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Public Jobs and Public Agendas: The Public Sector in an Era of Economic Stress

Daniel J. B. Mitchell (Ed.)

Abstract

[Excerpt] The issues described in this volume's chapters remained in flux as this book was being completed. The U.S. economy was in a recovery phase, albeit a recovery at a rather lackluster pace. Because of the lags in adjustment in state and local governments, the public sector was coping with prior circumstances even as the private sector resumed an economic expansion. At the international level, some European elections in the aftermath of the Great Recession have suggested that there is public frustration with austerity policies.

The Great Recession occurred in an era of political polarization, which the sharp downturn exacerbated. As a result, resolving the issues related to public sector employment was complicated by an infusion of ideology. Working out the problems that remain unresolved is likely to be marked by continued partisan struggles in state and local affairs, and in similar conflicts around the world.

Keywords

public sector, employment, Great Recession, pay, race, compensation

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The Public Sector in an Era of Economic Stress

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LABOR AND EMPLOYMENT RELATIONS ASSOCIATION
University of Illinois at Urbana-Champaign
School of Labor and Employment Relations
121 Labor and Employment Relations Building
504 East Armory Ave., MC-504
Champaign, IL 61820
Telephone: 217/333-0072 Fax: 217/265-5130
Websites: www.leraweb.org www.employmentpolicy.net
E-mail: leraofnce@iIlinois.edu

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Introduction

DANIEL J.B. MITCHELL
University of California, Los Angeles

In many respects, concerns and issues in managing employment are the same in the public and private sectors. There are traditional personnel responsibilities: recruitment, evaluation, incentives, discipline, retention, and compensation. But while these are common elements to both sectors, there are also substantial differences. Not surprisingly, a period such as the Great Recession and its aftermath—with the obvious strains it put on public sector budgets—tends to highlight differences. Readers may recall a quote attributed to financier Warren Buffett that "only when the tide goes out do you discover who's been swimming naked." Some state and local governments that had engaged in precarious fiscal practices indeed faced increasing public attention as their tax revenues receded. But that is not the whole story.

The reasons public sector workers and human resource practices are under scrutiny go beyond the impact of a recession putting the spotlight on already strained budgets. There are important public/private differences that account for the special attention visited upon the public sector starting with the Great Recession. The first of these differences was the timing of the response to the recession and its aftermath on revenues. The second difference involves employee compensation and the contrasts between public and private practices in that area. Intertwined with these two factors is politics.

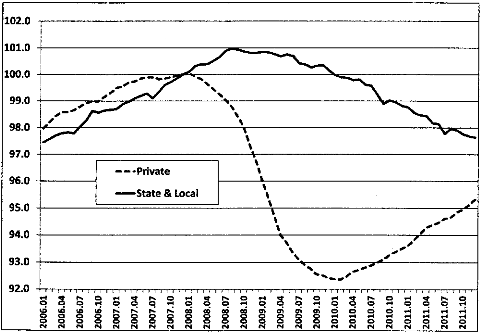
Employment Response

As Figure 1 shows, there were major differences in the employment response between the private sector and state and local sector when the Great Recession occurred. The former sector exhibited a much sharper and more immediate drop in employment than the latter. Indeed, the state and local sector for a time gained jobs even after the start of the Great Recession in late 2007 (as dated by the National Bureau of Economic Research).

Generally, as depicted in Figure 2, public employment has historically been less variable than private employment in response to business cycles. In that regard, the Great Recession was no exception. The decision process in government is more cumbersome since it involves legislative decisions, which often occur with a lag. Tax revenue may respond to the cycle with a lag since taxes on personal income and profits are collected after

FIGURE 1

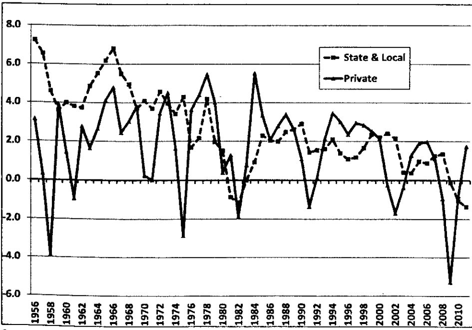
Private Nonfarm vs. State and Local Payroll Employment (December 2007 = 100)



Source: U.S. Bureau of Labor Statistics website www.bls.gov (downloaded April 9, 2012).

FIGURE 2

Annual Percentage Change in Nonfarm Payroll Employment, State and Local vs. Private



Source: U.S. Bureau of Labor Statistics website www.bls.gov (downloaded February 7, 2012).

the fact and are based on past income. Governments may also find ways—or simply be forced by their slow responses—to borrow to support current services. The decision lag in government means that the adjustment period is lengthened as accumulated debt is initially worked off even after economic recovery begins. As Figure 1 illustrates, private sector employment began to grow by early 2010. In contrast, after government employment peaked, the public sector exhibited a steady job decline through 2011, which reflected extended budget crises.

The consequences of the response differences between public and private employment were twofold. First, the public perception that government employment seemed more protected than private, particularly in the early stages of the economic downturn. Second, the ongoing crisis in public sector fiscal affairs (which was reflected in the protracted government employment decline) kept the issues of budget imbalances and state and local fiscal crises in the headlines.

