Policy Analysis

No. 645 September 28, 2009

Vallejo Con Dios

Why Public Sector Unionism Is a Bad Deal for Taxpayers and Representative Government

by Don Bellante, David Denholm, and Ivan Osorio

Executive Summary

Rates of unionization in the United States today are at historic lows and are unlikely to rebound. However, there is one sector in which organized labor is growing in strength: government. This has severe implications for the future of public finances for state and local governments across the nation, and for the nature of organized labor itself.

High rates of unionization in the public sector have led to very high labor costs in the form of generous collective bargaining contracts. Now state and local governments are under increasing financial pressure, as a worsening national economy has led to decreased revenues for states and municipalities—many of which remain locked into the generous contracts negotiated in more flush times. Thus, as businesses retrench, governments find themselves in a financial straitjacket. In addition, as government unions grow stronger relative to private-sector unions, their prevalence erodes the moderating influence of the market on the demands that unions make of employers.

Now, as an economic downturn threatens state and local government revenues, officials who want to keep their fiscal situations under control would do well to look skeptically at public-sector bargaining—especially since the existing political checks on it have proven ineffective. Public officials should eschew public-sector bargaining when possible, or at the very least, seek to limit its scope.

As keepers of the public purse, legislators and local council members have an obligation to protect taxpayers' interests. By granting monopoly power to labor unions over the supply of government labor, elected officials undermine their duty to taxpayers, because this puts unions in a privileged position to extract political goods in the form of high pay and benefits that are much higher than anything comparable in the private sector.

This paper shows how the unionization of government employees creates a powerful, permanent constituency for bigger government—one that is motivated, well-funded, and organized. It also makes some recommendations as to how to check this constituency's growing power—an effort that promises to be an uphill struggle.

Don Bellante is professor of economics at the University of South Florida. David Denholm is the president of the Public Service Research Foundation, a nonprofit organization that studies unions and union influence on public policy. Ivan Osorio is editorial director and a labor policy researcher at the Competitive Enterprise Institute.

CATO INSTITUTE

High rates of unionization in the public sector have led to very high labor costs in the form of generous collective bargaining contracts.

Introduction

Rates of unionization in the United States today are at historic lows, and unlikely to rebound. According to the federal Bureau of Labor Statistics, union membership stood at 12.4 percent of the nation's workforce as of the end of 2008.[1] However, there is one sector in which organized labor is growing in strength: government. This has severe implications for the future of public finances for state and local governments across the nation, and for the nature of organized labor itself.

High rates of unionization in the public sector have led to very high labor costs in the form of generous collective bargaining contracts. Now state and local governments are under increasing financial pressure, as a worsening national economy has led to decreased revenues for states and municipalities—many of which remain locked into the generous contracts negotiated in more flush times. Thus, as businesses retrench, governments find themselves in a financial straitjacket. In addition, as government unions grow stronger relative to private-sector unions, their prevalence erodes the moderating influence of the market on the demands that unions make of employers—throughout all of organized labor.

Unlike businesses, governments face little incentive to hold down labor costs. Politicians and bureaucrats, however, do have an incentive to gain public approval in order to secure their positions. Many public-sector employees are employed as police, firefighters, and paramedics—public services that people genuinely want and need, while many others are administrative bureaucrats whose work is not as visible to the public. Thus, when the workers who provide those services are unionized, government officials have a strong incentive to give unions what they want, rather than risk incurring the public's wrath through the disruption of those services because of strikes. As long as public services continue to function, the public has little incentive to pay attention to the cost. This means that public-sector unions end up getting most of what they ask for, while taxpayers foot the bill. In time, of course, such profligacy catches up to local governments—but by the time they seek to curb costs it is often too late to avert financial disaster.

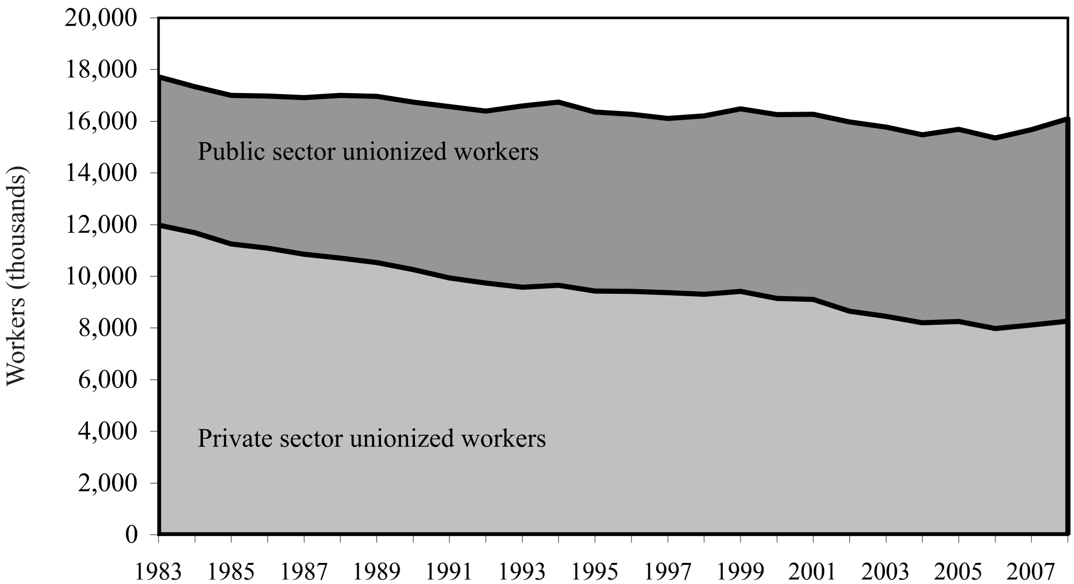
Financial disaster visited the city of Vallejo, California, last year. Vallejo, about 30 miles northeast of San Francisco, declared bankruptcy in May 2008. The city government could not pay the lavish salary commitments it had made to public safety workers under some extremely generous union contracts. Vallejo is an egregious case, but the trends that brought it to financial ruin are present in public sector union negotiations and contracts everywhere. Some states and municipalities are especially squeezed by the fact that, during the 1990s boom years, they had even less incentive than usual to control their own labor costs because they collected increased tax revenues. Now that those boom times have come to an end, those years of profligacy threaten to create severe problems for state and local government finances—and for the taxpayers who foot the bill.

This paper shows how the unionization of government employees creates a powerful, permanent constituency for bigger government—one that is motivated, well funded, and organized. Now, as an economic downturn threatens state and local government revenues, officials who want to keep their fiscal situations under control would do well to look skeptically at public-sector bargaining. They should eschew public-sector bargaining when possible, or at the very least, seek to limit its scope.

Shift from Private to Public

Unionism grew in the private sector as a result of government support through the passage of laws and the establishment of regulatory bodies intended to encourage the expansion of unionism and collective bargaining throughout the workforce. America's first national labor law was the Railway Labor Act of 1926, which was limited to a single industry.[2] The National Labor Relations Act, also known as

Figure 1
Changing Composition of U.S. Organized Labor, 1983–2008 (public, private, and total)



Source: Barry T. Hirsch and David A. Macpherson, "Union Membership and Earnings Data Book," Bureau of National Affairs, chart prepared by the Public Service Research Foundation.

the Wagner Act, enacted in 1935, extended government support of unionism and collective bargaining to private employers. And then came war. During World War II and the Korean War, war labor boards imposed union relationships, including union shops, on many employers in order to ensure continued productivity.

The years following World War II were the golden era of American organized labor. With Europe and Japan devastated, American manufacturers faced little foreign competition. That enabled large industrial firms to provide generous contracts to their unionized employees while passing the costs of those contracts on to consumers with little difficulty. Yet, like the economic prostration of Europe and Japan, this would not last.

The 1948 Taft-Hartley Act, passed in the wake of a public backlash against aggressive union strikes, repealed the Wagner Act's "closed shop" provision. Taft-Hartley gave states the option of enacting right-to-work laws, which bar union membership from being a precondition for employment.[3] In the 28 states that do not have right-to-work laws, unions may still require individual workers to pay "agency fees" allegedly to avoid "free riders"—that is, to cover the costs of representation, which the unions argue benefits both union and nonunion workers at a given workplace.

In the late 1950s, union membership as a percentage of the private-sector workforce began to decline; the shift from private- to public-sector unionism had begun. In 1959, Wisconsin became the first state to enact compulsory public-sector bargaining legislation. Since then, the federal government and most states have instituted compulsory public-sector bargaining schemes. In 1958, when the Bureau of Labor Statistics first began keeping track of public sector union membership as a distinct category, there were only 1,035,000 government-employee union members, or 12 percent of a workforce of about 8.5 million.[4] Between 1958 and 2008, public employment grew by almost 250 percent and government-employee union membership increased by more than 750 percent to 7.8 million. In 2008, 36.8 percent of the government workforce was

Between 1958 and 2008, public employment grew by almost 250 percent and government-employee union membership increased by more than 750 percent, to 7.8 million.

