

**MESSAGE TO THE LEGISLATURE REGARDING  
BINDING ARBITRATION AWARD  
FOR  
HAWAII GOVERNMENT EMPLOYEES ASSOCIATION**

On March 29, 2004 I received the Decision and an Arbitration Award for Bargaining Units 2, 3, 4, 6, 8, and 13. These six bargaining units represent an estimated 23,300 employees of which approximately 19,000 are employed by the State of Hawaii. In accordance with Section 89-11, Hawaii Revised Statutes, I have separately transmitted the cost items of this award to the Legislature. This message recommends that the Legislature not approve this arbitration award.

Fairness versus Affordability

The decision to recommend that the award be denied is based on what the State of Hawaii can afford, not on what is fair to the employees in these six bargaining units. Having been in public service for two decades, I know our County and State employees are hard-working and dedicated to serving the people of Hawaii. I appreciate and value the work each employee is doing to help improve our State.

Numerous and extensive negotiations were held in good faith with representatives of the Hawaii Government Employers Union. Regrettably the HGEA representatives chose to resort to binding arbitration once it became clear that the State had to remain firm in its position as to what it could realistically pay.

The Administration recognized that compensation levels should be increased. The State, after a careful analysis of its available resources, offered 0% in FY 2004 and 1½% in FY 2005 coupled with a step movement effective July 1, 2004. Because a step movement for most HGEA covered personnel is equivalent to a 2½% increase, the State, in effect, offered what is equal to a 4% raise in the second year of the contract.

## Why the Binding Arbitration Process is Flawed

In 2001 the Legislature repealed binding arbitration after 6 years of attempting to settle wage disputes under this system. Experience had demonstrated that binding arbitration did not work well in practice.

The State learned that having binding arbitration to fall back on lessens the incentive to engage in meaningful negotiation and good faith collective bargaining. Furthermore, decisions are made by third-party outside arbitrators who have no accountability for the outcome and do not have to live with the impacts of their decisions. By contrast, public officials, when faced with the potential of a strike, must balance the ability to maintain a well-paid workforce against government priorities and public resources. Unlike outside arbitrators, I, as a Governor, along with the mayors, must keep these competing interests in mind and be held accountable by the public.

Despite the dismal record of binding arbitration, the Legislature voted to reinstate this process in 2003, resulting in the situation we face today.

## The Magnitude of March 29, 2004 Award

The award, if not rejected, will have serious, long-term adverse impacts on the financial well-being of the State of Hawaii. The Arbitration Panel recognized the immediate fiscal precariousness of the State by awarding 0% for FY 2004, as the State had proposed.

However, the FY 2005 portion of the award, encompassing wage and step increases, is equal to a 7.8% pay increase in one year. Over the next five years this increase would total \$247 million. This projection assumes that HGEA does not receive any additional increases between now and 2009. Yet, we already know the State and counties will begin negotiations for the next contract in five weeks since the current award only covers the period through June 30, 2005.

To compound the problem, the Arbitration Panel coupled this significant increase in wages with a reduction in productivity by granting employees hired after July 1, 2001 nine more days of

vacation and six more days of sick leave beginning July 1, 2004. We have not included this as a cost item in our transmittal of the arbitrated settlement award. However, the unrebutted evidence produced at the arbitration hearings was that this vacation and sick pay increase equates to an \$8.9 million loss in productivity for the second year of the contract and an increasing loss of productivity each year thereafter.

The financial impact of this arbitration award does not end with the HGEA decision. Wage settlements are still pending for the Hawaii State Teachers Association (HSTA, Unit 5) and the United Public Workers (UPW, Unit 1).

Chart # 1 dramatically documents the significant deficits that the State will face if the HGEA arbitration award is not denied and the same wage increases are granted to bargaining units #1 and 5 who are currently under negotiation. These deficits will peak at \$295.8 million in fiscal year 2007. Again, I must emphasize this deficit amount assumes not a single dollar of additional salary increases are awarded through the end of this decade.

#### Flaws in the Arbitration Award Financial Analysis

The arbitrators made at least three errors in assuming the State could afford this award.

