Public Sector Unions and the Rising Costs of Employee Compensation

Chris Edwards

Public sector compensation is becoming a high-profile policy issue. While private sector wages and benefits have stagnated during the recession, many governments continue to increase compensation for public sector workers. At the same time, there are growing concerns about huge underfunding in public sector retirement plans across the nation.

This article examines the compensation of state and local workers, who account for 20 million of the 23 million civilian government workers in the United States.[1] State and local workers include teachers, college instructors, police officers, health care administrators, and many other occupational groups.

Examining state and local compensation is important because it represents a major portion of the overall U.S. economy. In 2008, the total cost of wages and benefits for state and local workers was $1.1 trillion, which was half of the $2.2 trillion in total spending by state and local governments.[2] Compensation costs are expected to rise rapidly in coming years due to growing pension and health care costs.

This study begins with a look at trends in state and local government compensation since 1950. Then it compares compensation lev-

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[1]U.S. Bureau of Economic Analysis, National Income and Product Accounts, Table 6.4D. This is based on total full- and part-time civilian employees in 2008.
[2]Ibid., Tables 3.3 and 6.2D.

els in the public and private sectors using data for 2008. Note that I will use the phrase "public sector" to refer to state and local governments and not the federal government, which is not examined here.

Next, the growth of labor unions in the public sector workforce is discussed. In 2008, 39 percent of state and local workers were members of unions, but that percentage varies widely by state as a result of differences in state legislation on collective bargaining and other aspects of union organization.

Does the presence of labor unions in the public sector increase the costs of public sector compensation? I use state-level data on public sector compensation and union shares in an OLS regression to explore this question. I find that public sector unions push up the costs of the public sector workforce in the United States by about 8 percent, on average, but the increase would be more in states with highly unionized public sectors such as California.

The final section discusses the coming fiscal crisis in state and local budgets. Many state and local governments have huge unfunded obligations in worker retirement plans, and they will need to make major reforms to their budgets in the years ahead. However, enacting reforms will be a significant challenge given the resistance to change in the politically active and unionized workforces of state and local governments.

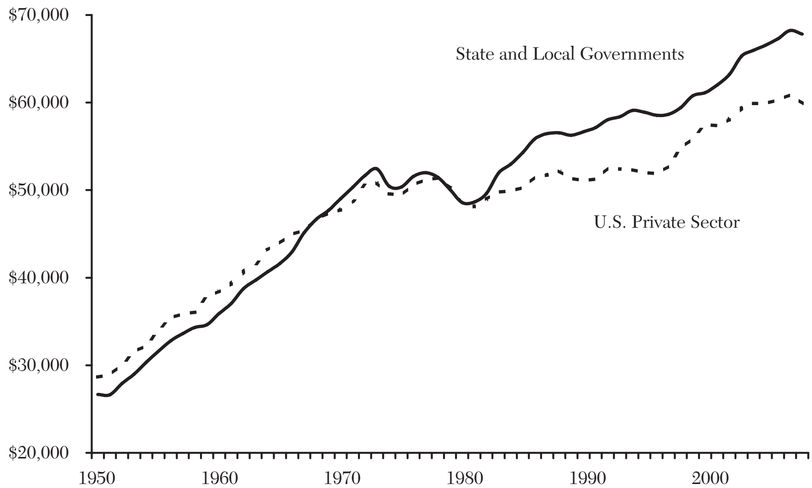
Growth in Public Sector Compensation

The U.S. Bureau of Economic Analysis publishes time series data on employment and compensation by industry.[3] Based on these data, Figure 1 shows average compensation levels in the public and private sectors since 1950. Compensation includes wages and benefits, such as the costs of health care and pensions. The data are in constant 2008 dollars, deflated by the consumer price index.

Between 1950 and about 1980, average compensation in the public and private sectors moved in lockstep. But after 1980, public sector compensation growth began to outpace private sector compensation growth, and by the mid-1990s public sector workers had a substantial pay advantage. In the boom years of the late-1990s, private sector workers closed the gap a bit, but public sector pay moved ahead again in the 2000s.

[3]Ibid., Tables 6.2D and 6.5D. Averages in Figure 1 are calculated using full-time-equivalent employment.

FIGURE 1
Average Compensation in Real 2008 Dollars



Source: U.S. Bureau of Economic Analysis.

The public sector pay advantage is most pronounced in benefits. Bureau of Economic Analysis data show that average compensation in the private sector was $59,909 in 2008, including $50,028 in wages and $9,881 in benefits. Average compensation in the public sector was $67,812, including $52,051 in wages and $15,761 in benefits.

The BEA data break down the public sector workforce into three groups: education, public enterprises (such as government liquor stores), and all other government functions. The long-term compensation trends in the three groups have been similar.

Finally, note that the BEA data on benefits include employer contributions to defined-benefit pension and health care plans. But state and local pension and retiree health plans are, in aggregate, hugely underfunded, as discussed below. Thus, these data understate the level of benefits that state and local workers are currently accruing.

