YANKEE INSTITUTE FOR PUBLIC POLICY
P.O. Box 260660, Hartford, CT 06126 - 0660
Telephone: (860) 297-4271, Fax: (860) 987-6218

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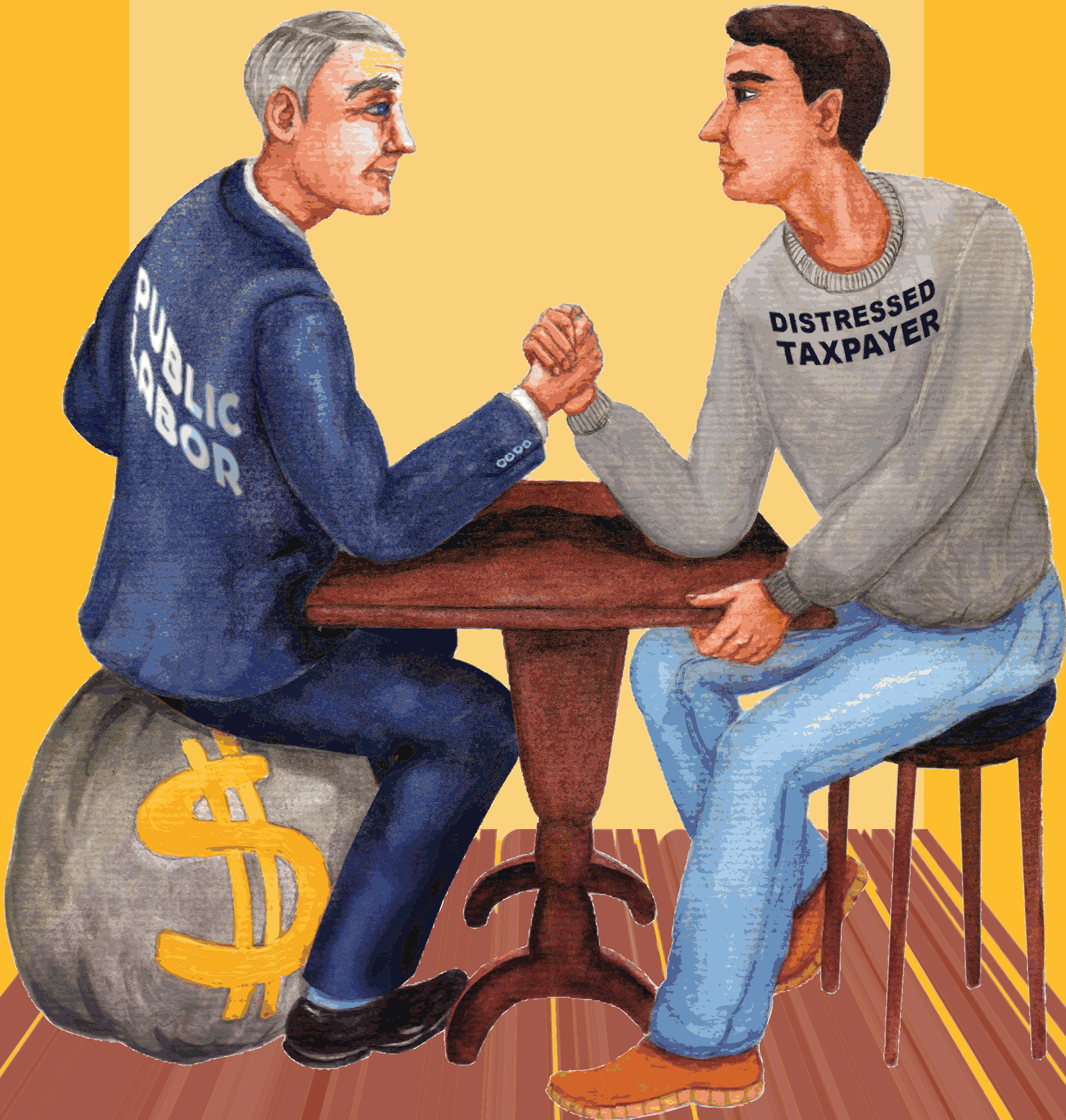

LEWIS M. ANDREWS PH.D.

