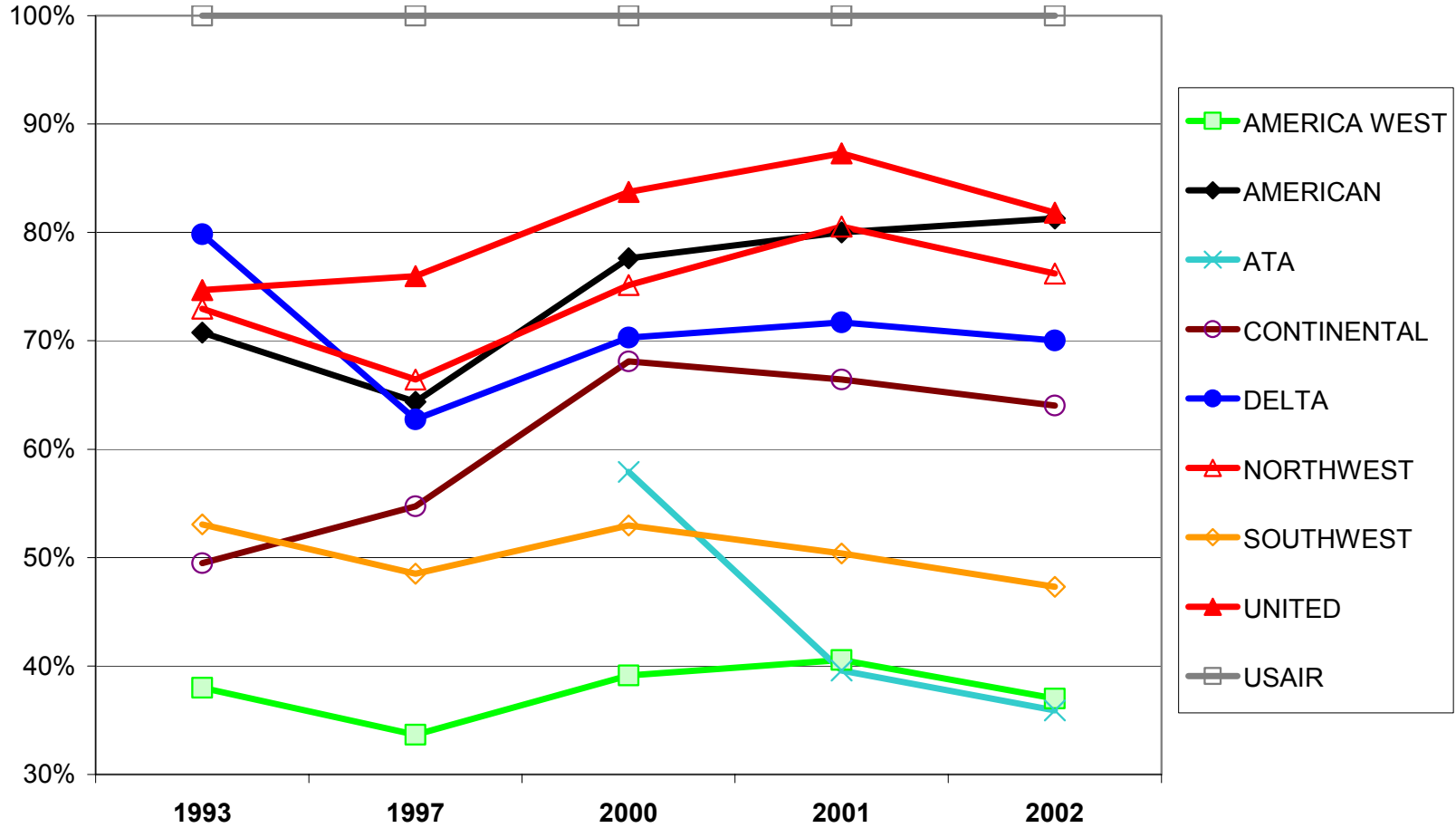
Revenue, Operating Costs, and Labor Costs per Available Seat Mile,
Real Values (2001 \$)
Major Carriers Weighted Average



Source: Department of Transportation Form 41 (from Database Products, Inc.)

