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COMPARING THE IMPACT: Public Sector Labor Reform in Wisconsin and Indiana

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Indiana's experience with reform of collective bargaining rules for government employees suggests that similar changes adopted by the administration of Wisconsin Governor Scott Walker, although uneven in their impact to date, hold the potential to control costs and limit public sector workforce layoffs over time.

Indiana abolished collective bargaining for state employees six years ago. According to the most recent data, Indiana has succeeded in limiting cutbacks in public employment, while not raising state taxes. The Indiana experience also contrasts with that of another Wisconsin neighbor, Illinois, which, although it also limited public employment cutbacks, did so only after a significant state tax increase. By contrast, Wisconsin enacted a sharp reduction in aid to municipalities that was effective immediately and led to significant layoffs and other reductions in headcount.

Over the next few years, as municipalities are able to take advantage of the bargaining reforms, they will, like Indiana, be better able to afford to retain and hire employees.

This paper concludes:

- **The compensation and bargaining reforms in the budget repair law are more essential than ever.** Over the next few years, these reforms will allow other Wisconsin municipalities to achieve savings similar to the ones seen in Milwaukee.

- **States shouldn't wait for a recession to reform public labor.** Indiana's fiscal preparations—including but not limited to public labor reform— positioned it unusually well for a downturn.

- **Wisconsin has seen such a sharp reduction in public employment because it made sharper budget cuts than many of its neighbors.** Public labor reform cannot immediately compensate for sharp local aid cuts.

Over the next few years, as municipalities are able to take advantage of the bargaining reforms, Wisconsin will, like Indiana, be better able to afford to retain and hire employees.

About the Author

Josh Barro is an expert on tax policy, entitlements and public employee compensation. He is a contributor to Forbes.com, where he writes the popular blog "The Barrometer." From 2010-2012 he was the Walter B. Wriston Fellow at the Manhattan Institute. He is the author of several previous Civic Reports and issue briefs focusing on state and local fiscal issues. He is also the co-author of the Empire Center for New York State Policy's *Blueprint for a Better Budget*.

Barro is a frequent television, radio, and print commentator on fiscal and economic issues. He is a regular contributor to National Review Online and has also written for publications including the *New York Post*, the *New York Daily News*, the *Washington Examiner*, *National Review*, and *City Journal*. Prior to joining the Manhattan Institute, Barro served as a staff economist at the Tax Foundation and worked as a commercial real estate finance analyst for Wells Fargo Bank. Barro holds an A.B. from Harvard College

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Through its controversial collective bargaining reform law, now the focal point of an unprecedented gubernatorial recall election, Wisconsin sought to control both state and municipal spending, while maintaining public services and public employment levels. Although public sector employment has, contrary to expectations, declined in the state at a rate higher than the national average, there is reason to believe that as the Wisconsin law takes full effect over the next three years this will cease to be the case.

This is the conclusion that can be reached by extrapolating from the experience of one of the Badger State's regional neighbors, Indiana, which preceded (by six years) Wisconsin in its abolition of state employee collective bargaining. According to the most recent data, Indiana has succeeded in limiting cutbacks in public employment, while not raising state taxes. The Indiana experience also contrasts with that of another Wisconsin neighbor, Illinois, which, although it also limited public employment cutbacks, did so only after a significant state tax increase.

Timing is the main issue here. Collective bargaining reforms do enable state and local governments to reduce their costs per employee. But because governments must honor existing collective bargaining agreements that precede reform, these savings do not manifest immediately. Wisconsin enacted a sharp reduction in aid to municipalities that was effective immediately and led to significant layoffs and other reductions in headcount. Over the next few years, as municipalities are able to take advantage of the bargaining reforms, they will, like Indiana, be better able to afford to retain and hire employees.

The Wisconsin Law

Wisconsin's 2011 "budget repair law" was intended to cope with the severe fiscal pressures facing the state and its local governments. While the law had many components, three were of paramount fiscal importance: employee contributions toward pension and health care benefits were significantly increased; collective bargaining was sharply restricted, allowing governments a much freer hand to reduce the cost of benefits and determine wage levels; and state aid payments were cut sharply, by about $1 billion per year, while municipal governments faced new restrictions on raising local taxes.[1] The idea behind the Wisconsin law was that, by giving cost control tools to local governments, the state would enable them to absorb a sharp reduction in local aid without severely reducing public employee headcounts or services delivered. Essentially, the first two provisions would offset the effects of the third, making it possible for local governments to deliver services more cost-effectively.