Pay Practices

Table 1 compares pay and benefits of private sector and state and local employees. Generally, private sector workers receive lower pay and lower employer expenditures on benefits than workers in the public sector. Workers in private employment may receive no health insurance at all, whereas regular workers in public employment typically receive health insurance and are likely to have a generous plan compared to workers who have some form of health insurance in private employment. There is a similar contrast with regard to pensions. In particular, public workers most often have defined benefit (traditional) pension plans under which retirement income is determined by a formula based on age, service, and pay history. Private sector workers, if they have any employer-based pension, are more likely to have a defined contribution plan in which investment risk for target retirement income is borne by the employee.

Of course, the data shown in Table 1 are not standardized for occupation, education, or size of employer, which are the kinds of statistical adjustments economists (and personnel directors) would want to make. However, especially in the context of a recession-induced budget crunch in public employment, average unadjusted pay and benefit magnitudes may matter more for public perceptions than carefully controlled comparisons.

Public perceptions, however, do not occur in a vacuum. There is a political context. That context was aggravated by a pension funding crisis. Beginning in the 1980s, public pension funds were more likely to be invested in the stock market, making their returns more sensitive to the ups and downs of that market. As Figure 3 shows, the financial crisis of 2008 substantially reduced the market value of pension portfolios relative to their annual payouts. Moreover, the stock market gains of the 1990s had led to more generous promises of future pension payouts. Thus, unfunded liabilities appeared or grew as the value of pension portfolios dropped.

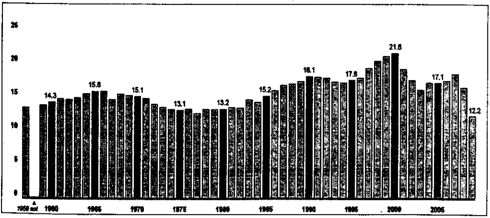
TABLE 1
Hourly Compensation of Private Workers Compared to State and Local Workers, September 2011

	Private		State and local	
	Amount	Share	Amount	Share
Total compensation	$28.24	100.0%	$40.76	100.0%
Wages and salaries	$19.91	70.5%	$25.57	65.2%
Benefits*	$8.33	29.5%	$14.19	34.8%
Health insurance	$2.15	7.6%	$4.74	11.6%
Pension				
Defined benefit	$0.45	1.6%	$3.10	7.6%
Defined contribution	$0.56	2.0%	$0.33	0.8%

*Benefits include payments for leaves, supplements, insurance other than health, and legally required benefits not shown separately.

Source: U.S. Bureau of Labor Statistics (2011), Tables 4 and 5.

FIGURE 3
Ratio of Market Assets to Total Expenditures of State and Local Pension Plans, 1957–2009



Source: U.S. Government Accountability Office (2011:11).

Politics

Particularly when focusing on state and local government, the kinds of jobs that come quickly to mind are basic services such as police, fire, and education. However, over the years and especially since the New Deal of the 1930s and the Great Society of the 1960s, state and local government has become intertwined with the federal government in the delivery of social welfare programs. Such programs may receive substantial funding from the federal government, but they are administered locally. For example, the New Deal ushered in unemployment insurance, a joint state-federal program. The same Social Security Act of 1935 that created the modern unemployment insurance system also provided federal support for state and local welfare programs. Medicaid, another joint federal-state-local program, was implemented in the 1960s.

It is a commonplace observation that the United States has seen widening polarization between the two major political parties along a liberal-conservative divide. At one time, conservatives might have favored local government over federal. But with the increased linkage of the two, a person who does not like social welfare programs may be hostile to all levels of government, not just federal. There is the old saying that a job not worth doing is not worth doing well. So, even the most efficient state and local governments—and those employees carrying out public functions—are likely to be disdained if one does not like what they are doing. And anything that smacks of inefficiency, irresponsibility, or even corruption will be an obvious target.

In fiscal year 2009, 22% of state and local expenditure fell into the social welfare category (public welfare, hospitals, health, social insurance administration, and veterans' services). Twenty-two percent of state and local revenue came from the federal government. Much of the expenditure of state and local governments goes to outside contractors who provide goods and services or to transfer payments. But about 37% of such expenditure goes to public employee pay and benefits (Barnett 2011). It is hard to separate social welfare from state and local governments and the employees of those governments, given these magnitudes.

Public and private employees are marked by substantial representation differences. As Table 2 shows, the private sector has become largely deunionized. The public sector, in contrast, has unionization rates similar to those achieved in the private sector by organized labor in the heyday of unionism back in the 1940s and 1950s. Union workers in the public sector, as in the private, are more highly paid than nonunion workers (again not adjusting for occupation or other characteristics). Seen along

TABLE 2
Union Representation in 2011

	Private	State Government	Local Government
Unionization rate	7.6% (6.9%)	35.0% (31.5%)	46.6% (43.2%)
Weekly earnings of full-time wage and salary workers			
Union	$875 ($878)	$946 ($956)	$967 ($973)
Nonunion	$716	$785	$743

Note: Figures in parentheses refer to actual union members as opposed to workers represented by unions who may or may not be actual members.