THE COMING SHOWDOWN WITH PUBLIC LABOR

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cover by Natasha Sazonova

About the Yankee Institute for Public Policy

The Yankee Institute for Public Policy, Inc. is a nonpartisan educational and research organization founded more than two decades ago. Today, the Yankee Institute's mission is to "promote economic opportunity through lower taxes and new ideas for better government in Connecticut."

About the Author

Lewis M. Andrews is executive director of the Yankee Institute for Public Policy. He holds a bachelor's degree in psychology from Princeton, a master's in communications research from Stanford, and a Ph.D. in social psychology from the Union Institute. He has been a research fellow at Yale University and a visiting scholar at the Columbia University Graduate School of Business.

Lew is the author of *Requiem for Democracy?* (Holt), *Man Controlled* (Free Press), and *To Thine Own Self Be True* (Doubleday). His writing has appeared in such diverse publications as *Saturday Review*, the *Wall Street Journal*, *Investor's Business Daily*, *The Nation*, *National Review*, *Policy Review*, *New Oxford Review*, *Budget and Tax News*, *Professional Counselor*, *School Reform News*, and *The American Enterprise*.

Under Dr. Andrews'direction the Institute has become a leader in education reform. Yankee's current projects include the design of an online calculator which shows the financial benefit to suburban towns of sending some children to private schools.

Dr. Andrews lives in Redding with his daughter Kate, his son Zachary, and two cats.

The Coming Showdown with Public Labor[†]

Executive Summary

With the cost of government at all levels – federal, state, and local – soaring wildly out of control, politicians will soon be forced to take the only action that can guarantee the continued delivery of public services at a reasonable cost: ***create laws to make the public sector more efficient and effective.***

New Zealand, which in 1984 initiated a sweeping privatization of national and regional services to forestall national bankruptcy, provides endless examples of how streamlining government to bring expenses in line with revenues actually improves the overall quality of services. Employees in transportation were reduced from 5,600 to 53, in forest services from 17,000 to 17, and in the national Ministry of Works from 28,000 to 1 – all with no loss of service or safety to the public.

The problem is that importing these kinds of savings to America will not go down well with public employee unions, which have grown accustomed to extracting generous benefits from politicians without having to give much in return. At the state level, government workers have been collecting nearly 50 percent more in total compensation than the average private sector employee, with taxpayers subsidizing 128 percent more than private employers to fund health care benefits and 162 percent more on retirement benefits.

When budget pressures have occasionally forced politicians to make modest demands for increased productivity, the response from public employees has been less than generous -- witness the 2005 holiday transit strike in New York City and repeated threats of illegal walkouts by nurses throughout the University of California system.

But as taxpayers and elected officials come to insist on more cost-effective government, public unions will discover that their leverage is limited.

** In a world where an Internet course can substitute for a live teacher, where technology is cutting the length of hospital stays and allowing medical centers in other countries to compete for American patients, and where Web-enabled technology can ease the impact of government workforce reductions,* ***the bargaining position of monopoly labor is slowly but surely eroding****.*

** Eventually,* ***public employees will see that they too have a vested interest in the productivity changes necessary to resolve the debt crisis****, especially at the local level where state legislatures have considerable latitude to restructure failing municipalities by re-writing union contracts. This has already happened in cities like Springfield, Massachusetts.*

** Indeed,* ***not all guarantees made to government workers are as ironclad as supposed.*** *Even without the threat of bankruptcy, officials in Texas, Oregon, and Rhode Island have challenged longstanding labor agreements.*

Although politicians are afraid to discuss it, most know that a raucous showdown between government workers and taxpayers is but a few years away – and that economics dictates only the taxpayers can win.

