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How Do Federal Employee Salaries and Benefits Compare with the Private Sector?

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Chairman Chaffetz, Ranking Member Cummings, and Members of the Committee. Thank you for the opportunity to discuss the compensation of the federal government workforce and how federal pay and benefits compare with those in the private sector.

Today I wish to make four main points:

1. The CBO's report on federal employee salaries and benefits uses high-quality data and cutting-edge methods. The CBO's finding that federal employees receive total pay and benefits averaging 17 percent above what similar employees would receive from large private sector employers is a reasonable one.
2. To the degree one would disagree with CBO's methodology, the result would be to find an even larger federal pay premium. Were the CBO to use the academic-standard approach for measuring wage differences and measure the value of federal pension benefits similarly to how corporate pension liabilities are valued, the resulting federal compensation premium would be substantially larger.
3. The CBO finds that the best-educated federal employees receive lower pay than in the private sector. This is an area where better data and a broader analytic approach might produce stronger results.
4. The Federal Salary Council's claim that federal employees receive salaries 34 percent below private sector levels also holds that federal salaries are a similar percentage below those of state and local government employees, a claim that simply isn't credible.

The Congressional Budget Office (CBO) has conducted a highly professional, state-of-the art analysis that compares the salaries and benefits of federal employees with what employees with similar levels of education and experience receive in large private-sector firms.[1] As the CBO will be the first to tell you, such studies cannot provide a precise figure telling us what each individual federal employee "should" be paid. However, over large numbers of employees, this sort of analysis can tell us whether pay and benefits on average are higher in the federal government or the private sector.

The CBO report's headline figure is that, on average, federal salaries and benefits are 17 percent above private-sector levels. And that is a figure that deserves headlines. All-in compensation per full-time equivalent federal employee in 2015 was about $123,000. Assuming a 17 percent federal pay premium, this implies that on average a similar private-sector employee would receive total pay and benefits of about $105,000, an annual difference of about $18,000.

When averaged over 2.1 million federal employees, the federal compensation premium adds up to real money. Total federal compensation last year was close to $260 billion. A 17 percent difference is about $38 billion per year, equal to what the federal government spends on energy and the environment and substantially exceeding federal spending on transportation.

Are the CBO Report's Conclusions Correct?

The CBO's conclusions are unquestionably reasonable. If the report's authors were to submit it to an academic journal—and there have been many academic reports published on

[1] Congressional Budget Office. "Comparing the Compensation of Federal and Private-Sector Employees, 2011 to 2015." April 25, 2017.

federal pay over the years—it would be taken very seriously. In most technical aspects, the CBO's report is the finest and most advanced study of federal employee compensation ever produced. It uses better sources of data and more advanced methods than studies that have been published in academic journals.

That said, I would consider the CBO's reported federal compensation premium to be on the low end of the reasonable range, for two reasons.

First, the CBO analyzed federal wages using a cutting-edge econometric methodology that attempts to address certain technical shortcomings in the standard approach used in academic studies. The CBO's approach finds that federal employees on average receive salaries that are about 2 percent above private-sector levels.

The standard approach for analyzing wage differences, which continues to be widely used in academic studies, would find a substantially larger federal salary premium. For instance, when I analyze federal employee wages using the methodology that the progressive-leaning Economic Policy Institute has used in numerous studies of state and local government salaries, I find an average federal salary premium of not 2 percent but of about 14 percent.[2] My point is not that 2 percent is "wrong" and 14 percent is "right," but rather that there is a range of reasonable answers found in studies of federal salaries and the CBO's result is likely toward the lower end of that range.

Second, any study that calculates the value of future pension benefits must choose an interest rate at which to "discount" those future benefits back to the present. In general, if a future benefit is very safe it should be valued using a low discount rate, while a risky future benefit should be valued using a higher discount rate. The higher the discount rate, the lower the present value of those pension benefits and the less valuable the overall employee compensation package is judged to be. The CBO chose to value federal employees' pension benefits using a 5 percent discount rate. Using that discount rate, the federal employee retirement package was found to be substantially more generous than is received by comparable private-sector employees.

