PARTNERING FOR PUBLIC VALUE: NEW APPROACHES IN PUBLIC EMPLOYEE LABOR-MANAGEMENT RELATIONS

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I. INTRODUCTION

States and municipalities today form the locus of innovation in American government. But the popular and scholarly commentary on public sector innovation overlooks its most crucial component: the transformation of public sector labor-management relations that has enabled local governments to change decisively their way of doing business. This transformation challenges longstanding bureaucratic obstacles to competition and workplace productivity obstacles deeply embedded in local law, union contracts, and government practice. Despite its modest beginning, the movement continues to gain momentum and to create public values altering outdated bureaucratic procedures and labor-management norms. It emphasizes the hourly worker, not the white-collar manager, as the key source of innovation and public value. This is a story worth telling as practical wisdom to local leaders and labor law scholars interested in the public workplace.

For decades, a failed model of labor-management relations pervaded public organizations and frustrated efforts at reform. The stimulus for change was a crisis in urban America. For two centuries, American cities had thrived. Industrialization provided rich economic opportunity, urban neighborhoods sustained civic involvement and community, and strong families, religious organizations, and schools instilled unity and shared values. By the 1970s, however, many cities were under siege. Tax revenues collapsed as citizens departed to the suburbs, businesses followed

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the exodus out of town, crime and urban decay surged, and federal programs exacerbated many of the problems they sought to correct. In contrast, the 1990s were a period of renewal. Local leaders emphasized pragmatism and experimentation often partnering with religious and civic organizations to better meet human needs. Their policies freed cities from dependency on the federal government and reduced crime, and partnered with religious and civic organizations in meeting human need. By 2000, cities long abandoned as unmanageable were undergoing a renaissance.

Reformed labor-management relations have been a cornerstone of this reform. To be sure, many problems in urban America persist, but the face of the municipal governments best addressing these problems has changed. The past decade has shown that reshaping the labor-management relationship, and structurally reforming bureaucratic procedure and organization, can unlock enormous value. Rather than being defined by its stereotypes, the public workplace can be a place of productivity, human capital formation, and job satisfaction. This essay sketches out key features of the traditional public sector workplace, describe the implications for the public employees, and then explore how competition and structural reform of bureaucratic procedures can improve labor-management relations and unlock public value.

II. THE STRUCTURE OF THE PUBLIC WORKPLACE

At least five features of the traditional public sector workplace thwart the efficient delivery of public goods. The origin of these features vary and include work rules, badly negotiated contracts, state law, and engrained practice. Even so, they are common in their disregard for competitive market pressures. First, we will describe them; second, we will show their implications for employees who work under them.

To begin, a rigid hierarchy defines the public sector workplace. Hierarchy defies the insights of the entrepreneurial and team-based management model employed by modern high-performance business organizations. The durability of hierarchy stems from politically accountable officials who favor avoiding the risk of public errors over the possibility of achieving better results, concern for administrative law forbidding policymaking by civil servants, and the desire to retain middle- to low-level white-collar management positions for patronage purposes. Equally important, however, is a deeper institutional distrust of workers. The result is organizational bloat in the lower supervisory ranks and enthusiasm for micromanagement. For example, when Indianapolis sought to outsource Department of Public Works functions, the ratio of supervisors to workers was originally one to four. As the local union prepared to bid on the same work, its activity-based cost analyses revealed that it could not compete cost effectively while saddled with existing levels of managerial overhead. Reducing the ratio to one to seventeen had no adverse effect on service delivery. Though multiple management layers may once have been necessary for effective communications, today these layers more often destroy value. Besides imposing unnecessary costs, they suppress the flow of good ideas from those workers most likely to have them. These effects fuel broad organizational malaise, complacency, and discontent.

Second, narrow job classifications restrict workers' ability to move horizontally in the organization, solve problems and develop cross-functional skills. These restrictions impede the efficient redeployment of workers to address the changing needs of the workplace and require maintaining excess staff capacity to respond to fluctuating demand for services. For example, crews charged with street cleaning after large events can easily assist solid waste workers with fall leaf removal, and vice-versa. Yet job classification schemes long forbade this in Indianapolis. Besides undermining effective capacity management, excessive classification frustrates efforts at cross-fertilization of ideas and innovation across departments. In Indianapolis, shifting from more than a hundred job classifications in 1993 to twelve in 1998 caused no disruption and enabled new forms of interdepartmental cooperation.