[†] An abbreviated version of this study was posted to HumanEvents.com on March 12, 2008.

The New Political Taboo

Events may have forced politicians to acknowledge the looming debt crisis, but none will honestly admit how it is going to resolved -- and, more importantly, which group will be forced to pay the biggest price.

"Touching the third rail of politics" used to mean any attempt to reform the cost of entitlements, especially Social Security. Now, with promised Social Security benefits exceeding revenues by $6.5 trillion, the projected deficit for the Medicare program five times that amount,[1] Medicaid for the poor and indigent currently covering one in every six people, and retirement plans for state and local employees already underfunded by an estimated $300 billion,[2] even politicians point with alarm to estimates showing all levels of government -- federal, state, and local -- barreling toward insolvency.

But while one political taboo has evaporated, it has been replaced by another. Events may have forced politicians to acknowledge the looming debt crisis, but none will honestly admit how it is going to resolved -- and, more importantly, which group will be forced to pay the biggest price.

In spite of statistical projections to the contrary, Democrats like to pretend that state and national budgets can be balanced simply by raising tax rates on the highest incomes.[3] Republicans, for their part, improbably suggest that economic growth will be enough to cover projected deficits, which at the federal level alone total an estimated $65.9 trillion, almost double our current national wealth.[4] What no legislator dares say outright is that the only pot of money big enough to solve the problem is the one that can be wrung from the waste and inefficiency in America's public sector.

Billions of Possible Savings In The Public Sector

In 2005, a *New York Times* investigation found that as much as 40 percent of the Empire state's $45 billion annual Medicaid budget was frittered away through fraud, mismanagement, abuse, and the indifference of Albany lawmakers.[5] Two years earlier, the Yankee Institute for Public Policy did a study for the October/November issue of the *American Enterprise*, which showed that if all 47.6 million U.S. public school children were educated with the same efficiency as private and parochial schools, the cumulative savings annually would be greater than all the state budget deficits combined.[6]

Tantalizing examples of what can be extracted from reorganizing government abound. Public universities, which have already suffered declining taxpayer support over the last two decades, have actually improved their productivity to around 2.5 percent annually -- approximately the same rate as private American industry.

As Chris Edwards of the Cato Institute has demonstrated in his book *Downsizing the Federal Government*, a cost-effective reform of national programs could in fact tame annual deficits.[7] William D. Eggers and Robert Campbell have done a similar study for the accounting firm of Deloitte Touche on the probable impact of private sector efficiencies at the state and local level. After warning of the dangers of ballooning deficits if nothing is done, they argue that the coming fiscal crisis is an unrecognized opportunity, not only to control the cost of regional government, but also to vastly improve beneficiaries' lives.[8]

Tantalizing examples of what can be extracted from reorganizing government abound. Public universities, which have already suffered declining taxpayer support over the last two decades, have actually improved their productivity to around 2.5 percent annually -- approximately the same rate as private American industry. Declining government support led to the elimination of needless bureaucratic overhead, the substitution of adjunct and part-time instructors for tenure-rack faculty, and the redesign of courses to make better use of online technology.[9] In Oklahoma, Medicaid-eligible citizens who repeatedly made expensive emergency room visits were identified and contacted to see if a less expensive approach could be taken to their health care. The result, according to *Governing* magazine, "has been a measurable decrease in chronic use of last-resort medicine."[10]

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Public Sector Unions Will Not Be Helpful

The problem, of course, is that importing these kinds of savings to America will not go down well with public employee unions, which have grown accustomed to extracting generous benefits from politicians. August 2006 data from the U.S. Bureau of Economic Analysis shows that the average federal civilian worker earns $106,579 a year in total compensation, or twice the $53,289 in wages and benefits for the typical private employee. Since 2000, federal pay has risen 38 percent, or double the pay increases for workers in manufacturing, retail, finance, private health care, and construction.