Compensation Levels in the Public and Private Sectors

The U.S. Bureau of Labor Statistics (BLS 2009d) provides data allowing a detailed comparison of compensation in the public and private sectors. Table 1 shows employer costs per hour of work for

TABLE 1
The Gap between Public and Private Sector Compensation
(June 2009 Dollars per Hour Worked)

Compensation Item	A Private Sector Workers	B State and Local Workers	State and Local Advantage col. B / col. A
Total Compensation	$27.42	$39.66	1.45
Wages and salaries	19.39	26.01	1.34
Benefits	8.02	13.65	1.70
Paid leave	1.85	3.27	1.77
Supplemental pay	0.83	0.34	0.41
Health insurance	1.99	4.34	2.18
Other insurance	0.14	0.17	1.21
Defined benefit retirement plan	0.41	2.85	6.95
Defined contribution retirement plan	0.53	0.31	0.58
Legally required	2.26	2.36	1.04

Source: U.S. Bureau of Labor Statistics.

each component of compensation in 2008. These data show a much larger gap between average public and average private sector compensation than the BEA data.

In June 2009, total compensation per hour was $39.66 in the public sector, which was 45 percent greater than the average $27.42 per hour in the private sector. The public sector advantage in average wages was 34 percent, while the advantage in benefits was a huge 70 percent.

These BLS data allow a public-private comparison for three broad occupational groups: "management and professional," "sales and office," and "service." For the first occupational group, average public and private compensation was similar, but public sector workers had a large compensation advantage in the latter two occupational groups.

Why is the public sector compensation advantage much larger in the BLS data than the BEA data discussed above? One important reason is that public sector employees work substantially fewer hours than do private sector employees. The BLS National Compensation Survey (BLS 2009c: Tables 4 and 5) shows that full-time private sector workers averaged 2,050 hours of work in 2008, or 12 percent more than the 1,825 hours worked by the average public sector worker.

Let's go back to the data in Table 1. They reveal that the largest public sector compensation advantages are in health insurance, defined benefit retirement plans, and paid leave. These advantages are due to the greater generosity of public sector benefit packages and the fact that more public employers offer those benefits.

The BLS (2009b) provides data on the share of employers who offer various types of benefit. The advantages of public sector employment include:

- Health care benefits are available to 71 percent of private sector employees but 88 percent of public sector employees.
- Retirement plans (defined-benefit or defined-contribution) are available to 67 percent of private sector employees but 90 percent of public sector employees. Among full-time employees, the shares rise to 76 percent and 99 percent, respectively.
- Life insurance benefits are available to 59 percent of private sector employees but 80 percent of public sector employees.
- Paid sick leave is available to 61 percent of private sector employees but 89 percent of public sector employees.

Many state and local governments have expanded their worker retirement benefits during the last couple of decades. Because most public sector workers receive defined-benefit pensions, policymakers have been able to expand promised benefits without incurring a large short-term budget impact. However, generous benefit packages have created large unfunded liabilities in employee retirement plans, as discussed below. As with the BEA compensation data, the BLS data understate the full cost of current employee benefits to the extent of underfunding in state and local pension and retiree health care plans.

Public sector retirement plans are usually more generous than those in the private sector. The annual benefit of the median public sector defined-benefit pension is more than twice the benefit in the median private plan (Pew 2007: 11). One factor driving that difference is that nearly all public sector defined-benefit plans calculate benefits based on earnings during the last one to three years of work (Braden and Hyland 1993: 19). By contrast, private sector defined benefit plans are more likely to use a lower-cost approach, such as basing benefits on career-average earnings.

Another difference between public and private compensation regards retiree health benefits. In the public sector, employees can retire early—usually at age 55—and then enjoy years of health care coverage at taxpayers' expense before Medicare kicks at age 65. Such retiree health care coverage is a very rare perk in the private sector.

Aside from all these monetary benefits of public sector employment, there is one very important nonmonetary benefit of working for the government: very high job security. During good times and bad, BLS data show that "layoffs and discharges" in the public sector occur at just one-third the rate as in the private sector (BLS 2009e).[4] Public sector workers rarely get fired for poor performance or laid off because of employer cost-cutting, but those events occur frequently in the private sector.

Finally, there is a very good market indicator of the generosity of compensation in the public sector: voluntary job-quit rates. If an industry has a low quit rate, it indicates that compensation is more than adequate to attract qualified workers. The BLS (2009e) has data on employee quit rates across industries, and over the years the quit rate among public sector workers has been just one-third the quit rate in the private sector. With the poor economy in 2009, quit rates

[4]See www.bls.gov/jlt for detailed data. Between 2001 and 2009, the public sector layoff and discharge rate averaged just 30 percent of the private sector rate.

fell in both the private and public sectors, but the public sector rate remained at just one-third the rate in the private sector.

Pension Scandals

So far I've focused on public sector compensation as reflected in national statistics, but those statistics tell only part of the story. In recent years, many news articles have highlighted examples of public sector pay packages—particularly pensions—that often seem grossly excessive. These excessive public pensions may not be reflected in official statistics on compensation because they reflect future costs, not current costs. Some of the excessive aspects of public sector pensions include:

- *Early Retirement*. Public sector workers generally retire earlier than workers in the private sector and then enjoy generous pension benefits for life. The great majority of public sector workers can retire at 55 or earlier as long as they have fulfilled a years-of-service requirement, which is usually 30 years. Writing in a BLS publication, Arlene Dohm (2000: 21) notes that "most government employees are covered under defined benefit pension plans that provide the maximum economic benefits to those who retire at the earliest possible age of pension eligibility." In California, for example, lawmakers greatly expanded the generosity of public pensions in 1999. According to the *San Diego Union-Tribune* (June 16, 2009), the law lowered the retirement ages for public employees to 50 for public safety workers and 55 for other workers, and increased annual benefit amounts. For example, public safety workers can retire after only 20 years of service with 60 percent of income or after 30 years of service with 90 percent (Weintraub 2004). Today, the state's plan, CalPERS, is massively underfunded and the 1999 pension bill has cost far more than expected.
- *Double Dipping*. In many states (such as New Jersey, California, and Utah), public sector workers can "retire" early and then proceed to take a new public sector job, and thus receive a full salary and generous pension at the same time (Heath 2009). A recent article explained this problem in Utah's government plan: "Auditors said double dipping has created an incentive for employees to retire early and return to work so they can collect their pension, salary, and a generous 401(k) payment. That costs

the retirement system money for two reasons: First, because the employee draws a pension from the retirement fund for more years, and second, because there is no contribution to the retirement system on behalf of the re-employed worker" (Gehrke 2009).