Figure 3

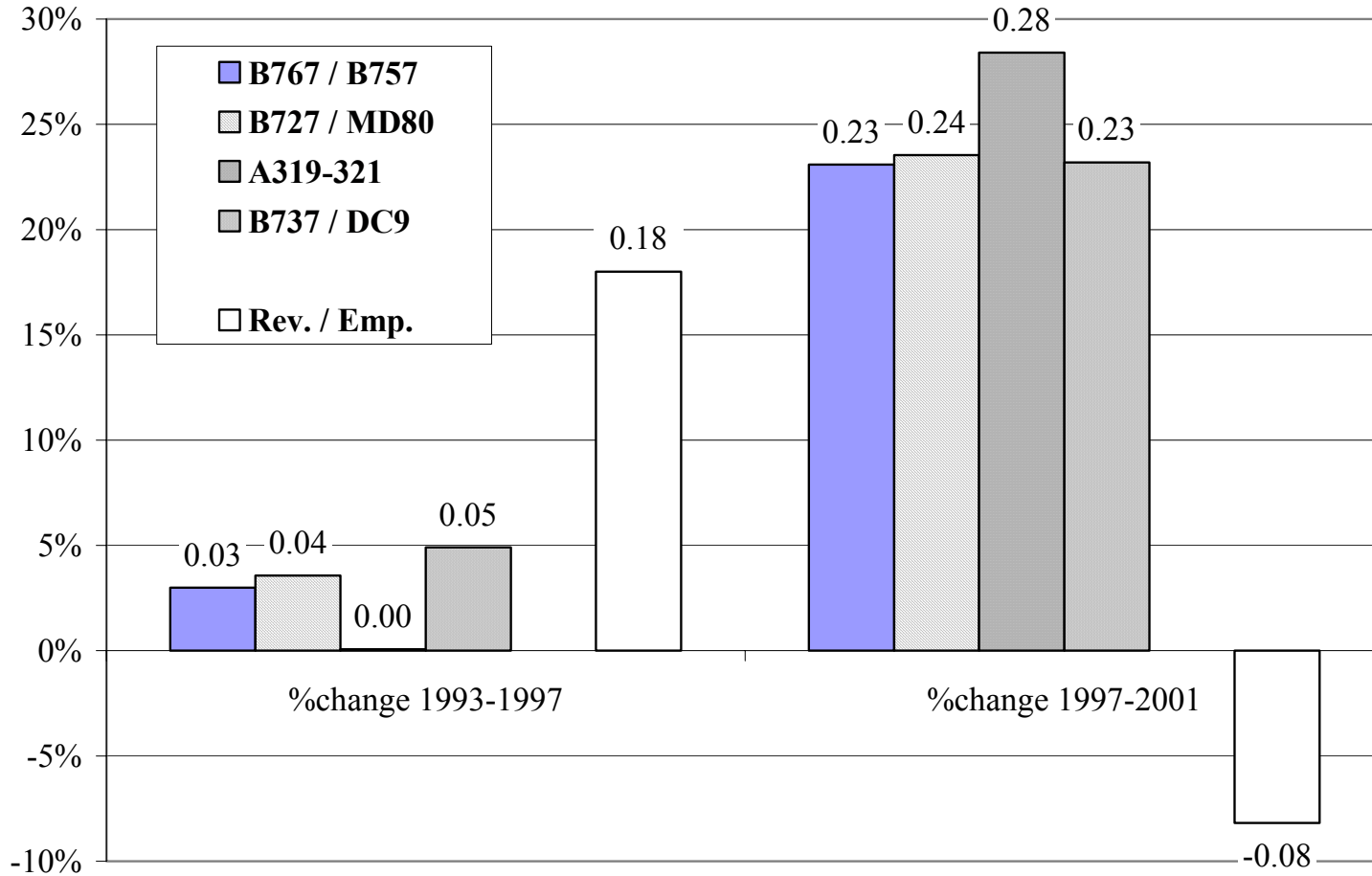
RELATIVE LABOR COST INDEX:
Each Carrier as Percent of Highest Cost Carrier, based on LaborCost / ASM



Source: Department of Transportation Form 41 (from Database Products, Inc.)