Source: U.S. Bureau of Labor Statistics (2012), Tables 3 and 4.

the conservative–liberal divide, however, unions in the public sector are more than collective bargaining agents. They are advocates of the programs their members administer (which conservatives often dislike) and opponents of outsourcing public functions to the private sector (which conservatives like). In terms of funding political activities, unions are much more likely to fund Democrats than Republicans. Unfortunately, there are no data sources that aggregate political contributions across state and local government. At the federal level in 2007–2008, however, more than 96% of union contributions in House of Representatives races went to Democrats. In U.S. Senate races, 93% of union contributions went to Democrats. In contrast, business interests are more likely to split contributions between Republicans and Democrats. Indeed, corporate and trade association contributions to members of the House and Senate were divided 50/50 in 2007–2008 (U.S. Bureau of the Census 2012:264). Put bluntly, weakening public sector unions equates to defunding Democrats.

In some states, such as Wisconsin and Ohio, there were overt moves by Republican governors and legislators to reduce the strength of public sector unions, ostensibly based on budgetary rationales. In states where the political balance did not allow such strategies, the funding problems of public pension plans became a proxy for such battles. The Great Recession's negative impact on the portfolio value of public pension plans combined with past excesses in pension practices and the fact that defined benefit pensions were becoming rare in private employment made the plans a logical surrogate.

The Chapters in This Book

With the exception of Chapter 9 (on Trinidad and Tobago), the Great Recession and its consequences linger in the background throughout this volume—and sometimes the foreground.

Chapters 1 and 2, by David Lewin and Mildred E. Warner, respectively, are overviews of the impact of the economic downturn on state and local government. Chapter 3, by Sabina Dewan, provides an international overview. These three broad chapters are followed by two chapters looking at the consequences of the downturn and of the resulting fiscal pressures. In Chapter 4, Ellen Dannin looks at pressures for privatization. William M. Rodgers III in Chapter 5 examines the differential impact on black and white public workers.

Two chapters then focus on pay issues. In Chapter 6, Keith A. Bender and John S. Heywood examine the issue of comparing public and private compensation. In Chapter 7, liana Boivie and Christian E. Weller focus on pensions and pension funding.

The final two chapters are case studies. In Chapter 8, I report how California, the most populous state in the United States, adjusted to the Great Recession. In the final chapter, Charlene M.L. Roach and Gloria Davis-Cooper look at the use of contract employees rather than civil servants for providing public services.

Overviews

In his chapter on the Great Recession and its impact on the public sector, Lewin first notes the large size of government employment. Not counting private contractors and their employees, government directly employs roughly one sixth of the U.S. workforce, and most of those workers are in the state and local sector. He notes that employment adjustment to the economic downturn in government was slower in the public than in the private sector. Pay adjustments in state and local government also were slower to respond. Apart from these macrolevel effects, there were a variety of eventual responses about restructuring of retirement plans and health care plans, with different states taking different approaches. Lewin notes the challenges to prevailing union-management relations that developed.

Warner reports in her chapter that one of the factors delaying the state and local response to the Great Recession was the availability of federal stimulus funds. Once these funds disappeared, however, adjustments had to be made. One difference she notes between public and private employers is that while revenues flowing to each are procyclical, the demand for many public services is countercyclical and rises during recessions. Apart from cutbacks even in the face of such demand, local governments have looked for efficiencies by pooling service delivery to achieve economies of scale. In some cases, local businesses and residents have assumed previous governmental roles through such devices as business improvement districts. In effect, the participants under these arrangements tax themselves for incremental services. Such arrangements existed before the Great

Recession, but the economic downturn stimulated a quest for new forms of service delivery.

The internationally oriented chapter by Dewan is macrofocused. She looks at all levels of government and includes central governments that have long been the locus of macroeconomic policy. Initially, she notes, many countries expanded their public sectors and public jobs to provide a fiscal stimulus as a counterweight to the unfolding economic crisis. However, after the initial move toward stimulus, many countries—worried about rising budget deficits and debts—reversed course. They embarked on austerity policies and public job cuts. A number of the countries Dewan cites are in the euro zone. It may be that this reversal of policy was a consequence of their earlier decision in joining the zone to abandon their national currencies.

As analysts cautioned before the euro zone came into effect, countries without monetary policies have limited fiscal discretion as a result. They become similar to U.S. state and local governments that must move toward austerity during hard times (Mitchell 1998). But although some countries had little choice about cutting back their public sectors, others with discretion (i.e., countries such as the United Kingdom, which retained national monetary systems) also cut back when voters chose conservative governments. Accordingly, some of the policy options described by Dewan appear to have been ideologically driven.

Privatization

Dannin notes in her chapter that the Great Recession led to another pre-existing arrangement receiving more attention: privatization. In a sense, the "make or buy" decision in the public sector is analogous to decisions that private employers regularly make. However, in the private sector, the decision-making process is conducted not within an ideological framework but on the basis of relative costs and quality control. In the public sector, advocates of outsourcing often do not base their decisions on a strict cost-benefit analysis. Rather, they simply prefer that the private sector be used to perform public functions and take it on faith that the outcomes of private provision will be better. Dannin also points out that resentment against public workers was used by post—Great Recession advocates of outsourcing to promote their agendas.