But a strong case can be made for using a lower discount rate to value federal employee pensions. For instance, corporate defined benefit pensions must value their liabilities using a discount rate of about 4 percent. And corporate pensions are not nearly as safe as federal pensions, as witnessed by pending benefit reductions for "multiemployer" defined benefit plans. Valuing federal pension benefits using a lower discount rate to better reflect their safety would find a higher overall federal compensation premium.

Again, any study of federal employee pay will involve judgments regarding the best methods and assumptions to use. The CBO's report is well within the range of reasonable judgments. I would simply point out that, where reasonable disagreements occur, alternate approaches would tend to find larger rather than smaller compensation premiums paid to federal employees.

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[2] For instance, see Biggs, Andrew G., and Jason Richwine. "Comparing federal and private sector compensation." American Enterprise Institute Working Paper No. 2011-02 (2011).

How Does the Federal Government Retain Highly Educated Employees?

The CBO's report breaks down differences in pay and benefits by the educational attainment of employees. The CBO finds that, on average, federal employees with educations ranging from high school graduates through master's degrees receive total compensation exceeding private-sector levels. These employees make up around 91 percent of the federal workforce.

However, the CBO also found that federal employees with professional or doctoral degrees, who make up 9 percent of the federal workforce, receive pay and benefits averaging 18 percent below private-sector levels. Most private-sector employers could not attract and retain employees while paying 18 percent less than their competitors, so it is worth considering how this could take place.

One answer is that the federal and private-sector employees being considered are not truly identical. For instance, a Ph.D. who graduated with middle grades from a middle university with a degree in a nonmarketable field is not the same as a top student from a top university with a doctorate in a STEM field. The data used in the CBO report don't provide that level of detail, which should cause an observer to be less certain of the results. Now, "less certain" does not mean that the pay penalty for highly educated federal employees does not exist. But given that market forces naturally work to erase pay differences for similarly skilled workers in the labor force, I am less confident that the CBO's results for these highly educated federal employees are correct.

A second answer is that federal employment offers nonfinancial benefits that other jobs do not. For instance, the security of federal employment is well known: Layoffs and firings for cause are extremely rare in federal employment, while they are far more common in the private sector. As a result, federal employees have a much smaller chance of becoming unemployed than similar private-sector workers. A second factor could be the opportunities afforded in federal employment to gain more responsibility at a younger age, to work on the most prominent and important policy issues of the day, and to have access to data and technology that are unavailable in the private sector. These factors are even more difficult to measure, but I suspect they play a role in attracting highly skilled individuals to federal employment in spite of seemingly low salaries.

What About Claims That Federal Salaries Are Below Private-Sector Levels?

Each year, the Federal Salary Council issues a report which contains an estimate of the percentage difference between federal salaries and salaries in nonfederal jobs—meaning, private sector and state and local government—that have similar skill requirements. The Federal Salary Council is made up of six representatives of federal labor unions and three outside members appointed by the president. In their last report, the Salary Council concluded that federal employees receive salaries that are, on average, 34 percent *below* those of comparable nonfederal jobs.

Many policymakers and reporters rely on the Salary Council's figures in considering appropriate pay levels for federal employees. However, the Salary Council's figures are highly flawed, and no other study I have seen reaches conclusions remotely like those of the council.

The Salary Council's figures rely upon data from the Bureau of Labor Statistics' (BLS) National Compensation Survey (NCS). As part of the NCS, BLS economists analyze the skill demands of nonfederal jobs and assign each job a "work level" based upon the federal General Schedule (GS) scale. The Salary Council compares salaries paid for these nonfederal jobs with the salaries paid via the federal General Schedule and concludes that federal employees are dramatically underpaid.

