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The Bankrupting of America

We have a ruinous collaboration of elected officials and unionized public workers.

By MORTIMER ZUCKERMAN

The American public feels it is drowning in red ink. It is dismayed and even outraged at the burgeoning national deficits, unbalanced state and local budgets, and accounting that often masks the extent of indebtedness. There is a mounting sense that taxpayers are being taken for an expensive ride by public-sector unions. The extraordinary benefits the unions have secured for their members are going to be harder and harder to pay.

The political backlash has energized the tea party activists, put incumbents at risk in both parties, and already elected fiscal conservatives such as Republican Gov. Chris Christie of New Jersey. Over the next fiscal year, the states are looking at deficits approaching hundreds of billions of dollars. The Center on Budget and Policy Priorities, a liberal think tank, estimates that this coming year alone states will face an aggregate shortfall of $180 billion. In some states the budget gap is more than 30%.

How did we get into such a mess? States have always had to cope with volatility in the size and composition of their populations. Now we have shrinking tax bases caused by recession and extra costs imposed on states to pay for Medicaid in the federal health-care program. The straw (well, more like an iron beam) that breaks the camel's back is the unfunded portions of state pension plans, health care and other retirement benefits promised to public-sector employees. And federal government assistance to states is falling—down by roughly half in the next fiscal year beginning Oct. 1.

It is galling for private-sector workers to see so many public-sector workers thriving because of the power their unions exercise. Take California. Investigative journalist Steve Malanga points out in the City Journal that California's schoolteachers are the nation's highest paid; its prison guards can make six-figure salaries; many state workers retire at 55 with pensions that are higher than the base pay they got most of their working lives.

All this when California endures an unemployment rate steeper than the nation's. It will get worse. There's an exodus of firms that want to escape California's high taxes, stifling regulations, and recurring budget crises. When Cisco CEO John Chambers says he will not build any more facilities in California you know the state is in trouble.

The business community and a growing portion of the public now understand the dynamics that discriminate against the private sector. Public unions organize voting campaigns for politicians who, on election, repay their benefactors by approving salaries and benefits for the public sector, irrespective of whether they are sustainable. And what is happening in California is happening in slower motion in the rest of the country. It's no doubt one of the reasons the Pew Research Center this year reported that support for labor unions generally has plummeted "amid growing public skepticism about unions' power and purpose."

In New York, public-service employees have received gold-plated perks for much of the 20th century, especially generous health-insurance benefits. Indeed, where once salaries were lower in the public sector, the salary gaps in the public and private sectors have disappeared or even reversed.

A Citizens Budget Commission report in 2005 showed that for most job categories in the greater New York City region, public-sector workers received higher hourly wages than private-sector workers. And according to a 2009 survey by the same group, this doesn't even count the money that New York City pays in full premiums for comprehensive health-insurance policies for workers and their families. Only 8% of workers in private firms enjoy that subsidy. In virtually all cases, the city also pays the full health-care premium costs for retirees and their spouses. And city pensions are "defined benefit" plans, which are more expensive since they guarantee specific benefits on retirement.

By contrast, private-sector workers in the survey were mostly in "defined contribution" plans, which means that, unlike their cushioned brethren in the public sector, they do not have a predetermined benefit at retirement. If New York City were to require its current workers to pay contributions toward health insurance equal to the amounts paid by the employees of local private-sector firms, the taxpayer savings would be $628 million a year. In New Jersey, Gov. Christie says government employee health benefits are 41% more expensive than those of the

average Fortune 500 company.

What we suffer is a ruinously expensive collaboration between elected officials and unionized state and local workers, purchased with taxpayer money. "Scratch my back and I'll scratch yours."

No wonder the Service Employees International Union has become the nation's fastest-growing union: It represents government and health-care workers. Half of its 700,000 California members are government employees. More and more, it wins not on the picket line but at the negotiating table, where it backs up traditional strong-arming with political power. It spends vast amounts of money on initiatives that keep the government growing and the gravy flowing.

The state's teachers unions operate in a similar fashion—with the result that California's various municipalities, especially Los Angeles, face budget shortfalls in the hundreds of millions of dollars. California can no longer rely on a strong economy to support this munificence. Its unemployment rate of 12.5% runs several points higher than the national rate and its high-tech companies are choosing to expand elsewhere. Why stay in a state with such higher taxes and a cumbersome regulatory environment?

California is a horrible warning of how dreams can turn to dust. In most states, politicians face a contracting local economy and shortfalls in tax receipts. Naturally, they look to cut expenses but run into obstruction from politically powerful unions that represent state and local government employees, teachers and health-care workers who have themselves caused pension and health-care insurance costs to soar. It is not an accident that in framing the national stimulus program in 2009 Congress directed a stunning $275 billion of the $787 billion as grants to the states to support public-service employees in health care, education, etc.

The lopsided subsidies for pension and health costs are a large part of the fiscal crises at the state and local levels. The subsequent squeeze on education and infrastructure investment is undermining the very programs that have made it possible for our economy to grow.

Between New York and California, the projected deficits run about $40 billion—and that doesn't account for projected billions of dollars in the operating deficits in the states' mass transit systems or the multibillion-dollar unfunded liability in many of the state pension plans. New York would be badly hit because it is on the verge of being deprived of tax revenues by Washington's increased regulations on the financial industry, especially the hugely profitable, multitrillion-dollar market in derivatives—an industry that is critical to the economy of New York state and the country.

City government was developed to serve its citizens. Today the citizenry is working in large part to serve the government. It is always hard to shrink government spending. It is particularly difficult when public-sector unions have such a unique lever of pressure.

We have to escape this cycle or it will crush us. One way is to take labor negotiations out of the hands of vulnerable legislators and assign them to independent commissions. They would have a better shot at achieving a fair balance between appropriate salary increases and the revenues and services of local municipalities. The electorate won't swallow any more red ink.

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