Demographics

Another consequence of the Great Recession, which Rodgers examines in his chapter, is a differential impact on black public worker's job losses compared to those of white public workers, with the former now having a higher probability of being laid off. In the private sector, the probability of job loss for blacks was also higher than for whites. However, prior to the Great Recession, blacks in public employment had a job loss probability equal to whites. What seems to have occurred, therefore, was an erosion of institutions in public employment that had previously equalized the rates.

Pay and Pensions

Bender and Heywood begin their chapter with the observation that there has long been a belief that public sector compensation should be comparable to private. In practice, determining comparability poses challenges because of occupational and other differences between the sectors. Like other authors, after standardizing for key differences in the public sector, they found no evidence of average overpayment in total compensation. They do note, however, the tendency of the popular news media to make comparisons without standardization. They also note that public sector pay from the lowest paid to the highest tends to exhibit more compression than is found in the private sector. The wage-benefit mix in the public sector is tilted more toward benefits, but much of that differential is because many private employers do not offer particular benefits (i.e., they spend nothing rather than just less on those benefits).

The public sector benefit that has gotten the most attention is pensions, the topic of Boivie and Weller's chapter. In that chapter, the authors note that alternatives to defined benefit pensions, such as defined contribution and cash balance plans, are more portable than traditional pensions, which have their primary payoff for career employees. Thus, private sector alternatives might be more attractive to other classes'of workers. However, the mobility-retarding aspect of traditional pensions might be an advantage for public employers who do not want to lose key employees. At the same time, the incentives under defined benefit plans produce departures at retirement age, which can also be an advantage to public employers seeking new talent. Boivie and Weller examine the alternative approaches that public jurisdictions have used to reduce the costs of underfunded plans. They found evidence that most public employers have kept at least some key elements of the defined benefit structure in revised plans they have implemented; the authors also found evidence that public workers prefer the defined benefit approach.

Case Studies

California, the most populous state in the United States, also—and not surprisingly—has the largest public pension plan, CalPERS, and other large state and local pension systems. However, California's immediate fiscal problem involves the general fund budget which, as I report in Chapter 8, was in a precarious position before the Great Recession. The state's heavy reliance on direct democracy processes complicates its adjustment process. Pressures for fiscal prudence were weak during a long period from World War II through the end of the Cold War in which military expenditure fueled economic expansion; in an important sense, the state has not adjusted to the end of that era. Expectations of services exceed revenues. The Great Recession led to large deficits, budget cuts, and temporary tax increases. But the process was painful and even included an episode in which some state bills and tax refunds were paid in IOUs.

The use of contract workers (i.e., workers outside the regular civil service system) in Trinidad and Tobago was not a Great Recession story. As Roach and Davis-Cooper describe in their chapter, the development of that practice does, however, have some common elements with post-Great Recession public sector events in the United States. On its face, contract employment is a way of acquiring workforce skills that may be unavailable within the regular civil service. It may save money under some circumstances or have other benefits. On the other hand, it may have the downside of upsetting morale of regular workers. In that respect, it is similar to outsourcing and privatization. What the consequences may be of such practices is an empirical matter, and the decisions involved require an analytical approach and evaluation after the fact. However, in actual practice Roach and Davis-Cooper found the policy toward contract employment to be a mix of ideology and politics. In that respect, the Trinidad and Tobago story has strong analogies to many state and local decisions in the United States that were undertaken during and after the Great Recession.

A Still Unfolding Story

The issues described in this volume's chapters remained in flux as this book was being completed. The U.S. economy was in a recovery phase, albeit a recovery at a rather lackluster pace. Because of the lags in adjustment in state and local governments, the public sector was coping with prior circumstances even as the private sector resumed an economic expansion. At the international level, some European elections in the aftermath of the Great Recession have suggested that there is public frustration with austerity policies.

The Great Recession occurred in an era of political polarization, which the sharp downturn exacerbated. As a result, resolving the issues related to public sector employment was complicated by an infusion of ideology. Working out the problems that remain unresolved is likely to be marked by continued partisan struggles in state and local affairs, and in similar conflicts around the world.

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CHAPTER I

Effects of Deep Recession on Public Sector Pay, Benefits, and Employment

DAVID LEWIN
University of California, Los Angeles

Introduction

What have been the effects of deep recession on pay, benefits, and employment in the state and local public sector of the United States? This chapter begins with a brief consideration of macrolevel pay, benefit, and employment trends in government during the first decade of the 21st century. That decade began with a relatively modest recession (2001), which was followed by recovery and relatively rapid growth (2001-2007) and then by deep recession (2007—2009).' Analytical emphasis will be placed on the relationship between public sector and private sector employee compensation—that is, pay and benefits—during this decade.