Bosses beholden to their employees are not likely to be accountable to the taxpayers.

unionized.[5] That is nearly five times the rate of union membership in the private sector—7.6 percent—down from a high of almost 36 percent in 1954.[6]

Public-sector unionization is greatest at the local level, where the unionization rate was 42.2 percent in 2008. "This group," notes the BLS, "includes many workers in several heavily unionized occupations, such as teachers, police officers, and firefighters." Of course, while these "heroic" public servants are the ones who are most visible in public disputes over collective bargaining, a large number of unionized state and local employees fall into more mundane categories such as secretaries, middle managers, engineers, administrative law judges, school custodians, and cafeteria workers. According to BLS data, there were 17.8 million state and local government employees, both full-time and part-time, in the United States in 2008 (6.2 million state and 11.6 million local employees).[7] Federal nonpostal employees can unionize under the supervision of the Federal Labor Relations Authority, set up under Title VII of the Civil Service Reform Act of 1978.[8]

As Figure 1 shows, union density in the public sector has been fairly constant since 1983, even as private sector union membership has continued to decline steeply. This lowers the total union density despite the high membership numbers in government employment. This transformation is impacting the internal structure of organized labor in America. Despite the fact that only one in six jobs is in government, more than 48 percent of all union members are government employees. In fact, in many states the majority of all union members are public employees. And now, even some unions that have traditionally focused on organizing private-sector workers are turning their attention to public employees—the Teamsters union, for example, has sought to organize police officers.[9]

These changes have stoked organized labor's already great interest in political activism—and public-sector unions are especially motivated. They are, after all, helping to elect their bosses. In addition to organizing existing jobs in the public sector, these unions are dedicated to increasing the number of jobs in government. That means that they lobby for more government programs and work to elect candidates who will vote for higher taxes to pay for them. Therefore, politically, public-sector unions constitute a permanent activist constituency that works to expand the size and scope of government. And bosses beholden to their employees are not likely to be accountable to the taxpayers, for reasons discussed in later sections.

Agency Theory and Unions in the Public and Private Sectors— Why the Difference?

There is an institutional dysfunction that makes public-sector unionism very costly, beyond the costs that unionization imposes in the private sector. This is due to the economic phenomena explained below.[10]

Both large-scale corporations and government agencies are controlled by managers rather than directly by their respective owners—stockholders in the case of corporations and citizens/voters in the case of government agencies. Many decades ago, the view of some economists was that this separation of ownership and control in private corporations would work to the significant detriment of not only stockholders, but of all of society. This is known as the principal-agency problem. Massive economic inefficiencies would result from a misalignment of managers' and owners' objectives, combined with and exacerbated by the bureaucratization of the corporation.[11] In short, the firm would not be able to sustain the level of innovation and entrepreneurship that characterized the more typical owner-managed firms of an earlier era.[12]

However, these theories have exhibited very little predictive power in the corporate world. What organization theorists refer to as the control problem has been mitigated by instituting practices that limit the extent of agency-related shirking. These practices include the transferability of ownership through the stock market; boards of directors with outside members with concentrated stock ownership; proxy battles; hostile mergers; and other well-established business practices.[13] In regard to labor negotiations between the union and management, mitigation of the control problem results in a lessening of what might otherwise be a tendency toward managerial shirking in collective bargaining. In short, while a union as the bargaining agent for a given number of employees seeks the best terms for them, the firm's management seeks the terms most profitable to stockholders.

By contrast, citizen control through elected officials of the bureaucrats who hire and manage employees, and who negotiate with union officials, is made difficult by the absence of control mechanisms that are characteristic of the private sector. Among these, the transferability of stock provides a mechanism for shifting control away from managers who are ineffective in representing stockholders, including in the area of labor relations. Further, the concentration of ownership that is characteristic of most publicly traded corporations gives at least some stockholders sufficient incentive to monitor the behavior of management, and thus provide substance to the notion that the transferability of ownership gives managers an incentive to act on behalf of stockholders.

The absence of similar controls in the public sector is aggravated by the fact that citizens lack a high degree of control over elected officials, who, in turn, lack a high degree of control over bureaucrats. This does not by itself suggest that public-sector managers will be considerably less resistant to union pressures than their private-sector counterparts. The reasons for less resistance stem additionally from the so-called rational ignorance of voters (and to some degree from voter apathy for any other reason), which gives disproportionate political power and influence to groups that are organized and politically active. One of those groups will be public employees, particularly if they are unionized.

The Weak Checks on Public Employee Unions' Influence

The powers of public sector unions are not unlimited, of course. Two limiting forces that often are discussed in public policy analysis are the "median-voter effect" and the "Tiebout effect."[14] However, they have proven insufficient to check the unions' influence.

The median-voter model posits that elected officials interested in reelection will tend to vote on specific issues in the way that would be preferred by the median voter in each of their constituencies. The Tiebout effect posits that citizens can exercise control over public-sector actions by choosing to reside in the jurisdiction that comes closest to their preferred combination of services and taxes. Citizens can, in effect, "vote with their feet." However, as disciplining devices in collective bargaining, both are of extremely limited effectiveness and arguably irrelevant.

The Median-Voter Model

The hypothetical median voter is the voter whose position on a particular issue places him "in the middle" of a spectrum of voter preferences. For example, if all voters were placed on a spectrum indicating the amount they would wish to spend for public safety, the median voter would be the one whose preference is such that half of the voters prefer less spending, and half prefer more, than he does. The median-voter hypothesis predicts that the political process would tend to produce the amount of spending preferred by the median voter. The median-voter model, although not directly provable, is at least consistent with some outcomes on highly visible single issues—for example, congressional votes on such issues seem to be predictable on the basis of the predominant economic interests of the constituency of a particular member of Congress.

However, the conditions under which the median voter serves as a strong check on matters such as excessive pay are not likely to be met. The effect at its strongest would require

Citizen control through elected officials of the bureaucrats who hire and manage employees, and who negotiate with union officials, is made difficult by the absence of control mechanisms that are characteristic of the private sector.

symmetric—as between voters and officials—and perfect information. In the real world, the presence of imperfect, asymmetric information dramatically reduces the effectiveness of any such effect and leaves no reason to believe that the median voter will be strongly influenced by the presence of any rents received by public employees.[15] The term "rents" as applied to labor markets includes any excessive pay or fringe benefits beyond what is competitively necessary to obtain the desired quantity and quality of labor.

The Tiebout Effect

The Tiebout effect is of less consequence than the median-voter model because its assumptions are more restrictive, and thus more at variance, than real-world conditions. The Tiebout effect hypothesizes that the ability of citizens to leave serves as a disciplining device on public officials. The contention of citizens voting with their feet, and an associated disciplining effect, are likely to be strongest under conditions of perfect information and of perfect and costless mobility. Even if information were perfect, the simple real-estate transaction costs of selling one home and buying another provides plenty of room for successful rent-seeking by public sector union members—in the form of overpayments benefiting them.

In some instances, these may not be the most significant mobility costs. Variation in local fiscal conditions would have to be quite considerable to overwhelm not only transaction costs, but all other factors that affect an individual's choice of residential location. University of Texas at Dallas economist Gerald Scully has demonstrated—both theoretically and empirically—the practical irrelevance (or at least severe limitation) of the Tiebout effect in the presence of the degrees of spatial convergence of average incomes and income distributions that have occurred across the United States. Further, he also demonstrates that such convergence does not limit the excessive growth of government budgets.[16]

The importance of "rational ignorance" in permitting overpayment of public employees—especially in the presence of relatively impotent median-voter and Tiebout effects—is illustrated in the public choice approach to public sector behavior. Voters are said to be rationally ignorant in the sense that the time and money costs of being fully informed of proposed legislative and bureau actions are prohibitive. For example, it is not unusual for the number of bills proposed in a year before a state legislature to number in the thousands. That would make it impossible for a voter to be fully informed, since being informed about even a small fraction of such matters would require the voter to spend most of his or her waking hours acquiring information. Indeed, one cannot reasonably expect legislators themselves to be fully informed of all bills proposed by their colleagues.

Visible Benefits, Dispersed Costs

The public choice literature contains many arguments to the effect that a politician's chances of reelection are enhanced by the provision of "political goods." The recipients of the political goods will be inclined to reward the politician providing those goods with their votes, while the bearers of the corresponding tax burden—unless they are also beneficiaries—will be more inclined to reward his opponent. Thus, it is in the interest of a politician seeking office or reelection to offer a package of programs or policies that is sufficient to build a majority coalition—by making the benefits highly concentrated and visible to its beneficiaries while making the costs vague and widely dispersed—and thus, veiled from the taxpayers. To the extent that the median-voter effect operates to any extent, both political opponents will tend toward the same strategy.

One likely and persistent element in the package will be higher-than-necessary wages to public employees.[17] These rents will be clearly understood by the recipients, and as long as the costs are borne out of general revenues, they will be largely unknown to the rationally ignorant public despite the best efforts of journalists, public policy think tanks, and other propagators of information. Even if public-sec-

It is in the interest of a politician to offer a program whose benefits are highly concentrated and visible to its beneficiaries while making the costs vague and widely dispersed—and thus, veiled from the taxpayers.

tor wages and salaries were known, the rent component would not be evident; and even if that component were well known, its impact on any one taxpayer might seem sufficiently small so as to not be a deciding factor in determining voter choice, and even less so in fostering a Tiebout-type reaction.

Politicians can further shield themselves from public scrutiny by back-loading the rents paid to their union supporters, so that they come due at a later time, when they will be somebody else's problem. One common way of doing this is through highly generous pension packages. University of Chicago law professor Richard Epstein describes public sector collective bargaining negotiations as "an unfair match" between taxpayers on one side and public officials and unions on the other. "The state, county, and local government officials don't face the certain wrath of shareholders," says Epstein. "Rather, they operate in uncertain political waters that allow them to escape voter wrath by granting public employees highly favorable, but less visible, pension packages that become payable only down the road."[18] The consequences of this can be dire. Epstein goes on:

> So what happens in bad times? First, no public employee loses either a job or a dollar in pension benefits. Ordinary citizens lose two ways: jobs are cut—unemployment in California just hit 10%—and taxes are raised. What makes this pill all the more bitter is that unions happily wave the libertarian banner of freedom of contract to lock in the status quo. Public unions point to court cases that require the state to honor its employment contracts just like other agreements. Translation: the downturn is everyone else's problem.[19]

Public Sector Unions' Ratchet Effect on Labor Costs

While it is true that in both the private and public sectors unions raise wages above what they otherwise would be through collective negotiations, such negotiations in the public sector proceed in a different environment from those in the private sector. Bureaucrats tend to know more about the demands of elected officials for the output of a government agency than the legislators know about that same agency's cost structure. This informational asymmetry weakens elected officials' control of the agency, and again, citizen control of elected officials is in turn weakened by the same asymmetry of information.

