

Public vs. Private Compensation:
A Comparison of Public and Private Compensation
in Alabama's Workforce

Wendell Cox



Founding Principles in Action



Alabama's Excess State Employee Compensation Bill

Introduction: The Economic Gap between State and Private Sector Employees Continues

by Michael Ciamarra, Vice President of the Alabama Policy Institute

Given that 2006 is an election year, the Alabama Legislature predictably passed a five percent pay raise for some 37,000 state employees. Those employees included in the pay raise are non-education employees and those employed by all General Fund state agencies. Some advocates of the raise contended that state employees are dedicated but underpaid public servants. Assuredly, most of them are dedicated. But underpaid? Perhaps not.

The Alabama Policy Institute (API) supports the general proposition asserted in a recent editorial, which reads, "In general, Alabama taxpayers should want as few state employees as possible, but only if there are enough of them to deliver adequate services" (*Montgomery Advertiser*, "Ensure new workers are really necessary," 3/21/2006). In addition to ensuring that any new state employees are necessary, the state should ensure that they are adequately compensated for the services they provide and within a range of what they would be paid if they were seeking employment in the private sector.

This report prepared by Wendell Cox demonstrates that Alabama state employees do very well financially in comparison to comparable employees in the private sector.

Protected Class

In the late 1980s and early 1990s many states found themselves facing serious fiscal hardships. In response, state legislators considered a number of proposals to make up their budget deficits. Many simply raised taxes or user fees. One strategy proposed reducing public sector workforce costs, including a cap on employment, a freeze in state hiring, a reduction in the number of government services, and the renegotiations of labor contracts with merit system or civil service unions. Predictably, these solutions never moved very far through the legislative process.

To make matters worse, during the surge in state revenues during the mid- to late-90s, most states used the additional revenue to increase state employee compensation and benefits. In a report on public employee compensation, the Connecticut based Yankee Institute stated that, "By the end of the decade, according to the Employee Benefit Research Institute, average state and local employees were collecting nearly 50 percent more in total compensation than the average private sector taxpayer, with local governments paying an astonishing 128 percent more than private sector employers to fund health care benefits and 162 percent more on retirement benefits."

About a decade ago, the American Legislative Exchange Council (ALEC), working with Wendell Cox, set out to delineate trends in public employee compensation at the state and local government levels. Through a series of seminal public policy reports, called *America's Protected Class*, Cox successfully illustrated the inequities in compensation found between public and private sector employment.

The Cox studies demonstrated that one of the major components of state and local tax increases in the 1980s was the rising cost of public employees. *Protected Class* also showed that over the

years, public sector compensation rapidly outpaced that of the private sector. All follow-up studies after *Protected Class* have shown that a major gap persists between the public and private sector pay scales, and the end result has been a drain on state revenues and state economies.

The Bureau of Labor Statistics' data on state, local, and private sector workers is revealing. In virtually every state, government workers have higher average annual salaries and benefits than those in the private sector.

In 1997, private sector workers in only six states had higher average annual salaries than those in state government. The number fell to five states in 2002. That year the salaries of state government workers in the United States averaged \$39,233 per year—compared to \$36,517 in the private sector.

State government workers across the United States also have experienced more steady salary growth than workers in the private sector. For example, in 1998 private sector salary growth was 5.6 percent, compared to 3.3 percent in state government. Private sector growth peaked at 6.3 percent in 2000 before falling to 1.0 percent in 2002, as the economy underwent a shallow recession. Growth in state government salaries, however, held steadily around 3 percent to 5 percent during the same time. While private sector salary growth fell by 4.6 percent from 1998-2002, state government salary growth increased by 0.5 percent.

As salaries have grown, so have the state's liabilities for state employee pensions. With state employee salaries, the growth has always been obvious. However, the growth in long-term unfunded pension and benefits liabilities for state employees has been largely hidden from the public because it has not been shown on the state's financial reports. That is about to change, new rules for transparency passed by the Government Accounting Standards Board (GASB) will soon require all state and local governments to show these unfunded liabilities on their balance sheets. For many states, this will expose to the public the enormous unfunded liabilities that are accruing that the state is obligated to pay. Nationwide, according to a Standard & Poor's analysis reported on in *USA Today* and cited the Yankee Institute, the shortfall in funding for state employee pensions is at \$284 billion. In an article widely published in Alabama newspapers just before Christmas, the head of the Retirement System Dr. David Bronner, wrote that in 10 years the state of Alabama could be faced with a \$15 billion unfunded liability.

While many erroneously believe that government workers are underpaid, the facts are that state and local government workers—state public employees in particular—enjoy some distinct advantages over their private sector counterparts when it comes to average annual salaries and benefits. Moreover, with record revenue surpluses Alabama state legislators and other elected officials must avoid the temptation to spend these surpluses on bigger government and expensive pay raises.

State Government Workforce

In 1995, Gov. Fob James instituted an across-the-board hiring freeze within state agencies. This hiring freeze was maintained throughout most of the Siegelman Administration. The number of state employees grew slightly in 2005. According to the state Personnel Department's annual report, state agencies employed almost 34,000 people at the end of fiscal year 2005, growing slightly by 0.3 percent from the previous year. The growth was mainly in the Department of Transportation and the Department of Human Resources.

