Let's Lay this Myth to Rest Once and for All!

We've all heard the statements by public officials. Gov. Scot Walker of Wisconsin said "we can no longer live in a society where the public employees are the haves and taxpayers who foot the bills are the have-nots." He also said that his state "cannot grow if our people are weighed down paying for a larger and larger government." His March 2011 budget address included the idea that Wisconsin's growth was being hindered by a "government that pays its workers unsustainable benefits that are out of line with the private sector."

In 2010, Senator Scott Brown of Mass. said "It's not right that lesser-paid private sector workers suffering through a recession have to pay for expensive government salaries."

Journalists Michael Fletcher and Brady Dennis (*Washington Post*) say that "...public employees often enjoy more generous pension and health-care benefits, and these are at the root of the long-term budget problems confronting many states."

David Brooks, conservative columnist for the *NY Times* argues that "public sector unions can use political power to increase demand for their product."

The "Publisher's notebook" piece which was the subject of the last blog post opined: "...other problems stem from the public-sector contracts that keep labor costs in our state, county, schools and municipalities out of whack with the private sector."

So, to sum up-

1. Public sector compensation is out of line with that in the private sector.

2. Public sector pay and benefits are the major cause of the financial difficulties being visited upon the states.

3. Public sector unions, through their political influence, are exacerbating state and local financial problems.

Here's the problem with these statements: They are all statements that "everybody knows" to be true. How do we know that? Because we have heard them repeated again and again. But here's the rub: They are all demonstrably wrong! So, let's get about the business of doing the demonstrating.

To keep blog posts to readable lengths, we'll do this over several posts.

Let's begin by looking at the state-by-state differential between private- and public-sector workers. These figures include both wages and benefits. The source is a recent *USAToday* article on the subject. A positive difference means that the average public employee earns MORE than the average private-sector worker, while a negative difference means the average public-sector earns LESS than the average private-sector worker.

Rank	State	Difference
1	Nevada	$17,815.00
2	Rhode Island	$17,603.00
3	Hawaii	$12,243.00
4	Florida	$9,099.00
5	California	$7,977.00
6	Connecticut	$7,687.00
7	South Carolina	$7,590.00
8	Montana	$7,396.00
9	Maryland	$6,931.00
10	New Jersey	$6,681.00
11	Michigan	$6,436.00
12	Iowa	$6,178.00
13	Vermont	$5,811.00
14	New Mexico	$5,715.00
15	Oregon	$5,607.00
16	Alabama	$5,001.00
17	Maine	$4,912.00
18	Mississippi	$4,713.00
19	Arizona	$4,310.00
20	Arkansas	$4,196.00
21	West Virginia	$3,655.00
22	Nebraska	$3,130.00
23	Wyoming	$3,116.00
24	Delaware	$2,911.00
25	Idaho	$2,855.00
26	Alaska	$2,764.00
27	Utah	$2,611.00
28	Louisiana	$2,473.00
29	Ohio	$2,392.00
30	Kentucky	$2,313.00
31	South Dakota	$1,909.00
32	North Carolina	$1,857.00
33	Wisconsin	$1,802.00
34	New York	$1,699.00
35	Oklahoma	$1,667.00
36	Pennsylvania	$1,567.00
37	Minnesota	$1,259.00
38	Indiana	$1,183.00
39	Washington	$532.00
40	Illinois	$485.00
41	D.C.	$457.00
42	North Dakota	$389.00
43	Tennessee	-$765.00
44	Missouri	-$1,075.00
45	New Hampshire	-$1,876.00
46	Virginia	-$2,328.00
47	Kansas	-$3,229.00
48	Colorado	-$3,391.00
49	Texas	-$3,580.00
50	Georgia	-$3,875.00
51	Massachusetts	-$4,688.00
	Total United States	$2,511.00

We can draw at least two conclusions from these figures-

1) New York is much farther down the table than many would have us believe. At number 34 out of 51, the average public-sector worker earns about $32/week more than the average private-sector worker. That's hardly enough to allow the difference to be called "out of whack."

2) The table seems to confirm the argument that public-sector compensation (with the exception of 9 states) is greater than that for the private sector.

Well, not really. And therein lies a story about reporters who can do arithmetic and Ph.D's who can do research. And that's where our next post will begin.

