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August 1, 2010

POLICY REVIEW » NO. 162 » FEATURES

### The Case Against Public Sector Unions

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A powerful force for unaffordable benefits

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STATE AND LOCAL governments today are, with few exceptions, in deep financial distress. While some governors can offer the recession, the housing crisis, or the loss of an important industry as an excuse for poor finances, many states are simply structurally insolvent — not unlike General Motors prior to bankruptcy. Indeed, California's travails began well before the recession, and warnings about the financial health of Illinois and New York predate the present crisis. It is no secret that the primary cause of the states' long-term problems are their bloated public sectors — particularly their public pension obligations.

Public employees unions have wielded huge influence to gain perquisites for themselves at the expense of the public. Early retirement, job tenure, high wages, and generous defined-benefit pension plans have gained increasing attention from commentators and voters, though many public sector perks are intentionally shrouded and confuse the public debate. What has received far less attention is the pernicious effect of public sector union privileges on the provision of public goods in the United States. Public sector unions have greatly distorted state spending priorities and made it more difficult for states to devise innovative public goods that would benefit their citizenry as whole. For example, prison guard unions have directly influenced penal policy, fighting reduced sentences or decriminalization of drugs. Teachers' unions fight charter schools and merit pay. The strong organizational rights of these unions, protected or abetted by statute and regulations, enables their outsized influence on public policy.

But crisis is also opportunity. The dire straits of states offer the chance for entrepreneurial governors to abolish public employee union privileges, like the rights to strike, to collectively bargain, to seek binding arbitration, and to collect dues. Public employee unions are the great reactionary force in public life today, using their privileged position both to defend the rewards their members receive and to block innovation. As a result, this recession offers a political opening for both liberal and conservative governors.

For conservatives, taking on public employee unions provides a way to eliminate inefficient spending and create a polity of low taxes and lean government. For liberals, it provides a way to redirect spending to effective public goods, like better educational outputs, that public employee unions frustrate. If both liberal and conservative governors moved against public employee unions, the public would have the best of all possible worlds, a demonstration project pitting a low-tax, small-government jurisdictions against a higher-tax, high-value public goods jurisdictions. It would create a fair fight between the attractive options that conservatism and liberalism can offer. Union contracts, however, prevent most state governments from nimbly responding to changing circumstances. This ossification short-circuits the beneficial competition among jurisdictions created by our federal system, which works best when there are not entrenched impediments to government innovation.

#### PRIVATE VERSUS PUBLIC SECTOR UNIONS

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THE IDEA OF eliminating union privileges in the public sector may seem like a radical one. But society has changed greatly from the era in which industrial unions were born, and, in any event, public sector unions raise substantially different issues than those in the private sector. In the early 20th century, workers were less educated and less mobile, and were indeed subject to exploitation by private companies, some of which had monopoly power in local labor markets or regularly employed private violence. To balance the bargaining power between such companies and their workers in such a climate, the federal government provided the employees with the mechanism of collective bargaining.

But the potential benefits of unions in the private sector are very attenuated and probably nonexistent in the public sector. First, public employees are typically protected by civil service statutes that provide an important measure of job security and protection from arbitrary hiring and firing decisions. These statutes also tend to regulate promotion and compensation decisions. The potential for a spoils system to arise or for politicians to seek vengeance on opponents in government employ provide strong arguments for such statutes. Their omnipresence, however, at the very least mitigates the need for an additional layer of union protection. Second, governments typically face lower borrowing costs and enjoy easier access to sources of direct financing (i.e., taxation) than private sector employers, which insulates the public sector from the business cycle. Indeed, despite much talk of layoffs in government, since the present recession began in 2008, private sector payrolls have declined by over seven million, while government payrolls overall hardly budged. Third, workers who prefer government employment typically have a variety of options (federal, state, county, city) or possess skill sets that are transferable to the large private service sector. In short, the potential social benefits offered by private sector unions are not present in the public sector.