The increase in state jobs in fiscal year 2005 is due to a good economy and growth in state tax collections. A state employee now earns an average of about \$36,730 per year. The raise enacted by the 2006 Legislature boosts that amount to about \$38,500 and is projected to cost taxpayers an extra \$78.2 million a year, including an estimated \$11.1 million of FICA and retirement costs. In addition, state employees also received a raise in 2005 and that about three-fifths of those employees are eligible for merit pay raises of 2.5 percent to 5 percent this year.

Public Pays

This report demonstrates that Alabama state employees are paid more compared to their relative counterparts in the private sector. *Protected Class* highlights some revealing findings, including the noteworthy disparity in the number of hours worked by state employees compared to the private sector employees each year. State employees work an average of 189 hours less than private sector employees per year, which translates into state employees working over four and a half weeks less than private sector employees.

In addition, other findings include the following:

- Alabama state employees have higher wages than would be expected at its relative economic level (based upon personal income per capita);
- Alabama state employees are paid for working, on average, almost two days less per month than private employees;
- The wages and salaries of Alabama state employees increase at a faster rate than in the private sector;
- Over a career, an Alabama state employee is estimated to receive \$195,000 more in compensation (wages, salaries, and benefits) than an employee of equal education and equal skill in the private sector;
- Over a career, an Alabama state employee is estimated to receive \$350,000 more in compensation (wages, salaries, and benefits) than an equal-education, equal-skill employee working the same number of hours in the private sector;
- The excess cost of Alabama state employee compensation appears to be between \$295 million and \$360 million annually;
- The excess cost of Alabama state employee compensation appears to be from \$169 to \$209 per household annually; and
- State employees average over twice as many sick days (10) per year as the private sector employees (4).

The principal problem in Alabama, as it is in most other states, is that government employee compensation and staff sizes are established through the political processes, not through the market processes that govern the private sector. A company that pays its employees more than market rates and allows them to work almost four and a half weeks less than their counterparts in the marketplace will soon be out of business. When private companies are faced with serious economic challenges, they pare down staff size and become more productive through cross training and the use of technology that allows them to become more efficient and more cost effective.

In the private sector, companies either fail or abandon economically unsustainable practices. In government, economically inefficient practices are sustainable because more money can be extracted from taxpayers. A *Montgomery Advertiser* editorial (3/26/06) warned, “Just because there is more revenue available should not automatically result in more state employees.”

Solutions

Although the API advocates neither layoffs nor terminations, we do believe that government employee compensation is in need of serious reform. The hiring freeze needs to be tightened and strictly kept in place, while lawmakers should carefully consider the following recommendations for making the state employee workforce less costly:

- To determine what services or programs could be contracted out to the private sector, hold a hearing and use competitive bids and contracts wherever possible.
- To reduce costs, reduce the number of paid state holidays from the current 13 to 10. Since the average number of official paid holidays granted state employees nationwide is 11.2 days, this three-day reduction would place Alabama in line with the average of other states, as well as with federal holidays. The authority of the governor to grant an extra state holiday at Thanksgiving and at Christmas by executive order should not be restrained, nor should such an executive prerogative be restricted at any other occasion. It should be noted that the cost to the state of a state holiday is not the total salary and benefits earned for the day, but rather the cost of overtime for those essential employees who are required to work that day. Other costs may be reduced as a result of updating state holidays; these can viewed as an offset against overtime.
- To motivate acceptance of these savings, grant higher wages, benefits, or both.
- To reduce employee costs in the shortest amount of time without having to terminate employees, require all Deferred Retirement Option Plan (DROP) program enrollees to retire once they have completed their enrollment period. Given that Alabama allows enrollment in the DROP program after 25 years of service and are at the most 55 years old, the potential savings in the short term would be substantial. Moreover, there would be a substantial reduction in the state's unfunded pension and health benefits liabilities for retirees. Any employees deemed critical for retention could be hired on a contract-employee basis as needed.

Additionally, the governor's office can emphasize cross training with state agencies to facilitate the reduction in manpower needs of the state, and technology and additional online services should be used to further reduce the manpower needs. In addition to these reforms, a comprehensive state employee compensation report should be produced annually by the State Auditor.

Cost-Effective Public Administration

Public employees in state government are still a protected class in the United States. State employees make more money, have more stable salary and job growth, and get better benefits, on average, than those in the private sector, while working substantially fewer hours.

At a time when Alabama's General Fund has experienced so many shortfalls and unpredictable growth projections, it is surprising that more state lawmakers are not re-assessing public/private pay equity. According to Cox and ALEC's series on state employee compensation calculations based on average salary differences and total number of employees, most states could have significant amounts of money in their General Funds merely by paying their own employees the average salary paid in the private sector.

Of course, this analysis is only quantitative and does not take a number of dynamics into account, namely the type of work done by state and private sector employees. Nor does this report attempt to evaluate the differences in the relative value of the work of a state employee, as compared to private sector employees performing similar functions.

The bottom line is that Cox puts to rest the myth that government workers on average are underpaid—especially when benefits, pensions, and hours worked are taken into account, compared to those in the private sector.