Third, compensation and incentive structures are rarely linked to performance. Compensation system design in the private sector is an ever-evolving discipline tied closely with vigorously contested metrics of value creation. However, the effort is rarely even initiated in the public sector. The lack of trust between labor and management, exacerbated by cronyism and partisanship, makes reliance on discretion difficult. Performance-based pay thus requires quantifiable, neutral metrics. The persistent refrain is that government work does not yield to accurate measurement. While this critique may be appropriate in some contexts—for instance, agency rulemaking or the exercise of prosecutorial discretion—it is flatly wrong with regard to most city services. During its period of reform, Indianapolis evaluated itself each month according to more than 200 metrics.

Incentive compensation need not be limited to piecework awards or performance awards tied to particular outcomes. Contracted programs to share savings eliminate most measurement concerns and place discretion where it is least likely to be abused. Efforts to implement shared savings plans have been historical oddities. One 1981 study noted only five attempts at the local level, and three at the state level.[1] Recently, however, they have become more common. In the 1990s, for example, Indianapolis contracted with its own Department of Public Works to provide trash

1. *See* JOHN M. GREINER ET AL., PRODUCTIVITY AND MOTIVATION: A REVIEW OF STATE AND LOCAL GOVERNMENT INITIATIVES 51 (1981).

collection services. When the department beat its bid price by $2.1M in 1994, workers received average incentive pay of $1,750. Unfortunately, these programs are the exception, not the norm. More often, compensation is determined solely by rigid classification and seniority schemes. This inhibits government's ability to incentivize workers, and it frustrates efforts to fire rule-abiding workers who perform poorly.

Another factor is institutionalized risk aversion. Public organizations often view rule- and process-compliance as measures of achievement, rather than insisting upon successful program outcomes. This is, at least in part, the legacy of hierarchical organization, narrow job classifications, and flat compensation programs. Public managers focus on inputs like expenditures (gravel and labor hours), and in some cases on outputs (filled potholes), but rarely on outcomes (smooth streets). The aversion to setting and insisting upon clear performance expectations—or the tendency to set the wrong ones—is deep-rooted and extends beyond the internal management of public organizations. Contracts with private parties to provide public services often betray the same impulse.

Finally, the government often has a monopoly on providing services to the public. In addition, it often shields *internal* government monopolies from market pressure. Because of their visibility, those monopolies most often discussed concern government services provided *to the public*. For example, the government may be the sole provider of street repair services. Exposing these services like certain regulated utilities to competitive pressure has stimulated reform of outdated bureaucratic management structures. Those services provided *to government* itself are perhaps more mundane: for instance, printing and travel services. These are not natural monopolies; the yellow pages are replete with service providers. Private corporations outsource these services, and scale and specialization reduces their costs. Too often, the government insists upon providing these services to itself, despite the absence of any comparative advantage. When Indianapolis outsourced its internal printing and copying functions, costs fell by 25%, pickup and delivery services improved, and clerical staff saved hundreds of hours. The savings were available to either help reduce city costs and taxes or to purchase additional core services.

III. VALUE DESTRUCTION AND THE LIFE OF THE PUBLIC EMPLOYEE

It is difficult to foster healthy labor relations when the pool of public values is stagnant or shrinking. Experience shows that the organizational stasis caused by outdated, monopoly-era workplace rules impedes the creation of public value. Managerial economics teaches that costs should decline as cumulative production increases. In the public sector, improvements in ongoing productivity and efficiency should create value that can be shared between labor and the taxpayers. Unfortunately, when outdated rules straitjacket government workers and prevent ongoing improvement, the pie of value remains constant or shrinks and negotiations become zero-sum. Predictably, labor relations turn antagonistic and the taxpaying public becomes exasperated.