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The cost of public sector unions, however, is very high. For a number of reasons, public sector unions are likely to impose larger wage and benefits premiums than private sector unions, as well as creating additional problems, like inhibiting democratic decision-making. Industrial unions faced natural checks on their own power — most importantly the power of the free market — and the free market constrains super-competitive wages and benefits. Unionized companies must raise capital and compete in the product market. For this reason, economists have suggested that unions can flourish indefinitely only when a firm has the ability to raise prices above a competitive level, an increasingly rare circumstance in the private sector.

By contrast, state and local governments typically have the ability to “raise prices” through higher taxes or worse services. The cost of moving from state to state is generally far higher than that of switching products. States also face less stringent controls from financial markets. While state and local governments do compete in some measure for residents and businesses, such a dynamic clearly takes much longer to play out in the public sector relative to the private sector, or indeed only becomes realizable in circumstances like the present crisis. In particular, places with significant local amenities (think California and New York) may be able to persist under a dreadful public sector because residents are willing to pay, in terms of higher taxes and worse services, to enjoy the weather or cultural opportunities offered. This dynamic transfers the benefits of those amenities from taxpayers and consumers of public services to public sector employees, a wealth transfer that is not, we suspect, one which most advocates of redistribution would choose as a first (or even third, fourth, or fifth) option.

In some contexts the market for the products offered by government may offer some

constraint on public union behavior. For example, parents may opt for private education. But the cost differential between private and public education weakens the strength of competition in this or indeed any area in which the government provides a service free of charge. Parents may also opt for suburban environments where they may more closely monitor the delivery of public goods. But even in that case, government delivered services are predominant and state laws passed at the behest of unions may stymie local innovations. Thus, competition for public goods will not be effective at disciplining public sector unions.

### THE HIDDEN COSTS

**T**HE UNION WAGE premium, public or private, is a notoriously difficult thing to measure. Estimates of public employee premiums run between 5 percent and 20 percent, and often focus on a particular type of union (e.g., police officers' unions). The "wage premium," however, relates only to cash compensation. Given the valuable intangible benefits of job security, early retirement, and defined-benefit pension plans, one wonders why any wage premium exists at all. Perhaps one can best gauge the excessive nature of public employee compensation by evaluating these intangible benefits. Public unions take compensation in the form of early retirement, gold-plated health care, fewer working hours, and large defined-benefit pension plans. We do not typically observe such benefits in the private sector, where the benefit to salary ratio is much lower. Why would the public sector unions focus so much effort on benefit packages, rather than outright compensation, to a degree not seen in the private sector?

One answer is that benefits are relatively opaque. Consider retirement benefits. Public employee union members get very large retirement benefits. Retirement benefits are not as transparent to the public as wages. Wages are more directly comparable from job to job, including from the private to public sector. The value of retirement benefits, in contrast, depends on a variety of factors, including the age and disability conditions under which they are available. In addition, because public pensions are defined benefit plans that pay out sums long into the future, the actual cost to the public of unfunded liabilities can be a subject of monumental dispute, depending on contestable assumptions regarding rates of return and the like. For example, one credible independent assessment placed California's unfunded public pension liability at a staggering \$535 billion, a sum vigorously disputed by California's pension managers, who placed the unfunded portion at around \$55 billion. But for the general public even a little complexity may serve as effective camouflage. Even a directly observed benefit, such as retirement age, is hard to quantify in terms of cost to the state and value to the employee. Without knowing the value of the pension, job security, arbitration provisions, and overtime pay options, it will be difficult for taxpayers to know whether such benefits are justified.

Some of the pension complexities favoring union members are quite extraordinary. They are often paid a pension based on their previous year's wages or an average of their previous three years' wages, including overtime. They then are permitted to put in lots of overtime work during this one period. The result is to top up their pensions, severing any close connection between pensions and public employees' lifetime earnings on the job.

Finally, retirement benefits are paid out in the future and do not have to be funded by current revenues. As a result, politicians do not have to raise taxes to pay for them now. They can fund them with debt or even, and perhaps better from a politician's point of view, not fund them at all. In any event, as just mentioned, the amount of liability is subject to great uncertainty. But tax payments are the most direct signal citizens get about the cost of government services. By substituting debt or unfunded mandates, politicians under union influence are able to distort the political process to both their

and the unions' advantage.