Next, the chapter turns to a microlevel focus on state governments that emphasizes recent actions taken by these governments to revise public employee compensation, especially fringe benefits and retirement and health care plans—actions that were motivated by deep recession and its aftermath. An especially notable feature of this analysis is to show how state-level decisions regarding public employee compensation apply not just to the employees of the state governments but also to the employees (and officials) of local governments in these states. Local government employment is typically much larger than state government employment.

The main lessons learned from these analyses are then identified and discussed, including lessons about public perceptions of public employee compensation, the likely effects of state-level reforms on public employee compensation, the power of state governments in effecting such reforms, and the role and limited influence of public employee unions on these reform efforts. Conclusions are presented in the final section of the chapter.

The Macro Picture

Employment

Government is a major industry in the United States, directly employing more than one sixth of the nonfarm workforce and indirectly affecting a substantial portion of private sector employment. Among major

U.S. sectoral divisions, government is second only to the trade, transportation, and utilities sector in terms of total employment (about 22.5 million compared to about 24.5 million) and is larger than professional and business services, health care, and leisure and hospitality. The government sector employs about twice as many people as the number employed in manufacturing.

Of the more than 22 million individuals who work for U.S. governments, about one eighth are employed by the federal government, about 23% are employed by state governments, and the clear majority, about 64%, are employed by local governments (Table 1). In state and local governments, more than half of the workforce, approximately 53%, is employed in education. In state governments, educational employment basically means the employment of faculty and staff in public colleges and universities that provide post-secondary education. In local governments, educational employment mainly means the employment of teachers and staff in public schools (i.e., K-12) that provide primary and secondary education.

The employment effects of recession typically differ between the public and private sectors (Table 2). For example, during rhe relatively mild 2001 recession and the two immediately following years (to 2003),

TABLE 1
Government Employment by Level, Total, and Percentage, United States, 2009 and 2010

	Total		Total	
	2009 (millions)	2010 (millions)	2009	2010
Total	22,555	22,482	100.0%	100.0%
Federal	2,832	2,968	12.6%	13.2%
Federal w/o postal	2,129	2,312	9.5%	10.3%
Postal service	703	65	3.1%	2.9%
Slate	5,169	5,142	22.9%	22.9%
Education	2,360	2,377	10.5%	10.6%
Other	2,809	2,765	12.4%	12.3%
Local	14,554	14,372	64.5%	63.9%
Education	8,079	8,011	35.8%	35.6%
Other	6,475	6,361	28:7%	28.3%

Source: Computed from ftp://ftp.bls.gov/pub/suppl/empsir.ceseebl.txt, Table B-l.

U.S. nonfarm private sector employment declined by about 2.3 million, or 2.1%, whereas government employment rose by about 465,000 or 2.2%. During the deep recession of 2007-2009 and the first year thereafter (2010), U.S. nonfarm private sector employment declined by about 6.9 million, or 6.1%, whereas government employment declined by about 27,000, or 0.1%. During both recession periods, moreover, private sector employment declined more or less continually, while government employment rose during the early portions of the recessions and fell later.[2] Hence, by two years after the end of the 2001 recession, government employment had risen to 16.6% of all nonfarm employment and by 2010 had risen to 17.3% of all nonfarm employment. During the first two thirds of 2011, however, nonfarm private sector employment increased by about 0.8%, while government employment declined by about 0.2%, thereby reducing government's share of total nonfarm employment to 16.7%.

These trends imply that private sector employment is considerably more sensitive to macroeconomic (i.e., business) cycles than public sector employment. They also imply, however, that if recovery from the deep recession of the late 2000s is sluggish and slow to develop, government's share of total nonfarm employment will decline further. This is because such sluggishness means that state and local governments will continue to have

TABLE 2
Employees on Nonfarm Payrolls, United Slates, 2000-2011

Year	Total employment (in 000s)	Govt, (in 000s)	Govt, as % of total
2000	131,785	20,790	15.76
2001	131,826	21,118	16.02
2002	130,341	21,513	16.51
2003	129,999	21,583	16.60
2004	131,435	21,621	16.45
2005	133,703	21,804	16.31
2006	136,086	21,974	16.15
2007	137,598	22,218	16.15
2008	136,790	22,509	16.46
2009	130,807	22,555	17.24
2010	129,818	22,482	17.32
Sep. 2011	131,334	21,985	16.74

Source: ftp://fTp.bis.gov/pub/suppl/empsit.ceseebl.txt, Table B-l.

budget deficits and will therefore have to determine the extent to which revenues can be raised and costs reduced to combat the deficits. If private sector employment rises slowly, then revenue growth will be insufficient to cover state and local budget deficits and policy makers will concentrate on deficit reduction through cutting costs. Given that state and local government services are human-capital intensive, such cost cutting will most likely be achieved by limiting or reducing public sector employment.

Compensation

Turning to the effects of recession on public employee compensation, these may be gauged in part by examining the Employment Cost Index (ECI) for state and local government workers compiled by the U.S. Bureau of Labor Statistics (BLS).[3] During the relatively mild 2001 recession and the two subsequent years, this index rose by 5.7%, which was larger than the 3.4% increase that occurred during the subsequent (i.e., 2003-2007) economic recovery. During the deep recession of 2007—2009 and the first year thereafter (2010), this index rose by 4%. However, all of the increase—and in fact slightly more—was concentrated in the first year of deep recession. By two years later (i.e., 2010), the index had declined by 0.2%. During the first half of 2011, the index declined by another 2.5%.