The underlying incentive of the bureaucrat is normally the growth of wages and employment.[20] With public employees constituting a significant interest group in any community, there tends to develop a symbiotic relationship among elected officials, bureaucrats, and public employees. Public employees have been found in a number of studies to be upward of 40 percent more likely to vote than private-sector employees.[21] Public employees do not have to be unionized in order to influence elected officials. However, if they are unionized, it will be easier for bureaucrats and elected officials to communicate with them, and as a group they will have significantly greater political clout. Thus, public employers should not be expected to be as antagonistic toward the formation of unions as their private-sector counterparts. In the public sector, government managers and union negotiators are in effect double agents of government bureaus and of their unionized employees.[22] Government employees are likely to be interested in the growth of public-sector employment because such growth enhances their political clout.[23]

There is abundant evidence of a tendency in a unionized setting for growth in employment to compound the tendency to create rents in negotiated pay levels.[24] Existing research also indicates that there is a tendency for state and local employment to ratchet upward with each business cycle. Interestingly, the ratio of state and local employment to private-sector employment tends to change little outside of a recession. While cuts in state and local government employment are highly pub-

There tends to develop a symbiotic relationship among elected officials, bureaucrats, and public employees.

licized during an economic downturn, the fact is that they are small relative to cuts in the private sector. But once recovery is underway, employment growth in state and local governments is just about the same as in the private sector.[25] This evidence is consistent with the double-agent relationship as suggested above.

Public Sector Rents

Empirical studies on differences in public and private wages are numerous, beginning with economist Sharon Smith.[26] However, few of these have distinguished between state and local levels of government; separately examined union and nonunion members; or taken into account fringe benefits differences and the financial value of sectoral differences in job security. Apparently, none have done all three.[27] Virtually all of the studies that examine wages conclude that public-sector employees obtain higher wages than their private-sector counterparts, with the degree of rent-containing wages generally being highest at the federal level and lowest at the local level. "Counterparts" means workers with comparable levels of education, experience, and other characteristics commonly examined in human capital studies. Studies that do not control for human capital and other productivity-related characteristics are potentially misleading and thus, inappropriate in public-private comparisons.

Virtually all of the studies that examine wages conclude that public-sector employees obtain higher wages than their private-sector counterparts.

Of those that do control for them, one of the earliest studies (using 1975 data) to take fringe benefits and the incidence of unemployment into account is by Don Bellante and James Long, although their study does not distinguish between union and nonunion employees.[28] The study found that on the basis of hourly pay alone, there was not a significant difference between local-government employees and comparable workers in the private sector. However, adding in the significantly higher value of fringe benefits received at that time by local-government workers gave a slight advantage to local public employees. Further, adding in the effect of differential probability of unemployment spells on expected annual earnings raised the rent element in local government pay levels to over 10 percent.

This adjustment for unemployment probability did not take into account the fact that individuals tend to be risk-averse, in the sense that even at the same expected wage—that is, the wage discounted by the probability of becoming unemployed—they would put a monetary value on the lower probability of becoming unemployed. Such risk-averse individuals are thus receiving a nonmonetary form of compensation that nonetheless has a monetary equivalent (a so-called equalizing difference) in addition to actual earnings. In the private sector, employees in industries and occupations that have lower unemployment incidence receive lower wages, all other things being equal. On average, an increase of 5 percent in the probability of becoming unemployed is associated with a wage increase of 1 percent.[29] If the commonly held perception that public employees are far less likely than private sector workers to become involuntarily unemployed is correct, then their wages would be lower if they were actually determined by market forces so as to reflect this value. Instead, there is considerable evidence of persistent excess supply to the public sector.[30] There is also some evidence that more risk-averse individuals disproportionately tend to seek out and obtain public-sector employment.[31] This study did not attempt to take into account the additional equalizing difference associated with what have been found to be *generally* more favorable working conditions in the public sector.[32] While this study did not distinguish between union and nonunion employees, many other studies have demonstrated that the rent element is larger for unionized than for nonunion public-sector employees, including at the local level.[33] In short, job security has market value.

More recent studies of public-private wage differentials use more sophisticated econometric techniques than earlier studies, such as correction for selection bias. One such study, unlike some earlier ones, provides evidence of a significant wage premium for public-sector employees at all levels, including at the local level.[34] At the local level, the differential in pay alone is estimated in a number of model specifications with results ranging from 2 percent to 18 percent. As with most other such studies, no attempt was made to include the value of fringe-benefit differentials, although there is ample evidence that these are far more available at the local government level than in the private sector. These include defined benefit pensions, employer-provided health and other insurance, paid leave, and other benefits.

For example, one study finds that, in general, local government employees, compared to private sector workers, enjoy greater fringe benefits—more paid vacation days, holidays, personal days, and sick time off; shorter work weeks; and earlier retirement.[35] The percentage of workers in local government receiving retirement benefits exceeds that of private sector workers by 27 percentage points—88 percent vs. 61 percent.[36] Most of the data available on fringe-benefit costs do not separate state from local government employees. With that in mind, it is worth noting that in 2008 the cost of fringe benefits to state and local government employers was $5.48 more per hour than for private sector employers—$13.41 per hour worked vs. $7.93. That difference amounts to an additional fringe benefit cost of approximately $11,000 per year that is borne by taxpayers.[37]

The observation that much of the local government rent or overpayment is in the form of fringe benefits is not surprising in light of the "double agent" explanation discussed above. Such rents are less likely to be observable to the taxpayers. In the absence of any check on this double-agent relationship, a bloated public sector is the possible, even likely, outcome, in terms of both total compensation and employment levels. Today, it is actually observable. As *Forbes* reporter Stephane Fitch noted recently:

> In public-sector America things just get better and better. The common presumption is that public servants forgo high wages in exchange for safe jobs and benefits. The reality is they get all three. State and local government workers get paid an average of $25.30 an hour, which is 33% higher than the private sector's $19, according to Bureau of Labor Statistics data. Throw in pensions and other benefits and the gap widens to 42%.
>
> For New York City's 281,000 employees, average compensation has risen 63% since 2000 to $107,000 a year. New Jersey teaching veterans receive $80,000 to $100,000 for ten months' work. In California prison guards can sock away $300,000 a year with overtime pay.[38]

Even in states that prohibit compulsory unionism through right-to-work laws, compulsory bargaining for public employers gives public-sector unions disproportionate influence on public policy.

Now some unions are trying to expand the definition of "public" by trying to organize government contractors. Washington state provides a good example of this. There, the trend began in 2001, when voters approved a ballot measure, Initiative 775, to allow independent long-term health care providers to unionize and bargain collectively over hours, compensation, and working conditions.[39] Then in 2007, Washington state authorized collective bargaining for adult-home-care providers who receive Medicaid and other state aid.[40] Stretching the definition of "public employee" to any home-care provider who may contract with the state can give a public employee union a foothold in the private sector. Further, under such an arrangement, union fees can be deducted from state compensation checks before the recipients ever see them, so the care providers never miss money they never see.

Even worse, pro-union members of Congress are seeking to get in on unionizing state and local government employees. In the current Congress, the Public Safety Employer-Employee Cooperation Act,[41] sponsored by Rep. Dale Kildee (D-MI), seeks to mandate unionism and collective bargaining in state and local public safety departments—that is, police, fire, and rescue personnel. Specifically, the bill instructs the Federal Labor Relations Authority, which over-

In 2008 the cost of fringe benefits to state and local government employers was $5.48 more per hour than for private sector employers—$13.41 per hour worked vs. $7.93.

Unions are major contributors to political candidates, yet union political contributions are determined by the preferences of union leaders, not the rank-and-file members.

sees collective bargaining among nonpostal federal employees, to promulgate regulations for unionism and collective bargaining in state and local police and fire departments in states that have not enacted laws giving unions those powers and privileges. For union-friendly federal politicians, this is a sweet deal—they score points with their union backers while other government entities pick up the tab. Considering that federal legislation that forces state and local governments to unionize their workforces would significantly increase those governments' labor costs, such legislation would amount to unfunded mandates upon states, counties, and cities.

Employee Rights vs. Union Privileges

While public-sector unions seek to benefit their members at the expense of the public, the agency problem between union leadership and rank-and-file members described above can manifest itself most starkly in the area of political activity. Almost without exception, such laws require that the union be the sole or exclusive representative of all the employees in a unit. This denies employees the right to negotiate individually with employers or to be represented by another organization of their own choosing. Unions commonly exploit their monopoly bargaining power by insisting that because they are "forced" to represent all employees, that all employees, having lost the right of representation to the union, should be forced to join or support the union as a condition of employment. This violates individual employees' right to freedom of association.