#### THE POWER OF PUBLIC SECTOR UNIONS

**P**OLITICAL DYNAMICS ALSO explain more generally the powerful leverage of public employee unions. In the private sector, negotiations take place between owners, or their agents, and unions. Thus, the negotiations are at least two-sided. By contrast, in the public sector, the citizens of the state who pay taxes and receive benefits are the stakeholders across the bargaining table from unions. The citizen stakeholders are represented by elected officials, most of whom have received significant campaign contributions from public sector unions. In such a situation, taxpayers are liable to exploitation by the union. Taxpayers are a classic example of a diffuse group whose influence in politics is far less than their numbers. Because each taxpayer is less likely to decide an election through his vote than he is to be hit by lightning on his way to the polls, a taxpayer rationally does not invest much in learning about government policies or the positions of the candidates. In contrast, public employee unions are a classic example of a concentrated group which can monitor the behavior of government officials. Public employee unions, by virtue of the dues they collect from members, possess war chests from which they can contribute to politicians who support their goals. These goals, not surprisingly, involve first and foremost accruing benefits for their members. It is an axiom of political science that politicians tend to reward concentrated groups at the expense of the public, because these groups can in turn provide the most rewards to them.

Moreover, the time horizon of politicians is short and the problems with union benefits or job protections often become clear only after a long while or in moments of crisis. Thus, politicians have strong but perverse incentives to provide benefits to unions, often in hidden ways that only come to light in bad times. Of course, by that point, the politicians have left. The costs remain.

It is true that public employees are not the only set of like-minded individuals who can combine to form an interest group. Others, from milk producers to oil companies, also lobby the legislature for benefits that often come at the expense of the public interest. But public employees formed into a union have both special privileges and a special position that gives them uniquely powerful and damaging leverage in the political process. First, unlike milk producers and other typical interest groups, most public sector unions enjoy the legal privilege of assessing dues from their members. This privilege helps them avoid the free-rider problems that plague collective action. Individual people and companies are reluctant to give to a self-serving political cause unless they can be sure others benefited will also support it financially. But, armed with the coercive authority to collect dues, public sector unions have the legal infrastructure to become particularly effective at wielding political influence.

***Public employees are uniquely positioned to gain exactions. The government operates through employees and sets their wages and benefits.***

Second, public employees are uniquely positioned to gain exactions. The government operates through employees and must set their wages and benefits. In some sense, government must bargain with its employees and govern their daily activities. In contrast, there is no necessary direct relation between the government and milk producers or other private actors. This special interrelationship provides more opportunities for employees to seek benefits. Moreover, unjustified benefits are harder for the public to spot. Social norms have also developed in market democracies that force companies and governments to deal with each other at arm's length. Such norms are harder to formulate and to enforce for public employees, given the necessarily

special connection between the government and its employees.

Third, the extensive and necessary relation between government and its employees, combined with a lack of transparency inherent in that relation, facilitates exactions peculiarly noxious to the public interest. Public employees, unlike other interest groups, can negotiate directly with the government for a special kind of benefits that only employees can receive and which may not be very visible to the public. For instance, public school teachers can bargain for tenure. Yet tenure may lead to enormous costs when a school is unable to fire incompetent teachers and properly incentivize other teachers, thus leading to large losses in student achievement and later losses in productivity for society. Paying a larger wage premium to teachers would likely be better for society than teacher tenure, but unions and politicians choose tenure because it is an opaque benefit arising out of the employment relationship. The public is unlikely to focus on an issue like teacher tenure, whose relation to the bottom line is far more subtle than wages. Indeed, it is a benefit teachers can exact, while at the same time alleging that they are underpaid.