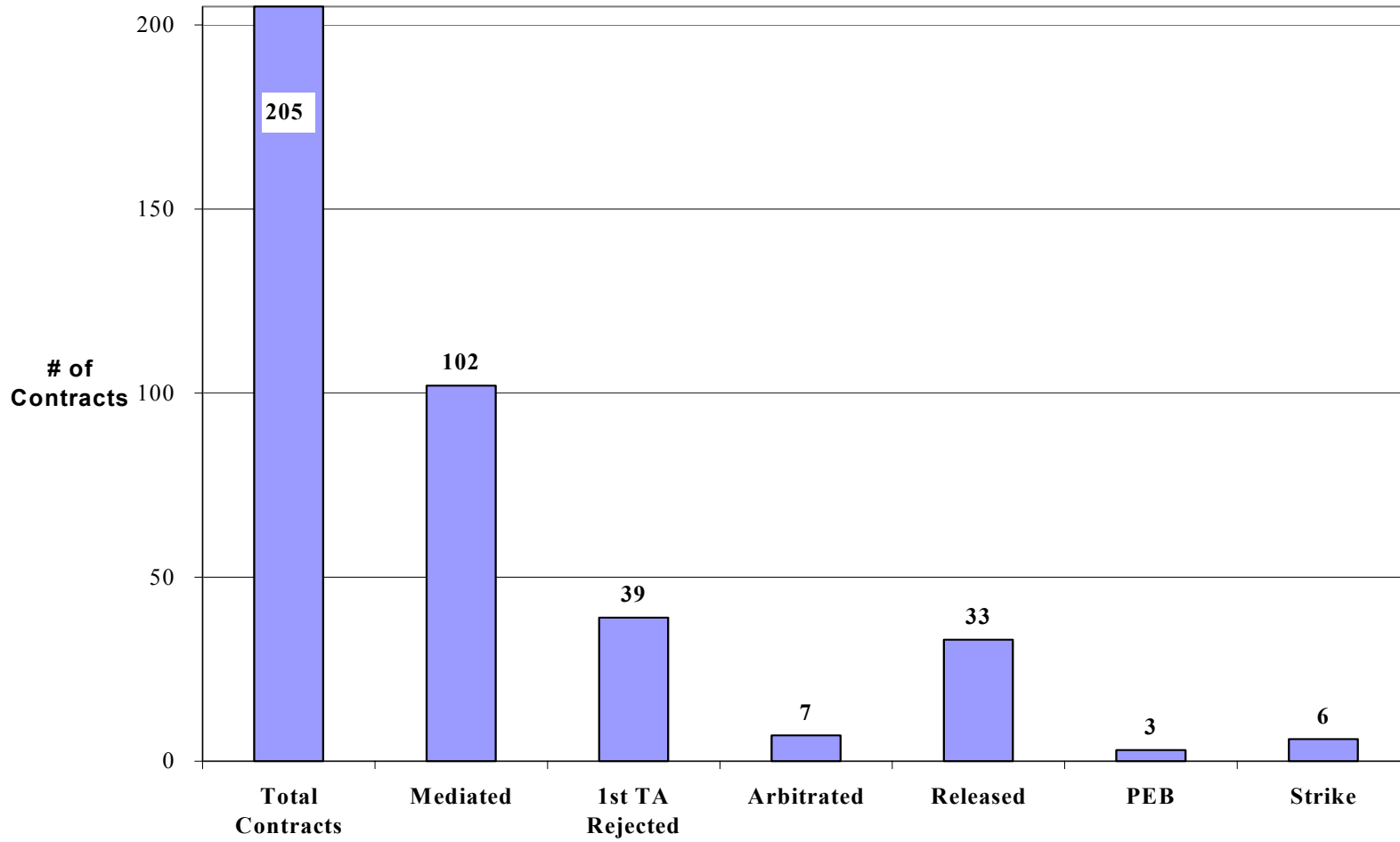
Figure 4

Average 4-yr Change in Pilot Pay Rates by Aircraft Type vs. 4-yr Change in Revenue per Employee, 1993-1997 & 1997-2001