When budget pressures have occasionally forced politicians to make modest demands for increased productivity, the response from public employees has been less than generous.

At the state level, according to the Employee Benefit Research Institute, government workers have been collecting nearly 50 percent more in total compensation than the average private sector employee, with taxpayers subsidizing 128 percent more than private employers to fund health care benefits and 162 percent more on retirement benefits.[12]

When budget pressures have occasionally forced politicians to make modest demands for increased productivity, the response from public employees has been less than generous -- witness the 2005 holiday transit strike in New York City and repeated threats of illegal walkouts by nurses throughout the University of California system. In Nevada, a proposal by former Gov. Kenny Guinn to trim retiree healthcare benefits for any state employee hired after 2006 precipitated a firestorm of protest. Although the law was estimated to save the state $500 million annually, government workers lobbied aggressively to scotch the bill, which ultimately failed in the Carson City legislature.

More worrisome is the ease with which disgruntled union members have resorted to violence, the callous intimidation of co-workers, and life-threatening negligence to get their way. An investigation by the Connecticut attorney general into a strike against state nursing homes found that picketers had removed identification bracelets from Alzheimer's patients, fed chocolate to diabetics, and loosened bolts on lifts used to support elderly patients.[13]

In the state of Washington, the local federation of state employees demanded that legislators in Olympia fire 800 government workers who would not join and financially support the union. Further south, the National Labor Relations Board actually had to overturn an organizing campaign by the notoriously bellicose California Nurses Association because members threatened health workers who opposed the union, telling one his "little kittens would look good in a frying pan."[14]

At the national level, the National Air Traffic Controllers Association has consistently demonstrated a startling disregard for the safety of the traveling public. In its 2006 contract negotiations with the Federal Aviation Agency, NATCA controllers with an average annual salary of $166,000 -- the most senior controllers earning more than cabinet secretaries -- demanded an additional $2.6 billion payout, which left little in the FAA budget to fix the nation's notoriously antiquated air traffic monitoring system.

Politicians' Silence Reinforces Myths About The Debt Crisis

Anticipating the civil strife that will accompany the reorganization of the public sector, most politicians have kept their mouths shut about changes they know are needed: more competition in K-12 education, a reliance on cost-conscious insurance companies to manage government-funded health care, and a sweeping privatization of many other government services. Their silence may be understandable but its effect is to sustain the three myths obscuring the public's understanding of how the debt crisis will inevitably end.

Anticipating the civil strife that will accompany the reorganization of the public sector, most politicians have kept their mouths shut about changes they know are needed.

Myth #1: The debt crisis will be resolved by trimming Social Security, Medicare, and Medicaid benefits.

Not likely. According to the Congressional Budget Office,[15] Social Security accounts for 40 percent of the income of people over 65, and a quarter of all baby boomers have failed to accumulate any significant savings.[16] Voters who agreed to wage deductions on the grounds that average people can't be trusted to save for their retirement needs will have zero tolerance for politicians who say "oops -- we aren't so good at managing your money either."

Furthermore, as director of the Congressional Budget Office Peter Orszag pointed out, Social Security by itself does not contribute nearly as much to the nation's fiscal gap as many believe. He notes that spending on Social Security is slated to increase just 2 percent of gross domestic product (GDP) over the next 30 years,[17] an amount that can be reduced further with incentives for later retirement.

As to the much larger problem of shortchanging retirees and the disabled on promised medical services or reforming the government's inefficient health care system, the voting public has clearly signaled its preference. When Viewpoint Learning teamed up with the conservative Heritage Foundation and the more liberal Brookings Institution (as well as with the Concord Coalition) to survey average Americans on how to resolve the looming debt crisis, participants overwhelmingly favored a more efficient use of tax dollars.[18]

Myth #2: The debt crisis will be addressed by allowing inflation to rise high enough and long enough to solve the problem.

While it is true that, historically, government tends to bridge the gap between income and expenditures by printing more money, America's last experience with rapid currency devaluation -- at the end of President Carter's only term in the late 1970s -- is too recent.

