Recent empirical evidence strongly suggests that, on average, combined wages and benefits for public sector workers now outstrip compensation for comparable private sector workers. The most obvious implication of this imbalance is that public money is being used inefficiently. The compensation disparity poses an even greater problem for public administrators, however, who risk losing legitimacy in the eyes of voters and taxpayers. People want to know that government employment is truly public service—not a gateway to special privileges.

Elected officials and other policy makers need to get compensation right, and the first step is measuring it accurately. Here we describe strategies that economists have used to compare public and private compensation.

We start with wages. Many economists favor a “person-to-person” or “human capital” approach, which compares wages for government employees with that of private sector workers who share similar education, experience, and demographic characteristics that correlate with productivity and pay. This approach generally finds that state and local government employees receive slightly lower salaries than private sector workers, while federal employees receive slightly higher salaries.

An alternative to the human capital model is a “job-to-job” approach, which compares wages for jobs demanding similar levels of effort and skill. By and large, this approach generates similar results. A recent analysis published by two economists at the Bureau of Labor Statistics (BLS) found that state government employees earn about 4 percent less than private sector workers whose jobs demand similar skills, while local government jobs pay about 7 percent more than similar private positions.

With both approaches showing only small differences in wages, fringe benefits push average public sector compensation well ahead of the private sector. The disparity is primarily the result of generous public sector retirement benefits, including traditional defined-benefit pensions and retiree health benefits that cover employees who retire before Medicare eligibility. The Congressional Budget Office (CBO) found that federal pensions and retiree health coverage are 2.7 times as valuable as the retirement benefits enjoyed by private workers in large firms. At the state and local level, retirement packages are often even more generous.

The one comparison for which the person-to-person and job-to-job approaches generate a major inconsistency is the federal versus nonfederal wage comparison. Two recent studies using the human capital model conclude that federal employees receive wages that are 2 percent to 14 percent higher than those of similar private sector workers. At the same time, the President’s Pay Agent, which conducts the government’s official wage (but not benefit) comparison each year, concluded that federal jobs offer wages fully 26 percent lower than nonfederal jobs with similar skill requirements.

What might account for this difference? For academics or practitioners looking to develop their own pay comparisons, it is instructive to explore this question in detail.

Federal jobs are given General Schedule (GS) grades, ranging from GS-1 to GS-15, based on each job’s specific duties and skill requirements. The Pay Agent takes a sample of nonfederal jobs and essentially maps the federal government’s GS system onto that sample. After collecting data on job requirements, the Pay Agent has the BLS assign GS grades to the sample of nonfederal jobs.

Then the Pay Agent compares the wages in each federal GS grade to the wages in nonfederal jobs with the same corresponding GS grade. In other words, federal GS-8s are matched with nonfederal GS-8s, federal GS-9s are matched with nonfederal GS-9s, and so on.
There are two potential problems with the Pay Agent’s method that could explain why its results are so dramatically different from the human capital model.

First, the criteria used to assign GS grades to nonfederal jobs are not necessarily the same criteria that determine the actual GS grades of federal jobs. Both the CBO and the Government Accountability Office have documented “overgrading,” in which federal jobs are given GS grades that are inappropriately high for the level of work involved. This means that when the Pay Agent compares a nonfederal GS-9 with a federal GS-9, the federal job might actually qualify only as a GS-8 by the BLS criteria.

The federal government also engages in what might be called “overpromotion”—hiring employees at higher positions or promoting them faster than the private sector would. University of California economist Melissa Famulari found in 2002 that as a result of overpromotion, “Federal workers have significantly fewer years of education and experience than private sector workers in the same level of responsibility in an occupation.” For instance, a senior accountant in the federal government might have the qualifications of a junior accountant in the private sector. But if education and experience are good proxies for worker productivity, then private sector employees who hold the same jobs as federal workers may perform those jobs better and thus warrant higher wages.

Overgrading and overpromotion combine to produce the result that, while federal jobs may appear underpaid, the employees who fill those jobs are fairly paid or even receive a salary premium.

Fixing the Pay Agent’s method would start with having the BLS assign GS levels to a sample of federal jobs without reference to the actual GS grades of those jobs. This would ensure that federal and nonfederal jobs are compared on a level playing field. In addition, the Pay Agent should combat the overpromotion bias by controlling for individual worker characteristics in addition to job characteristics. Another idea is to incorporate data from the federal government’s Occupational Information Network (O*NET), which could be used to isolate how specific skills and job characteristics are rewarded in the private labor market.

The most significant problem with the Pay Agent, however, is not an obscure technical issue at all, but rather a simple omission: the Pay Agent entirely omits fringe benefits from consideration. As we noted earlier, it is primarily fringe benefits rather than wages that push public sector compensation ahead of private sector compensation on average, which is why it is crucial that any compensation comparison include benefits as well as wages.

By matching public and private workers using a consistent set of skill criteria, then comparing both wages and benefits between each sector, public administrators can begin to bring public sector compensation in line with market levels.

Reference