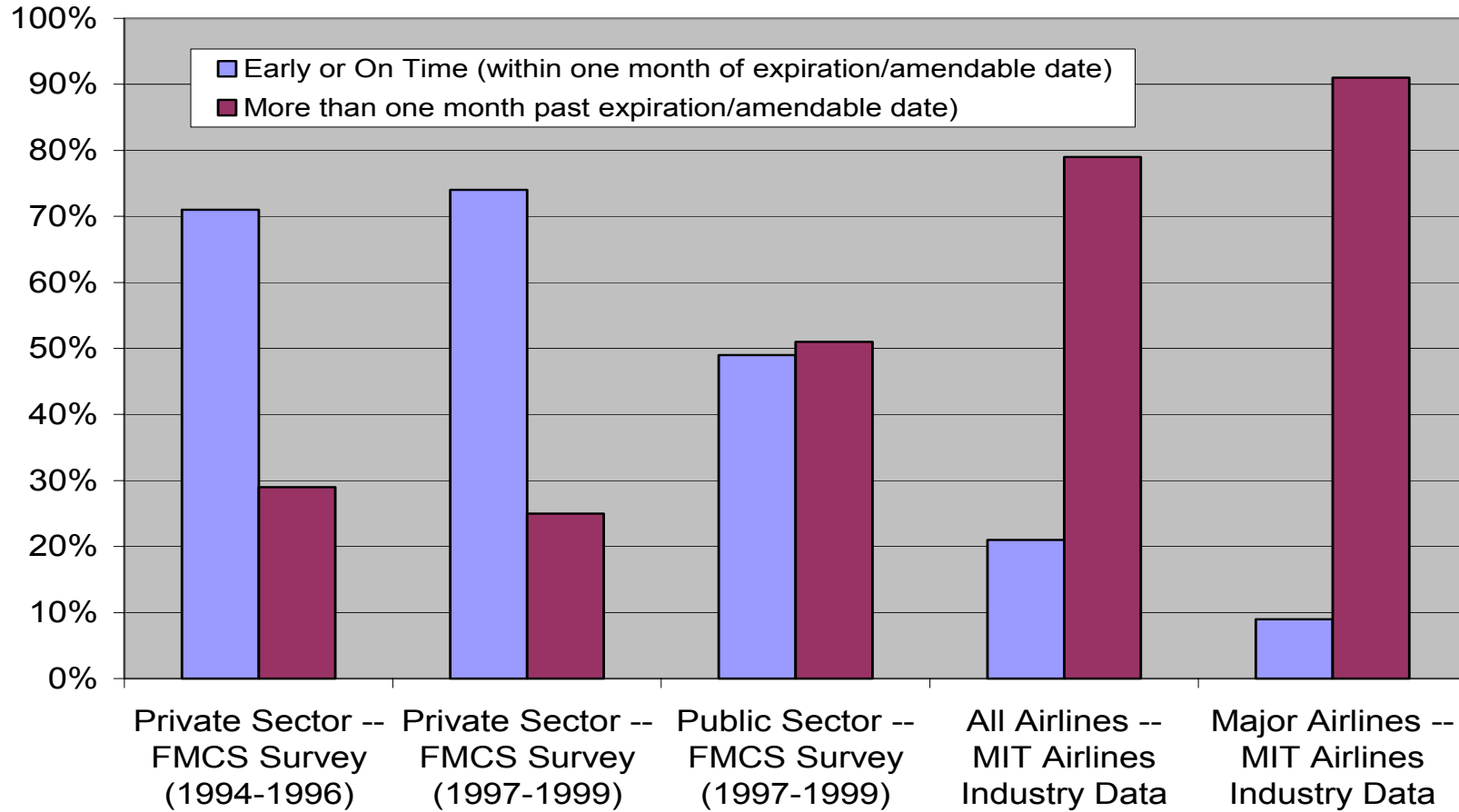
Source: Department of Transportation Form 41 (from Database Products, Inc.) and Airline Industrial Relations Conference