The many millions who remember ballooning mortgage interest rates, shrinking savings, and soaring prices for everything from gas to groceries include seniors who are now on fixed incomes and who are also the fastest growing and most politically astute segment of the population. When aggrieved, seniors not only vote in disproportionately high numbers, but have the time and ability to organize effectively.

Among serious economists who study government deficits there is a remarkable consensus on the deadline by which politicians will finally be forced to take serious action: by the end of the next president's first term -- in other words, by 2012.

Additionally, the resolution of the looming fiscal crisis is not some far-off event that would let a modest annual erosion in the value of the dollar do its cumulative work. While financial journalists seem to enjoy predicting the confiscatory tax rates needed 50 years from now to finance government promises, Moody's Investor Service has said that the U.S. government is on track to loose it's "triple-A" credit rating within a decade.[19]

"Never mind the widely publicized and far-off dates when trust funds go broke," warns *Barron's* editor Thomas G. Donlan.[20] Among serious economists who study government deficits there is a remarkable consensus on the deadline by which politicians will finally be forced to take serious action: by the end of the next president's first term -- in other words, by 2012.

Myth #3: The debt crisis will be solved by substantially raising taxes on everyone, not just "the rich."

One of the few constants in American economic history is that federal revenues as a percentage of GDP have ranged from 16.1 percent to 20.8 of GDP, with the average being 18.5 percent.[21] Anything much above this band means consumers will have less money to travel, to finance new cars, to mortgage home purchases and improvements, to get an education, or to enjoy recreational activities -- and the economic miracle known as the United States of America begins to wobble.

Already average lifetime net tax rates on middle and upper earners, who supply the vast majority of government revenues, are at the high end of the spectrum.[22]

Add to this the fact that our current standard of living has become heavily dependent on consumers having access to a pool of cash beyond their regular take-home pay: stock market profits from the 1980s through the 1990s and, more recently, borrowings against dramatically increased home values. This so-called "wealth effect" has been aptly described by economist Robert Samuelson as a "powerful jet afterburner," which has boosted the economy for over two-and-a-half decades.

Today, with both the stock market and housing market falling, the last thing the national economy needs is a reduction in disposable income. Even many liberal Democrats who advocate surcharges on high income earners concede the need to return the revenue directly to consumers in the form of middle class tax cuts.

The Only Real Solution

If, then, benefit cuts are out -- and inflation will not help -- and taxes, if anything, will have to be reduced, then how will politicians finally cope with ballooning deficits?

At some point in the next few years, after all the possible delays and shuffling of funds have been exhausted, lawmakers will have to extend the productivity revolution, which began with corporate America under Ronald Reagan, to the sprawling public sector. Public employee wages and benefits will also have to be brought in line with private industry. Anticipating these changes, the Government Accounting Standards Board, a widely respected not-for-profit organization that sets government financial reporting standards, has suggested that states and cities report the long-term obligations and annual costs associated with retiree health insurance and other post-employment benefits (GASB statement 45).[23]

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Given the salience of health care in the current presidential campaign, change at the federal level will probably start with legislation turning Medicare and Medicaid into subsidized health insurance, allowing companies to enforce the kinds of efficiencies politicians cannot. Good bets for the first major overhaul of the states include a merit-based pay scale for teachers and pensions for public employees that more closely resemble private sector plans.

Initially, government unions will resist any and all such reforms with every tool at their disposal: demonstrations, radio and television ads funded by member dues, and regrettably the threat -- occasionally materializing -- of violence. Already public employees are engaged in a furious effort to fortify their numbers by organizing a new class of employee: child care providers, home health aides, and others who are not employed directly by government, but whose salaries are reimbursed through entitlements.[24]

Why Public Employee Unions Will Not Win

But as time goes on, union leaders will discover that their leverage is not strong enough to prevent needed streamlining of the public sector. Certainly, as the historical background to labor's obstinacy becomes clear, average citizens will muster little sympathy for a faction that in the past has demonstrated so little sympathy for them.