Alabama's Excess State Employee Compensation Bill
By Wendell Cox

This report evaluates information available on Alabama state employee compensation, making comparisons to other states and to the private sector. Generally, the conclusion is that Alabama state employee pay is higher than in comparable states. More importantly, it is concluded that state employee compensation (that is, wages and employer-paid benefits) in Alabama is substantially higher than for *equivalent* employees in the private sector in the state. As will be shown below by an analysis of comparable state and private employees (equal education, equal skill), this discrepancy in pay is principally the result of the fact that the state, unlike the private sector, does not establish employee compensation using reliable market mechanisms.

Comparison to Other States

In 2002, Alabama's average income per capita was 12.5 percent below the median of the states. Average state employee wages and salaries were 1.8 percent below the median of the states. Thus, in relation to average income per capita, Alabama state employees were paid 12.4 percent more than if wages and salaries differed from the state median by the same percentage as personal income per capita (see Table 1).

The average Alabama state employee wage and salary level is notably high compared to the neighboring states of Georgia and Florida. These two states have 13 percent to 16 percent higher income per capita, respectively, than Alabama. Yet, the average Alabama state employee is paid more than in either state.

Finding #1: Alabama state employees have higher wages than would be expected at its relative economic level (based upon personal income per capita).

State and Private Compensation in Alabama

At first glance, it appears that state and private employees receive similar wage and salary rates in Alabama. The average full-time-equivalent private employee was paid \$33,628 in 2002.¹ In contrast, the average full-time-equivalent state employee was paid \$33,807,² only 0.5 percent higher than the average private employee.

¹ Average private wages and salaries have been increased to adjust for full-time equivalency.

² Estimated for full-time equivalent employees based upon information provided by the State of Alabama Personnel Department.

**Table 1
State Personal Per-Capita Income and State Government Employee Wages and Salaries**

	Per-Capita Income		Average State Government Wages & Salaries		Index	Rank
	Personal	Compared to State Median (\$29,182)	Per Employee	Compared to State Median		
Alabama	\$25,548	-12.5%	\$36,529	-1.6%	12.4%	11
Alaska	32,799	12.4	47,736	28.5	14.4	8
Arizona	26,360	-9.7	35,082	-5.5	4.6	25
Arkansas	23,556	-19.3	31,328	-15.6	4.5	26
California	32,989	13.0	54,795	47.5	30.5	1
Colorado	33,723	15.6	47,418	27.7	10.5	18
Connecticut	42,468	45.5	49,236	32.6	-8.9	44
Delaware	32,090	10.0	38,689	4.2	-5.3	38
Florida	29,758	2.0	35,022	-5.7	-7.5	43
Georgia	28,821	-1.2	32,340	-12.9	-11.8	47
Hawaii	29,875	2.4	39,529	6.4	4.0	28
Idaho	25,476	-12.7	36,715	-1.1	13.2	10
Illinois	33,053	13.3	44,990	21.1	7.0	22
Indiana	28,032	-3.9	34,213	-7.9	-4.1	35
Iowa	28,089	-3.7	43,026	15.9	20.4	3
Kansas	28,905	-0.9	34,310	-7.6	-6.7	42
Kentucky	25,494	-12.6	35,942	-3.2	10.8	17
Louisiana	25,296	-13.3	34,258	-7.8	6.4	23
Maine	28,038	-3.9	39,860	7.3	11.7	13
Maryland	36,303	24.4	43,533	17.2	-5.8	41
Massachusetts	39,085	33.9	47,757	28.6	-4.0	34
Michigan	29,816	2.2	45,185	21.7	19.1	5
Minnesota	33,322	14.2	47,272	27.3	11.5	15
Mississippi	22,550	-22.7	28,862	-22.3	0.6	31
Missouri	28,512	-2.3	30,881	-16.8	-14.9	50
Montana	24,831	-14.9	35,215	-5.2	11.4	16
Nebraska	29,182	0.0	32,078	-13.6	-13.6	48
Nevada	30,559	4.7	45,460	22.4	16.9	7
New Hampshire	33,985	16.5	37,320	0.5	-13.7	49
New Jersey	39,461	35.2	49,670	33.7	-1.1	32
New Mexico	24,823	-14.9	35,386	-4.7	12.0	12
New York	35,805	22.7	50,143	35.0	10.0	19
North Carolina	27,785	-4.8	35,883	-3.4	1.5	30
North Dakota	26,852	-8.0	32,370	-12.8	-5.3	39
Ohio	29,195	0.0	43,868	18.1	18.1	6
Oklahoma	25,936	-11.1	34,385	-7.4	4.2	27
Oregon	28,792	-1.3	39,481	6.3	7.7	20
Pennsylvania	31,116	6.6	41,753	12.4	5.4	24
Rhode Island	30,859	5.7	49,555	33.4	26.2	2
South Carolina	25,502	-12.6	31,415	-15.4	-3.2	33
South Dakota	26,967	-7.6	32,886	-11.4	-4.2	36
Tennessee	27,611	-5.4	33,606	-9.5	-4.4	37
Texas	29,039	-0.5	34,855	-6.1	-5.7	40
Utah	24,639	-15.6	37,659	1.4	20.1	4
Vermont	29,764	2.0	42,946	15.6	13.4	9
Virginia	32,793	12.4	36,957	-0.5	-11.4	46
Washington	32,638	11.8	44,484	19.8	7.1	21
West Virginia	23,794	-18.5	31,400	-15.5	3.7	29
Wisconsin	30,050	3.0	42,658	14.9	11.5	14
Wyoming	31,021	6.3	35,191	-5.2	-10.9	45
State Mean	\$29,659		\$39,223			
State Median	29,182		37,138			

Sources: U.S. Department of Commerce and U.S. Census Bureau.
State employee wages and salaries. Excludes education, utilities, liquor stores, airports, and waterway personnel.