Early Returns

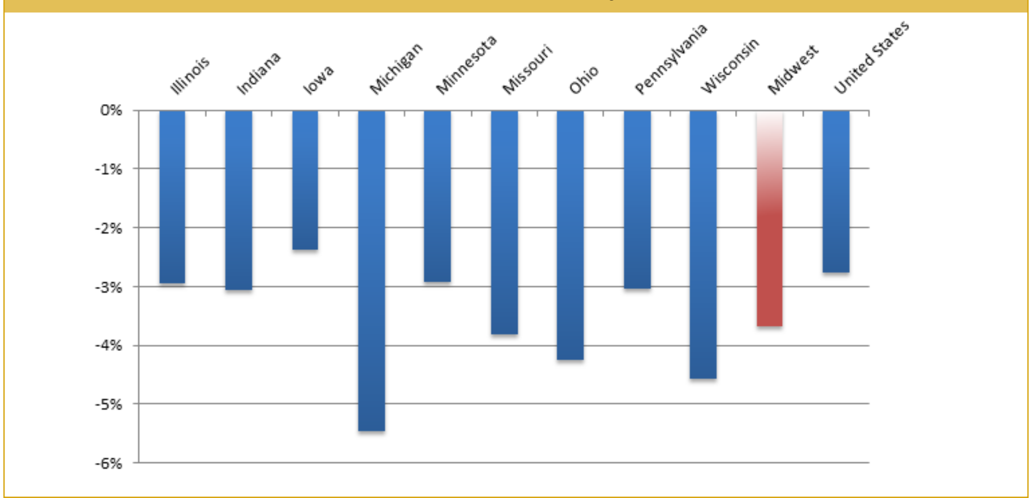
While not the intended effect, early data indicate that Wisconsin's new law has led to significant reductions in the public workforce. This happened mostly because the cut to local aid and property tax restrictions were immediate, while municipalities must wait for the expiration of existing labor contracts to achieve savings from the compensation and bargaining changes.

In 2011, Wisconsin ranked seventh out of 49 states for the shrinking of public employment headcounts, with 2.7 percent fewer public employees at the end of the year than at the beginning, compared with a national average of 1.2 percent.[2] This reflects the squeeze that municipalities are feeling from the local aid cut. Many municipalities cannot yet take full advantage of new cost-cutting tools.

Overall, payrolls shrank faster in the industrial Midwest than in most of the country, but Wisconsin still saw sharper declines than most—among Rust Belt states, only Pennsylvania saw a steeper drop in public employment in 2011. Indeed, many states that did not do major public employment reforms (such as Illinois and Ohio) also saw declines in public employment, though less steep than Wisconsin's.

When viewed over the past three years, Wisconsin's headcount reductions remain exceptional, though they have not been as sharp as Michigan's.

Reductions in State and Local Employment, 12/2008-12/2011



Variation Within Wisconsin

The budget repair law experience has not been uniform across the state of Wisconsin. Some jurisdictions that are not encumbered by legacy labor contracts were able to achieve significant savings right away due to the budget repair law, and were not forced to make sharp reductions in employment—some, such as the City of Milwaukee, were even able to expand public services.

Milwaukee lost $14 million in annual aid payments from the state, but found $30 million in employee benefits savings, of which $20 million was made possible by the budget repair law. These savings came mostly from changes to health benefits: partly requiring employees to pay a larger share of their insurance premiums, and partly switching to more economical plans. This is an example of what Wisconsinites can expect to see in cities and towns across their state in the next few years.