A recent analysis by the Wisconsin Legislature found that during the entire four-year period when states were struggling to cope with a loss of revenue from the 2000 stock market meltdown -- pleading with taxpayers to understand why government fees had to go up, while college scholarships and other popular benefits declined -- unions forced a succession of relaxed retirement rules and pension enhancements through all 50 statehouses. From 2001 to 2004, New Jersey alone approved 17 new public employment benefits, costing its taxpayers an added $6.8 billion.[25]

There may once have been a time when low wages and few benefits gave government workers the right to voter sympathy; but today we live in a world where, according to the National Compensation Survey, school teachers make more in wages and benefits than private sector engineers, architects, and computer scientists -- at the same time keeping their ten weeks of summer vacation.[26]

In the words of* Detroit News *columnist Thomas Bray, those who make their living though government are "living in a dream world, insulated from reality" by the illusion of an unshakable stranglehold on vital services.

Neither will the public be happy to learn that the price tag for previous concessions to labor will be much higher than even the official estimates. According to a December 2007 study by the PEW Center on the States, the under funding of public employee retirement benefits is "about $731 billion."[27] In some states, including Connecticut, Delaware, and Hawaii, the per capita liability already exceeds $5,000.[28]

Government employees will also find that the march of technical innovation has greatly reduced their ability to extort concessions by shutting down vital public services. Television coverage of the New York City transit strike naturally focused on the hordes of stranded subway commuters forced to walk to work across the Brooklyn Bridge or cram uncomfortably into mandatory car pools, but thousands of others were able to do their jobs electronically from home with relative ease.

In a world where an Internet course can substitute for a live teacher, where technology is cutting the length of hospital stays and allowing medical centers in other countries to compete for American patients, where electronic surveillance systems replace the need for many police, where faxes, e-mails, and teleconferencing can reduce the need for personal interaction, and where Web-enabled technology can ease the impact of government workforce reductions, the bargaining position of monopoly labor is slowly but surely eroding.

In the words of *Detroit News* columnist Thomas Bray, those who make their living though government are "living in a dream world, insulated from reality" by the illusion of an unshakable stranglehold on vital services.[29]

Finally, government unions will find themselves in a Catch-22 situation, where the only kind of action local governments can take to maintain high levels of inefficient spending -- sell off public assets such as toll roads, toll bridges, and airports to private investors -- means a decline in the public workforce that services these assets. Already, Chicago mayor Richard Daly has raised cash for his city by selling off the automobile Skyway for $1.8 billion and downtown garages for another half-billion. He's now trying to sell Midway Airport for an estimated $3 billion.[30]

Eventually, many public employees will see that they too have a vested interest in the productivity adjustments necessary to resolve the debt crisis, especially at the local level where state legislatures have considerable latitude to restructure failing municipalities. Consider what happened after the third largest city in Massachusetts, Springfield, flirted with default and was placed under the autocratic thumb of the state's Finance Control Board (FCB) in June of 2004. Almost immediately more than 500 administrative, teaching, and paraprofessional positions in the schools were eliminated; there were unilateral cuts in cost-of-living benefits to retired city employees; salary schedules for new government hires were reduced; and the school day was lengthened. The board then moved to eliminate caps on school class sizes, link teacher compensation to student test scores, sell public golf courses, and require agencies that benefit from local government to pay fees in lieu of taxes.[31]

Eventually, many public employees will see that they too have a vested interest in the productivity adjustments necessary to resolve the debt crisis.

Across the country, America's seventh largest city, San Diego, California, provides an ominous example of what public employees can expect if they fail to provide voters with more value for their tax dollar. When the dark clouds of bankruptcy appeared in 2005, this Democrat-dominated city elected a Republican mayor, who refused to impose new taxes. Instead he immediately pushed laws to require voter approval for any pension benefit increases and to allow landscapers, mechanics, and contractors in the private sector to bid for municipal business.