- *Pension Spiking*. In some jurisdictions, government workers can artificially inflate their pension earnings by pulling strings to get themselves big raises in their final year of work or putting in overtime in their final year. This is called "pension spiking." In Sacramento, for example, the recently retired police chief engineered a 20 percent raise for himself soon before he retired, which had the effect of pushing his annual pension to $173,000 a year, or 90 percent of his final salary (Breton 2009).
- *Disability Claims*. Excessively generous and fraudulent claims for disability by public workers is a growing problem. In an article in *Forbes*, Stephane Fitch (2009) noted that in Nevada "heart disease among uniformed safety workers is job-related. . . . Veteran Las Vegas firemen hobbled by heart disease can collect an inflation-protected $40,000 a year for life on top of their pension. That applies even if they're healthy enough to work in another occupation." Jonathan Walters (2007), in an article in *Governing* magazine, noted that rising disability costs are a big problem: "Across the country, hundreds of local governments and several states are wrestling with what some view as out-of-control disability pension and health insurance systems hard-wired to allow police and fire personnel to retire early and with very generous benefits. At the same time, they may pursue other full-time careers, often in fields similar to the one that they abandoned when they left public service."
- *Excessive Pension Benfits*. Many recent articles have focused on examples of apparently excessive pensions of public sector employees, mayors, city council members, and government administrators. In California, there are an enormous 6,144 retired public employees in the CalPERS system who are receiving annual pensions of more than $100,000 a year, and another 3,090 retired teachers in the state's teachers retirement plan who are in the "$100,000 pension club."[5]

[5]A searchable database of recipients is available at http://californiapensionreform.com.

- *Overpromising Benefits*. Like California, many other states increased their already generous employee retirement benefits during the stock market boom of the 1990s, and they are now suffering the consequences. Pennsylvania's troubles are typical. Taxpayers are facing large increases because at the end of the boom nine years ago, "lawmakers … awarded themselves a 50 percent pension boost and then extended a 25 percent raise to 340,000 state and school workers . . . at the same time, they decided to vest employees at five years' rather than 10 years' service" (Erdley 2005).
- *Pay-to-Play Corruption*. The reliance of state and local governments on defined-benefit pension plans has resulted in governments holding huge financial portfolios. That has encouraged "pay-to-play" influence-peddling schemes whereby Wall Street firms bribe public officials in order to get a slice of the government's financial business. New York's public pension fund, for example, is currently engulfed in scandal, as reported by the *Wall Street Journal:* "Money manager Elliott Broidy on Thursday admitted to making nearly $1 million in gifts to benefit four former top officials in the office that oversees New York state's pension fund, including onetime state comptroller Alan Hevesi" (Karmin and Lattman 2009). A good way to tackle such corruption would be to drain the swamp—transition government workers from defined-benefit pension plans to defined-contribution plans, which would avoid the problem of public officials having to actively manage vast pools of pension cash.

A recent *Forbes* article (Fitch 2009) on a Florida policeman is representative of today's public sector compensation excesses:

> Glenn Goss … retired four years ago, at 42, from a $90,000 job as a police commander in Delray Beach, Fla. He immediately began drawing a $65,000 annual pension that is guaranteed for life, is indexed to keep up with inflation and comes with full health benefits. Goss promptly took a new job as police chief in nearby Highland Beach. One big lure: the benefits. Given that the average man his age will live to 78, Goss is already worth nearly $2 million, based on the present value of his vested retirement benefits. Looked at another way, he is a $2 million liability to Florida taxpayers.

Unfortunately, the type of absurd benefits provided to workers such as Glenn Goss is pushing many governments to fiscal ruin. A recent Cato Institute paper chronicled how Vallejo, California, declared bankruptcy in 2008 because of the crushing costs of compensation increases (Bellante, Denholm, and Osorio 2009). Other towns and cities are also on the brink of bankruptcy (Siedle 2009). The website *www.pensiontsunami.com* has collected hundreds of news articles on excesses in public sector compensation and pensions that indicate the widespread nature of the problem.

Growth in Public Sector Unions

Figure 2 shows BLS data on the shares of public and private employees that are members of unions (BLS 2009a). In 2008, 38.5 percent of all state and local workers were members of unions, which is five times the union share in the U.S. private sector of 7.6 percent. The share of state and local government workers who are *represented* by unions was slightly higher at 42.3 (Some workers who are represented by unions are not union members).