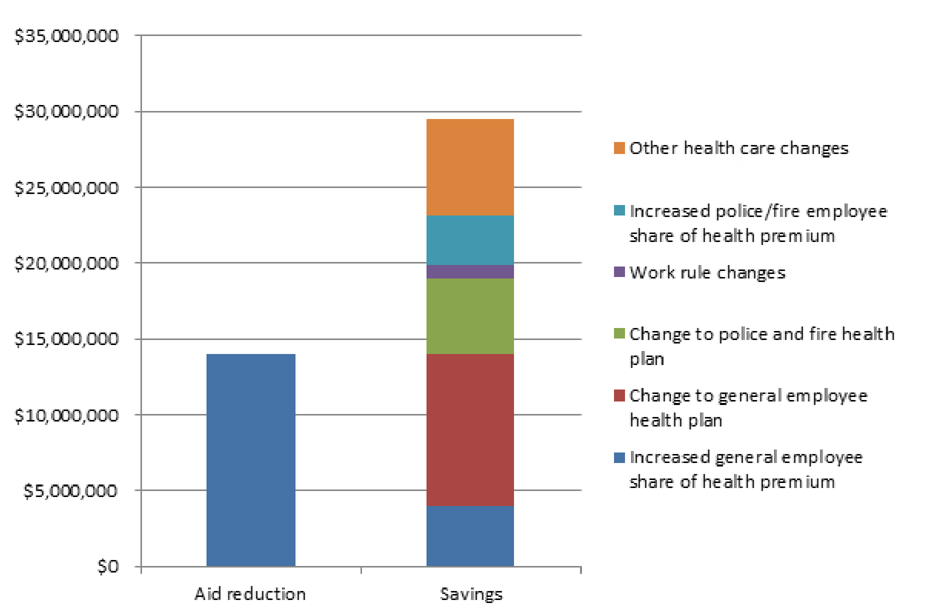
But other jurisdictions that must honor existing contracts have had very different experiences. Take, for example, the Milwaukee Public Schools. The district lost $82 million in state aid. But it was not able to realize any health care or pension savings with unionized employees, because it entered into a four-year employee contract at the end of 2010. As a result, the district laid off 119 teachers and over 100 other employees.

This situation is difficult, but temporary. There will be significant labor savings available to the Milwaukee Public Schools starting in 2014 when existing contracts expire. Employees will make larger pension and health contributions, and the district will have a free hand to modify health benefits.

Those savings, when realized, should be substantial. A recent study found that even simply moving MPS employees into the same health plan used by state employees would save $64 million per year, enough to nearly wipe out the loss of state aid.[3]

Over the next three years, municipal governments will begin taking advantage of labor reforms, and we can expect their ability to maintain or expand headcount to improve. Over time, the City of Milwaukee experience will move from unusually fortunate to

Milwaukee City Budget FY 2012
Reduction in State Aid and Savings from Employee Benefits Changes



typical—much as we've seen with how Indiana governments have weathered the recession.

Indiana's Experience

In 2005, on his first day in office, Governor Mitch Daniels abolished collective bargaining for state workers by executive order. Most local employees in Indiana have never engaged in collective bargaining, with teachers being the major exception. And under Daniels's administration, Indiana has taken initiatives to streamline government and reduce the cost of employee benefits, particularly health benefits.

The state also had a prudent fiscal policy during the middle of the decade, running up a sizeable rainy day fund. Just as it has not had as sharp a contraction in public employee headcount as Wisconsin had in the past three years, it did not have as sharp a run-up in headcount during the preceding three years. Stable fiscal policy and flexible employment policy has made it less necessary for Indiana to cut back sharply today. As Daniels says, "[Collective bargaining reform] helped us in a thousand ways. It was absolutely central to our turnaround here."