Consider a few examples of how value creation and labor relations suffer from outdated rules and policies:

1. Policies that shield government functions from market competition communicate the counterintuitive message that government workers are inferior. This discourages the sense of ownership and assumption of responsibility that pervade high-performance organizations. The implication of anti-competitive policies is that government employees are incapable of competing successfully. Yet the last decade has shown that when bureaucratic rules and processes are relaxed to permit government workers to compete on the same terms as private competitors, public employees often win. In Indianapolis, they won more than half the contracts for which they competed. On the other hand, insistence upon government monopolies leads to a self-perpetuating ethic of inferiority and entitlement. This pathology destroys initiative. Furthermore, the absence of performance-based pay exacerbates the tendency.

2. Anti-competitive policies also engender employee hostility toward the innovation that is essential to ongoing productivity improvement. The institutional obstacles to innovation arise from several subsidiary sources. First, measuring inputs and evaluating rule- and process-compliance rather than assessing program outcomes, fails to create needed incentives. Instead, workplace norms encourage "keeping one's head down" and maintaining an excessive level of deference to one's superiors. Second, over time, government employees and institutions shed the analytical and technical tools necessary to innovate in the delivery of services. Simple private sector management tools like business process reengineering and activity based costing yield surprisingly large results when introduced into the private sector, primarily because they are applied to institutions that have failed to self-critique on an ongoing basis. Even though many tools of scientific management were borne of government necessity, for instance in the defense contracting arena, many have failed to penetrate the operations of state and local government.

3. Rigid and immutable workplace rules create adversarial labor-management relations. When real value does not exist to be shared, union leadership uses litigation and grievance filing to demonstrate its worth to the rank and file. After a hard fought 1992 election campaign emphasizing privatization, the new Indianapolis administration saw grievances triple to between two and three hundred each year. In contrast, after the reforms, only one grievance was filed in 1997 and one in 1998. Additionally, when

unions file grievances, management typically responds by increasing the amount of control it exerts over employees and unions often wasting even more funds.

4. The galaxy of rules and procedures under which government workers operate makes it difficult to attract and retain high caliber staff. In addition, the managerial skills needed in the traditional public workplace differ significantly from those needed to manage partnerships in a market environment. Whether the partnership is with an outside group or with the municipality's own employees, the partnering model requires managers to negotiate with outside vendors, set clear goals and expectations, delegate discretionary authority to workers executing against defined targets, and reward performance. In contrast, the traditional model values enforcing rule-compliance and other mechanisms of bureaucratic process control. Local government management permits greater delegation and operational discretion. In these contexts, the public manager requires skills nearly identical to his or her private sector counterpart.

Government service imposes a high opportunity cost vis-à-vis private sector opportunities. However, the compensation differential, while often substantial, is not necessarily the greatest deterrent. Spending formative years of professional life operating under bureaucratic procedures magnifies the opportunity cost; so too does the perception of inefficiency and laziness. Because government service can be viewed as a detriment to one's resume, the dilemma is perpetuated: high quality executives eschew government service, government performance lags, and the reality approaches the perception. Of course for many, the sheer frustration that accompanies working in inefficient organizations is enough to divert talent elsewhere. Many of those managers who remain, particularly low-level supervisors, tend to embrace their bureaucratic culture and oppose efforts to make needed reforms. Some of these professionals chose government service because of its risk-free environment.

IV. POSSIBILITIES FOR REFORM

The experience of the1990s showed that cities could change the status quo and sharply improve their labor-management relations. Even with a history of good government Indianapolis had built up its bureaucracy over time. In particular, its middle management had gradually accreted. City leaders introduced competition in the 1990s to structurally realign internal labor-management incentives. Competition began to erode inefficient processes and rules; in doing so, it enabled further reform and more competition. This result squares with the data: while the number of cities contracting for services remained stagnant between 1988 and 1997, the number of services contracted for by those cities increased by 16%, and the number of cities contracting for greater than 30% of their services increased more than tenfold.[2]

Reformed labor-management relations arise by partnering with labor to pursue competition, not by insisting on privatization. Just as replacing government monopolies with private monopolies fails to generate guaranteed savings,[3] privatization alone will not reform the public workplace. In contrast to privatization, competition expresses no preference as to who wins: it emphasizes outcomes, not inputs. Experience has shown that government workers freed from bureaucratic rules often compete successfully against private sector actors. The desire for cost reductions and superior policy outcomes motivates many competition initiatives, and Indianapolis saved an average of 20% on services that it put out for bid. Yet the transformative effect of competition on human resources management and labor-management relations is equally dynamic.