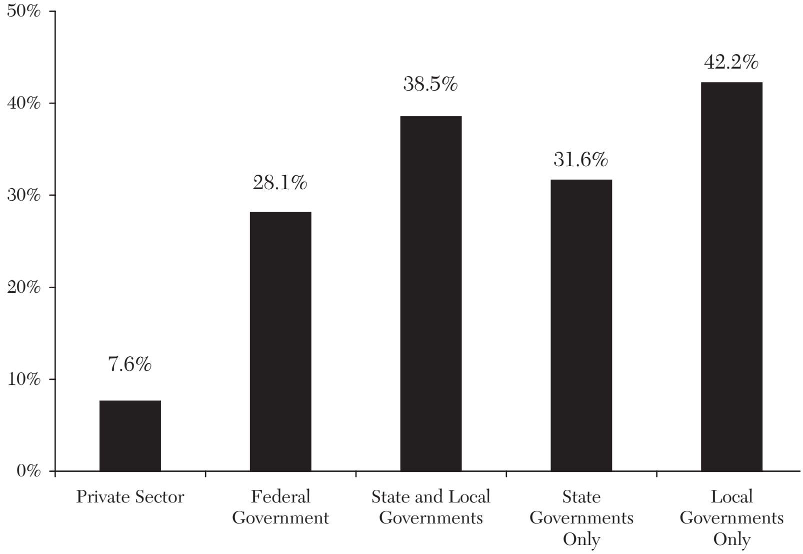
With the inclusion of federal workers, public sector union members totaled 7.8 million in 2008, which was almost half of the 16.1 million total union members in the nation. Local governments have the largest group of public sector union members. About one-third of all local government workers are in education, and about two-thirds of those workers are members of unions. Police and fire departments are also heavily unionized with union member shares of almost 60 percent (see Farber 2005).

Figure 3 shows the union member shares in the public and private sectors in recent decades.[6] While the private sector share has plummeted, the state and local shares have remained high at just over 30 percent and 40 percent, respectively. Data on public sector union membership before the 1980s are sketchy, but it appears that the share rose from less than 15 percent of the state and local government workforce in the 1950s to the current high levels by the late-1970s (Freeman 1986: 45).

Part of that increase was accounted for by the conversion of "professional associations," such at the National Education Association,

[6]Data are from www.unionstats.org, which is based on information from the U.S. Bureau of Labor Statistics.

FIGURE 2
Union Member Shares of Employment



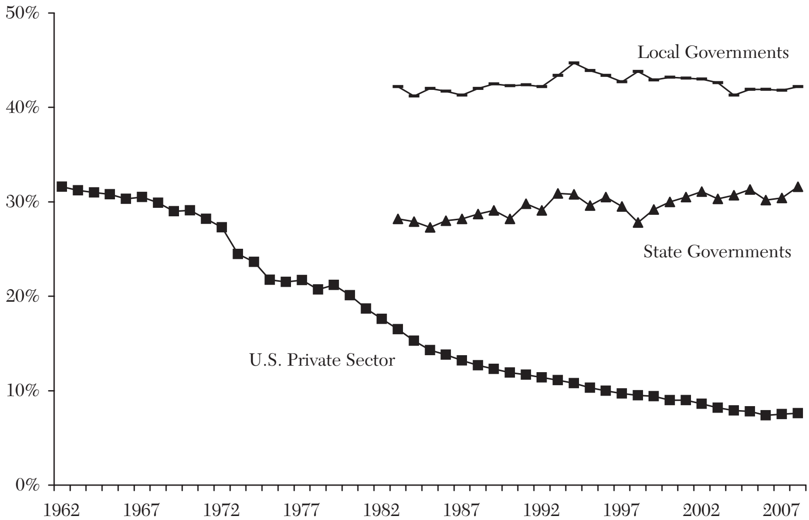
Source: U.S. Bureau of Labor Statistics.

into full-blown unions. NEA membership has grown from 766,000 in 1961 to 3.2 million today, and as it has evolved into a union it has become much more involved in politics and lobbying (Lieberman 1997). Some of the other large public sector unions include the American Federation of Teachers, with 1.4 million members, and the American Federation of State, County, and Municipal Employees, with 1.4 million members. (These membership counts can include retired and private sector members.)

The slew of pro-union laws enacted by dozens of states during the 1960s and 1970s triggered the rise in public sector unionism (Freeman 1986: 47–48). The legislation encouraged unions to launch aggressive recruiting drives in the public sector and to lobby for further pro-union policy changes.

Prior to the 1960s, courts generally held that public sector workers did not have the same union privileges, such as collective bargaining, that private sector workers do under the 1935 Wagner Act. But that changed rapidly during the 1960s and 1970s with a rash of state legislation encouraging or requiring collective bargaining and impos-

FIGURE 3
Union Member Shares of Employment



Source: U.S. Bureau of Labor Statistics.

ing various "union security" provisions, such as mandatory union dues (Farber 2005: 15).

Princeton University's Henry Farber (2005) has documented the rise in public sector union legislation passed since the 1950s in great detail. He finds that the number of states allowing collective bargaining for public sector workers jumped from 1 in 1955 to 10 in 1965. Trendsetter New York City granted collective bargaining privileges to nearly all city workers in 1958 (O'Neal and McMahon 2007: 4).

By 1970, about half of state government workers in the nation had collective bargaining privileges and more than half the states allowed collective bargaining for local government workers. Pro-union legislation advanced further during the 1970s, but then around 1980 the advance slowed and union rules have remained fairly stable since then. Today, 26 states have collective bargaining for essentially all state and local employees, and a further 12 states have collective bargaining for a portion of their public sector workers. The remaining 12 states do not have collective bargaining in the public sector (GAO 2002: 8).