These changes can be compared to those that occurred for private industry workers during the same periods (Table 3). During 2001-2003, the ECI for private industry workers increased by 5.1%, which was about 0.5% less than for state and local government workers. During the subsequent economic recovery, however, the ECI for private industry workers declined by 0.1%, which contrasts notably with the 3.4% ECI increase that occurred for state and local government workers. During 2008-2010, the ECI for private industry workers increased by 2.1%, or about half of the increase for state and local government workers. During the first half of 2011, the ECI for private industry workers declined by 1.4%, or about half of the decline for state and local government wotkers. In sum, by the end of the first decade of the 21st century, the ECI for U.S. state and local government workers stood at 104.3 and the ECI for private sector workers stood at 101.0. Nevertheless, the ECI for both groups of workers was lower at the end of 2010 than at the onset (in December 2007) of deep recession.

These trends again imply that the private sector is more sensitive to macroeconomic (i.e., business) cycles than the public sector. In this instance, such sensitivity takes the form of compensation adjustments, with private sector pay and benefits clearly falling during recession and rising during recovery, whereas public sector pay and benefits rise during both recovery and mild recession but fall during deep recession. If recovery from deep recession is sluggish and slow to develop, however, then public sector compensation will either rise less rapidly than private sector compensation or will decline. As noted earlier, with sluggish recovery from deep recession, state and local governments will face

TABLE 3
Employment Cost Index (ECI), Constant Dollars,
March 2001-June 2011 (December 2005 = 100)

	Private iiidustry workers			
Year	Mar.	Jun.	Sep.	Dec.
2001	94.9	94.9	95.7	97.3
2002	97.1	97.5	97.5	97.9
2003	97.7	98.8	99.1	100.0
2004	99.7	99.5	100.3	100.5
2005	100.0	100.1	98.5	100.0
2006	99.3	98.6	99.4	100.6
2007	99.6	99.1	99.7	99.6
2008	98.9	97.2	97.7	102.0
2009	101.2	100.0	100.2	100.5
2010	100.5	100.8	101.1	101.0
2011	99.8	99.6	NA	NA
	State and local government workers			
2001	93.4	92.9	94.7	96.0
2002	95.4	95.2	96.7	97.6
2003	96.6	97.2	98.1	99.1
2004	98.2	97.4	98.9	99.3
2005	98.7	98.4	98.1	100.0
2006	98.9	97.9	100.1	101.5
2007	100.7	99.8	101.6	101.6
2008	100.3	98.4	100.1	104.5
2009	103.9	102.9	103.8	104.0
2010	103.5	103.6	104.4	104.3
2011	102.7	101.8		

Source: www.bls.gov/web/eci/ecconsmaics.pdf.

continued budget deficits that necessitate public policy decisions regarding revenue increases and/or cost reductions. A slowly growing private sector means that public sector revenue increases will be modest at best. In this circumstance, state and local government officials will pursue budget deficit reduction through cuts in public employee pay, benefits, or both.

Political Climate

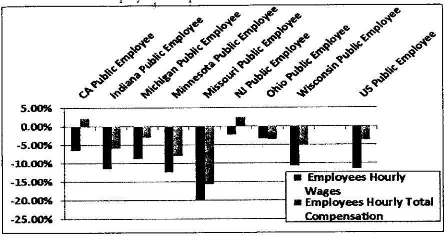
While these aggregate employment and total compensation data constitute one way of telling a story about the effects of deep recession on the U.S. public sector, another way is to consider the political climate affecting the public sector, especially the differences between that climate during mild recession and deep recession. During 2001-2003, it was not uncommon for government employers to undertake hiring freezes and workforce reductions and to seek bargaining concessions from unionized employees. These initiatives were especially pursued during the latter part of that recession and the immediate post-recession period and in some ways closely resembled similar initiatives that occurred during prior recessions, such in the mid-1970s, early 1980s, and early 1990s.[4]

During the more recent deep recession, government employers, especially elected officials, have for the most part gone much further than previously to hold public employees responsible for governments' fiscal adversity. Operating under this premise, some elected officials have sought to limit or eliminate public employees' rights to unionize and bargain collectively with their government employers.[5] This dynamic has played out largely at the level of state government and has been especially notable in 2011, ostensibly a post-recession year. Governors and other elected officials in Wisconsin, Ohio, New Jersey, New Hampshire, Florida, and several other states have led this charge. In doing so, they claim that public employees are overcompensated compared to their private sector counterparts. How valid is this claim?