Competition only creates better public employee output if it is accompanied by major changes in the traditional bureaucratic systems. These changes are necessary to ensure that public employees can compete effectively and to create the context for vastly improved relationships between labor and management. Here are seven reforms that would be effective places to begin instituting change:

1. *Increase discretion and reduce vertical hierarchy.* Liberating workers creates value for many stakeholders. Eliminating unnecessary hierarchy enables workers to assume responsibility for outcomes, to implement innovations more immediately, and to compete with lower overhead costs. Many changes are necessary to fully empower workers from updating procurement rules to rewriting job descriptions, enhancing training, and more. However, to reduce hierarchical controls, an important first step is to recruit and develop energetic managers committed to reform. Very often, the enthusiasm of hourly workers who understand the possibilities of reform vastly exceeds that of their immediate white-collar supervisors. Political leaders and senior executives need to be willing to make tough decisions, including encouraging superfluous employees to take advantage of retirement incentives and outplacement job services to persuade them to exit the public workplace. Senior leaders should also

2. REASON PUBLIC POLICY INSTITUTE, PRIVATIZATION 2000: THE 14TH ANNUAL REPORT ON PRIVATIZATION 3 (2000).

3. In Indianapolis, the initial foray into privatization was an effort to outsource billing for sewer services (an annual city cost of nearly $3M incurred to collect $40M in receivables). City officials approached Indianapolis Water Corporation (IWC), the private water utility, which offered to perform the job for 5% less than the city's cost. Only when bidding was opened to all central Indiana utilities did the IWC proposal become compelling: a 30% cost reduction, plus an extensive program to collect missing revenue and share the proceeds with the city. STEPHEN GOLDSMITH, THE TWENTY-FIRST CENTURY CITY 17-19 (1997).

commit to being accessible to workers at all levels in the organization (including by email) and to respond promptly to suggestions.

2. *Organize employees in teams responsible for solving discrete problems.* Enabling horizontal cooperation complements the reduction in vertical hierarchy. Teams, whether physical or virtual, should be flexible and able to form and then to reform as issues change. Rather than organizing around inputs or processes, individuals must take responsibility for outcomes and be evaluated accordingly. All employees must own responsibility for some effort. E-Government and other technology tools allow public employees to share information, work concurrently, act as teams, and measure results in ways never before possible.

3. *Solve non-monetary labor complaints quickly and effectively.* These issues may be job security, workplace conditions or equipment and training. The foundation of good labor relations is built on taking workers seriously, addressing their concerns, and treating them as colleagues. In the private sector, the experience of former Alcoa Chairman and CEO Paul O'Neill is instructive. When O'Neill became the first outsider to lead the aluminum giant, the industry faced depressed prices and longstanding labor relations problems. He immediately established workplace safety as the number one priority, higher even than profits, and he fired managers who did not adopt the program. He ended Alcoa's policy of paying for memberships to an all-white Pittsburgh country club, and he implemented an identical profit-sharing plan for white collar and hourly workers. Over time, Alcoa developed model labor relations and achieved an extraordinary economic transformation.[4] Similarly, municipal officials must address issues unrelated to compensation, including race relations, safety, training and workplace conditions. And they must make clear to middle managers that top city officials and union leaders work on the same team. Where this has occurred, as in Indianapolis, cost savings have followed.

City officials can begin by pledging to minimize short-term forced layoffs as they introduce competition. Privatization alters the mix between public and private provision of public goods; while private contractors often hire public workers, they do not hire them exclusively. The aging demographics of the public workforce makes this commitment more practicable than it might otherwise seem: unless replenished, the public workforce will shrink as baby boomers retire. Retirement incentives and outplacement programs can accelerate this process. Still, management must commit to help displaced workers find other public sector jobs.