Official histories of unions describe the dramatic changes of the 1960s and 1970s. From the AFT website:

> Another challenge of the sixties was the battle for collective bargaining rights. The age of teacher militancy began in November 1960 with a one-day walkout of the United Federation of Teachers of New York City; two years later the UFT won the first comprehensive teacher contract in the country. The events in New York City spawned more than 300 teacher strikes throughout the country in that decade, and the national AFT grew from under 60,000 members in 1960 to more than 200,000 by 1970. The sixties also saw the first major strike by university professors in the United States…. In 1969, the UFT led the way for other AFT locals when it successfully won the right to represent 10,000 paraprofessionals in New York City. In the years that followed, the AFT organized thousands of paraprofessionals and school-related personnel in the nation's schools.[7]

AFSCME's official history describes similar growth and similar aggressive tactics:

> In 1958, a series of strikes and demonstrations forced the mayor of New York City to grant collective bargaining rights to unions representing city employees. A turning point had been reached. The desire for collective bargaining became AFSCME's driving force. . . . By the end of 1969, several states had enacted collective bargaining laws and the union's membership grew to more than 250,000…. In the 1970s and 80s, AFSCME members increased their efforts politically in order to win collective bargaining laws, organize new members, and wield clout on behalf of existing members. All across the country, at every level of government, candidates for public office learned they had to pay attention to AFSCME's political muscle.[8]

These are some of the reasons for the initial growth in public sector unionism, but what has sustained it at a high level while private

[7]American Federation of Teachers, "History," www.aft.org/about/history/index.htm.

[8]American Federation of State, County, and Municipal Employees, "AFSCME: 75 Years of History," www.afscme.org/about/1028.cfm.

sector unionism has declined? First, public sector agencies tend to be static so that once a union has organized a group of workers they tend to stay organized. By contrast, the private sector is dynamic with businesses going bankrupt frequently and new businesses arising. Since all new businesses start out nonunion, constant organizing efforts are needed to sustain the union rate in the private sector. "Unions in the public sector can maintain membership levels with less new organizing than is required in the private sector" (Farber 2005: 11).

Second, many services provided by the government are legal monopolies, such as police and fire services. The result is that consumers generally don't have the option of abandoning unionized public services if they become too high-cost and inefficient, as they can with private services.

Third, there are few downsides to aggressive union tactics in the public sector. Public sector unions lobby for higher pay and higher government spending on activities that benefit them. When that lobbying leads to higher costs for the government, the burden is borne by someone else—the taxpayers. By contrast, private sector unions need to keep in mind that higher business costs may result in lost sales and fewer jobs. Private sector union members are constrained by concerns about their job security, but there is no such constraint in the public sector.

Variations in Public Sector Compensation

Table 1, above, presented BLS data showing compensation differences between public and private sector workers. To shed further light on public sector compensation, the BLS provided me with an unpublished tabulation that breaks out the public sector workforce between union and nonunion. Table 2 presents the results.

Unionized public sector workers have far higher wages and benefits, on average, than nonunionized public sector workers. Their wages are 31 percent higher, on average, and their benefits are 68 percent higher. Overall, the union compensation advantage in the public sector is 42 percent.

Of course, a substantial part of this union-nonunion difference relates to variations in compensation levels across the country. High-wage states in the northeast, for example, tend to be more unionized. The BLS provided me another unpublished set of tables that show

TABLE 2
Public Sector Compensation: Union vs. Nonunion
(June 2009 Dollars per Hour Worked)

Compensation Item	A State and Local Nonunion	B State and Local Union	Union Advantage col. B / col. A
Total Compensation	$33.33	$47.46	1.42
Wages and salaries	22.86	29.90	1.31
Benefits	10.47	17.57	1.68
Paid leave	2.63	4.06	1.54
Supplemental pay	0.26	0.45	1.73
Health insurance	3.07	5.91	1.93
Other insurance	0.12	0.22	1.83
Defined benefit retirement plan	1.94	3.98	2.05
Defined contribution retirement plan	0.36	0.25	0.69
Legally required	2.09	2.70	1.29

Source: U.S. Bureau of Labor Statistics. Unpublished data.

regional variations in public sector compensation. I summarized the data in Table 3, which is rank-ordered by state and local worker compensation in 2009 (the second column).

The first thing to note is the dramatic variation in public sector compensation across the Census regions. In the Pacific region, public sector workers are paid an average $49.02 per hour, which is 60 percent greater than the $30.73 paid in the West South Central region.

The third column in Table 3 shows the public sector compensation advantage over the private sector within each region. Public sector workers earned substantially more, on average, than private sector workers in all regions of the country. But the public sector advantage was particularly high in the Pacific, Middle Atlantic, East North Central, and East South Central regions.

The BEA publishes state and local government compensation data by state.[9] Table 4 shows the average compensation (wages and benefits) by state, ranked from highest to lowest.[10] California tops the ranking with average public sector compensation of $86,417, which was 64 percent higher than average compensation in the bottom-ranked state of Kentucky.

Union Members by State

Let's take a look at public sector union membership by state. Table 5 shows the estimated share of state and local government workers who were union members in 2008. To derive these data, I first took data on total federal, state, and local government union members from the website *www.unionstats.org*, which is tabulated from the BLS *Current Population Survey*. I then subtracted estimated federal union members from the total.

The states with the highest estimated shares of state and local union members are New York, Rhode Island, Hawaii, New Jersey, and Connecticut. The states with the lowest union member shares are North Carolina, South Carolina, Mississippi, Virginia, and Georgia.