Doing The Unthinkable: Scaling Back Union Contracts

If successful, this action could create the legal framework for revoking public employee contracts in every jurisdiction where the dominant political party is unduly influenced by government unions.

And something else happened, which could further persuade labor leaders to make needed productivity concessions. Discovering evidence for criminal collusion between previous administrations and the public unions, city attorney Michael Aguirre, a self-described "liberal Democrat," brought suit in federal court to have worker benefits granted since 1996 rolled back on grounds that they violate conflict-of-interest laws.[32] If successful, this action could create the legal framework for revoking public employee contracts in every jurisdiction where the dominant political party is unduly influenced by government unions.

Conflicts-of-interest aside, it turns out that not all guarantees made to government workers are as ironclad as generally supposed. Many policymakers are quietly challenging long-standing labor agreements, notes *New York Times* reporter Mary Williams Walsh. "Financially troubled San Diego is the highest-profile example, but a handful of states, cities, and smaller government bodies have also found ways to scale back existing promises and even shrink some current payments."[33]

Voters in Houston have taken advantage of a clause in the Texas constitution, which allows towns and cities to opt out of pension agreements. A federal appellate court affirmed that Oregon could stop paying a guaranteed 8 percent per year to pensioners with individual accounts; and in Rhode Island the legislature cut pensions for everyone with less than ten years of service -- about 11,300 people.

In the San Francisco Bay city of Vallejo, unions were forced to defer half of the $3.5 million in buyout packages owed to 21 recently retired police officers and firefighters in order to forestall municipal bankruptcy. Active personnel also accepted a reduction in recently granted salary increases.[34]

The fall of the Berlin Wall may well prove the best metaphor for the coming struggle.

Officials may not yet be ready to touch the new "third rail" of politics, but the looming fiscal crisis makes a showdown between government workers and other voters inevitable. The conflict will begin within a few short years, and at times it will be loud and raucous. But if Americans will not suffer the tyranny of an English king or of the Robber Barons or of racial discrimination, they will certainly not become the economic slaves of their public sector.

The fall of the Berlin Wall may well prove the best metaphor for the coming struggle. The economic and social reforms that liberated Eastern Europe appear, in retrospect, both necessary and inevitable. Yet right up until their astonishingly rapid implementation, their prospects were obscured by ideology, propaganda, and the fearsome posturing of the bureaucratic order.

[1] Arnold Kling, *Crisis of Abundance*. Washington, DC; Cato Institute; 2006, p. 86.

[2] This statistic becomes even more worrisome, when we read two footnotes: first, the usual standard for determining whether public plans are adequately funded assumes an optimistic 8percent annual return on investment. Second, in the case of public school educators, retirement benefits are based on the average income of the highest few years, while the actuarial tables used to calculate post-retirement benefits assume the average salary of all teachers. According to E. J. McMahon of the Empire Center for New York State Policy, the nation's real public pension funding shortfall ranges "from an added $500 billion for state retirement systems to at least $1 trillion for all public systems." See E. J. McMahon, "Public Pension Price Tag," *Wall Street Journal*. (August 21, 2006), p. A10.

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[22] L. Kotlikoff, "Is the United States Bankrupt?" *Federal Reserve Bank of St. Louis Review* (July/August 2006), p. 340.

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[25] Dennis Cauchon, "Public Workers' Pensions Swelling," *USA Today*. (January 17, 2006), p. A1.

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[28] K. Barrett and R. Greene, principal authors, *Promises with a Price*. PEW Center on the States, Philadelphia, 2007, p. 7.

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[31] For more on the Springfield Finance Control Board, go to http://www.springfieldcityhall.com/COS/Services/control_board.htm.

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P.O. Box 260660
Hartford, CT 06126-0660
(860) 297-4271
www.yankeeinstitute.org
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