Complaints circulating in the workplace become a symbol of management indifference when simple requests go unfulfilled. If handled correctly and consistently, addressing basic concerns can lead to much

4. *See* Michael Lewis, *O'Neill's List*, N.Y. TIMES, Jan. 13, 2002, § 6, at 20.

improved relations. The simplest requests are often the most important: replacing a broken piece of equipment, enhancing the appearance of a warehouse, providing breaks and better water availability on very hot days, or dealing with a biased manager. Upper management is only infrequently even aware of these requests.

4. *Loosen entrenched impediments to internal labor mobility.* Working collaboratively with union leaders to enhance internal labor mobility is essential not only to enable the reassignment of displaced workers, but also to ensure optimal deployment of human resources and the full development of workers' human capital. The joint labor-management team should relax seniority rules, significantly widen job classification schemes, and alter rigid pay scales in favor of performance-based, value-sharing models.

5. *Guide managerial and compensation practice with objective, scientific performance metrics.* Objective metrics overcome the lack of trust that traditionally pervades the labor-management relationship. Particularly in basic services, the public sector can readily import private sector managerial accounting practices. Sharing these skills beyond the managerial group is essential to enable public employees to identify unnecessary costs and bid for public work. Value metrics defined in advance, and shared by both managerial and hourly workers, form the basis of effective compensation systems that neither rely upon managerial discretion nor lend themselves to political abuse.

6. *Remove obstacles that prevent labor from competing successfully.* As a department's functions are put out for competitive tender, public workers seeking to retain the function search for inefficient practices that can be eliminated. Take procurement rules as an example. If accounting systems allocate costs properly, public employees seeking to bid competitively will either expose the inefficiencies of internal monopolies, or private sector competitors not bound to inefficient practices will submit superior bids. Empowering workers to realize these savings opportunities creates better employer-employee relations and better products. Executives must take on high cost, internal monopolies that cause organizational tension and division. Access to the right equipment, parts and tools makes better results possible.

7. *Celebrate success.* The road to competition often proceeds one contract at a time. Celebrate successes frequently, and recognize failures for what they are. Study them carefully, propose solutions, and move on.

These reforms can advance other important public goals. City officials should identify important public values and structure their partnership relationships to achieve them. For example, consider minority entrepreneurialism. Internal monopolies preempt contracting by minorities; when competition is introduced, it can be structured to facilitate minority participation. Municipal contracts in Indianapolis were traditionally bid in sizes too large for many small, minority businesses to bond at the required level. By aggressively putting more city services out for bid between 1992 and 1998, and defining contracts carefully to enable women and minorities to participate, the percentage of minority participation in total municipal contracts grew by 55%.[5] No quotas were required and the city also saved $400 million.[6] Without imposing subcontracting requirements, the city's articulation of these values led city contractors, as a customer service matter, to meet and exceed the city's expectations in this area, expanding the circle of productivity and developing business relationships that spill into private sector work.

The public workplace often suffers from structural barriers to diversity, and competition can remove many of them. Performance matters when government agencies are held accountable for financial results and compensated accordingly; patronage and seniority do not. By relaxing job classifications, rethinking compensation schemes, and thinning management ranks, outstanding performers have incentives and the capability to rise from hourly to managerial positions, and top officials have heightened incentives to promote them. In departments marked by disproportionately white managers and disproportionately non-white workers, ending the impermeable labor-management divide calms racial animosity and broadens the composition of management.

V. CONCLUSION

Local governments face challenges that show no sign of abatement. Increased financial resources are unavailable as municipalities cope with under-performing public schools, persistent poverty, juvenile criminality, child abuse, and the crisis of affordable housing. As the renaissance in urban America revealed when it began in the 1990s, reforming labor-management relations by removing bureaucratic procedures and structures can unlock substantial public value. The Indianapolis experience teaches that bureaucratic stasis need not prevail. While individual governments will adopt solutions suited to their own particular circumstances, the pathology of the traditional public workplace mandates that rethinking labor-management relations be a top agenda item. Government agencies will otherwise lag behind their private sector competitors, destroying finite human and financial resources. Instead, municipal leaders can use competition to work a transformation that embraces partnership with labor.

5. Stephen Goldsmith, *Value-Added Diversity*, 10 STAN. L. & POL'Y REV. 233, 235 (1999).
6. *Id.*

The public, city leaders, and most especially the union members whose potential is too often untapped all have much to gain.