The union share of public sector employment across the states is strongly correlated with the presence of favorable union legislation, including collective bargaining rules and "union shop" and "agency

[9]Data are from the U.S. Bureau of Economic Analysis, Regional Economic Accounts (www.bea.gov/regional/spi).

[10]The average is based on employment measured by full-time equivalents, which is available from the Bureau of the Census.

TABLE 3

Regional Variations in Private vs. Public Sector Compensation
(Total Compensation per Hour Worked, June 2009 Dollars)

Regions	A Private Sector Workers	B State and Local Workers	State and Local Advantage col. B / col. A	States in Region
Pacific	$30.78	$49.02	1.59	Alaska, California, Hawaii, Oregon, Washington
Middle Atlantic	31.69	48.53	1.53	New Jersey, New York, Pennsylvania
New England	33.29	43.22	1.30	Connecticut, Maine, Massachusetts, New Hampshire, Rhode Island, Vermont
East North Central	26.72	43.00	1.61	Illinois, Indiana, Michigan, Ohio, Wisconsin
Mountain	26.18	36.14	1.38	Arizona, Colorado, Idaho, Montana, Nevada, New Mexico, Utah, Wyoming
South Atlantic	25.33	34.90	1.38	Delaware, D.C., Florida, Georgia, Maryland, North Carolina, South Carolina, Virginia, West Virginia

(continued)

TABLE 3 *(cont.)*
Regional Variations in Private vs. Public Sector Compensation
(Total Compensation per Hour Worked, June 2009 Dollars)

Regions	A Private Sector Workers	B State and Local Workers	State and Local Advantage col. B / col. A	States in Region
East South Central	$20.76	$32.14	1.55	Alabama, Kentucky, Mississippi, Tennessee
West North Central	25.35	32.00	1.26	Iowa, Kansas, Minnesota, Missouri, Nebraska, North Dakota, South Dakota
West South Central	24.35	30.73	1.26	Arkansas, Louisiana, Oklahoma, Texas

Source: U.S. Bureau of Labor Statistics. Unpublished data.

TABLE 4
Average Annual Compensation for State and Local Government Employees, 2008

California	$86,417	Delaware	$66,982	Nebraska	$57,949
Connecticut	82,457	Colorado	66,576	Idaho	57,278
Nevada	80,094	New Mexico	64,432	New Hampshire	57,035
New Jersey	78,674	Virginia	64,182	North Carolina	57,010
Washington	76,544	Utah	63,406	South Dakota	56,985
New York	74,615	Arizona	62,315	Missouri	56,463
Maryland	74,054	Iowa	62,090	Texas	56,309
Rhode Island	73,827	Florida	61,367	Alabama	55,503
Hawaii	71,883	Ohio	61,346	Maine	55,034
Oregon	70,909	Wyoming	61,080	Georgia	54,722
Minnesota	69,901	South Carolina	60,870	Tennessee	54,699
Michigan	69,577	Oklahoma	60,555	Arkansas	53,725
Wisconsin	69,449	Montana	60,435	Indiana	53,401
Alaska	69,257	Louisiana	60,227	Kansas	52,958
Illinois	68,625	Vermont	59,782	Mississippi	52,779
Massachusetts	68,544	Pennsylvania	59,657	Kentucky	52,565
West Virginia	67,354	North Dakota	59,244		

Sources: BEA compensation data; Census employment data, which are in full-time equivalents.

TABLE 5
Estimated Union Member Shares of State and Local Government Employment, 2008

New York	75.5%	Vermont	42.5%	Idaho	14.3%
Rhode Island	68.8	Montana	42.3	Kentucky	14.2
Hawaii	68.1	Ohio	42.2	Arkansas	14.1
New Jersey	67.3	Delaware	40.2	North Dakota	13.9
Connecticut	66.7	Nevada	37.9	Tennessee	13.4
Alaska	66.4	Maryland	33.0	South Dakota	13.4
Massachusetts	65.9	Iowa	31.6	Texas	12.6
Oregon	65.1	Alabama	30.2	New Mexico	12.5
California	61.9	Florida	27.9	Utah	12.3
Michigan	61.4	Indiana	27.3	Wyoming	10.8
Pennsylvania	58.5	Nebraska	27.2	Louisiana	10.8
Minnesota	58.2	West Virginia	24.8	North Carolina	8.2
Washington	55.9	Missouri	22.1	South Carolina	8.2
Illinois	53.8	Colorado	20.7	Mississippi	6.0
New Hampshire	51.4	Arizona	17.3	Virginia	5.2
Wisconsin	49.8	Oklahoma	15.5	Georgia	4.2
Maine	48.2	Kansas	14.6		

Source: Author's estimates based on BLS data compiled by www.unionstats.org.

shop" provisions (see Farber 2005). Union shop provisions require employees to become dues-paying members of unions, while agency shop provisions require workers to either join the union or pay a fee to the union. Today, 22 states have "right-to-work" laws, which outlaw union and agency shop provisions in union contracts (Farber 2005: 14).[11] In right-to-work states, workers cannot be forced to join a union or pay union dues. These states generally have substantially lower union shares than do other states (Farber 2005: 20).

Across the states, public sector collective bargaining laws range from an outright ban on the activity to actively requiring it. Some of the most pro-union states also allow public sector strikes and some have mandatory arbitration, which usually works in favor of the unions. Note that union rules can vary within states for different types of public sector worker. For example, teachers are more likely to be allowed to strike than police or fire service employees.