Part 2

The previous blog post left us discovering that the average public-sector worker does indeed do better than the average private-sector worker in total compensation (wages plus benefits). All it takes to find this out is simple arithmetic, which most reporters are quite capable of handling. That's why these figures are so often reported in the popular press.

And so, end of story. Nothing more to see here, please move along. But wait! There's a gigantic assumption involved in all of this: That the "baskets" of workers we are comparing contain comparable sets of workers. Are we comparing apples to apples or apples to oranges?

This is where we need to replace the arithmetic of reporters with the economic research methodology of the Ph.D's, the folks trained to investigate how these two "baskets" of workers may be different and how we may go about actually making valid comparisons.

We need, for example, to look at studies such as *Out of Balance? (Comparing Public and Private Sector Compensation over 20 Years).* This study was done for the Center for State & Local Government Excellence and the National Institute on Retirement Security by Drs. John Heywood and Keith Bender and published in April, 2010. Dr. Heywood is distinguished professor in the Department of Economics and Director of the Masters in Human Resources and Labor Relations program at the University of Wisconsin-Milwaukee. Dr. Bender is associate professor in the Department of Economics and in the Masters in Human Resources and Labor Relations Program at the same institution.

Heywood and Bender set out to "...examine the extent to which state and local government compensation in the United States is comparable to compensation in the private sector." They point out that "Levels of compensation help determine both the competence and efficiency of governmental services. Excessive levels waste resources, depriving the governments of the opportunity to address other costly objectives or to reduce burdens to taxpayers. Insufficient levels make it difficult, if not impossible, to attract workers of the quality needed to provide the services demanded by citizens."

They conclude that "Comparability with the private sector is the most generally accepted standard by which economists and compensation specialists judge whether the processes for determining compensation in the public sector are working."

In the Executive Summary of the study, they list their conclusions:

1) "Public and private workforces differ in important ways. For instance, jobs in the public sector require much more education on average than those in the private sector. Employees in state and local sectors are twice as likely as their private sector counterparts to have a college or advanced degree."

2) "Wages and salaries of state and local employees are lower than those of private sector workers with comparable earnings determinants (e.g., education). State employees typically earn 11% less; local workers earn 12% less."

3) "Over the last 20 years, the earnings for state and local employees have generally declined relative to comparable private sector employees."

4) "The pattern of declining relative compensation remains true in most of the large states we examined, although some state-level variation exists."

5) "Benefits (e.g., pensions) comprise a larger share of employee compensation in the public sector."

6) State and local employees have lower total compensation than their private sector counterparts. On average, total compensation is 6.8% lower for state employees and 7.4% lower for local workers, compared with comparable private sector employees."

Their final paragraph reads: **"This recession call for equal sacrifice, but long-term patterns indicate that the average compensation of state and local employees is not excessive. Indeed, if the goal is to compensate public and private workforces in a comparable manner, then the data do not call for reductions in average state and local wages and benefits."** [Emphasis mine.]

Things are getting interesting! In the next post we'll take a look at some numbers inside the study. In case you're wondering, New York was one of the "large states" which were specifically studied and we will have some interesting numbers concerning our state.

Part 3

To review: This all began when a local WNY paper opined that labor costs in the public sector were "out of whack" with the private sector. (Click here to see the related blog post.) No support was given for this claim, they were just making the argument based on the idea that "everyone knows" this to be the case.

In the next post, *Let's lay this myth to rest once and for all*, we identified three "everybody knows" statements which are demonstrably false:

1. Public sector compensation is out of line with that in the private sector.

2. Public sector pay and benefits are the major cause of the financial difficulties being visited upon the states.

3. Public sector unions, through their political influence, are exacerbating state and local financial problems.

In *Part 2: Let's lay this myth to rest once and for all*, we looked at research done by experts in the field who concluded that public sector compensation is in line with that in the private sector. In fact, when considering wages plus benefits, comparable public

sector workers were, if anything, more poorly compensated than private sector workers. Now we look inside the study.

Heywood and Bender point out that "...the characteristics of state and local government employees differ dramatically from those of the private sector. **State and local governments consist disproportionately of occupations that demand more skills and earn higher wages. As a consequence, the typical state or local government employee has substantially more education, training and experience.** Adjusting for these differences is required to compare apples to apples. Indeed, adjusting for these differences typically explains most of the observed earnings advantage of the typical state and local worker....State and local government workers across the country are more than twice as likely to have at least bachelor's degrees. Thus, **the fact that public sector workers receive greater average compensation than private sector workers should be no more surprising than the fact that those with more skills and education earn more.**" [Emphasis mine.]

