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Business Roundtable Study Deeply Flawed

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The Ohio Business Roundtable recently issued a study regarding public sector compensation that is deeply flawed. This memo outlines some of the more egregious claims in the study, which was conducted by Andrew G. Biggs and Jason Richwine of the American Enterprise Institute.[i]

Before getting into the problems with the study, we reiterate what more reputable work has previously found: public workers in Ohio and elsewhere are slightly underpaid in comparison to private-sector workers with similar levels of education and experience. Public workers are far more likely to have a 4-year college degree, and to have masters, professional or doctoral degrees beyond college. Nearly half (49%) of full-time public employees have a 4-year degree and 23 percent have masters, professional (legal, accounting or similar) or doctoral degrees. In contrast, only 26 percent of private sector workers have even a 4-year degree.[ii] Taking all full-time workers together, the average salary is about $47,000 in public sector and about $46,000 in private sector (numbers you won't find in the Biggs and Richwine study – they never cite the actual compensation numbers). But if you control for education, looking at just those with at least a 4-year degree, salaries are still about $46,000 a year in the public sector compared to about $62,000 in the private sector.[iii]

Biggs and Richwine also find that public worker wages and salaries are lower than those of comparable private sector workers. This is the aspect of their study that is easiest to comprehend and that is most compatible with numerous other studies on the issue, including a new one from the Boston College Center for Retirement Research.[iv]

They then use a series of calculations – some that are difficult to comprehend or follow, some that rely on sourcing that can't be verified, and some that rely on double counting – to conclude that benefits in the public sector are equal to 87.7 percent of salaries and that benefits are equal to 39.5 percent in the private sector. Both of these conclusions defy common sense for anyone who has ever managed a public or private workplace or examined costs of benefits. These numbers differ dramatically from costs faced by employers – public or private – because Biggs and Richwine attempt to assess the value of compensation to workers, rather than the cost of paying workers. This is mysterious, since the purported goal of SB-5 is to save public money, not to punish public workers. It is also curious because costs are often relatively easy to measure, whereas measuring benefits perceived by recipients requires numerous judgment calls.

The authors put a value on "job security" of about 9.3 percent. As workers and community members, we want security for public and private workers - it's a good thing if Ohioans who are doing their jobs don't expect to be made jobless. But neither public nor private sector workers have security. Since peak public sector employment in Ohio in September 2006 more than 36,000 state and local public sector employees in Ohio have lost their jobs, and with 50% cuts to the local government fund and $2 billion

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less in school funding in this budget, those casualties are about to get higher. Ask school social workers and nurses in Cleveland if they feel secure – all the social workers and half the nurses were just dismissed. Biggs and Richwine argue, however, that because unemployment is higher in the private sector, that lower public sector unemployment is worth a wage premium of 10 percent. This means that a salary of $40,000 would actually be valued at $44,000 because of this lower unemployment. It is odd to monetize this in this way and in fact there is no evidence that the private sector delivers higher wages to those in less-secure jobs – for example retail is both low-paid and subject to high levels of layoffs. Their methodology is difficult to follow, but they begin by estimating that the value of lower unemployment is equivalent to 1.8 percent of pay, then inflate it through a process of repeated multiplication in order to take into account that public sector workers are supposedly better compensated and therefore value keeping their jobs more. This eventually becomes the 9.3 percent figure. They follow this by making a minor rounding error to get 10 percent in their summary statements.

Biggs and Richwine arbitrarily reduce the value of Social Security, in order to make private sector compensation look lower, and arbitrarily inflate the value of pensions, in order to make public compensation look higher. Any private employer knows that she must pay 6.2 percent of salaries (up to $106,000) for Social Security. They instead calculate that the value of Social Security is only 2 percent of salaries. They provide a convoluted rationale for this[v] – again relying on the notion that they are not measuring the simple cost to employers, which is not in dispute, but that they are measuring the benefit to workers, which they claim should be lower. They also seem to undervalue private sector contributions to pensions. It seems likely that the main rationale for both of these is to make private compensation appear lower.

Further, instead of using what public employers actually pay into public pensions, they use a different number that is substantially higher. They inflate the present cost of future benefits, by assuming that pension fund assets will earn a very low rate of return. Instead of using a conservative measure based on the realized returns over the past few decades, which is what pension funds and estate planners do, Biggs and Richwine argue that one must calculate the future value of pensions using the rate of return on U.S. treasuries, which they estimate at 4 percent over the long term. The difference in present value depending on those two assumptions is immense - $10,000 invested now is worth $1.13 million over thirty years at an 8 percent rate of return (which is what the Ohio public pension fund assumes), but is worth just $560,000 at a 4 percent rate of return. If we assume the 4 percent treasury yield, less than half of what funds have historically earned, we would price the cost of providing that benefit at more than twice as much in present dollars. Interestingly, Biggs himself argued, in an earlier effort to privatize social security, that it is appropriate to assume a rate of return well above that of treasury bonds.[vi]