More Lucrative Employer-Paid Benefits

The near-equality in state government and private employee pay is erased when employer-paid benefits (such as health insurance, social security, retirement, and other employer-paid benefits) are considered. State government employer-paid benefits are considerably higher than in the private sector. State government employee-benefit costs are estimated at 28.5 percent³ compared to wages and salaries. Private employee-benefit costs are estimated at 21.9 percent of wages and salaries.⁴ Thus, the employer-paid benefit factor for state employees is nearly one third higher than that of private employees.

Employer-paid benefits raise the average private employee compensation level to \$40,987. The average compensation, including wages, salaries, and benefits, of state employees was \$44,672. Thus, in 2002, the average state employee was compensated 9.0 percent more than the average private employee in Alabama.

More Pay for Less Time

However, even the widened gap created by more expensive state employee benefits does not fully quantify the state employee advantage. State employees receive more paid time off than private employees in Alabama.

On average, full-time state employees spend 10 percent fewer hours on the job for their compensation than private employees. State employees use more than twice as many annual sick days as private employees (10.2 compared to 4.4).⁵ It is estimated that state employees spend 1,726 hours per year at work.⁶ Private employees spend an average of 1,915 hours on the job.⁷ It is estimated that Alabama private employees are at work, on average, more than a month more each year than state employees (189 hours). Each month, the average state employee is paid for not working approximately two days that private employees would work.

As a result, the average private employee is compensated \$21.41 per hour worked. The average state employee is compensated \$25.88 per hour worked (see Figure 1), 21 percent more than the average private sector employee. This amounts to a compensation difference of more than \$7,700 for a 1,726-hour work year.⁸

³ Calculated from information provided by the State of Alabama Personnel Department.

⁴ Calculated from U.S. Bureau of Labor Statistics private employer cost for employee compensation for the South region, of which Alabama is a part.

⁵ As compared to national data from the U.S. Department of Labor Bureau of Labor Statistics.

⁶ The number of work hours in a year is 2,080, before deducting vacations, holidays, and sick time. On average, state employees are absent for 21.1 days of vacation (State Employees Insurance Board, *State of Alabama, State Employee Compensation, Southeastern States Survey*, December 2003), 10.2 sick days (*Southeastern States Salary Conference Benefits Survey*, 2000), and 13 holidays (State of Alabama Personnel Department, *2002 Annual Report*). This off time reduces the number of hours worked to 1,726 (at eight hours per day).

⁷ Calculated from U.S. Bureau of Labor Statistics private employer cost for employee compensation for the South region.

⁸ Hourly difference in pay multiplied by state employee average hours worked.

Figure 1: Alabama Employee Compensation—2002



Finding #2: Alabama state employees are paid for working, on average, two days less per month than private employees.

Compensation Increases

Further, state employee pay has been rising faster than private pay in Alabama. Since 1980, the average wage per state full-time-equivalent employee has risen 15.4 percent, after adjustment for inflation.⁹ This calculation compares to a one-third lower private employee increase at 9.5 percent. In 1980, the average state employee was compensated \$1,300 more than the average private employee (adjusted for inflation).¹⁰ By 2002, this advantage had risen to nearly \$3,700.

Finding #3: The wages and salaries of Alabama state employees increase at a faster rate than in the private sector.

Employment Compensation and the Market

The preceding analysis shows that the people who pay the taxes that finance state employee compensation—private employees—are paid less than state employees. Of course, this statement is not to suggest that state employees do not pay taxes. However, state employees are net recipients of tax funding—they pay far less in taxes than they receive in tax-generated wages, salaries, and employer-paid benefits. Of course, private employees receive virtually no wages, salaries, or employer-paid benefits from taxes.

Not all jobs are the same, and the fact that average state employee compensation is above private employee compensation is not, in itself, evidence of overpayment. It is routinely argued that government employee staffs tend to have more highly educated and specialized work forces than in the private sector. All things being equal, higher compensation rates for state employees, therefore, could be justified. However, there is no reliable standard for comparison. Further, there is general agreement that government employee compensation should be, like private

⁹ Calculated from U.S. Census Bureau, *Public Employment*. Data for non-education state employees.

¹⁰ Estimated for Alabama full-time-equivalent private employees.

employee compensation, at rates determined by the market. Unfortunately, without a genuine market test, it is nearly impossible to reliably determine market rates. As Nobel Laureate economist Frederik Hayek rightly pointed out, the market price cannot be known until there is competition.

Employee compensation in the private sector is established by the market. Employers compete to attract and maintain qualified employees by paying competitive wages and providing competitive benefits and other features of the job. Government, though, generally is not in a competitive (market) environment, so other mechanisms must be used to estimate market-based employee compensation rates.¹¹

In the United States, the philosophy generally is that government employees should be paid at the same rate as persons doing comparable work in the private sector. This comparability, if achieved, should help assure that government employees are paid market rates, but that determination is not so simple.