The researchers go on to look at the public vs private pay differentials once corrections are made for education, training and experience. Here is their summary for the years 2000-2008.

Average Public-Private Wage Differentials, 2000-2008

	State-Private (%)	Local-Private (%)
Full Country	-11.4	-12.0
California	-9.8	-6.1
Texas	-16.6	-17.6
New York	-7.0	-5.9
Pennsylvania	-4.5	-12.9
Illinois	-12.5	-13.3
Michigan	-10.1	-11.2
Florida	-4.8	-0.2

They conclude that, over this time period, "State workers earn 11% less and local workers 12% less than private sector workers." Notice that the wages for NY workers are 6-7% below those for comparable private sector workers for this period.

But wait, "everybody knows" that it's really the benefits of public sector workers that are really "out of whack" with those in the private sector. Maybe public sector wages are lower, but the obscene benefits will more than make up for the lower wages.

Think so? Benefits will be the subject of the next post.

Part 4

As shown in the last blog post, once we correct for differences in education, experience, training, etc. we can then compare the basket of workers in the private sector with that in the public sector on an "apples-to-apples" basis. When this is done, we find that **not only are wages of public sector workers 11-12% less than comparable private sector workers, this negative wage differential has been increasing for public sector workers since the mid-1990's.** [see pg 9 of the Heywood/Bender study.]

But what about the benefits? Surely they must be much better for workers in the public sector? Let's go to the numbers.

Heywood and Bender looked at benefits "in nearly two dozen categories, including pensions, insurance, bonuses and supplemental pay, paid leaves, and legally required benefits (e.g., Social Security, Medicare)." They did find that "benefits comprise a larger portion of compensation in state and local government; thus earnings are a smaller share of compensation in state and local government."

The difference, however, is not large. They found that **benefits as a share of total compensation across the entire private sector amounted to 29.15%. In large private firms (100+ employees), benefits were 31.42% of total compensation. The figure for local and state governments is 32.65%, hardly a dramatic difference!** [Emphasis mine.] (Large firms were broken out of the private sector data because many state and local governments also have 100+ employees, allowing a more accurate comparison.)

When looking at benefits, we must recognize that some of these benefits are at least partially paid for by employees in both sectors. According to the study: "**in March 2009, the share of family medical coverage plans paid by private sector employees averaged 30 percent, while that share paid by state and local employees averaged 27 percent. Interestingly, if one limits the size of the employer to 500 workers or more, the share by private sector employees is only 24 percent, while the state and local share remains 27 percent.**" [Emphasis mine.]

What about retirement plans? In doing a comparison here, we must recognize that there are two different types of retirement plans in use in our country. The "traditional pension" plan is often referred to as a "defined benefit" plan because the worker's retirement benefit is a defined amount based on years of service and final average salary. While most state and local governments provide such a "defined benefit" plan for their employees, less than 25% of employers in the private sector provide such a plan.

Over the past decade or two, most private sector employers have moved to a "defined contribution" type of plan. Most readers will recognize this type of plan by its more common name, "401(k)." In this plan, the employee makes a contribution of a percentage of pay, sometimes matched--up to a certain point--by the employer. These funds are invested in a small number of mutual funds and whatever accumulates during the worker's career is what the worker takes away to live on (plus Social Security and other savings) during retirement.

(For a more detailed comparison of defined benefit vs defined contribution plans, see the blog post titled "What's so bad about 401(k)-type plans?"

Comparison is further complicated by the fact that "28% of state and local workers are not eligible for Social Security." But, "**when limiting state and local pensions to those in which workers are eligible for Social Security, the employee contribution rate averages 5%. This can be compared to the private sector average contribution rate of 6% for defined-contribution plans and essentially zero for defined benefit plans.**" [Emphasis mine.]