Unions are major contributors to political candidates, yet union political contributions are determined by the preferences of union leaders, not the rank-and-file members whose dues finance these contributions. Union members, like all large groups, may be a diverse lot, but union political contributions flow almost uniformly to one narrow band of the political spectrum. That may also be true of other large, diverse groups, but in other cases group leaders' ability to act without regard to individual members' interests is held in check by members' ability to leave any one group. By contrast, individual workers—with the exception of private-sector workers in right-to-work states—face an enormous, and usually unaffordable, cost for exiting the union: loss of a job. According to the Center for Responsive Politics, the American Federation of State, County and Municipal Employees has been the nation's biggest campaign donor from 1989 until the present, giving nearly $40 million during that period, with 98 percent of that going to Democratic candidates. The National Education Association is in seventh place, at $28.4 million, with 93 percent going to Democrats, and the American Federation of Teachers comes in 14th, at nearly $25 million, with 98 percent going to Democrats.[42]

A prospect for reform in this area is the application of the U.S. Supreme Court's decisions in a series of cases beginning with *Abood* (1976) and culminating in *Lehnert* (1991). These decisions provide that a public employee can only be required to pay a union representative for the actual cost of representation and also give employees due process rights in the determination of the size of the fee the union can charge.

After the *Abood* decision, which provided that nonmembers—agency-fee payers—could not be charged for nonrepresentation costs, the unions were left in control of the determination of the amount that goes toward "representation." Generally, they said that 5 percent of dues were spent for nonrepresentation purposes.[43] For most employees who were not union sympathizers, 5 percent was not sufficient incentive to invite the wrath of union officials by switching from membership to a fee-payer status.[44]

The 1986 *Hudson* decision gave nonmembers due process rights in the determination of the amount of the fee. Due process includes notice of the amount to be charged with sufficient information on the determination, an independently audited statement of the union's finances, and the right to resolution of challenges to the size of the fee by a neutral party. Teacher union dues are quite high by most standards.

Public employers are liable for damages under *Hudson* for agreeing to a fee that does not comply with its standards. Often union contracts provide that the public employer will be indemnified by the union for any damages arising from the implementation of an agency-shop clause in a contract. These contract provisions may give employers a false sense of security. Several recent court decisions have held that a union may not indemnify an employer for a violation of the due process rights of an employee.[45]

In 1991, in *Lehnert v. Ferris Faculty Association*, the U.S. Supreme Court established a three-part standard for determining whether a union can charge non-members for an expense without impinging upon the nonmembers' First Amendment rights:

> Abood and other of the Court's decisions in this area set forth guidelines for determining which activities a union constitutionally may charge to dissenting employees. Specifically, chargeable activities must (1) be "germane" to collective bargaining activity; (2) be justified by the government's vital policy interest in labor peace and avoiding "free riders" [500 U.S. 507, 508] who benefit from union efforts without paying for union services; and (3) not significantly add to the burdening of free speech that is inherent in the allowance of an agency or union shop.[46]

As significant as these Court decisions are in relieving public employees of the obligation to support union spending not related to representation, they fall short of achieving full freedom of association. They do not protect the public from the consequences of granting public-sector unions monopoly bargaining privileges.

Government Unions' Privileged Tactics

Private-sector unions have to reckon with the discipline of the market in that they cannot seek demands so onerous that they would put their employers out of business, which would result in the loss of a union's members at a given company. Government-employee unions face no such deterrent.

Public-sector unions are also different in that their employer—government—enjoys a monopoly on the use of force within a certain jurisdiction. Because of this, it can bestow considerable power, on any scale, to any special-interest group it favors. By enjoining governments to negotiate with unions, compulsory public-sector bargaining laws empower unions to participate in public-policy decisions to an extent greater than that of other citizen interest groups. This point was emphasized in a U.S. District Court opinion that upheld the constitutionality of a North Carolina law that declared public-sector union contracts to be void. The court said:

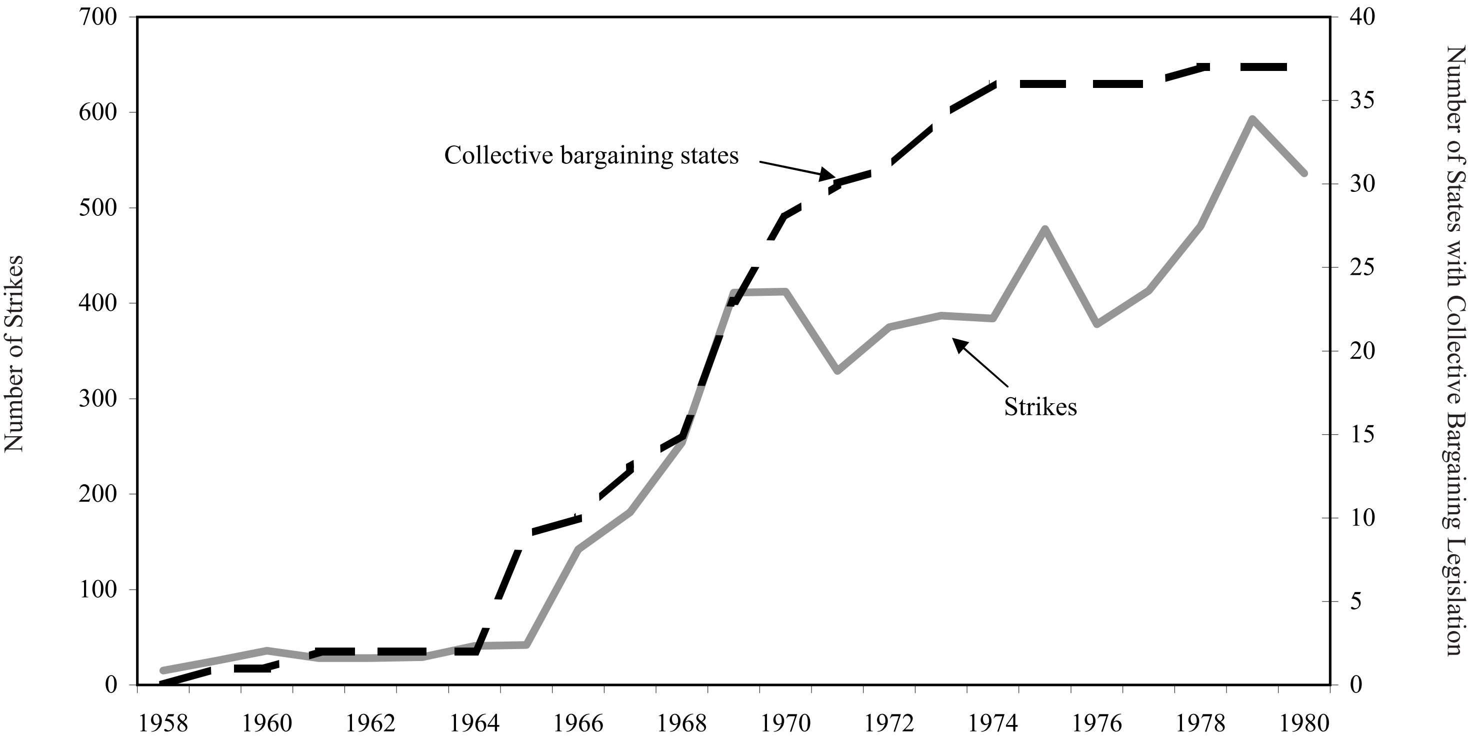
> [T]o the extent that public employees gain power through recognition and collective bargaining, other interest groups with a right to a voice in the running of the government may be left out of vital political decisions. Thus, the granting of collective bargaining rights to public employees involves important matters fundamental to our democratic form of government. The setting of goals and making policy decisions are rights inuring to each citizen. All citizens have the right to associate in groups to advocate their special interests to the government. It is something entirely different to grant any one interest group special status and access to the decision-making process.[47]

For these reasons, public-sector unions have an incentive to be more radical in their demands and tactics.

Consider strikes. In the private sector the strike is an economic weapon. The employer faces economic losses through loss of business, and the employee faces economic losses through loss of wages. If there is a strike at one provider of a good or service, consumers—the public—can shift to another provider, or not

Compulsory public-sector bargaining laws empower unions to participate in public-policy decisions to an extent greater than that of other citizen interest groups.

Figure 2
Public Employee Strikes and Collective Bargaining 1958–1980



Source: Bureau of Labor Statistics.

purchase at all. In the public sector the strike is a political weapon. The employer—government—does not suffer an economic loss, since it cannot lose "customers"—it keeps collecting taxes no matter what it does. And, as noted, the Tiebout effect and median-voter model are of little use in moderating this. In many cases, the employees do not lose, either, especially in education, where most public-sector strikes occur—teachers can make up classes into the summer, and they get paid for a full school year, strike or not.

Public-sector strikes are disruptive of the normal political process. Under normal circumstances, divergent interest groups with an interest in public policy exert pressure from various directions on elected representatives. Of these groups, a union of public workers is the only group that has the power—whether by law or not—to unilaterally deprive the rest of society of a service provided by government monopoly. When this occurs, the general public will tend to demand restoration of that service. In most instances, the only way to restore the service is to give in to union demands. Thus the union, by using a strike or the threat of a strike, can dominate the political process and push for increasing the size, cost, and scope of government—to its own benefit.[48]

A study of Bureau of Labor Statistics data, which covers all strikes against governments from 1958 to 1980, shows that in most states that had adopted compulsory public-sector bargaining laws, there was a tremendous increase in the number of strikes—legal or illegal. In 1958, before the passage of the first public-sector collective bargaining law, there were 15 strikes against government. By 1980, after 37 states had enacted compulsory public-sector bargaining legislation that covered one or more groups of public employees, there were 536 strikes (see Figure 2).

In some states, public-sector unions enjoy another privilege in the form of compulsory binding arbitration, which is intended to resolve public-sector labor disputes without disruption of public services—yet its results often hit the public purse even worse than strikes. For the unions, it is a "can't lose" proposition, because an arbitrator will never award a settlement that is anything less than management's final offer, so the union is guaranteed to obtain at least some of its demands and will never come out worse than the status quo ante.[49] There is one check on union demands in arbitration—a union's final offer must be acceptable to the arbitrator for it to be incorporated into a new contract, but that relies on the discretion of the arbitrator, whose incentive to hold down costs is unlikely to be very strong due to his or her lack of a vested interest in the labor dispute's outcome.