Governments generally attempt to establish employee compensation by studying compensation patterns in similar jurisdictions. The results of such a study can be inherently invalid, because the theory assumes that the compensation rates in other states (as in the present case) have been set on a genuine market basis, and they generally have not been. Surveys are performed routinely to compare government jobs that are perceived to be similar in the private sector. Usually such studies are limited to the largest employers, which may not be reflective of the genuine market for the required labor. In an inquiry intended to produce genuine market rates, the question presented is, “What is the compensation rate necessary to obtain sufficiently qualified employees?” rather than “What are other large employers paying?” There can be a considerable difference in the answer of both questions.

Moreover, government compensation comparison studies often do not consider the value of benefits, such as vacations, holidays, retirement packages, and health insurance. It is in these benefit areas that the largest differences generally will be found between government and private compensation. In general, government employees work fewer hours than their counterparts in the private sector, and they receive more lucrative benefits, as has been shown to be the case in Alabama.

Another problem with comparing public and private positions and pay is that the mechanisms used to estimate compensation for comparable jobs in the private sector can be subject to political pressures and outright manipulation.¹² More importantly, government employee

¹¹ Competitive rates can be obtained by government for employee compensation through the use of competitive contracting, which involves the provision of government services through periodic competitive procurements. There are many examples of competitive contracting both in Alabama and the rest of the nation. However, competitive contracting is more extensively used in other nations, such as the United Kingdom, Australia, and New Zealand.

¹² Compensation comparability studies are normally conducted by government agencies themselves or through consultants. Either approach is subject to difficulty. Internally-developed studies can be expected to err on the side of suggesting higher compensation levels for employees. A similar situation exists with respect to consultant studies. Generally, consulting firms that rely upon large clients (such as government or large companies) must be forever mindful of the necessity for obtaining repeat business or engagements from other large organizations. Often, consultants receive a “good idea” of what results would be preferred by the client, or know from experience. The results of the study, therefore, will often reflect the wishes of the contracting agency more than an objective analysis

compensation studies virtually never consider employee turnover. Employee turnover is the best measure for determining competitive compensation in the following ways:

- If employees consider the value of compensation and other factors to be well below market, it will be reflected in a much higher than average turnover rate.
- If employees consider the value of compensation and other job factors to be well above market, it will be reflected in a much lower average employee turnover rate.

This situation exists by and large in government and certainly in Alabama. The average state employee in Alabama has been on the job 12.2 years. This average is more than three times the national median¹³ for all employees. More importantly, it is more than double the rates for private sector executives, managers, and administrators. It is also more than double the rate of professional specialty employees, such as engineers and scientists. Establishing the genuine market rate for state and other government employment would require studies and management systems designed to replicate market turnover rates in the government sector.

Equal-Education/Equal-Skill Employee Analysis

Without such a system, however, it is possible to estimate the difference between state and private sector compensation for comparable employees in Alabama. An equivalent employee analysis can be performed to estimate the difference between compensation of comparable employees in state government and the private sector. This analysis compares the compensation, including overtime, of *equivalent* state and private employees who begin their careers at the *same* time and at the *same* wage or salary level. It is assumed that two employees, with the *same education, skills, and job requirements* begin working on the same day, one in the private sector and one an employee of state government. Both employees in the example would retire after 40 years. The starting pay would be the average state wage or salary.

Wage Premium: As noted above, it can be expected that average wages and salaries will rise faster for the state employee, producing, at the 1980 to 2002 rate, an estimated \$73,700 in additional pay over a 40-year career for the state employee (see Table 2).

Table 2
Wages & Salaries Comparison: Equivalent Employees

Year	Employee Type		State Employee Advantage		
	Private	State Government	Monetary	Percent	Cumulative
1	\$34,761	\$34,761	\$0	0.0%	\$0
10	36,078	36,853	775	2.1	3,821
20	37,600	39,326	1,726	4.6	16,718

of the situation, a situation which also occurs in the private sector, with the Enron-Arthur Anderson case appearing to be a recent example.

¹³ Means and medians are different, and caution should be exercised when comparing the two. Where differences of such great magnitude are identified, however, it is reasonable to expect that broadly similar results would occur from comparisons of the medians themselves or the means. Mean data are not available for national tenure, while median data are not available for Alabama tenure.

30	39,187	41,965	2,778	7.1	39,673
40	40,841	44,781	3,940	9.6	73,749
Total	\$1,508,844	\$1,582,594	\$73,749	4.9%	\$73,749

Assumes average annual inflation adjusted increase rate from 1980 to 2002.

Wage and Benefit Premium: As noted above, wages and salaries are just the beginning. Employer-paid benefits add substantially to the state employee advantage over private employees, as follows (see Table 3):

- In the first year, the more costly employer-paid benefits for state employees would result in a total compensation advantage of \$2,300 (5.4 percent), compared to the equivalent private employee.
- By the tenth year, the larger state government salary increases and more costly benefits produce a \$3,400 (7.7 percent) annual state employee advantage, compared to the equivalent private employee.
- By year 20, the state employee advantage grows to \$4,700 annually (10.3 percent).
- By year 40, the state employee advantage will have grown to \$7,800 annually (15.6 percent).
- Overall, over a 40-year period, the value of additional compensation for the state employee, compared to the comparable private employee, would be nearly \$195,000.