There is a technical reason for the Salary Council's findings, which I will explain. But policymakers should first understand the sheer implausibility of the Salary Council's reported 34 percent federal salary deficit. Remember that the BLS data used for the Salary Council's figures cover both private-sector and state/local government jobs. And BLS economists have found that private-sector and state/local jobs with the same work demands pay very similar salaries. This implies that, if the Salary Council's figures are correct, not only are federal workers "underpaid" by 34 percent relative to private-sector jobs, federal workers are *also* underpaid by 34 percent relative to state and local government employees. No one who has worked in state and local government finance would find this result to be even remotely plausible. A standard regression analysis that compared federal employee salaries with those of state/local workers with similar levels of education and experience would likely find a federal salary premium in excess of 25 percent.

Why are the Salary Council's figures so flawed? It is difficult to say for certain without a more in-depth investigation, which the Salary Council has not undertaken despite its figures being the clear outlier in studies of federal employee pay. However, there is one clear flaw in the Salary Council's approach. Recall that the BLS analyzes the skill requirements of private-sector and state/local government jobs and assigns them a rating on the federal GS pay scale. However, the BLS *does not* independently analyze the work requirements of federal jobs. In the Salary Council's analysis, it is assumed that each federal job is correctly assigned to the appropriate spot on the GS scale. However, this assumption overlooks the problem of "overgrading" in federal employment, in which a job is assigned a higher GS rating than the work demands of that job justify. The CBO, the GAO, and academic analysts have documented federal overgrading in various studies over the years. If federal jobs are overgraded on the GS scale, they could pay well relative to private-sector jobs—as the CBO's analysis, my own study, and many others have found—while still appearing to be underpaid using the Salary Council's flawed methodology.

It is misleading and, indeed, inflammatory for the Salary Council to notify federal employees that they are dramatically underpaid in the face of multiple studies that find the opposite. I would urge the committee to work with the Salary Council to ensure that a more appropriate methodology is used for analyzing the adequacy of federal employee pay.

What Should Policymakers Do About Federal Pay and Benefits?

Salary and benefit policies are extremely complex, and the federal government is a large and complex organization to begin with. Thus, it is understandable that policymakers concerned with the high cost of federal employees might resort to broad-brush policies such as a salary freeze, a hiring freeze, and higher pension contributions. I don't believe that such policies have done the federal workforce a great deal of harm: Salaries continued to rise despite the so-called pay freeze, and federal employees still contribute less toward their traditional pensions than do most state and local government employees. But it would be better to make the federal pay scale more flexible and nimble, and better able to respond to individual needs and what the labor market demands at any given time. That will take a far larger effort by Congress and the executive branch.

Obviously, there is a budgetary cost when the federal government pays more in salaries and benefits than it needs to. But there is a social and economic cost as well. As the CBO report shows, for less-educated workers federal pay is more than 50 percent higher than private-sector levels. This makes it almost impossible for an employer of less-educated workers to compete and, as a result, the best of that group—employees with the greatest drive, imagination, and leadership—may find themselves employed in government rather than the private sector, where they might make a larger impact on their communities.

And while federal pay for better-educated workers is less compelling, it is hardly stingy. A married couple with two GS-15 federal employees could collect nearly $300,000 in annual salaries plus perhaps another $120,000 in current or future fringe benefits. Four of the five highest-income counties in the United States are in the suburbs of Washington, DC. That doesn't come from the federal government paying low salaries. There are many highly-educated, highly-skilled, highly-motivated Americans working for the federal government doing important jobs. But we shouldn't miss the risk that generous federal pay could mean the founders of the next Google or Tesla find themselves working in a federal office building instead of creating the innovations that can change the world.

The CBO's report should settle the public debate on whether the federal government pays well. It does, and in most cases better than the private sector. The next debate is over how to make federal compensation work better, in the sense of attracting and retaining the employees the federal government needs without paying above-market salaries and benefits.