The city of San Luis Obispo, California, shows how bad things can get under binding arbitration. In June 2008, an arbitrator awarded hefty salary increases to unionized police officers in San Luis Obispo. Police officers received immediate raises of 22.28 percent, while dispatchers and technicians got raises of 27.82 percent. For the average police officer's salary, this represents an increase from $71,000 to $93,000 a year, with salaries including overtime expected to top $100,000, according to city officials. City administrative officer Ken Hampian said the increases cost the city $1.8 million above what it planned to pay.[50] While this may be an egregious case, the mere possibility of such a scenario should make state and local governments wary of binding arbitration.

Bloated Public Sector: The Case of Vallejo

The dynamics described in the above sections can wreak havoc on state and local government budgets—and the taxpayers who fund them. Essential public services have to compete for limited funds with lower-priority government functions, which are defended by their direct beneficiary constituencies. Some municipalities are now feeling the pain. During the 1990s boom, many state and local governments spent their increased tax revenues as fast as they came in, setting up a situation that was unsustainable into the future.[51] Across the nation, state tax collections rose by 86 percent—about $250 billion—from 1990 to 2001, and local property-tax collections rose by 86 percent, while inflation increased by 30 percent. As Steven Malanga of the Manhattan Institute notes, "Rather than give surpluses back to taxpayers, government went on a spree, lavishing opulent pensions on employees and expanding popular health and education programs."[52]

The consequences of such spendthrift policies were seen last year in the city of Vallejo, California. On May 23, 2008, Vallejo's city government declared bankruptcy, facing a $16.6 million budget shortfall due in large part to soaring public-employee payroll costs, along with declining tax revenue. Solano County, where Vallejo is located, has been hard-hit by the mortgage crisis—it had one of the nation's highest foreclosure rates in 2008,[53] which alone accounted for a $5-million drop in the city's revenue projections between June 2007 and February 2008.[54] Vallejo, with a population of 117,000, is the largest California city to declare bankruptcy—and the first to do so because it could not cover basic expenses. "We've exhausted all avenues at this point, and this is all we had left," said Vallejo Mayor Osby Davis after the city announced bankruptcy. "It's something we can't avoid. It just doesn't work. We can't pay our bills."[55]

Public-employee unions immediately decried the decision, saying that the city's finances were not as dire as city officials claimed. The police and firefighter unions announced plans to file legal challenges. Yet it was months of unsuccessful negotiations with those unions that had led the seven-member city council to vote unanimously on May 6 to authorize the city manager to file bankruptcy.[56]

The city had been negotiating with the police and firefighter unions for about two years. City officials asked for salary, benefit, and staff cuts, but the unions retorted that those would endanger public safety and the safety of the police and firefighters. Police and firefight-

Vallejo, with a population of 117,000, is the largest California city to declare bankruptcy—and the first to do so because it could not cover basic expenses.

In 2007, 292 Vallejo city employees made over $100,000.

er salaries, pensions, and overtime accounted for 74 percent of Vallejo's $80-million general budget, significantly higher than the state average of 60 percent.[57] Contracts include minimum staffing requirements, which significantly increased overtime pay. And how generous could contracts get? A police captain, for example, could receive $306,000 a year in pay and benefits, a lieutenant $247,644, with the average for firefighters at $171,000 (with 21 earning over $200,000, including overtime). Police and firefighters become eligible for lifetime health benefits. In 2007, 292 city employees made over $100,000.[58]

In March, seeking to avoid bankruptcy, the city cut several million dollars from payroll, museums, public works, senior centers, and other programs, but needed further cuts to meet increased expenses for the next fiscal year.[59] On June 17, the city asked a bankruptcy judge to allow it to cancel labor contracts covering 400 public employees. The unions remained unyielding. A bankruptcy attorney representing the unions said that his clients would contest the bankruptcy on the grounds that the city could pay its bills if it increased revenues and cut expenses, and that the unions would seek tens of millions of dollars in damages if the city got the green light to obviate labor contracts.[60]

The city owed employees raises of 14 percent on July 1, 2008. Vallejo financial officials, on July 23, told Judge Michael McManus of the U.S. District Bankruptcy Court for the Eastern District of San Francisco that the city would have run out of money in the first two weeks of the fiscal year that started July 1, had it not declared bankruptcy and sought to void union contracts. Before declaring bankruptcy, the city projected exhaustion of its reserves before the end of the last fiscal year, negative cash flows each month of the current fiscal year, and a cumulative $16.6 million deficit.[61]

The unions argued that Vallejo could pay its debts if it accepted $10.6 million in concessions that the unions had then offered, spent some of the $136-million reserve it held outside the general fund, and took other measures to cut spending and increase revenue. The union based its case on an analysis by a consultant it hired, Roger Mialocq of Harvey M. Rose Associates, a firm that also serves as the independent budget analyst for several California local governments, including the San Francisco Board of Superintendents.[62]

The city contested each of Mialocq's savings and revenue estimates, saying they were either already implemented or impossible. "The Report lacks credibility and is riddled with fundamental analytical defects," argued the city's lawyers. They also accused Mialocq of bias—he had said in depositions that he took the assignment because he was worried about the impact of bankruptcy on other California local governments, particularly Santa Clara County, a struggling Rose client—and said that he should not be considered an expert on government finance because he is not a certified public accountant. The city also said that the $136 million off-budget reserve is independent of the general fund. Wells Fargo & Co., trustees of the city's enterprise-fund debt, supported the city's contention. "There are no circumstances under which the city—in or out of Chapter 9 [bankruptcy]—can freely access these funds," argued an attorney for Wells Fargo. "The funds are irrevocably dedicated to the protection of bondholders."[63] On September 4, 2008, Judge McManus approved the city's petition.[64] The police and fire unions appealed the ruling on September 18, 2008.[65]

The Vallejo disaster unfolded against the backdrop of budget trouble for all of California. On September 23, 2008, California governor Arnold Schwarzenegger (R) signed the tardiest state budget ever in California history—by 85 days[66]—after long negotiations over how to close a $15 billion deficit.[67] Schwarzenegger sought to control costs by vetoing $510 million in spending, which comes on top of an executive order imposing a hiring freeze on about 10,000 state workers that were laid off in August 2008.[68] (On October 2, Schwarzenegger alerted then-Treasury Secretary Henry Paulson that California planned to request $7 billion in emergency federal loans.)[69] On December 1, Schwarzenegger declared a state fiscal emergency and ordered the legislature to hold a special session to address the state's ailing finances.[70]

By January 2009, with the country in recession, the state's projected budget deficit threatened to balloon to a whopping $42 billion.[71] To address this looming shortfall, the new budget, which was approved by the legislature and sent to the governor in February 2009, includes $15 billion in spending cuts over 17 months and $13 billion in new taxes.[72] However, some parts of the budget needed to be approved by voters. On May 19, 2009, California voters rejected five of six ballot proposals by wide margins across the state. (The one measure to pass, Proposition 1F, freezes pay for legislators and statewide office-holders in budget deficit years.)[73] As a result, the state's deficit projection, which the proposed budget sought to cut to $15 billion, jumped to $21 billion.[74]

A big stumbling block in Schwarzenegger's efforts to curb the growth of state spending was employee payroll. The January 29, 2008, approval by a state superior court of Schwarzenegger's plan to shut down several state offices for two Fridays a month—forcing 238,000 state workers to stay home without pay—was an overdue breakthrough in a long history of frustrations for his predecessors, but this modest step was too little, too late, to halt years of growth of state employees' salaries. "Past plans for reductions have been tangled in a thicket of policy protections, political alliances, and legal precedents that organized labor has built up over the years," noted *Los Angeles Times* reporter Evan Halper after the ruling. In 1991, a state court thwarted then-governor Pete Wilson's (R) effort to cut state employees' salaries by 5 percent, ruling that he could not do so without the legislature's consent. And in 2003, then-governor Gray Davis's (D) efforts to lay off nearly 12,000 state workers went nowhere. Halper reports that the last round of mass layoffs in the state had occurred in 1975, when 2,500 California Department of Transportation employees were let go during a previous budget crisis.[75] On May 20, 2009, the California State Personnel Board listed 2,817 vacancies.[76]

As unionization in the public sector is common in state and local governments around the nation, this scenario could be repeated elsewhere. Pew Center on the States managing director Susan Urahn told the *New York Times* that "California is an example of what you will see" across the country, as other states (40 of which are in the red), as well as cities, seek to manage their own deficits.[77] A September 2008 National League of Cities survey of the nation's city financial officers paints a discouraging picture. "Confronted with declining economic conditions driven by downturns in housing, consumer spending, and jobs and income, city finance officers report that the fiscal condition of the nation's cities has weakened dramatically in 2008," says the report. An overwhelming majority of survey respondents identified employee-related costs as having increased substantially: wages (cited by 95 percent of respondents); health benefits (86 percent); and pensions (79 percent). Wages and health care costs were cited by respondents ahead of all other costs, except for inflation (98 percent).[78] In public-sector collective bargaining agreements across the nation, the conditions that led to the mess of Vallejo have been baked into the cake.

In public-sector collective bargaining agreements across the nation, the conditions that led to the mess of Vallejo have been baked into the cake.

Conclusion: What Can Be Done?

Over the past five decades, organized labor's overall membership has shifted to include an ever-greater number of government employees, a trend that appears likely to continue. As more labor unions come to represent employees in the public sector, they are likely to increase costs on governments, especially at the state and local level, where unions are most prevalent. Unlike private-sector unions, public-sector unions are not fettered by the need to keep their employer from going out of business. As a result, public-sector unions can make demands for their members well beyond what private-sector unions can.