Table 3
Wages & Salaries Comparison: Equivalent Employees

Year	Employee Type		State Employee Advantage		
	Private	State Government	Monetary	Percent	Cumulative
1	\$44,672	\$42,367	2,305	5.4%	\$2,305
10	47,361	43,973	3,388	7.7	28,393
20	50,539	45,829	4,711	10.3	69,442
30	53,930	47,762	6,168	12.9	124,450
40	57,549	49,778	7,772	15.6	194,825
Total	\$2,033,849	\$1,839,024	\$194,825	10.6%	\$194,825

Applies estimated 2002 state and private employee benefit rate.

Increase in Benefits Rate: The state employee advantage could be even greater. From 1980 to 2002, the benefits to wage ratio of state and local government employees in the United States rose 3.3 percent, more than six times the 0.5 percent increase in the private sector. If the state data of increase matched the national data, then over a 40-year career \$57,000 would be added to the state employee advantage over an equivalent private employee. Data for Alabama is not readily available. As a result, the equivalent employee analysis does not include an adjustment for increased benefit rate.

Finding #4: Over a career, an Alabama state employee is estimated to receive \$195,000 more in compensation (wages, salaries, and benefits) than an equal-education/equal-skill employee in the private sector.

Time-Worked Compensation Premium: The state employee advantage is even greater on a total compensation-per-hour-worked basis, wherein it is assumed that the private employee would work 1,889 hours per year,¹⁴ the estimated work year for a private white-collar employee, which is somewhat less than the private sector average but more than the state average of 1,726 hours. Therefore, the comparable private employee would work the equivalent of approximately 7,500 more hours than the state employee over a 40-year career—the equivalent of 4.4 state employee work years. On a compensation-per-hour worked basis, the following discrepancies exist (see Table 4):

- The state employee would be compensated nearly \$6,000 more (15.4 percent) than the private employee for working 1,726 hours in the first year.
- The state employee would be compensated nearly \$7,200 more (17.9 percent) than the private employee for working 1,726 hours in the tenth year.
- The state employee would be compensated nearly \$8,700 more (20.7 percent) than the private employee for working 1,726 hours in the twentieth year.
- The state employee would be compensated nearly \$12,100 more (26.6 percent) than the private employee for working 1,726 hours in the fortieth year.
- Over the 40 years, the state employee would be compensated \$353,000 more for 1,726 hours worked annually than the private employee.

**Table 4
Compensation for State Work Year (1,726 Hours)**

Year	Employee Type		State Employee Advantage		
	Private	State Government	Monetary	Percent	Cumulative
1	\$ 44,672	\$ 38,705	\$ 5,968	15.4%	\$ 5,968
10	47,361	40,172	7,190	17.9	65,710
20	50,539	41,867	8,673	20.7	145,651
30	53,930	43,633	10,297	23.6	241,191
40	57,549	45,474	12,075	26.6	353,809
Total	\$ 2,033,849	\$ 1,680,040	\$ 353,809	21.1%	\$ 353,809

Finding #5: Over a career, an Alabama state employee is estimated to receive \$350,000 more in compensation (wages, salaries, and benefits) than an equal-education, equal-skill employee working the same number of hours in the private sector.

Security Premium: Government employees have stronger job security than private employees. Private employers merge with other firms, downsize, or can close. Generally, government

¹⁴ Calculated from U.S. Bureau of Labor Statistics private employer cost for employee pay for the South region.

agencies continue to operate, and government employees need have little concern that their employers will involuntarily terminate their employment, such as through layoffs. For example,

- While it is theoretically possible for a government to declare bankruptcy, it is virtually unheard of in recent decades.
- There is virtually no possibility that the state of Alabama will merge with Georgia or Mississippi and lay off large numbers of employees to reduce costs.
- There is no possibility that the state of Alabama will be purchased by the government of Texas, a Japanese company, or any other entity, with resulting layoffs.

There is little more economically secure job than government employment. On the other hand, since the middle 1980s, private employees have been approximately four times as likely to lose their jobs involuntarily.¹⁵

The superior security makes government jobs inherently more valuable. If a genuine market were operating in the government sector, this higher value would be discounted into compensation lower than what is paid for comparable jobs in the private sector where employees must face higher levels of uncertainty.

This security advantage has very real monetary value. Based upon an analysis of involuntary separation rates and pay rates for jobs obtained after involuntary separation, the 40-year career value of superior security for government employees is estimated at nearly \$136,000, or 7.4 percent (see Table 5).¹⁶

Table 5
Security Premium

Years	Percentage Security Advantage	Compared to Private Employee Compensation
10	\$ 2,023	4.5%
20	3,660	8.0
30	4,806	10.2
40	5,581	11.3
Total	\$ 136,123	7.4%

Even this calculation underestimates the advantage of state employees. This comparison is based upon the employer cost of employment and does not include the loss of retirement income that is likely to occur in the event of involuntary separation, which is four times more likely to happen in the private sector, as noted above.

Gross State Employee Premium: Combining the actual monetary benefits of state government employment, as compared to an equal-education, equal-skill employee in the private sector, and the security premium yields the following (see Table 6):

¹⁵ Based upon an analysis of U.S. Bureau of Labor Statistics data from 1987 to 2000.