First, the arbitrators mistakenly accepted that the State had a balance of \$972 million in unrestricted funds at the end of FY 2003. This figure represents the net of \$1.065 billion in assets from the Airports Fund, the Harbors Fund, and the Unemployment Compensation Special Fund, minus \$92.9 million from all other governmental activities. Balances in the airport, harbors, and unemployment funds must, by law, be used for the specific purposes named. It is neither fiscally or legally possible to use these monies for wage settlements. This misleading and incorrect assessment of the State's fiscal condition produced the erroneous conclusion that the State could pay for the wage increase.

Second, the Arbitration Panel incorrectly used the State of Hawaii Comprehensive Annual Financial Report (CAFR) to estimate available funds at the end of FY 2003. The State's financial reports

are published on an accrual basis. This means the end of year figures in 2003 included tax revenues generated in FY 2003 but not collected until FY 2004. The figures also included expenditure liabilities (such as Medicaid and payroll) incurred in FY 2003 but not paid out until FY 2004. To use the CAFR, which is a backward looking document, to project what funds may be available in a future year, is inaccurate and misleading.

Third, the arbitration panel referenced the State's good credit rating to conclude the State could pay for this award. The fact of the matter is credit rating agencies consider a wide variety of factors in their analysis of a jurisdiction's creditworthiness. The credit rating process examines the State's economy, revenue collections, and the Administration's commitment to fiscal discipline. The willingness of the State to control expenditures during periods of slower economic growth, allowing the State to carryover sufficient financial reserves, also contributes to its positive credit rating. The rating is performed to assure bondholders that the State is able to pay its existing debts, not to indicate the State's ability to pay for future salary increases.

#### Why the Arbitration Award is not Affordable

The first year cost of the award covering the six bargaining units in question would be \$32 million. In the past the Legislature has paid for these types of wage settlements by raiding special funds. This approach is both short term and shortsighted. In the long run it is fundamentally detrimental to the fiscal health and well-being of Hawaii.

For example in 1999 the Legislature withheld \$346.9 million from the Employees Retirement Fund to pay for wage increases. From 1967 to 2002 an estimated \$1.687 billion has been diverted from the retirement fund resulting in an unfunded liability that now totals \$2.878 billion as of June 30, 2003. Similarly, prior administrations and legislatures had permitted raids on the hurricane relief fund and used the emergency and budget reserve fund to cover general fund expenses.

We have seen current legislative proposals this session which would take money out of the Highway Fund, the Mental Health and Substance Abuse Fund, the Environmental Response Revolving

Fund, the Tourism Special Fund, and even the fund to manage and care for our public lands (Special Land and Development Fund). It is disheartening to think that these funds would be raided without any thought given to how we would pay for the HGEA raises next year, when the price tag jumps to \$54 million, or the years thereafter. Continuing this approach to balancing the budget guarantees the fiscal hole we have dug for the State will deepen over time.

To put the cost of the arbitration award in context, it is important to recognize that 83% of the State's annual budget is non-discretionary. This means a total of \$ 3.215 billion out of the \$3.893 billion FY 2005 budget must be set aside to pay for debt service, retirement costs, health insurance for our existing and retired employees, public assistance to persons with low income and disabilities, adult and child mental health services pursuant to a court decree, and instructional expenses at the University of Hawaii and the Department of Education.

This leaves a balance of \$678.3 million for everything else the public would like their State government to do. If the HSTA and the UPW settlements are similar to those for HGEA, total additional collective bargaining costs would amount to \$645 million for the six-year period (FY 2004 through FY 2009). This would adversely impact the public programs our citizens deserve and expect, including clean parks, adequate public assistance access to community health services, environmental protection, relief of prison overcrowding, highway maintenance, and school building repairs to name just a few.

The impact of this arbitration award on crowding out available funds for critical public programs cannot be overstated. We need only look at what is happening in neighboring California to glimpse our future if we fail to address the need for fiscal discipline now.

#### Legal Flaws in the March 29, 2004 Arbitration Award

In addition to the fact that this award is not affordable, there are also legal concerns with the Arbitrator's findings. The panel failed to adequately explain how it took into account at least five factors set forth in section 89-11(f) of the Hawaii Revised Statutes.

