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Perspective

Rethinking the Role of the Profession on Public Sector Compensation

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It is understandable that public employees would be defensive when it comes to discussions about public sector pay and benefits. The financial crisis and associated media attention have placed public sector employment and, more specifically, compensation for public sector workers under the microscope. In some cases, the media has sensationalized the topic of public sector pay. However, in other cases, the media has simply chronicled the differences in benefits between the two sectors. While wage comparisons between the public and private sectors are often mischaracterized and fail to account for many differences in education and job type, the divide between the two has narrowed considerably. Disagreements on pay and total compensation comparison studies vary because of different approaches, methods, and data.

Instead of constantly defending postretirement benefits and arguing that public sector employees are paid less than their private sector counterparts, I would like to suggest that the public administration profession take the lead in reforming public pay and benefits. If public managers, along with elected officials and employee and union groups, do not comprehensively address this issue, fed-up citizens will head to the ballot box, and their remedies will likely be much more punitive and draconian than any legislation or policy changes. Our field has been slow to lead in this area.

Most public pension plans guarantee retirees a set income for the rest of their lives, indexed for inflation. In addition, many public employees have access to subsidized retiree health care that requires little or no co-payment. These types of benefits have mostly disappeared in the private sector. The recession quickly devalued the nation's retirement accounts, as many pension funds and 401(k) plans suffered significant losses. Recently, voters in San Jose and San Diego overwhelmingly approved ballot measures on public pension overhaul. The supermajorities on these ballot initiatives suggest that there may not be much sympathy for preserving pensions and other retiree benefits for public employees when most private sector

taxpayers will never earn comparable benefits for their own retirements. As the public has become aware of the more generous benefits packages that public workers receive and as states, counties, and cities have been forced to cut vital services such as police, fire, education and safety-net programs to meet their pension obligations, taxpayers' resentment has grown.

According to the Pew Center for the States, state and local governments are facing huge pension and retiree health care obligations that have significantly contributed to their financial challenges—nationwide unfunded liabilities for pension and retiree health care range anywhere from \$1.4 trillion to more than \$3 trillion, depending on the assumptions that one uses. Pension and health care costs for retirees have risen faster than inflation, for several reasons. Retirees are living longer, and low interest rates have drastically reduced the returns on pension funds used to pay benefits. Further, many of the promises made to public employees are simply not sustainable, and many jurisdictions are struggling to make payments into these systems, leaving less each year to spend on core governmental services. The recession was not the primary cause of the pension and retiree health care problem, but it contributed to it by reducing the value of investments. In some cases, states and local governments have shifted limited money away from paying their full share of pension costs and instead diverted funds to pay for more immediate concerns. When they fall behind in their retirement contributions, they have to come up with even more money later on to make up the difference in lost investment from the diverted contributions.

The adoption of many pension and postretirement benefits has occurred within a tight circle of individuals (elected officials, public managers, and union and employee groups) largely out of the public view. These groups have often failed to insist on transparency. Union and employee groups have enjoyed considerable influence with legislators on this issue, and public managers often benefit from the very contracts they

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negotiate. The practice of providing deferred compensation has been carried out in ways that often hide a full accounting of the costs from the public and push a significant amount of the costs onto future generations of taxpayers, elected officials, and public managers. The result has been to transfer current fiscal deficits into future debt, with interest.

At least 40 states have recently enacted some type of pension reform. Many have fallen short of comprehensive reform, and a significant number of local governments responsible for their own pension systems have failed to enact any meaningful reform, including, for example, eliminating basic anti-abuse provisions. Further, the majority of legislation has not included retiree health care reform and has focused only on new employees. Most of the changes will not result in any budget relief for decades.

The field of public administration should be at the forefront, driving the reform agenda and discussion. I suggest four areas in which we could move in this direction.

1. **Transparency.** Our field must insist on transparency in the adoption of public pay and benefits, including an independent analysis of the current cost of any pay or benefit increase, as well as how future costs will be paid for and managed.
2. **Shared pension (and retiree health care) costs.** Similar to Social Security and defined contribution plans, there should be equal employee/employer contribution. Allowing public employees to take reduced pay increases in lieu of sharing in the cost of pensions is problematic and allows for a good deal of gamesmanship. If the pension rate goes up 2 percent and the employee gets a 3 percent cost-of-living adjustment, does that mean he or she would otherwise have gotten 5 percent? The reality is that in many jurisdictions, the public employer has largely picked up employee contributions. Courts have generally held that existing pension benefits are

protected, but increasing existing employees' contributions is generally permissible, which can significantly address a portion of the current underfunding.

3. **Hybrid and cash-balance pension plans.** Our field should take the lead in designing hybrid plans that combine elements of existing defined-benefit plans with a new 401(k)-style system in which money is invested on behalf of the retiree. The Federal Employee Retirement System has adopted such a model. Under cash-balance plans, workers get an individual retirement account to which both the employee and the employer contribute while the employer guarantees a minimum return. These plans have the potential to increase active participation of public employees in retirement planning while transferring some of the risk away from the taxpayer. Moving public employees to these type systems will also allow portability of these benefits so that they can follow workers if they choose to switch jobs and move to the private or nonprofit sector or to another public sector job.
4. **Retirement security for all.** Our field can use the increased national attention on public employee benefits to expand the conversation on the need for retirement security for all Americans. According to data from the Federal Reserve, U.S. Census Bureau, and Internal Revenue Service, 25 percent of American families have no savings at all, and the average amount saved for retirement is \$35,000. Our nation is not adequately prepared to deal with this retirement security crisis.

Ultimately, real reform needs to extend beyond the pension problem to consider how we compensate, manage and reward public employees. The deficits created in state and local budgets by unsustainable promises to public employees will continue to manifest themselves unless broader civil service reforms are enacted. The current scrutiny of public pay presents a unique opportunity for our field to lead on public pension policy instead of defending the past.