¹⁶ The analysis uses the probability of involuntary separation and the average change in income for separated employees.

- The state employee would be compensated \$9,200 more (22.9 percent) than the private employee for working 1,726 hours in the tenth year.
- The state employee would be compensated \$12,300 more (29.5 percent) than the private employee for working 1,726 hours in the twentieth year.
- The state employee would be compensated nearly \$17,700 more (38.8 percent) than the private employee for working 1,726 hours in the fortieth year.
- The cumulative effect, over a 40-year career, would result in compensation for the state employee of nearly \$490,000 more than that of the private employee (see Figure 2).

A market correcting downward adjustment of 24 percent would be required in the starting salary for the state employee to compensate for the compensation and security advantages of government employment, as compared to that of an equal-education, equal-skill employee in the private sector.¹⁷

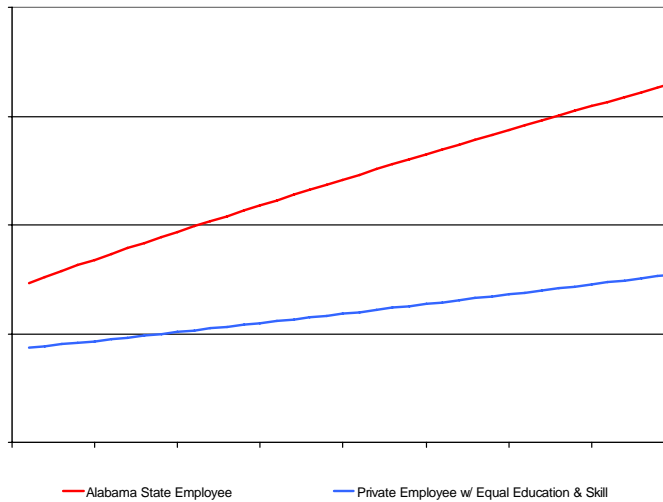
Table 6
Estimated Career Compensation Premium
State Employee Compared to Equal-Education, Equal-Skill Private Sector Employee

Year	Employee Type		State Employee Advantage		
	Private	State Government	Monetary	Percent	Cumulative
1	\$ 44,672	\$ 38,705	\$ 5,968	15.4%	\$ 5,968
10	49,384	40,172	9,212	22.9	76,268
20	54,199	41,867	12,333	29.5	185,914
30	58,736	43,633	15,103	34.6	324,717
40	63,130	45,474	17,656	38.8	489,932
Total	\$ 2,169,972	\$ 1,680,040	\$ 489,932	29.2%	\$ 489,932

Based upon state work year of 1,726 hours.

¹⁷ It should be noted that this percentage is only an estimate, and that Hayek's caution (above) applies here, as with any other estimates of market rates without the influence of genuine competition.

Figure 2
State vs. Private Sector Employee Compensation



Finding #6: The superior security inherent in Alabama state employment raises the state employee’s pay advantage over an equal-education, equal-skill employee to nearly \$490,000 over a career.

The Excess Costs of State Employee Compensation

It is clear that the taxpayers of Alabama are paying more in state employee compensation than is necessary. If state employee compensation were at the rate estimated in the equivalent employee analysis above, the state’s payroll bill would be approximately \$295,000,000 less annually. At this rate, each Alabama household is paying \$169 to subsidize excess state employee compensation.

This estimate was compared for reasonableness to employee compensation rates in Missouri, which has the lowest state average employee wages and salaries to per capita income ratio in the nation. There is no obvious indication that Missouri has a substantially more difficult time in recruiting or maintaining a quality staff of employees relative to the private sector (the market). If the average state employee wage and salary to per capita income ratio were the same in Alabama as in Missouri, 2002 state expenditures would have been \$365 million lower (see Figure 3). At this rate, each Alabama household is paying \$209 to subsidize excess state employee compensation, as compared to employee compensation in Missouri (see Figure 4).

Using Missouri state government as a standard, Alabama state government inefficiencies represent approximately 25 percent of total costs, which means that Alabama state government is approximately 75 percent as efficient as Missouri in compensating its employees.¹⁸

¹⁸ This is not to suggest that Missouri state government has achieved optimal efficiency.