The fact that government officials lack an incentive to hold down costs does not mean that government's capacity for growth is unlimited, or that such growth will always be rapid. Government services are paid for by taxes, on which popular opposition acts as a check. This, naturally, limits to some extent the potential reach of public-employee unions.

Nevertheless, the checks that do apply to public-sector unions' power are weak. The Tiebout effect posits that citizens can "vote with their feet" by choosing to reside in the jurisdiction that comes closest to their preferred package combination of services and taxes. However, real-estate transaction costs of selling one home and buying another provide plenty of slack room for successful rent-seeking by public-sector union members, as variations in local fiscal conditions would have to be quite considerable to overwhelm not only transaction costs, but all other factors that affect an individual's choice of residential location. Similarly, the theoretical disciplining effects of the median-voter model are overwhelmed by the effect of imperfection in taxpayer information. Such rational ignorance results in politicians offering packages of benefits that are highly concentrated and visible to the beneficiaries, while making the costs vague and widely dispersed—and thus, veiled from taxpayers. One likely and persistent element in the package will be higher-than-necessary wages to public employees. However, even when the costs are well known, their impact on any one taxpayer might seem sufficiently small so as to not be a deciding factor in determining voter choice, and even less so in fostering a Tiebout-type reaction.

To enforce their demands, the weapons that unions have at their disposal include strikes and mandatory arbitration. In the case of strikes, they can be especially disruptive in the public sector, where an interruption of public services causes severe pain among voters, who cannot simply shift to different suppliers for the public services that government provides in a monopolistic fashion. To avoid the threat of such strikes, many unions and governments agree to submit to binding arbitration, which can impose costs on government finances as great as, or even greater than, strikes. An arbitrator will never award a settlement that is less than management's final offer, so the union is guaranteed to obtain at least some of its demands, and will never come out worse than the status quo ante.

Public-sector unions' upward-ratcheting effect on wages has reinforced itself wherever government employees have become unionized—as the economic literature indicates. As noted, the public sector is more amenable to union-based collective bargaining than the private sector. While unionism did manage to gain a significant foothold in the private sector at one time—due in large part to government intervention—it has nonetheless receded there, while it has grown in state employment.

This dynamic will persist in government regardless of which political party controls the elected branches of government. In Washington, in state capitals, and at city halls, executives and lawmakers come and go, but career government employees stay on in the bureaucracy.

While repeal of state collective bargaining laws may be desirable, it is politically very difficult, so there are other reforms that governments can undertake. Politically viable reforms include repealing laws that legalize strikes against government, as well as laws that impose binding arbitration on the settlement of public-sector labor disputes. Another possible reform is to limit the scope of collective bargaining. At present, particularly in the field of public education, teacher-union contracts control almost every aspect of school activity—there is no reason why matters like textbook selection should be subject to collective bargaining.

Moreover, unlike most of their private-sector counterparts whose dues are collected by private parties, public-employee unions enjoy the privilege of having their collection of dues paid by government—that is, the taxpayers. Requiring the unions to pay for the cost of their dues collection would be a small, though sensible, reform. Amendment 49 in Colorado, a ballot initiative that lost at the ballot box in November 2008, was such a measure.

Politically viable reforms include repealing laws that legalize strikes against government, as well as laws that impose binding arbitration on the settlement of public-sector labor disputes.

However, Colorado voters did approve Amendment 54, which was on the same ballot as Amendment 49. Amendment 54 prevents parties that receive "sole source government contracts" from making, facilitating, or inducing contributions to any state or local political party for two years after the end of the contract. This would include collective-bargaining agreements. However, how the law will play out in practice remains to be seen. On January 28, 2009, several unions filed suit in Denver District Court seeking to have the law declared unconstitutional, on First Amendment free-speech grounds and 14th Amendment equal-protection grounds.[79]

The fight over these two ballot measures underscores the difficulty of reform. Protect Colorado's Future, an organization set up to oppose the two above measures (as well as Amendment 47, a right-to-work proposal, which failed to pass), and financed mostly by public-employee unions, spent nearly $30 million on the campaign.[80]

Richard Epstein proposes some other reforms that merit lawmakers' consideration. Epstein endorses what he describes as "a blanket prohibition against unearned increases in pensions or wages to public employees for completed work." He also favors creating a mechanism to allow citizens to challenge public-sector collective bargaining agreements in court, "say within 60 days of signing." In addition, Epstein says that "we have to insist that government officials negotiate contracts that permit them to reduce employment levels in the face of diminished revenues." This last proposal is easier said than done, and may require imposing such a statutory requirement on public officials (which Epstein does not mention).[81]

At the federal level, Congress should refrain from making the problem worse by intervening in state and local governments' labor relations, as some members of Congress now seem to want to do vis-à-vis public safety workers, such as police and firefighters.

These suggested reforms are only a beginning. Many of the problems outlined in this paper will persist as long as government employees continue to unionize in large numbers. Thus, state and local lawmakers would best serve the interests of the majority of their constituents by avoiding public-sector collective bargaining. Short of that, they need the ability to drive a harder bargain.

Journalists have a role to play, as well, in keeping government officials and unions accountable. Collective-bargaining agreements are public information, and are posted online by the Department of Labor. (Union financial reports are available at unionreports.gov; collective bargaining agreements are available at http://www.dol.gov/esa/olms/regs/compliance/cba/index.htm.) By providing publicly digestible scrutiny and analysis of the large amount of information in collective-bargaining agreements in their own jurisdictions, local reporters can help voters overcome (even if partially) the problem of rational ignorance described above. For its part, the federal government should look for ways to make these data more user-friendly.

As keepers of the public purse, legislators and local council members have an obligation to protect taxpayers' interests. By granting monopoly power over their governments' supply of labor to labor unions, elected officials undermine their duty to taxpayers, since this puts unions in a privileged position to extract political goods in the form of high pay and benefits that are way above anything comparable in the private sector. Under such an arrangement, government, being itself a monopoly, leaves the citizens whose money it squanders with no options.

State and local lawmakers would best serve the interests of the majority of their constituents by avoiding public-sector collective bargaining.

Notes

1. Bureau of Labor Statistics, "Union Members in 2008," Economic News Release, January 28, 2009, http://www.bls.gov/news.release/pdf/union2.pdf. This was a slight uptick from 12.1 percent for 2007, but small enough to not be significant.

2. David E. Bernstein, *Only One Place of Redress: African Americans, Labor Regulations, and the Courts from Reconstruction to the New Deal* (Durham, NC: Duke University Press, 2001), p. 6.

3. Max Green, *Epitaph for American Labor: How*

Union Leaders Lost Touch with America (Washington: American Enterprise Institute Press, 1996), p. 100.

4. The numbers are derived from Bureau of Labor Statistics figures at www.unionstats.com, which is maintained by economists Barry Hirsch of Georgia State University and David Macpherson of Florida State University. The BLS began keeping track of public sector union membership in 1958.

5. Ibid.

6. Bureau of Labor Statistics, "Union Members in 2008."

7. Ibid.

8. Federal Labor Relations Authority, http://www.flra.gov/10.html. Because federal employees operate under this different system, they are beyond the scope of this paper.

9. S. Brady Calhoun, "Police Union: Panama City Is Dragging Its Feet," *Panama City News Herald*, August 16, 2008, http://www.newsherald.com/news/panama-67520-city-union.html.

10. This section borrows heavily from Don Bellante and James Long, "The Political Economy of the Rent-Seeking Society: The Case of Public Employees and Their Unions," *Journal of Labor Research* 2 (Spring 1981): 1–14; and from Don Bellante and Philip Porter, "Agency Costs, Property Rights, and the Evolution of Labor Unions," *Journal of Labor Research* 13 (Summer 1992): 243–56.

11. See, for example, Adolph A. Berle and Gardiner C. Means, *The Modern Corporation and Private Property* (New York: Macmillan, 1932).

12. Joseph Schumpeter, to cite another such example, was of the opinion that this agency problem would become so severe as to lead to the demise of capitalism. See his *Capitalism, Socialism, and Democracy* (New York: Harper & Brothers, 1942).

13. One of the classic examples of the literature examining the mitigation of the agency problem in the modern corporation is Henry Manne, "Mergers and the Market for Corporate Control," *Journal of Political Economy* 73 (April 1965): 110–20.

14. On the median-voter model, see Anthony Downs, *An Economic Theory of Democracy* (New York: Harper Collins, 1957). On the Tiebout effect, see Charles Tiebout, "A Pure Theory of Local Expenditures," *Journal of Political Economy* 64 (October 1956): 416–24.

15. Robert Congleton has demonstrated in a formal model how rational ignorance is sufficient to generate "fiscal illusion." See his "Rational Ignorance, Rational Voter Expectations, and Public Policy: A Discrete Informational Foundation for Fiscal Illusion," *Public Choice* 107 (April 2001): 35–64. Thus, it is entirely possible that median-voter effects will not significantly affect the lack of resistance to public employee rent-seeking.

16. Gerald Scully, "The Convergence of Fiscal Regimes and the Decline of the Tiebout Effect," *Public Choice* 72 (October 1991): 51–59.

17. Melvin Reder, "The Theory of Employment and Wages in the Public Sector," in *Labor in the Public and Nonprofit Sectors*, ed. Daniel Hamermesh (Princeton: Princeton University Press,1975).

18. Richard Epstein, "The Public Mischief of Public Unions," *Forbes*, March 3, 2009, http://www.forbes.com/2009/03/01/pensions-bankruptcy-government-opinions-columnists_california. html.