When you put it all together (wages plus benefits), how do the numbers shake out? **When comparing total compensation state workers are behind their private sector counterparts by 6.8%, while local government workers trail by 7.4%. If you compare them with just the large firms in the private sector sample, state workers trail their private counterparts by 10.4% with local workers trailing by 9.8%**

Heywood and Bender conclude with this paragraph: "**There are several implications of our exercise. First, the compensation of state and local workers is not excessive. Second, this remains true when including benefits. Third, the pattern of results over the last 20 years has generally been one of declining relative earnings of state and local workers compared to similar private sector workers. Fourth, this remains true in most of the states that we examined, although some heterogeneity exists. These implications lead to the policy prescription that now is not the time to advocate for large-scale rollbacks in the compensation of state and local workers. Although the current recession calls for equal sacrifice, the long-term pattern indicates that state and local workers are not, on average, overcompensated. If the goal is to compensate state and local sector employees in a manner comparable to those in the private sector, the data do not call for reductions in state and local wages. If anything, they call for increases.**" [Emphasis mine.]

There is still one more part of this myth to lay to rest: That public sector unions, through their political influence, are exacerbating state and local financial problems. That's coming up.

Part 5

Over the last 4 posts, we've looked at the research that shows that when total compensation is viewed (i.e. wages plus benefits), public employees are not overcompensated. If anything, they are somewhat undercompensated.

The research done by Heywood and Bender is not an outlier. Their work has been replicated in other national studies. Two examples are *Debunking the Myth of the Overcompensated Public Employee* by Jeffrey Keefe of the Economic Policy Institute and *The Wage Penalty for State and Local Government Employees* by John Schmitt of the Center for Economic and Policy Research.

There is one additional question to address before we can lay this entire myth to rest: Were public sector workers and their unions to blame for state budget problems?

Twelve states have attacked collective bargaining by public sector unions in 2011: Wisconsin, Ohio (since repealed by voters), Indiana, Arizona, Idaho, Michigan, New Hampshire, Oklahoma, South Carolina, Tennessee, Utah and Wyoming. All accuse public sector workers--and their unions--of being at the root of state budget deficits. Once again, the answer is in the research.

The Center on Wage and Employment Dynamics, part of the Institute for Research on Labor and Employment of the University of California, has published a 2011 study titled *The Wrong Target: Public Sector Unions and State Budget Deficits*.

"**The large state deficits have frequently been blamed on a growing public sector.** For example, Governor Scott Walker warned that Wisconsin 'cannot grow if our people are weighed down paying for a larger and larger government.' However, **the size of the public sector has not grown in recent years, neither in terms of public sector employment levels nor public sector compensation.**" [Emphasis mine.]

Let's look at the numbers. "**State and local government workers as a share of the workforce has been relatively steady since 1979.**...Overall, the share of workers in state

and local employment averaged 14.2 percent over the thirty year period and ranged from a low of 13.6 percent at the height of the boom in 1999 to a high of 15.2 percent in the great recession in 2009 reflecting the greater loss in private sector employment—over 5 million private sector jobs were lost that year. By midway through 2011, the share of workers employed by state and local governments had fallen back to 14.6 percent." [Emphasis mine.]

"Not only has the share of state and local government jobs remained relatively steady as a percentage of all jobs, but **state and local government employment per thousand residents has also remained steady**....**In 1990, the United States as a whole had an average of 17.2 state workers per thousand residents. In 2009, there were 16.8**."[Emphasis mine.]

"Might union states be different? New York Times columnist David Brooks argued, “public sector unions can use political power to increase demand for their product.” If he is correct, we should expect states with high public sector union density—the share of public sector workers in a union—to have more public sector workers per thousand residents, than states with lower public sector union density. In order to test this hypothesis, we examine the ten states with the highest share of public employees in unions and the ten states with the lowest share of public employees in unions. .. the lowest union density states averaged 69.1 state and local employees per thousand residents in 1990 and 74.6 in 2009. The highest union density states averaged 65.1 state and local employees per thousand residents in 1990 and 68.3 in 2009. **The number of state and local employees per thousand actually fell in the high union density states between 2001 and 2009....No correlation was found between public sector union density and the level of public sector employment in a state. Contrary to Brooks' assertion, there is no evidence that public sector unionization has resulted in a growth of the public sector workforce.**" [Emphasis mine.]

"Not only has the number of public sector workers per thousand residents remained steady, but **public sector compensation as a share of state budget has actually declined....The share of state spending that went towards compensation fell steadily between 1992 and 2002 and remained stable from 2002 to 2009.**" [Emphasis mine]

"The average share of the budget spent on compensation over the time period for the ten most highly unionized states was 19.6%, compared to 18.7% for the ten least unionized states. By 2009, that gap between the two groups had narrowed to 0.5% (19.8 vs 19.3 percent)...Budget deficits were not caused by an increase in funding going to compensation for public sector workers." [Emphasis mine.]