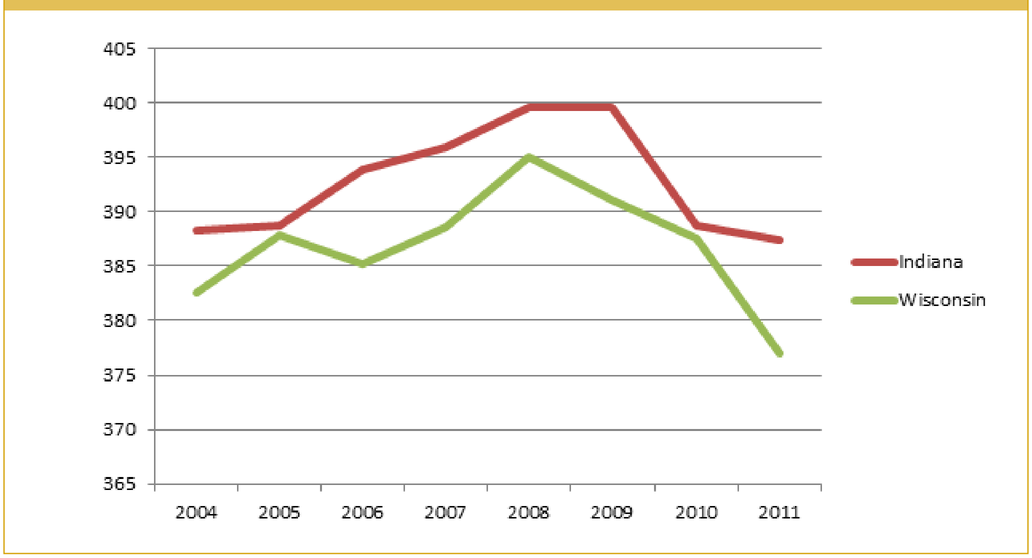
Indiana had the least sharp reduction in public employment in the Midwest in 2011—just 0.3 percent. Over the last three years, it was not such an outlier, though it did significantly outperform its neighbors. While Indiana lost 3.1 percent of public employee headcount since December 2008, that's substantially better than the average for the rust belt (3.7 percent) and not far behind the national average (2.8 percent).

Again, the difference between Wisconsin and Indiana is all in the timing—Indiana abolished state employee collective bargaining in 2005, and has never had collective bargaining for most local government employees. When the recession hit, Indiana government already had the tools in place to manage its costs and could better cope with reductions in revenues. As a result, Indiana was able to avoid raising taxes and did not have to shrink its public workforce as aggressively as Wisconsin did.

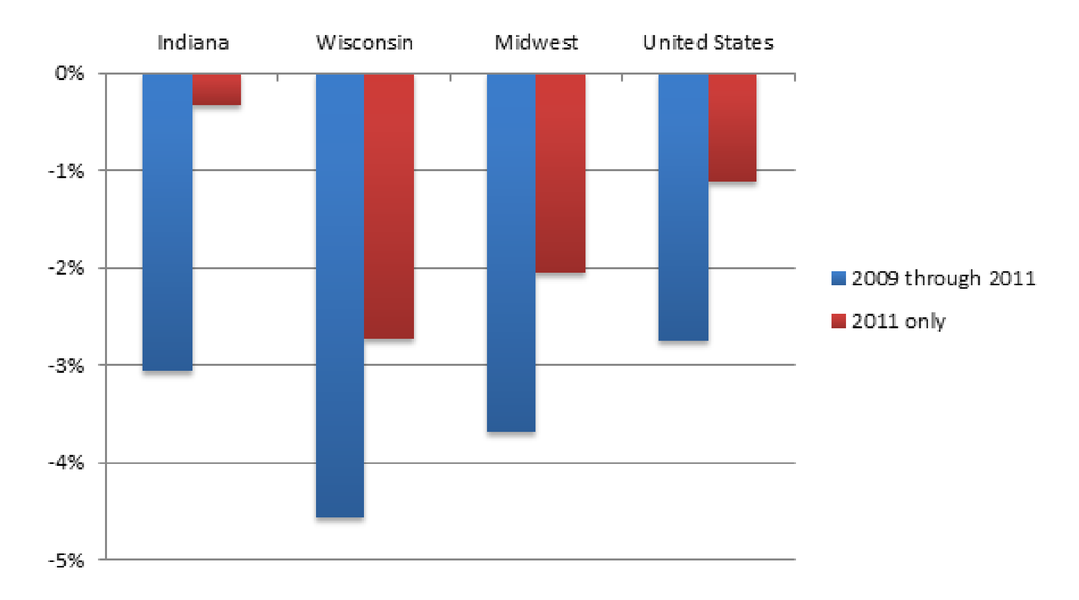
Other Rust Belt Neighbors Provide Counterfactuals

Indiana's 3.1 percent decline in public employment over the last three years very closely tracks the trend in Illinois and Pennsylvania. Yet the three states took very different paths to get there. Pennsylvania significantly expanded state-sponsored gambling and has experienced a boom in natural gas production. Indiana already had expansive legal gambling before the recession and wasn't able to take advantage of fracking and other innovative drilling techniques.