Public—Private Sector Pay Relationships

Available evidence indicates that on a total compensation basis, the claim is not valid. To illustrate, consider the data shown in Figure 1 comparing the total compensation of public and private sector employees for the United States as a whole and for eight U.S. states (Keefe 2011). Nationally, these data indicate that, controlling for education, public employee pay is about 11.5% lower than the pay of comparable private sector employees. This differential declines to about 3.7% when fringe benefits are taken into account, which suggests in turn that fringe benefits are about 7.8% higher in the public than in the private sector.[6] This national picture encompasses considerable variation by state in public-private sector pay and total compensation relationships, which is also illustrated in Figure 1.

FIGURE 1
Public Sector Hourly Wages and Hourly Total Compensation Compared to Private Sector Employees of Equal Education (Keefe 2011)



In a related study, Munnell and her colleagues (2011) point out that the ratio of public to private sector wages in the United States, which stood at about 103% during the mid-1990s, declined markedly to about 93% during the remainder of the 1990s, rose to about 96% by 2003, and declined to about 94% by 2010 (Munnell, Aubry, Hurwitz, and Quinby 2011). More to the point, Munnell and colleagues (2011) used Current Population Survey (CPS) data to estimate the U.S. public–private sector pay differential during 2006–2010, controlling for level of government employment (i.e., federal, state, and local), organizational size, region, and human capital and demographic variables such as education, work experience, race, gender, marital status, and immigration status. The main findings were that state and local government employees earn about 9.5% less than comparable private sector employees and that federal government employees earn about 14.5% more than comparable private sector employees. Because state and local government employment is about seven times greater than federal employment, aggregating these two empirical findings indicates that, on an overall basis, U.S. public employees earn roughly 6.5% less than their private sector counterparts.[7]

This study also found that public–private sector pay differentials varied considerably by job and pay level. When the basic wage equation was re-estimated by wage tercile, the results showed that public employees in the lowest third of the pay distribution were paid more than their private sector counterparts, those in the middle third were paid about the same, and those in the top third were paid about 20% less than their private sector counterparts. Hence, this study confirmed a finding first reported almost 40 years ago, which is that the job/occupational pay structure is considerably more egalitarian in public sector than in private sector organizations (Fogel and Lewin 1974).

Additional insight into public-private sector pay differentials is provided by focusing on knowledge workers, meaning those whose work requires specialized education, training, or skills. Analysis of CPS data indicates that knowledge workers constitute 32.3% of all private sector workers compared to 68.7% in state government and 67.5% in local government (Greenfield 2011).[8] In state and local government, workers with education below a college degree earn more than private sector workers with comparable education. By contrast, state and local government workers wirh college degrees earn less than their private sector counrerparts, and this differenrial increases with higher levels of educarion.[9]

According to one recent estimate, knowledge workers in state government earn 20% less than knowledge workers in rhe private sector, and knowledge workers in local government earn 25% less than knowledge workers in the private sector (Greenfield 2011). These differentials are likely to increase in the wake of deep recession. Privare sector demand for knowledge workers remains relatively strong. In contrast, state and local governments are restricting pay for public employees (including knowledge workers) through a combination of modest pay increases for some, pay freezes for othets, and pay reducrions for still others.[10]

Public—Private Sector Pension Benefits

The main nonwage benefits for borh public sector and private secror employees pertain to retirement and health care. Traditionally in both sectors, pension plans were used ro "finance" retirement benefits, and health insurance plans were used to finance benefits and mitigate risks associated with employee health. Also, most pension plan contributions traditionally were made by employers or jointly by employers and employees, and most health care insurance premiums were paid in whole or in large part by employers. During roughly the last quarter century, however, pension plans for private sector employees shifted from defined benefit to defined contribution plans (often so-called 401(k)s), and the costs of (premiums for) health care insurance plans increasingly shifted from employers to employees. While these developments in the private sector are well known, rhey did not spur similar shifts in the public sector, including during the relatively mild 2001 recession and subsequent recovery period.

These developments help to explain how and why various researchers find that public employee fringe benefits, notably retirement benefits (or pensions) and health care benefits (including for retirees), are considerably greater than comparable private employee fringe benefits. But they are not sufficienrly greater to fully offset the pay disadvantage of public sector employees relative to the private sector. Hence, Munnell and her colleagues (2011) conclude that total compensation is about 4% less in the public than in the private sector—a conclusion that closely matches the conclusions reached by other researchers (Keefe 2011; Lewin et al. 2011; Bender and Heywood 2010).

Nonetheless, in the wake of the deep recession of the late 2000s, claims that state and local governments are in fiscal crisis have become widespread, and a great deal of attention has focused on the supposed role of public employee fringe benefits, especially retirement and health care benefits, in this crisis. For example, a much-publicized characterization of public employee pension plans is that they are $1 trillion underfunded. But rather than being due to overly generous pension arrangements, to the influence of unions on such arrangements, or to the behavior of public sector management and employees more broadly, the vast bulk of this underfunding is due to the sharp financial market decline that occurred during the deep recession of 2007-2009. As one public sector pension expert put it, "If [state and local government] pension funds had earned returns just equal to the interest rate on 30-year Treasury bonds in the three years since 2007, their assets would be more than $850 billion greater than they are today" (Baker 2011:1).