Collective bargaining laws also affect the level of union membership. In states where collective bargaining is prohibited, such as Virginia, just 17 percent of state and local workers are unionized, on average (Farber 2005: 20). In states where there is a duty for state and local employers to bargain with a union, half or more of the public sector is unionized.

Do Public Sector Unions Increase Compensation?

This article has looked at data suggesting that public sector workers generally do very well with regard to their level of compensation. But does the presence of unions in the public sector workforce raise compensation levels above what they would otherwise be?

Statistical studies have consistently found that union members in the private sector receive a wage premium as a result of their union membership of about 15 percent or more (Hirsch and Macpherson 2007). Some studies have found that the union wage premium is somewhat lower in the public sector than in the private sector.[12] Some of these studies have looked just at wages and not benefits, which is a crucial part of the public sector advantage.

I estimated a simple OLS regression model to explore the effect of unionism on public sector compensation. The model is cross-sectional, using data for the 50 states in 2008. The model is as follows:

[11]See also www.nrtw.org/rtws.htm.
[12]For a discussion of the literature, see Freeman (1986: 47–48).

$$(1)\ GovComp = \alpha + \beta_1\ PrivComp + \beta_2\ UnionShare + \epsilon$$

where:

GovComp is the average compensation (wages and benefits) for state and local employees in a state.
PrivComp is the average compensation for private sector employees in a state.[13]
UnionShare is the share of state and local government employees who are union members.

The coefficient of *PrivComp* is expected to be positive because higher private sector compensation in a state would likely prompt officials to offer higher compensation to public workers.

The coefficient of *UnionShare* is expected to be positive because the higher the union share, the more leverage public sector workers have over the political process of setting compensation.

The BEA publishes state-by-state data on total compensation and number of employees in the private sector and state and local governments.[14] The public sector unionization rate is estimated from data on *www.unionstats.org*, which is based on the BLS *Current Population Survey*. I removed the estimated number of federal union members from the public sector union member count.[15]

The estimated model is as follows:

$$\begin{aligned}(2)\ GovComp = {} & \underset{(4.6)}{19{,}992} + \underset{(6.0)}{0.57}\ PrivComp \\ & + \underset{(3.5)}{11{,}672}\ UnionShare\end{aligned}$$

F-statistic = 55
R-Square = 0.70

The results are highly statistically significant. The t-statistics (in parentheses) and F-statistic indicate significance above the 99 percent level. The R-square indicates that the two variables explained 70 percent of the variation across the states in public sector compensation.

[13]The private sector workforce excludes self-employed persons in order to provide an apples-to-apples comparison with the public sector workforce.
[14]Data are from the U.S. Bureau of Economic Analysis, Regional Economic Accounts (www.bea.gov/regional/spi).
[15]To remove federal union members, I assumed that the share of union members was a fixed 28 percent across the states, which is the national share in the federal workforce per CPS data.

The coefficients on the explanatory variables had the expected signs. The coefficient on the union share variable indicates, for example, that if the public sector unionization share in a state increased by 10 percentage points, it would lead to higher annual average public sector compensation of about $1,167.

What would be the difference in compensation between two states that had unionization rates of 0 percent and 39 percent? Based on the *UnionShare* coefficient, the difference in annual average compensation between the two states would be $4,552. Given that average public sector compensation in 2008 was $56,040 in this BEA dataset, that union difference would amount to an 8.1 percent average compensation difference.

The U.S. average state and local unionization rate is 39 percent, thus the results suggest that public sector unionism pushes up the cost of the U.S. state and local workforce about the same 8.1 percent. Given that annual state and local compensation is $1.1 trillion in 2008, that union compensation premium costs taxpayers about $89 billion a year.

In sum, the results indicate that the union compensation premium for public sector workers may be less than the union premium in the private sector, as other studies have indicated. However, the data indicate that public sector employees are well compensated in general, and so an 8 percent premium represents a substantial and unneeded additional cost to taxpayers.

Furthermore, note that the costs of public sector unionization for states with high unionization rates are larger. California's 62 percent unionization rate, for example, translates into a statewide boost in public sector compensation costs of more than 10 percent, according to these regression results.

Finally, these estimates do not take into account the rising levels of unfunded costs in state and local retirement plans. The regression estimates reflect current compensation costs of government workers, but we know that the costs of benefit plans are scheduled to rise rapidly in many states in coming years.

States Face Large Fiscal Challenges

The recent recession has created fiscal challenges for state and local governments across the nation, but these troubles are just a prelude to larger problems ahead. State spending on Medicaid and other programs is soaring, state debt is rising rapidly, and many governments face huge underfunding in their pension and health care plans.

To solve these problems, governments will need to make major budget reforms and cuts. As noted, employee compensation represents half of all state and local spending. As such, compensation will be a major policy battleground in the years ahead involving taxpayers, workers, unions, and elected officials.

Consider the problem of rising government debt. State and local debt outstanding soared from $1.2 trillion in 2000 to $2.3 trillion in 2009—a 92 percent increase (Federal Reserve Board 2009: Table D.3). Governments are increasingly using debt to fund investments that used to be funded on a pay-as-you-go basis, and some governments are using debt to cover routine operating costs. Rising debt levels will make future state and local budgeting that much more difficult.

In addition to this explicit debt, governments have built up large liabilities in employee pension plans. Officially, state pension plans are currently underfunded by about $1 trillion and many have funding levels far below the lowest level considered adequate of 80 percent (*The Economist* 2009). The pension system for 365,000 Illinois teachers, for example, has only a 35 percent funding level, according to a recent actuarial report (McNichol 2009). The down stock market in recent years has hit pension funds hard. But PricewaterhouseCoopers calculated that even with strong market growth in coming years, public pension systems will continue to be hugely underfunded (Cho 2009). Note that the pension problem is not really "underfunding," but the "overpromising" of benefits that the states cannot afford.