Total State and Local Government Employment (in Thousands)



Reductions in Public Employee Headcount by Time Period



But Indiana did use labor law flexibility to its advantage. It froze state employees' pay in 2009 and 2010. It has also enacted major changes to employee health benefits, saving tens of millions of dollars a year by moving most state employees into high deductible health plans. These moves obviously cause pain for public workers, but they have reduced Indiana's need to reduce the size of its workforce due to economic conditions.

The sharpest contrast, though, is with Illinois, which enacted a massive income tax increase for 2011. The state raised its income tax from a flat 3 percent to a flat 5 percent, a move which led to a 20 percent increase in the state's general fund revenues. Indiana has not raised state level taxes at all in the last three years. Yet each state has had to cut almost exactly the same percentage of government jobs—all that Illinois's massive tax increase allowed it to do was match Indiana's public employment trend.

Wisconsin could have avoided layoffs with a sharp tax increase like Illinois' (and with all the attendant economic costs of such an increase) but in a few years, it should be able to do as Indiana did by relying on labor flexibility to control costs without taxes and with fewer layoffs.

Conclusions

Thus, there are a few lessons that Wisconsin can draw from these data:

- **The compensation and bargaining reforms in the budget repair law are more essential than ever.** Public employee unions will point to the layoffs in many Wisconsin municipalities as evidence that budget repair "hasn't worked." It's more accurate to say that, in some jurisdictions, the law hasn't been ***able to work yet***. Over the next few years, these reforms will allow other Wisconsin municipalities to achieve savings similar to the ones seen in Milwaukee. If the reforms are repealed, municipal governments will not get the cost relief they need and will have to impose further layoffs.

- **States shouldn't wait for a recession to reform public labor.** Indiana's fiscal preparations—including but not limited to public labor reform—positioned it unusually well for a downturn. This allowed the state to enter the recession on healthy fiscal footing, and avoid both sharp cutbacks in employment and tax increases at a time when the private labor market was weak. As a result, Indiana had the mildest contraction of public payrolls in the industrial Midwest in 2011—just 0.3 percent—and better than average performance over the last three years. It did this without raising taxes. If Wisconsin had reformed public labor at the same time that Indiana did, more jurisdictions would have had experiences similar to Milwaukee's, and it would have been possible to avoid many more layoffs.

- **Be careful about local budget austerity.** The reason Wisconsin has seen such a sharp reduction in public employment is that it made sharper budget cuts than many of its neighbors. For example, Ohio's biennial budget cut about half as much from local aid as Wisconsin's on a per-capita basis. Wisconsin also imposed new restrictions on local taxes, while in Ohio and many other states, jurisdictions have been making choices between higher local taxes and layoffs on a case-by-case basis. All of these decisions involve trade-offs: Illinois is likely to see economic consequences from its huge tax increase. Voters in some Ohio jurisdictions have approved significant increases in local taxes. But states including Wisconsin should be mindful that public labor reform cannot immediately compensate for sharp local aid cuts, and that sharp cuts in local budgets will lead to layoffs in the short term.

As with every other state, Wisconsin voters will have to make hard choices in the next few years about how to deal with budget gaps: raise taxes, cut spending, or some combination thereof. The experiences in the City of Milwaukee, and in the state of Indiana, show how reforms to public employee benefits and collective bargaining can make those difficult choices easier, given enough lead time.

Endnotes

[1] Other provisions, such as those relating to the recertification of unions, are beyond the scope of this paper.

[2] State and local government data from the Bureau of Labor Statistics. Data from Mississippi are unavailable.

[3] https://www.hctrends.com/lib_docs/3671/Wisconsin_Teacher_and_Private_Health_Plan_Comparisons

The Manhattan Institute's **Center for State and Local Leadership (CSLL)** promotes promising new approaches to reform of state and local government. CSLL works on a broad range of issues, including public sector reform (specifically of pensions and health benefits), education reform, prisoner reentry, policing, public housing, infrastructure, immigration, and public service delivery. By spotlighting new ideas, and providing the research and proposals to inform creative new policies, the CSLL hopes to lay the groundwork for an environment in which commerce, employment, and a rich civic life can flourish.

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