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Collective bargaining in the public sector and the role of budget determination

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Abstract

This paper considers collective bargaining in a public sector institutional setting. The model demonstrates how budget constraints and hierarchical structure affect the bargaining outcome. A trade union bargains over wage and employment either with an output-maximizing bureau or the bureau's sponsoring institution. The slope of the contract curve depends on the bargaining level because the budget constraints differ. Various assumptions are made about the timing of the sponsor's decision concerning the budget of the bureau. Local bargaining and budget determination between the wage and employment bargains can be optimal for the sponsor because it yields a low wage. © 2001 Elsevier Science B.V. All rights reserved.

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1. Introduction

Public sector trade unions are often regarded as influential. However, despite the large body of theoretical literature on collective bargaining, few papers have considered a public sector institutional setting explicitly. This is necessary to discover and interpret differences in collective bargaining outcomes between the public and private sector. Empirical results from the US indicate lower union–nonunion wage differentials in the

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public sector than in the private sector (see the surveys in Ehrenberg and Schwarz, 1986; Freeman, 1986). If public sector trade unions are as influential as their private sector counterparts, then they must extract more of other kinds of rents, such as higher employment. This paper argues that the hierarchical structure of the public sector can lead to high union employment even though the union has low bargaining power.

I take into account several aspects that distinguish public and private sector labor markets. First, the decision-making environments differ. Total available income limits the production in the public sector in contrast to product demand in the private sector. Dunlop (1958) clearly describes the analogy between the market and budgetary constraints. The specification of the budget constraint is important in all public sector models with optimization, including labor market models. Strøm (1999) discusses wage bargaining in local governments, distinguishing between local financing and cash limits from the central government. With cash limits, a sponsoring institution determines the wage costs. Holmlund (1997) investigates the macroeconomic effects of trade union influence in both the public and private sectors when the public sector bureaus are constrained by cash limits. Modeling public sector wage bargaining in a cash-limit framework was introduced by Leslie (1985). With labor as the only input, cash limits imply that the bargaining parties face an elasticity of labor demand equal to one in absolute value. There is no room for bargaining over employment. The model developed in the present paper includes non-labor expenditures in order to take possible bargaining over employment into account.

Babcock and Engberg (1997) include additional relevant cost elements in a model where both the employment level and the budget size are given. In their model, a union induced wage increase is financed either by reallocating money from non-labor expenditures toward wage costs, or by reducing hiring and turnover costs by hiring less productive workers. An underlying premise of the approach is that employment is less flexible than wages, a realistic characteristic for many public sector services. Changing or restructuring a public service usually requires a long preparation process, often involving political controversies. The common view for the private sector where the variation in employment is larger, however, is that employment is the more flexible variable.[1]

Public sector trade unions are typically important actors in public debates about the content and organization of public services. These issues are important for the employment level. It can therefore be a reasonable simplification to assume that the unions have bargaining power over employment. In addition, recent evidence from aggregate data supports this assumption (see Alogoskoufis and Manning, 1991; de la Croix et al., 1996). However, the union influence over employment differs from the influence over wages. In contrast to the employment determination, wage bargaining is formalized to occur with given time intervals. In the sequential bargaining framework introduced by Manning (1987a,b), bargaining over the wage and employment take place at different times and in different environments (see also Pencavel, 1991). Collective bargaining is a

[1] Notice that the assumption of employment as more flexible than wages in the private sector is not a universal assumption (see, for example, Grout, 1984; Horn and Wolinsky, 1988; Moene, 1988).