To further inflate the value of public compensation, they calculate a value for retiree health care, which they add to all public worker compensation and which it appears they don't add to any private worker compensation (they say, on page 15, "we do not attempt to calculate the value of retiree health care for private sector workers"). This is erroneous. Public workers do **not** all get retiree health care. The Medical Expenditure Panel (MEPS)[vii] reports that 36.4% of state and local governments provide health insurance to retirees under age 65 and 25.4% provide health insurance to retirees over age 65. Further, many large private sector firms **do** provide health benefits to retirees: 34.5% of private firms with more than 1,000 workers provide such benefits to those under age 65 and 31.8% of such firms provide them to those over age 65 – Biggs and Richwine themselves acknowledge this on page 14. In addition to calculating that all public workers get this benefit, when some do not, and that no private workers get this benefit, when some do, they "gross up" (their words) the value of this benefit from what they claim is 3.86 percent (possibly already inflated, we could not replicate that figure and could find only a lower one in their source) to 6.3 percent of salaries (see page 16), based on how much this insurance might

cost in the individual market, which is irrelevant.[viii] Last but not least, the cost of public worker retiree health care is already figured into pension costs – public employers pay for retiree health care when they pay for pensions so it is not appropriate to add an additional value for this. This relies again on their logic, repeated throughout, that they are not assessing costs that employers pay – a relatively transparent thing to measure – but benefits to workers, something that is subject to numerous judgment calls.

Despite all of the flaws detailed above, the authors indulge in an additional double count that further inflates their claim of differential compensation. As mentioned, they claim that public sector wage and benefit premium is 31.2% and that job security is worth 9.3%, and then they say that raises the total public sector pay premium to 43.4%. Even that simple addition appears to be off by 2.9 percentage points. They include an explanation in a footnote but their calculations and reasoning remain opaque.

In short, the Biggs and Richwine analysis works in numerous ways to make private sector workers appear to be paid less and to make public workers appear to be paid more. Much of the analysis rests on their curious decision to assess the value of compensation to workers rather than the much more transparent cost of compensation to employers. This enables them to engage in much harder-to-follow calculations. Their final findings defy common sense. The paper is not a reasonable basis for policy-making or policy discussion.

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[i] "Public vs. Private Sector Compensation in Ohio: Public workers make 43 percent more in total compensation than their private-sector colleagues", by Andrew G. Biggs and Jason Richwine, September 14, 2011, Ohio Business Roundtable.
[ii] Keefe, Jeffrey, "Are Ohio Public Employees Overcompensated", EPI Briefing Paper #296, February 2011, available at http://www.epi.org/page/-/old/briefingpapers/BriefingPaper296.pdf
[iii] ibid
[iv] See for example work by Alice Munell and others at the Boston College Center for Retirement Research available at http://crr.bc.edu/briefs/comparing_compensation_state-local_versus_private_sector_workers.html; John Schmitt at the Center on Economic Policy Research at http://www.cepr.net/index.php/publications/reports/wage-penalty-state-local-gov-employees/ ; work by National Institute on Retirement Security and the Center for State and Local Government Excellence and conducted by University of Wisconsin – Milwaukee economists Keith Bender and John Heywood, which compared twenty years of publicly available data from the U.S. Bureau of Labor Statistics, at http://www.nirsonline.org/storage/nirs/documents/final_out_of_balance_report_april_2010.pdf; the previously mentioned Keefe study; and "Public sector compensation lower than that of comparable private sector workers: A literature review", June 15, 2010, at http://www.policymattersohio.org/pdf/PublicSectorWorkers2010_0615.pdf
[v] They claim the adjustment is justified because some Social Security contributions go toward paying legacy costs--the cost of paying benefits for the earliest beneficiaries. Citing a study on "money's worth ratios," they also implicitly adjust for the fact that higher-income workers are less likely to receive survivor and disability benefits. Aside from the fact that it is employer costs, not the supposed value of benefits received, that really matters, Biggs and Richwine are selective in making such adjustments when it comes to Social Security. Specifically, they do not attempt to compare the value of Social Security insurance coverage to the cost of obtaining equivalent disability and life insurance in the private market, as they do with retiree health care.
[vi] Biggs, Andrew. 2002. "The Stock Market and Social Security Reform." Cato Institute, cato.org.
[vii] U.S. Department of Health and Human Services (DHHS)/Agency for Health Care Research and Quality (AHRQ) and National Center for Health Statistics (NCHS) Medical Expenditure Panel Survey (MEPS).
[viii] A major reason for the cost difference between individual and employer-sponsored insurance is selection bias—sick people are more likely to buy insurance. This has nothing to do with how much this insurance costs public employers or even with how much workers value this insurance.