Figure 3
Excess Cost of State Employee Pay: 2002 Annual Estimate

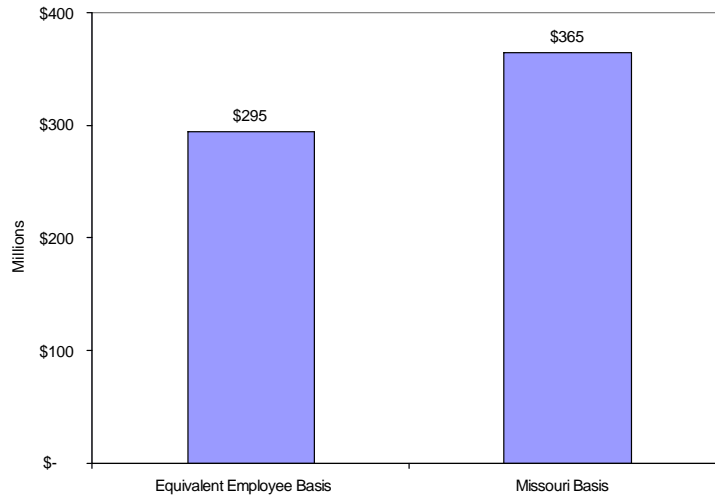
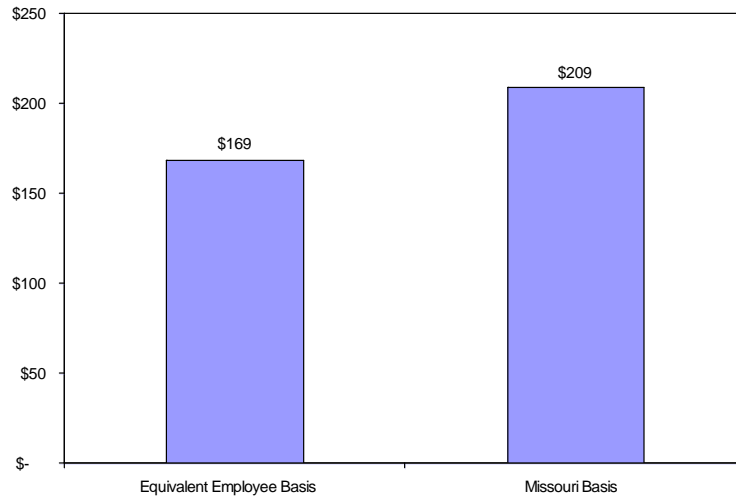


Figure 4
Excess Cost of State Employee Pay per Alabama Household: 2002



Finding #7: The excess cost of Alabama state employee compensation appears to be from \$295,000,000 to \$360,000,000 annually.

Finding #8: The excess cost of Alabama state employee compensation appears to be from \$169 to \$209 per household annually.

Data Considerations

It was difficult to obtain Alabama’s state employee compensation information necessary to complete this report. Despite enlisting the assistance of legislative leadership, it took months to obtain payroll information that would have been available in an “off the shelf” report in other states (such as Pennsylvania). We did not find a central repository of compensation information

for state employees. Some information is maintained by the Personnel Department and other information by the State Employees Insurance Board. There is no need to reorganize the portfolios of these agencies.

There is a need, however, for an independent, central reporting function, which relies on the information maintained by the Personnel Department and the State Employees Insurance Board. State employee compensation represents more than one quarter of state expenditures. An expenditure category this significant must be a principal driving force in the state budget, deserving of a management reporting system that provides immediate, complete, and consistent information to the Governor, the legislature, and the citizens of Alabama.

Recommendations

There is a need to better control Alabama state employee compensation. It is unfair and inappropriate for state employees to have the special treatment of higher compensation and fewer work hours, as compared to the private employees who pay the bill. The state should undertake a program to adjust, over a reasonable period of time, state employee compensation to reflect genuine market rates.

Recommendation #1: State employee compensation should be no higher than necessary to attract sufficiently-qualified personnel.

This recommendation requires fundamental reform of a system that has produced a significant excess “bill” for state taxpayers. The most important reform would be to use genuine market mechanisms to establish compensation levels, to the maximum extent feasible. Finally, a comprehensive, independent reporting mechanism should be established.

Compensation Determination by Tenure Management: State personnel policy should be based upon “tenure” management. The market value of government employment can only be reliably determined by how attractive jobs are to employees, which requires managing employee tenure rates to replicate the experience in the private sector (the market). Average state employee tenure should be compared to that of similar employment classifications in the private sector. Where average state tenure is greater than in the private sector, compensation (wages, salaries, and benefits) should be frozen until tenure comparability is achieved. Where average state tenure is less than in the private sector, compensation should be increased to the point where tenure comparability is achieved.

Tenure management is far more reliable for determining compensation of government employees than the “comparable pay” systems that routinely exclude important factors of value and are particularly susceptible to political manipulation.

Finally, a competitive value compensation determination system would not preclude the state from job classification specific compensation increase recommendations where it is clear that state employee tenure is substantially below that in the private sector.

Recommendation #2: State employee compensation should be determined by replicating employee turnover in comparable private sector jobs to establish the gross value of wage, salary, and benefit levels.

State Employee Work Hours: State employee salaries, wages, and benefits (including paid

time off) should be reported per hour worked. In coordination with the tenure management system proposed above, the state should adjust employee work hours upward to equal the private sector. This adjustment would make it possible to hire fewer employees in the long run and thereby to reduce expenditures.

Recommendation #3: State employee work hours should be adjusted to equal those of the private sector as rapidly as feasible.

Employee Compensation Report: A comprehensive, independent, annual employee compensation report should be prepared by the State Auditor. This report should include at least the following information:

- annual wages and salaries, including both total and employee classifications;
- average full-time, part-time, and full-time equivalent employees (total and by employee classifications);
- average employee turnover rates (total and by employee compensation); and
- average employee turnover rates for the same classifications in the Alabama private sector.

Recommendation #4: A comprehensive state employee compensation report should be produced annually by the State Auditor.

BIOGRAPHICAL INFORMATION

Wendell Cox is principal of Wendell Cox Consultancy (metropolitan St. Louis), an international public policy and demographics firm. He also serves as a visiting professor at the Conservatoire National des Arts et Metiers, a French national university in Paris.