#### THE DISTORTION OF DEMOCRATIC POLITICS

**P**UBLIC EMPLOYEE UNIONS impose even more substantial costs on states beyond the unjustified direct benefits their workers receive. Their worst consequence is the distortions they create in the public policy arena. Because of their concentrated influence, they are able to substantially direct — indeed sometimes dictate — the shape of public policy in the area in which they are employed.

The most notorious example is public education. Teachers' unions are the single greatest obstacle to improving education in this country. Unions are almost universally associated with seniority pay, job tenure (including layoffs based on seniority), inflexible work rules, and lack of productivity-based pay. Teachers' unions are no exception: They make it difficult or impossible to fire bad teachers, pay good teachers more, or conduct layoffs in a rational fashion. Media reports have recently highlighted the difficulties in New York City. There, teachers earn tenure after only three years on the job, and a hearing to dismiss a teacher take years and costs hundreds of thousand dollars (teachers are paid in full for the duration of such hearings, although they don't actually do any work). Although the city has stepped up its effort at dismissals, very few teachers are fired for incompetence. In many places, union rules on teacher assignments make it more difficult to match teachers with the pupils for whom they would make the most difference. The unions also make it harder to create flexible schedules that would make more efficient use of school facilities. In some states, such as Minnesota, unions have made it impossible for their educational systems to participate in the Obama administration's Race to the Top program. In short, the teachers' unions make the public school rigid, unproductive, and hidebound at great monetary cost to taxpayers and at educational cost to the children that they are supposed to teach.

In addition, because government controls the vast majority of education spending, teachers' unions can use political power to throttle competition. Because private schools and charter schools do not necessarily employ union members, teachers' unions see the growth of such schools as a danger to their size and resulting political power. As a consequence, they have tried to obstruct such initiatives at every turn. A recent shocking example is their ability to exert influence over the Democratic Congress in order to end the small-scale school voucher program for low-income students in the District of Columbia.

One does not have to believe that vouchers or charter schools are the solution to problems in education to see the influence of teachers' unions as pernicious. The nation simply does not have full information about the most efficient way to educate its

children or the best way to address a host of social problems. Democracy works through informal experiments. But teachers' unions make it hard to conduct the necessary experiments, because their focus is simply on protecting the perquisites of their members. And teachers' unions are extremely powerful. As Steven Brill pointed out in a recent *New York Times Magazine* article, they have contributed \$57 million over the last 30 years to federal campaigns — more than any other union or corporation. And their contributions at the state level are even larger. But teachers' unions are far from the only example of a union that distorts public policy in the area of employment.

***Unions are focused on getting high salaries and other benefits for their members as well as expanding their workforce.***

Correction officers' unions are powerful forces in states like California and New York; they push for the construction of more prisons and for longer sentences for criminals (so that there are more people for correction officers to guard). Their activities in California are a case in point. In the last eight years they have spent \$10 million on state politics — either in direct contributions to politicians or in spending on ballot initiatives relating to crime and punishment. They have mounted full-scale political campaigns. For instance, the California corrections union has attacked public officials, such as the Los Angeles district attorney, who supported an alternative to the union-favored “three-strikes law.” Indeed, Supreme Court Justice Anthony Kennedy in February of this year noted that “the three-strikes law sponsor is the correctional officers' union and that is sick!” In 1999 the union even successfully opposed a proposal to permit the California attorney general to prosecute brutality in prisons.

One does not have to be a soft-on-crime liberal to believe that such influence is likely to distort sound penal policy. In particular, it is likely to inhibit experiments in the use of modern technology to impose constraints on law violators *outside* of prison, at less expense to taxpayers, and with more chance of aiding the reintegration of criminals in society.

As this last example shows, public employee unions cannot be counted on to support liberal causes. There is no intrinsic reason they will advance the goals of progressives. Unions are focused on getting high salaries and other benefits for their members as well as expanding their workforce in order to gather more dues and be more effective at wielding their influence for further increases in salaries and benefits. But if progressivism is focused on helping the least advantaged of society, unions are likely to cause systemic harm. The least advantaged are by definition not among their members. While members of some public service unions may work in areas that greatly affect the poor, their interest in working shorter hours and avoiding high standards of accountability are naturally at odds with the interest of the clients they serve.