Only about $80 billion of this underfunding (or shortfall) resulted from the decisions of state and local governments to cut back their pension plan contributions during the 2007-2009 recession. Hence, any upswing in financial markets—about a 20% increase in the value of publicly traded equities occurred between mid-2009 and mid-2011—will reduce the underfunding of public employee pensions. Even without such a development, however, the aforementioned increase in the underfunding of state and local government employee pensions amounts to less than 0.2% of projected gross state product over the next 30 years for most states, and less than 0.5% of projected gross state product in states with the greatest underfunding. It is mainly for this reason that various pension specialists regard the current public sector pension shortfall as manageable and consider that "most state and local pension funds have been seriously misrepresented in public debates" (Baker 2011:15).

Also typically missing from such debates is recognition or acknowledgment of the fact that for many state and local government employees, pension funds substitute for federal Social Security as a source of retirement income. This is the case for nearly half of all public school teachers—the largest group of local government employees—and about two thirds of police and firefighters in local government (ICMA 2011). This point is especially germane in light of the fact that the average (annual) retirement benefit for public employees is estimated to be $22,600 (ICMA 2011; Boivie and Almeida 2009).

Public—Private Sector Health Benefits

Regarding health care, the rising costs of premiums for health insurance policies has presented challenges to public sector and private sector employees alike. The average family health insurance plan cost (i.e., premium) for private sector employees increased from $5,742 per year in 1999 to $13,770 per year in 2010, adjusted to 2009 dollars (Lewin et al. 2011). Comparable data for the public sector are not available; however, a study of teachers employed in the state of Illinois found that the average family health insurance plan cost increased from $5,758 per year in 1993 to $10,905 per year in 2008, again adjusted for 2009 dollars (Olson 2011). Such rates of cost (premium) increase are not sustainable over the longer run, which is why both private and public employers are undertaking various initiatives, such as increased employee co-payments, deductibles, and additional limitations on catastrophic illness payments, to control employer health care expenses. Such initiatives are also aimed at health care payments for retired workers, who represent an especially substantial portion of overall health care costs paid by older companies and governments.

The Compensation Trade-Off

State and local government employees typically contribute less than private sector employees to cover their respective health care costs, and they also receive a relatively higher proportion of their total compensation in the form of health insurance benefits, although in this regard there is considerable variation by state (Lewin et al. 2011). The same is true of pension benefits; that is, public sector employees receive a relatively higher proportion of their total compensation in pension benefits than do private sector employees (Bender and Heywood 2010). Consequently, there is a wage—benefits trade-offin government employment generally and in state and local government in particular, whereby public employees accept relatively lower pay in exchange for relatively higher benefits.

This trade-off is not a new phenomenon but rather one of long standing. What is new and motivated by deep recession, however, are the widespread calls by elected officials for state and local governments to change their employee retirement and health care policies, practices, and financing, and, in this respect, to follow private sector trends. It is the perceived public-private sector benefit disparity that appears to be the main driver of elected officials' claims that public employees are overcompensated and are therefore primarily responsible for governments' fiscal crisis.

Unionization and Collective Bargaining

Further to remedy this disparity and enable change, say many elected officials, public employees should also have their unionization and collective bargaining rights curbed or shorn. This particular claim is further supported by the continuing decline of private sector, but not public sector, employee unionization. Today in the United States, less than 7% of the private sector workforce is unionized, whereas about 35% of public sector workers are union members. Public employee unionization is especially prevalent in education (meaning largely among teachers) and to a lesser but still substantial extent in health care. Elected officials in state and local governments are therefore able (and obviously willing) to claim that the overcompensation of public employees is mainly attributable to union influence. That claim in turn has led such officials to initiate the aforementioned efforts to restrict and/or eliminate public employee unionization and collective bargaining rights.

In sum, the deep recession of the late 2000s has fundamentally shaped a political climate favoring the reduction of public employment, public employee compensation, especially benefits, and public employees' exercise of unionism and collective bargaining rights. These deep recession-induced effects have persisted and expanded during the post-recession period. They stand in sharp contrast to the relatively modest effects on the political climate associated with the mild recession of the early 2000s and with similar recessions, ranging from relatively deep to relatively mild, that occurred during the last quarter of the 20th century.

The Micro Picture

At a more microlevel, consider the findings from a survey of state and local government human resource executives and professionals conducted in late 2009 by the Center for State and Local Government Excellence (2010).[11] This survey found that the current economic climate (i.e., deep recession) caused two thirds of the state and local governments represented by the respondents to implement hiring freezes, about 60% to institute pay freezes, 40% to conduct layoffs, 30% to initiate furloughs, 20% to offer early retirement incentives, 10% to make pay cuts, and 5% to undertake employee buyouts.

Survey respondents reported that almost half of these governments postponed employee retirement dates and about 11% accelerated employee retirement dates. A slight majority of state and local governments represented by the respondents to this survey had made changes to employee health care plans. Among these governments, 70% increased employee contributions to the plans, 24% reduced health care benefits, and 10% decreased employer contributions to the plans. While a majority of these governments did not make changes to their employee retirement plans, among those that did about 18% instituted higher employee contributions to the plans and about 5% replaced a defined benefit plan with a defined contribution plan.