#### 1) Section 89-11(f)(1) - Lawful Authority of the Employer

By both statute and the State Constitution, the budget must be prepared using the Council on Revenues projections. The panel ignored this legal restriction and, over the State's objections, incorrectly relied on the Comprehensive Annual Financial Report (CAFR) as a superior indicator of future ability to pay. By substituting reliance on CAFR for the legally imposed process, the panel violated Section 89-11, criteria 1.

#### 2) Section 89-11(f)(3) - Interest and Welfare of the Public

The panel failed to consider competing interests, most notably the State's spending priorities as reflected in its printed budgets. The award did not provide a discussion or explanation as to which priorities were not justified or could be reduced to pay for collective bargaining increases. Further, there was no indication or identification of where in the budget the monies should come from to pay for the award.

In fact, the only public interest cited by the panel was a "public interest" in public employees receiving a pay raise.

#### 3) Section 89-11(f)(4) - Ability to Pay

The panel imposed a burden on the State to demonstrate inability to pay. Nowhere in Chapter 89, HRS, is this burden placed on either party. To place a burden of persuasion without any authority or agreement is unlawful.

#### 4) Section 89-11(f)(6) - Wage Comparisons

The panel disregarded the wage comparison analysis conducted by the State's wage expert, despite evidence that she conducted careful job matches with private and public sector employees performing "similar services." Instead, the panel chose to focus its analysis on pay raises awarded to other State and county employees, most notably first responder personnel. In doing so, the panel failed to follow the statutory mandate that requires the panel to consider both the conditions of employment of other persons performing

“similar services” and “of other state and county employees of Hawaii.”

In addition, the panel found that “each party, in presenting wage data pertaining to employees performing similar services, has selected data which is supportive of its own position.” This is not borne out by the record. The State’s wage expert presented objective wage data for classes where she could find appropriate job matches. She did not selectively present the data. In fact, the record indicates that she provided data that argued in both the affirmative and negative including job classifications where the State fell behind its private and public sector counterparts.

#### 5) Section 89-11(f)(8) - Overall compensation package

In evaluating the proposals, the panel only addressed wage comparisons, but it is mandated to consider the overall compensation package including medical and hospitalization benefits, vacation, sick leave, retirement benefits and the like. Additionally the panel was tasked to factor in the continuity and stability of employment. The panel did not incorporate these conditions into its final decision.

Specifically, the State provided evidence that its benefit package compares extremely favorably with private sector benefits. Additionally the State provided data on turnover rates, average length of service, reduction in force figures, and recruitment data which documented the continuity and stable nature of State employment. In ignoring this evidence, the panel erred in its evaluation of the true value of the State’s complete compensation proposal.

#### Conclusion

Based on the fiscal and legal arguments set forth in this message, I strongly urge the 22<sup>nd</sup> Legislature to reject the arbitration award.

# CHART #

IMPACT ON GENERAL FUND PLAN BASED ON ARBITRATOR'S DECISION						
	FY 2004	FY 2005	FY 2006	FY 2007	FY 2008	FY 2009
Balance	86.7	84.6	18.5	(175.1)	(295.8)	(293.3)
Revenue over Expenditures for year		7.1	(68.8)	14.3	147.6	268.7
Revised Balance		91.7	(50.3)	(160.8)	(148.2)	(24.6)
UHPA (actual)	(2.1)	(8.6)	(13.0)	(19.4)	(29.5)	(51.4)
HGEA (arbitrated)	0.0	(32.2)	(53.8)	(54.3)	(54.3)	(54.3)
UPW (pending)	0.0	(5.8)	(9.3)	(9.3)	(9.3)	(9.3)
HSTA (pending)	0.0	(26.6)	(48.7)	(52.0)	(52.0)	(52.0)
Total for collective bargaining increases	(2.1)	(73.2)	(124.8)	(135.0)	(145.1)	(167.0)
New Balance	84.6	18.5	(175.1)	(295.8)	(293.3)	(191.6)