19. Ibid.

20. Elaboration of this point is a large part of the subject matter of William Niskanen's classic work: *Bureaucracy and Representative Government* (Chicago: Aldine-Atherton, 1971).

21. See, for example, James Bennett and William Orzechowski, "The Voting Behavior of Bureaucrats: Some Empirical Evidence," *Public Choice* 41 (January 1983): 271–83.

22. This likelihood presents a potential principal-agency problem between a union and its members, which may misalign the incentives of union officials with those of their members to a degree. It would strengthen the symbiotic relationship between bureau managers and elected officials on the one hand and union officials on the other.

23. This interest is in contrast to private-sector workers, for whom the lack of such interest is at the heart of the "insider-outsider" theory of union behavior. See Assar Lindbeck and Dennis Snower, *The Insider-Outsider Theory of Employment and Unemployment* (Cambridge, MA: MIT, 1989).

24. See Kevin O'Brien, "Compensation, Employment, and the Political Activity of Public Employees Unions," *Journal of Labor Research* 13 (June 1992): 189–203, and the studies cited therein.

25. See Don Bellante and Philip Porter, "Public and Private Employment over the Business Cycle: A Ratchet Theory of Government Growth," *Journal of Labor Research* 14 (Fall 1998): 613–28.

26. See Sharon Smith, "Equal Pay in the Public Sector: Fact or Fantasy?" Princeton University,

Industrial Relations Section, Research Report Series no. 122 (1977).

27. The literature through 2003 is briefly surveyed in Josefa Ramoni, "Compensation Comparisons between the Public and Private Sectors in the United States: A Propensity Score Matching Approach" (doctoral dissertation, University of South Florida, 2004).

28. Bellante and Long.

29. See the studies cited in George Borjas, *Labor Economics* (New York: McGraw-Hill, 2010), p. 226.

30. For the earliest such evidence, see James Long, "Are Government Workers Overpaid? Additional Evidence," *Journal of Human Resources* 17 (Winter 1982): 123–31.

31. See Don Bellante and Albert Link, "Are Public Sector Workers More Risk Averse Than Private Sector Workers?" *Industrial and Labor Relations Review* 34 (April 1981): 408–12.

32. See Joseph Quinn, "Wage Differences among Older Workers in the Public and Private Sectors," *Journal of Human Resources* 14 (Winter 1979): 41–62.

33. A rather exhaustive survey of these studies is H. Gregg Lewis, "Union/Nonunion Wage Gaps in the Public Sector," *Journal of Labor Economics* 8 (January 1990): S260–S328.

34. Joseph Gyorko and Joseph Tracy, "An Analysis of Public- and Private-Sector Wages Allowing for Endogenous Choices of Both Government and Union Status," *Journal of Labor Economics* 6 (April 1988): 229–53.

35. Wendell Cox and Samuel Brunelli, *America's Protected Class: The Excess Value of Government Employment* (Washington: American Legislative Exchange Council, 1994).

36. Bureau of Labor Statistics, *National Compensation Survey: Employee Benefits in State and Local Governments in the United States, September 2007*, http://www.bls.gov/ncs/ebs/sp/ebsm0007.pdf.

37. Bureau of Labor Statistics, *Employee Benefits in the United States, March 2008*, http://www.bls.gov/news.release/pdf/ebs2.pdf.

38. Stephane Fitch, "Gilt-Edged Pensions," *Forbes*, January 22, 2009, http://www.forbes.com/forbes/2009/0216/078.html.

39. Scott Dilley, "A History of Public-Sector Collective Bargaining in Washington State," *Policy Highlighter*, Evergreen Freedom Foundation, September 2, 2008, http://www.effwa.org/main/article.php?article_id=2532. Unions spend large amounts of money on ballot initiatives and candidate races, often outspending their opponents in a pattern that is consistent with the public-choice model of concentrated benefits and diffuse costs.

40. "Making the Governor the Public Employer of Adult Family Home Providers," Final Bill Report, ESHB 2111, http://apps.leg.wa.gov/documents/billdocs/2007-08/Pdf/Bill%20Reports/House%20Final/2111-S.FBR.pdf.

41. H.R. 413, 111th Cong., 1st sess., http://frwebgate.access.gpo.gov/cgi-bin/getdoc.cgi?dbname=111_cong_bills&docid=f:h413ih.txt.pdf.

42. Including these government unions, 12 of the top 20 all-time donors are unions. Center for Responsive Politics, "Top All-Time Donors 1989–2008 Summary," http://www.opensecrets.org/orgs/list.php?type=A.

43. Similarly, the 1988 U.S. Supreme Court's *Beck* decision gave private-sector agency fee-paying employees the right to pay only for "representational" expenses, thus withholding the portion of agency fees to be used for political activity. *Communications Workers of America et al. v. Beck et al.*, 487 U.S. 735 (1988), http://caselaw.lp.findlaw.com/scripts/getcase.pl?court=US&vol=487&invol=735.

44. *Abood et al. v. Detroit Board of Education et al.*, 431 U.S. 209 (1977), http://caselaw.lp.findlaw.com/cgi-bin/getcase.pl?court=US&vol=431&invol=209.

45. *Chicago Teachers Union, Local No. 1, AFT, AFL-CIO et al. v. Hudson et al.*, 475 U.S. 292 (1986), http://caselaw.lp.findlaw.com/cgi-bin/getcase.pl?court=US&vol=475&invol=292.

46. *Lehnert et al. v. Ferris Faculty Association et al.* 500 U.S. 507 (1991), http://caselaw.lp.findlaw.com/cgi-bin/getcase.pl?court=US&vol=500&invol=507.

47. *Winston-Salem/Forsyth County Unit of the North Carolina Association of Educators et al. v. A. Craig Phillips, State Superintendent of Public Instruction et al.*, United States District Court for the Middle District of North Carolina, Winston-Salem Division, September 18, 1974, 381 F. Supp. 644, 87 L.R.R.M. (BNA) 2925, 75 Lab. Cas. 53, 542.

48. One rare case of pushback was President Ronald Reagan's firing of striking members of the Professional Air Traffic Controllers Association. In 1981, PATCO proposed legislation to revamp relations between the Federal Aviation Administration and air traffic controllers. Since it was unable to negotiate for wages and benefits under existing federal law (the Civil Service Reform Act of 1978), PATCO made administration support for this leg-

islation one of its bargaining demands. The Reagan administration contended that to accede to such a demand would set a very bad precedent. PATCO apparently believed that the threat of a strike against an industry so essential to the nation's economy would bring about a change in administration policy and that, even if there were a strike, they could negotiate amnesty for strikers as part of a settlement. That was a serious miscalculation. The air traffic controllers went on strike and President Reagan, following the mandates of federal law, fired the strikers. After that, the number of strikes against government declined by about 50 percent . The Bureau of Labor Statistics, which had kept detailed statistics on public sector strike activity since 1958, ceased reporting on strikes in the public sector, making further analysis of this issue impossible from that time on. However, this can be considered the exception that proves the rule, since it is a unique event. The reaction among politicians and media pundits at the time was surprise bordering on disbelief.

49. However, as noted, teachers unions generally like to maintain the ability to strike, and thus hold the vast majority of public-sector strikes. Keeping kids out of school may be a big problem, but it will not lead to the serious disasters that would result from police officers and firefighters going on strike.

50. Sally Connell, "SLO Police to Receive Higher Pay," *San Luis Obispo Tribune*, June 15, 2008.

51. See Chris Edwards, Stephen Moore, and Phil Kerpen, "States Face Fiscal Crunch after 1990s Spending Surge," Cato Institute Briefing Paper no. 80, February 12, 2003, http://www.cato.org/pubs/briefs/bp80.pdf.

52. Steven Malanga, "The Conspiracy Against the Taxpayers," *City Journal*, Autumn 2005, http://www.city-journal.org/html/15_4_taxpayers.html.

53. Andrew Ward, "Vallejo Asks Permission to Reject Contracts," *The Bond Buyer*, June 19, 2008, http://www.bondbuyer.com/article.html?id=20080618218D1M2S.

54. Michael B. Marois, "Vallejo, California, Plans to File for Bankruptcy," Bloomberg, May 7, 2008, http://www.bloomberg.com/apps/news?pid=20601103&sid=atl3yFmV508A&refer=news.

55. Terence Chea, "City Officially Files for Bankruptcy Protection," *San Jose Mercury News*, May 24, 2008.

56. Ibid.

57. Marois.

58. George Will, "Pension Time Bomb," *Washington Post*, September 11, 2008, http://www.washingtonpost.com/wp-dyn/content/article/2008/09/10/AR2008091002726.html.

59. Carolyn Jones, "Vallejo Votes to Declare Chapter 9 Bankruptcy," *San Francisco Chronicle*, May 7, 2008, http://www.sfgate.com/cgi-bin/article.cgi?f=/c/a/2008/05/06/BACH10HUK6.DTL&tsp=1.

60. Ward.

61. Andres Ward, "Is Vallejo Really Broke? Its Unions Want to Know," *The Bond Buyer*, July 25, 2008, http://www.bondbuyer.com/article.html?id=20080724HFB58CR6.

62. Ibid.

63. Ibid.

64. Jim Christie, "Judge Approves California City Bankruptcy Petition," Reuters, September 5, 2008, http://www.reuters.com/article/marketsNews/idUSN0529542020080905.

65. "Unions Appeal Ruling Granting Vallejo Bankruptcy," *San Francisco Chronicle*, September 21, 2008, http://www.sfgate.com/cgi-bin/article.cgi?f=/n/a/2008/09/21/state/n100835D77.DTL.

66. Matthew Yi, "Governor Cuts, Signs Long-Overdue Budget," *San Francisco Chronicle*, September 24, 2008, http://www.sfgate.com/cgi-bin/article.cgi?f=/c/a/2008/09/24/MND1133LEV.DTL.