Figure 5
Airline Dispute Resolution under the Railway Labor Act



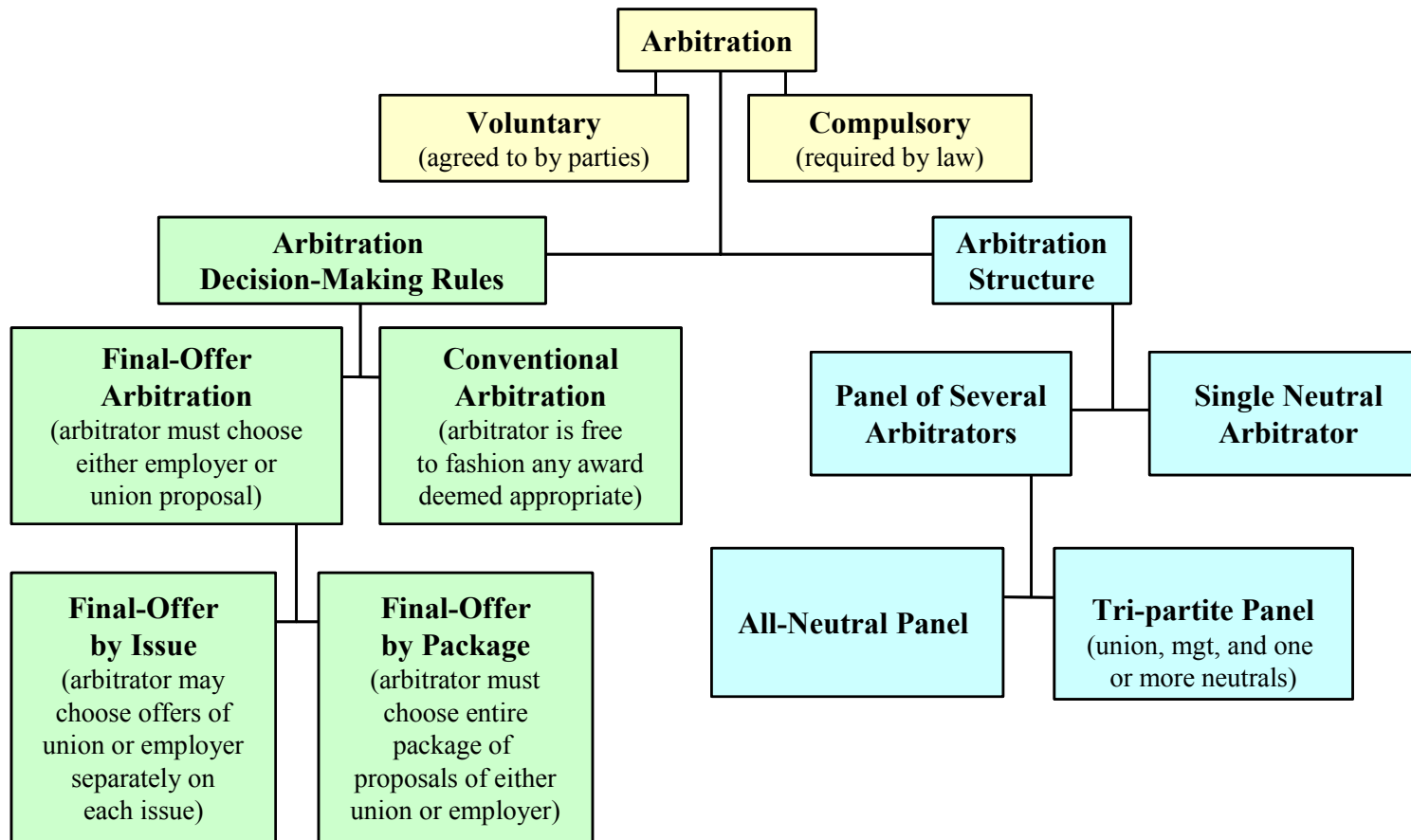
Source: Airline Industrial Relations Conference

Figure 6
Comparison of Delays Past Contract Expiration
Under NLRA and for Airlines Industry (MIT Airlines Industry Data 1984-2001 and
FMCS National Performance Review Surveys 1994-1996 & 1997-1999)



Source: Airline Industrial Relations Conference; and Federal Mediation and Conciliation Service

Figure 7
Alternative Forms of Interest Arbitration



Source: Harry Katz and Thomas Kochan, *Collective Bargaining and Industrial Relations*. Homewood, Ill.: Irwin (1988)