Of course, it is true that public employee unions are interested in growing government. But big government cannot be the end in itself of justified progressivism. Because of their incentives, public employee unions in fact make it less likely that progressives can shape state services into a force for the long-term betterment of the poor. Public employee unions discourage citizens in the long run from supporting high levels of public goods because citizens realize over time that a large portion of their support is siphoned to give union members an easier life. One question voters will come to ask is what share of additional funds going to public schools or public transit will go to unions. Moreover, in the long run as well, inefficient public services are likely to drive business and individuals out of the state, depriving progressive governors of the tax base to pay for public goods that actually deliver the goods.

In short, public employee unions impede the ability of governors to use states as

laboratories for progressive experiments. States with high taxes that deliver high quality public goods are viable in the long-term competition among states. Public sector union privileges, however, will significantly impede such experimentation.

#### ALTERNATIVES AND PROSPECTS

**W**HILE THE KIND of exploitation that led to industrial unions is not relevant in the public sector, one may still have reason to worry about some kinds of exploitation and unfairness. The most substantial concern is that the political parties will use the public sector as a patronage dumping ground and penalize individuals who do not agree with the party in power. Such a patronage system could also lead to some of the same problems created by public sector unions by undermining the quality of public services and leading to excessive wages and benefits.

But there are already substantial protections against these concerns under most state laws. Reform movements beginning in the 19th century moved to a civil service model of government hiring and promotion. In the last century, the Supreme Court sharply curtailed the ability of state governments to fire people for their opinions. In the cases where these protections are inadequate, any entrepreneurial governor should strengthen them as part of the same package in which he gets rid of union privileges. Fairness for public employees is in the interest of an efficient public service, but the interest of unions is not primarily in fairness but in the insulation of employees from accountability — a very different matter.

Given the political strength of public employee unions, it remains a legitimate question how any governor could muster the political will to abolish their privileges. But the current financial situation of states is unprecedented. Even more importantly, the crushing burdens of unfunded government employees, hidden for years, are becoming plain for citizens to see. It is difficult to get citizens engaged in any particular dispute with an individual union or even a set of unions. There are too many unions and no one dispute makes enough difference to citizens' lives to elicit sustained interest. But the solution to the problem of public apathy is to elevate the dispute with unions to the level of union power in general and to make clear the ability of unions to extort money from government and squeeze the vitality from its services. Public employee unions came into being largely in the shadow of the powerful case that industrial unions had already made for themselves. But recent events have shown up the way public employee unions exploit the powerless citizenry, depriving them of the moral high ground.

Some governors have already reacted to the crisis by cutting salaries and curbing pension benefits for new workers. Such action is welcome, but it does not address the structural problems for democracy that public sector unions cause. Once the crisis passes, unions will use their privileged position to gain new exactions and frustrate democratic reforms. Only through real structural change — the abolition of public union privileges — can a state reduce the entrenched and disproportionate influence of public employees on state politics.

Thus, the time is ripe for a dispassionate case for radical change in the power of public sector unions. A sitting governor or gubernatorial candidate, no matter what his or her preferred policy (whether more government services or lower taxes), can argue that these privileges are unnecessary to protect workers in the public sector and a threat to the financial and indeed democratic health of state government. Union influence not only burdens taxpayers with unjustifiable and nontransparent expenses, but also inhibits important experiments in the delivery of essential public goods like education.

After the public services unions' legally enforced right to bargain collectively, to enjoy mandatory arbitration, to strike, and to collect union dues has been abolished, public employees will be able to individually and collectively petition state government about conditions in their workplaces. State employees still have political rights as citizens.

Their knowledge of government and proximity to power will tend make them more effective at pressing their concerns than ordinary citizens, too. But state employees should not be able to wield, in addition, the cudgels of legal coercion now enjoyed by public employee unions. Democratic deliberation about the nature and extent of public goods can flourish only if those whom the public must use to produce those goods cannot direct and dictate the terms of their provision.

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