One problem is that public pension plans have used very optimistic assumptions to value future liabilities, a practice financier Warren Buffett has called "accounting nonsense" (Cho 2008). Buffett argues that public pension plans are "ticking time bombs" that are ready to explode in many states as baby boomers begin to retire (Cho 2009). To pick one small example, annual taxpayer contributions to the teacher pension fund in Vermont jumped from $24 million to $64 million in the last six years, and "the cost of retirement benefits for public workers is threatening to swallow up the state budget" (*Burlington Free Press* 2009).

A recent study by Robert Novy-Marx and Joshua Rauh (forthcoming) found that state and local governments are "severely underestimating" their future pension liabilities by using high discount rates. Using more realistic assumptions, the authors found that at the end of 2008, state and local pension plans were underfunded by $3.2 trillion, or three times more than the officially reported amount. That represents a shortfall of $21,500 for every U.S. household according to the authors, indicating the possible exposure to taxpayers if these plans are not cut.

Governments have also built up large unfunded obligations in their employee health plans. Most state and local governments provide health care coverage to retired employees, but these plans are typically completely unfunded. In other words, they have not put any assets aside to cover future benefits. My colleague Jagadeesh Gokhale and I have estimated that these unfunded health care obligations total at least $1.4 trillion nationwide (Edwards and Gokhale 2006). In California, the annual cost of public employee retirement health care is expected to skyrocket from $3.4 billion in 2005 to an estimated $31.4 billion by 2020 (Boyken 2007).

The upshot of all this is that policymakers will need to make large budget reforms in the years ahead. They will to need to deliver public services more efficiently, to privatize services when feasible, to cut staffing levels, and to terminate low-value programs. Policymakers often hesitate in making such reforms, but the high level of unionization in many state workforces will make reforms even harder to achieve. During labor negotiations, for example, public officials often succumb to pressure to make short-term concessions that end up damaging public finances in the long run.

Unions reduce the ability of government managers to cut costs and increase efficiency in many ways. They protect poorly performing workers, they push for minimum staffing levels, they resist the introduction of new technologies that threaten their jobs, and they create a rule-laden and bureaucratic workplace. In New York State, for example, "Virtually any idea for saving money through outsourcing and consolidation of services must first be negotiated and agreed to by the union representing the employees who currently provide the service" (O'Neal and McMahon 2007: 17). A recent Cato paper describes some of the structural problems with unions in the public sector (Bellante, Denholm, and Osorio 2009; see also Denholm 1994).

When they need to, governments are able to cut costs in the nonunion portions of their workforces. Consider this excerpt from an October 2009 press release by the Chicago Transit Authority:

> In 2010, the CTA will again be deferring merit pay increases and will be instituting more furlough days and unpaid holidays for nonunion employees. In addition, it will eliminate 70 nonunion jobs…in 2009, the CTA required up to six unpaid days off for management and deferred raises for nonunion employees. In 2010, pay increases for nonunion employees will be deferred once again [CTA 2009].

The CTA is taking steps to balance its budget, but it might have been more efficient if the pain had be shared throughout CTAs workforce. As state fiscal pressures build, public managers will need the flexibility to find savings across their entire organizations, not just the nonunion parts.

Conclusion

In the private sector, businesses can mitigate the inefficiencies created by unions. Businesses can substitute capital for labor to compensate for excessive union labor costs, and they can increase the quality of their workforces in response to rising union wages. Unfortunately, public sector managers have fewer incentives and less flexibility to make such changes.

Unions have a broader effect on state finances than just pushing to increase employee compensation because they also lobby to increase government spending in general. Public sector unions are some of the most powerful special interest groups in the nation. The advent of public sector collective bargaining in the 1960s and 1970s essentially invited millions of public sector workers to become politically active. Government workers are more likely to vote than other Americans, which magnifies their political power (Bellante, Denholm, and Osorio 2009: 7). States that have mandatory union dues allow unions to build up large war chests to fund their public policy efforts.

The teachers unions are particularly powerful. The teachers union in California, for example, has aggressively entered the fray on a wide range of state ballot questions. Teachers unions in Maine and Washington helped defeat budget reform measures on the ballot in the 2009 elections. Teachers unions have helped to kill school vouchers in the District of Columbia and other places (see Carney 2009).

In a book on the teachers unions, Lieberman (1997) notes that the NEA's and AFT's "influence on noneducation issues at the federal and state levels is arguably more important than their influence on educational issues." So the problem with public sector unions is not just that they block compensation reforms, but that use their privileged status to control broader policy debates.[16]

The NEA has 3.2 million members, a staff of 555, and a 2009 budget of more than $350 million (NEA 2009). Over the last two decades, it has been the seventh largest contributor to political campaigns in the United States. AFSCME, with 1.4 million members, is another powerful public sector union. Over the last two decades, it has been the second largest contributor to political campaigns in the nation. AFSCME uses its clout on a wide range of policy issues, such as opposing privatization of government services.[17]

Americans need higher-quality government services at lower cost to avert a fiscal crisis in state and local governments. Public sector compensation—and benefit plans in particular—need to be overhauled to ensure financial sustainability. And the whole area of public sector unionism needs to be reexamined given the need for greater flexibility and more restraint in public finances.

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