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FINAL OFFER ARBITRATION AND INTERTEMPORAL COMPROMISE — A COMMENT

GENE SWIMMER

When I originally discussed the possibility of intertemporal compromise under a final offer arbitration system,[1] I had hoped that this empirical hypothesis would be tested. In a recent issue of this journal, Dworkin[2] applied the hypothesis to the results of professional baseball arbitration. In this reply, I wish to discuss the following issues: the appropriateness of baseball as a test group, and Dworkin's interpretation of his own test results.

Briefly stated, the hypothesis is that if final offer arbitration occurs in one wage round, then the loser in that arbitration will expect to win (be selected) in the subsequent round, and will therefore be expected to push negotiations to arbitration in the subsequent round. The arbitrator wants to look unbiased and thereby avoid alienating either of the parties. A «biased» award might lead to not being rehired as an arbitrator. Given this situation, it is clear that the risk of looking biased is greater if he sides against the loser in the previous wage round. In addition, on purely objective grounds, the fact that one party lost in the previous round makes their final position that much more reasonable. In any case, the arbitrator cannot make a decision in one time period without being affected by the arbitration award in the last wage round. In summary, the hypothesis has two testable propositions. The probability of going to the arbitration step in time period t would be substantially greater if a final offer arbitration award was issued in time period t-1, than if the parties negotiated a settlement without third-party intervention in period t-1. Secondly, final offer arbitration awards between wage round should flip-flop or represent compromises with the winner in time period t being the loser in time period t-1 and vice versa.

Does professional baseball arbitration represent a reasonable sample in which to test the intertemporal compromise hypothesis? Arbitration of baseball salaries more resembles a grievance or rights arbitration of an individual than arbitration of outstanding issues in a collective agreement for a group of workers. Only one employee is affected by the decision of the arbitrator, and the financial stakes involved are reasonably meager. Looking at the sample that we are provided with by Dworkin, one should note that average difference between the management and the employee offer is about $16,000.[3]

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[1] SWIMMER, Gene. «Final Offer Arbitration and Intertemporal Compromise — The University of Alberta Experience», *Relations industrielles*, Vol. 30, N° 3, 1975, pp. 533-536.

[2] DWORKIN, James. «Final Offer Arbitration and Intertemporal Compromise», *Relations industrielles*, Vol. 32, N° 2, 1977, pp. 250-261.

[3] *Ibid.*, p. 254.

Compare this with the Alberta case where 1% represented between $100,000 — $150,000 to the parties. One can reasonably argue that the risk to the arbitrator of alienating one of the two parties would be somewhat lower for the baseball case. A more important reservation with using baseball arbitration has to do with the fact that in the original article, I proposed that an important part of the scenario for intertemporal compromise was a situation of inflation which was simultaneously reducing workers' real wages and reducing the real size of public sector employers' budgets. Clearly none of the baseball players involved are particularly concerned with the inflation rate (the average salary in major league baseball must exceed $30,000 per year), nor are any of the owners faced with possible extreme financial difficulty as a result of a particular outcome of negotiations with any specific player.

All these caveats aside, I think that a careful look at Dworkin's results indicate that they are relatively consistent with the concept of intertemporal compromise. The first testable proposition is that the probability of arbitration in one year increases when arbitration has taken place the year before. Dworkin reports that roughly 500 players were eligible for arbitration in 1974 and 1975 and there were 28 arbitration awards rendered in 1974 and 14 awards in 1975.[4] The fact that only 4% of negotiations ever reach final offer arbitration each year is probably indicative of the low financial stakes involved. It is not contrary to the intertemporal compromise hypothesis which has nothing to say about the probability of going to arbitration in general — only that the probability of arbitration is larger in one period if, in fact, arbitration has occured in the period before. According to Dworkin, « only » 6 out of the 28 players used arbitration in both 1974 and 1975. Thus the proportion (« probability ») of negotiations going to final offer arbitration in 1975, given that arbitration occurred in 1974, is .214. Now compare this with the « probability » of arbitration in 1975, given no arbitration in 1974. Eight players out of a pool of 472 who did not go to arbitration in 1974 (500 — 28) went to arbitration in 1975 for a proportion of *only* .017.[5] A test for a difference in two proportions is significant at the .01 level.

Dworkin then discusses the outcomes of the six players who in fact did go to final offer arbitration in both 1974 and 1975. He admits that in 5 out of 6 cases the awards did flip-flop as the intertemporal compromise hypothesis would predict. He goes on to say that the key question is whether arbitrators make decisions on the basis of the most reasonable final position or, to minimize the risk of alienating the parties.[6]

To my mind, Dworkin totally misses the point. It doesn't matter what an arbitrator's motives may be. Ex post explanations for reasonableness and/or self interest on the part of the arbitrators can be made

[4] *Ibid.*, pp. 253-254.
[5] A test for a difference in two proportions is significant at the .01 level.
[6] DWORKIN, *op. cit.* p. 254.

for arbitration in both baseball and the University of Alberta cases. What does matter is whether the parties can expect a flip-flopping of awards and if this expectation is built into the negotiating strategy. If so, the likelihood that the parties will settle their differences without third-party intervention is reduced. None of Dworkin's evidence has refuted this proposition.

INTERTEMPORAL COMPROMISE REVISITED: A REPLY

JAMES B. DWORKIN

Originally proposed as an «ideal» substitute for interest arbitration of the conventional variety, final offer arbitration has recently been the target of much criticism in academic circles.[1] Specifically, Professor Swimmer has postulated that final offer arbitration is subject to the «narcotic effect,» and more importantly, that arbitration awards will «flip-flop» over time as arbitrators attempt to avoid deciding for any party two time periods in a row.[2] Rather than evaluating the comparative merits of the final positions of the parties in rendering their decisions, Swimmer argues that arbitrators will hand down decisions in time period t based solely on what the award was in time period t-1. If true, this is clearly a serious indictment of the technique of final offer arbitration and of the neutrals who operate as Swimmer has suggested.

The evidence that I presented in this Journal[3] from the realm of professional baseball demonstrated that a much closer, more rigorous examination of the intertemporal compromise notion was necessary before accepting it on face validity. Professor Swimmer has taken issue with my remarks on the grounds that: (a) professional baseball does not serve as an appropriate test group; and, (b) the results from pro-

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[1] For example, see Hoyt N. WHEELER, «Closed Offer: Alternative to Final Offer Selection,» *Industrial Relations*, Vol. 16, N° 3, October 1977, pp. 298-305; Clifford B. DONN, «Games Final Offer Arbitrators Might Play,» *Industrial Relations*, Vol. 16, N° 3, October 1977, pp. 306-314; Peter FEUILLE, «Final Offer Arbitration and Negotiating Incentives,» *The Arbitration Journal*, Vol. 32, N° 3, September 1977, pp. 203-220; and Paul C. SOMERS, «An Evaluation of Final-Offer Arbitration in Massachusetts,» *The Journal of Collective Negotiations in the Public Sector*, Vol. 6, N° 3, September 1977, pp. 193-227.

[2] Gene SWIMMER, «Final Offer Arbitration and Intertemporal Compromise — The University of Alberta Experience», *Relations Industrielles*, Vol. 30, N° 3, 1975, pp. 533-536.

[3] James B. DWORKIN, «Final Position Arbitration and Intertemporal Compromise», *Relations Industrielles*, Vol. 32, N° 2, 1977, pp. 250-261.