67. Jennifer Steinhauer, "State Budget in California Sets Record for Tardiness," *New York Times*, September 2, 2008, http://www.nytimes.com/2008/09/03/us/03calif.html?ref=us.

68. Yi.

69. March Lifsher and Evan Harper, "Schwarzenegger to U.S.: State May Need $7-billion Loan," *Los Angeles Times*, October 3, 2008, http://www.latimes.com/business/la-fi-calif3-2008oct03,0,5726760.story?track=rss.

70. "California Faces 'Budget Crisis,'" BBC News, December 2, 2008, http://news.bbc.co.uk/2/hi/americas/7760249.stm.

71. CBSNews.com, January 3, 2009, http://www.cbsnews.com/stories/2009/01/03/eveningnews/main4696947.shtml.

72. Stu Woo and Justin Check, "Californians Get a Budget That Leaves Few Happy," *Wall Street Journal*, February 20, 2009, http://online.wsj.com/article/SB123503429614220905.html.

73. Eric Bailey, "California Voters Kill Budget Measures," *Los Angeles Times*, May 20, 2009, http://www.latimes.com/news/local/la-me-props20-2009may20,0,5134709.story.

74. Stu Woo, "Cuts Loom in California if Propositions Fail," *Wall Street Journal*, May 12, 2009, http://online.wsj.com/article/SB124208323316008467.html.

75. Evan Halper, "Reducing California State Payroll a Daunting Task," *Los Angeles Times*, January 31, 2009, http://articles.latimes.com/2009/jan/31/local/me-workers31.

76. California State Personnel Board, http://jobs.spb.ca.gov/wvpos/search_p.cfm?showAll.

77. Jennifer Steinhauer, "In Budget Deal, California Shuts $41 Billion Gap," *New York Times*, February 20, 2009, http://www.nytimes.com/2009/02/20/us/20california.html?scp=1&sq=in%20budget%20deal,%20california&st=cse.

78. Michael A. Pagano and Christopher W. Hoene, "City Fiscal Conditions in 2008," in *Research Brief on America's Cities*, Issue 2008-2, National League of Cities, September 2008, http://66.218.181.91/ASSETS/A49C86122F0D4DBD812B91DD5777F04D/CityFiscal_Brief_08-FINAL.pdf. Other items receiving high response rates included infrastructure (85 percent) and public safety (83 percent), both of which carry high labor costs. The authors describe the survey as follows: "The City Fiscal Conditions Survey is a national mail survey of finance officers in U.S. cities. Surveys were mailed to a sample of 1,055 cities, including all cities with populations greater than 50,000 and, using established sampling techniques, to a randomly generated sample of cities with populations between 10,000 and 50,000. The survey was conducted from April to June 2008. The 2008 survey data are drawn from 319 responding city finance officers, for a response rate of 30.2%. The responses received allow us to generalize about all cities with populations of 10,000 or more."

79. Felisa Cardona, "Two Suits Challenge Amendment 54," *Denver Post*, January 29, 2009. Some nonprofit organizations that receive state funds—including Children's Hospital, the Denver Center for the Performing Arts, and the University of Denver—filed another suit, fearing that their lobbying ability would be hamstrung.

80. Charles Ashby, "Pro-Union Groups Sue to Nullify Amendment 54," *Pueblo Chieftain*, January 30, 2009.

81. Epstein.

STUDIES IN THE POLICY ANALYSIS SERIES

644. **Getting What You Paid For—Paying For What You Get Proposals for the Next Transportation Reauthorization** by Randal O'Toole (September 15, 2009)

643. **Halfway to Where? Answering the Key Questions of Health Care Reform** by Michael Tanner (September 9, 2009)

642. **Fannie Med? Why a "Public Option" Is Hazardous to Your Health** by Michael F. Cannon (July 27, 2009)

641. **The Poverty of Preschool Promises: Saving Children and Money with the Early Education Tax Credit** by Adam B. Schaeffer (August 3, 2009)

640. **Thinking Clearly about Economic Inequality** by Will Wilkinson (July 14, 2009)

639. **Broadcast Localism and the Lessons of the Fairness Doctrine** by John Samples (May 27, 2009)

638. **Obamacare to Come: Seven Bad Ideas for Health Care Reform** by Michael Tanner (May 21, 2009)

637. **Bright Lines and Bailouts: To Bail or Not To Bail, That Is the Question** by Vern McKinley and Gary Gegenheimer (April 21, 2009)

636. **Pakistan and the Future of U.S. Policy** by Malou Innocent (April 13, 2009)

635. **NATO at 60: A Hollow Alliance** by Ted Galen Carpenter (March 30, 2009)

634. **Financial Crisis and Public Policy** by Jagadeesh Gokhale (March 23, 2009)

633. **Health-Status Insurance: How Markets Can Provide Health Security** by John H. Cochrane (February 18, 2009)

632. **A Better Way to Generate and Use Comparative-Effectiveness Research** by Michael F. Cannon (February 6, 2009)

631. **Troubled Neighbor: Mexico's Drug Violence Poses a Threat to the United States** by Ted Galen Carpenter (February 2, 2009)

630. **A Matter of Trust: Why Congress Should Turn Federal Lands into Fiduciary Trusts** by Randal O'Toole (January 15, 2009)

629. **Unbearable Burden? Living and Paying Student Loans as a First-Year Teacher** by Neal McCluskey (December 15, 2008)

628. **The Case against Government Intervention in Energy Markets: Revisited Once Again** by Richard L. Gordon (December 1, 2008)

627. **A Federal Renewable Electricity Requirement: What's Not to Like?** by Robert J. Michaels (November 13, 2008)

626. **The Durable Internet: Preserving Network Neutrality without Regulation** by Timothy B. Lee (November 12, 2008)

625. **High-Speed Rail: The Wrong Road for America** by Randal O'Toole (October 31, 2008)

624. **Fiscal Policy Report Card on America's Governors: 2008** by Chris Edwards (October 20, 2008)

623. **Two Kinds of Change: Comparing the Candidates on Foreign Policy** by Justin Logan (October 14, 2008)

622. **A Critique of the National Popular Vote Plan for Electing the President** by John Samples (October 13, 2008)

621. **Medical Licensing: An Obstacle to Affordable, Quality Care** by Shirley Svorny (September 17, 2008)

620. **Markets vs. Monopolies in Education: A Global Review of the Evidence** by Andrew J. Coulson (September 10, 2008)

619. **Executive Pay: Regulation vs. Market Competition** by Ira T. Kay and Steven Van Putten (September 10, 2008)

618. **The Fiscal Impact of a Large-Scale Education Tax Credit Program** by Andrew J. Coulson with a Technical Appendix by Anca M. Cotet (July 1, 2008)

617. **Roadmap to Gridlock: The Failure of Long-Range Metropolitan Transportation Planning** by Randal O'Toole (May 27, 2008)

616. **Dismal Science: The Shortcomings of U.S. School Choice Research and How to Address Them** by John Merrifield (April 16, 2008)

615. **Does Rail Transit Save Energy or Reduce Greenhouse Gas Emissions?** by Randal O'Toole (April 14, 2008)

614. **Organ Sales and Moral Travails: Lessons from the Living Kidney Vendor Program in Iran** by Benjamin E. Hippen (March 20, 2008)

613. **The Grass Is Not Always Greener: A Look at National Health Care Systems Around the World** by Michael Tanner (March 18, 2008)

612. **Electronic Employment Eligibility Verification: Franz Kafka's Solution to Illegal Immigration** by Jim Harper (March 5, 2008)

611. **Parting with Illusions: Developing a Realistic Approach to Relations with Russia** by Nikolas Gvosdev (February 29, 2008)

610. **Learning the Right Lessons from Iraq** by Benjamin H. Friedman, Harvey M. Sapolsky, and Christopher Preble (February 13, 2008)

609. **What to Do about Climate Change** by Indur M. Goklany (February 5, 2008)

608. **Cracks in the Foundation: NATO's New Troubles** by Stanley Kober (January 15, 2008)

607. **The Connection between Wage Growth and Social Security's Financial Condition** by Jagadeesh Gokhale (December 10, 2007)

606. **The Planning Tax: The Case against Regional Growth-Management Planning** by Randal O'Toole (December 6, 2007)

605. **The Public Education Tax Credit** by Adam B. Schaeffer (December 5, 2007)

604. **A Gift of Life Deserves Compensation: How to Increase Living Kidney Donation with Realistic Incentives** by Arthur J. Matas (November 7, 2007)

603. **What Can the United States Learn from the Nordic Model?** by Daniel J. Mitchell (November 5, 2007)

602. **Do You Know the Way to L.A.? San Jose Shows How to Turn an Urban Area into Los Angeles in Three Stressful Decades** by Randal O'Toole (October 17, 2007)

601. **The Freedom to Spend Your Own Money on Medical Care: A Common Casualty of Universal Coverage** by Kent Masterson Brown (October 15, 2007)

Published by the Cato Institute, Policy Analysis is a regular series evaluating government policies and offering proposals for reform. Nothing in Policy Analysis should be construed as necessarily reflecting the views of the Cato Institute or as an attempt to aid or hinder the passage of any bill before Congress. Contact the Cato Institute for reprint permission. Additional copies of Policy Analysis are $6.00 each ($3.00 each for five or more). To order, or for a complete listing of available studies, write the Cato Institute, 1000 Massachusetts Ave., N.W., Washington, D.C. 20001 or call toll free 1-800-767-1241 (8:30-4:30 eastern time). Fax (202) 842-3490 • www.cato.org

CATO INSTITUTE