Part 6

As detailed in the previous blog post, the research by the Center on Wage and Employment Dynamics of the University of California concluded the following:

"Following the 2010 elections, multiple states took action to curtail collective bargaining rights arguing that public sector unions were a major cause of state budget deficits. A close examination of the available evidence finds that the claim that public sector unionization leads to greater deficits does not withstand scrutiny."

"The public sector workforce has not been growing relative to the population; this is true in union and non-union states alike. There is no correlation between the share of public workers in unions and the size of the public sector workforce. This belies the notion that

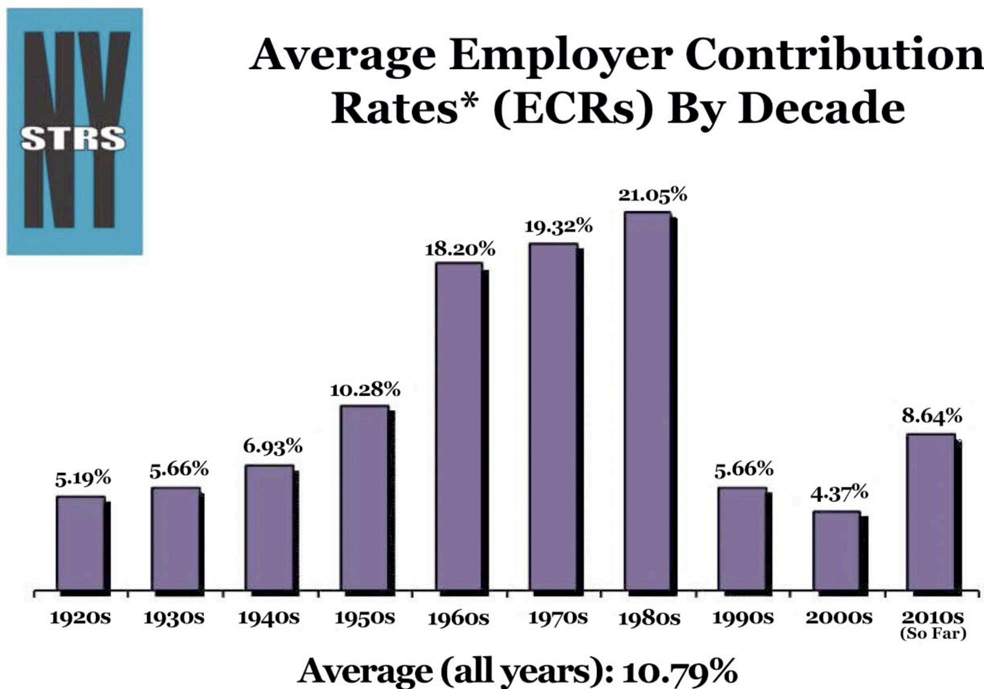
public sector unions are increasing the demand for their product."

"Compensation has fallen as a share of state expenditures over the last twenty years; this is true for both high and low-union states. Controlling for education, experience and other relevant factors, public sector workers are not more highly paid than their private sector counterparts. Public sector unions provide workers with a voice on the job and enable members to choose their form of compensation. This has generally led to a greater share of compensation paid in health and retirement benefits than in cash wages. "

"Budget deficits were primarily caused by the housing crisis and subsequent economic downturn which resulted in a decline in revenues as the economy contracted. Finally, controlling for the decline in housing prices, we find no statistically significant correlation between union density, union strength and the size of state budget deficits."

"For states to address their budget deficits, the most important factors are national economic growth and a resolution to the housing crisis. Solutions that focus on cutting state and local budgets can be expected to further weaken the economy."

Before ending, let's look at one last thing specific to our state. Much groaning can be heard that the cost of public pensions has risen to unsustainable levels. Here's an interesting chart from the website of the New York State Teachers' Retirement system showing employer contribution rate (ECR) since the 1920's:



Note that the ECR is based on a 5-year rolling average of the performance of NYSTRS investments. This means that the losses incurred in the financial collapse of 2007-2008 will soon work their way out and be replaced by the large gains of recent years. Unless there is another collapse, it is reasonable to assume that the ECR will decrease in coming years.