Mitchell's Musings 6-24-13: Two Cheers for the SEIU

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The occasion for the title of this Mitchell's Musing is a tentative deal between SEIU Local 1000, the largest union of California state employees – 95,000 workers in various units - and Governor Jerry Brown that provides for pay increases contingent on the future condition of the state budget. It is likely that this contract will be a pattern setter for state workers represented by other unions. As with all union contracts, there are many detailed provisions. However, there is a basic raise of 2% a year from now (July 1, 2014) followed by 2.5% a year later. The first 2% is contingent on state revenue projections being met as determined by the state's finance director. If revenues fall short of projections, the 2% is postponed to the following year at which time 4.5% would be paid.[1]

This new agreement was reached against a fiscal background that many readers will have some familiarity with based on news headlines. California had fiscal difficulties going back to the dot-com bust after 2000. The state is highly dependent on personal income tax revenue – roughly 6 out of 10 dollars going to the general fund come from that tax. The income tax is highly progressive and so its receipts are heavily dependent on higher income earners and, particularly, capital gains that can come and go with the vagaries of financial markets. Economic forecasting – particularly calling future downturns correctly – is always difficult. Forecasting financial markets is even more difficult. Indeed, if one could do it consistently, vast riches would ensue. So far, despite claims to the contrary, no one has mastered the secret.

After the dot-com bust, Gov. Gray Davis was recalled – largely because of the resulting budget crisis. Arnold Schwarzenegger replaced him and essentially adopted and enlarged a Davis plan to borrow the state out of its immediate difficulties. But the repair to state finance was at best incomplete and the 2008 financial meltdown and Great Recession pushed the state back into a Davis-style fiscal crisis. Jerry Brown was elected in 2010. He eventually persuaded the California electorate to approve temporary taxes and essentially brought the state back to a rough fiscal balance. However, the state remains subject to volatility in revenue – particularly because the temporary taxes included a hike in the hard-to-predict income tax.

[1] http://www.calhr.ca.gov/Documents/bu01-03-04-11-14-15-17-20-21-seiu-ta-legislative-summary-dated-06132013.pdf.

As the legislature considered a budget for the coming fiscal year starting July 1, 2013, a dispute developed with the governor. The governor's projections of revenue were below that of the Legislative Analyst's Office (LAO), a non-partisan entity that advises the legislature and offers critiques of gubernatorial budget recommendations. The legislature – not surprisingly – gravitated toward the LAO projections which allowed more spending.[2] In theory, since Democrats hold a two-thirds supermajority in both legislative houses, the legislature could have imposed its own budget and overridden any veto by the governor. However, not all Democrats would have gone along with such a confrontation so, in the end, the governor's "conservative" revenue projections were adopted.[3]

With that background, let's get back to the SEIU Local 1000 contract. Generally, I like pay systems that include contingencies for downturns. During the 1980s and 1990s, there was much discussion of such arrangements in the private sector geared to some form of profit sharing or revenue sharing. The standard practice in the U.S. is for nominal pay to be relatively rigid in the short run so that downturns are dealt with by layoffs rather than reduced pay. Using pay rather than layoffs as the adjustment mechanism tends to reduce unemployment – a good result.

However, in the public sector, there are no "profits" on which to base such contingencies. In addition, because there always an option of increasing taxes, making pay somehow contingent on revenues has potential complications. Revenues don't just happen; they can be enhanced. Moreover, state and local fiscal accounting is subject to manipulation. In California, for example, there is an accrual accounting system with historically fuzzy definitions. Revenue can be slid around by attributing it to past or future years. Nonetheless, I like the idea of pay contingency in the public sector. It avoids layoffs (or the furloughs that became common in the public sector). And it has an element of fiscal prudence which is always a Good Thing; if revenue falls, spending on pay also declines.

So why only two cheers for the SEIU accord rather than the full three? One reason is that there isn't much contingency in the recent deal. It is only 2% a year from now or, instead, postponed an additional year. In addition, although the future is always uncertain, the revenue projections of the governor were admittedly conservative – at least relative to the LAO's. Therefore, at least from the vantage point of June 2013, it is more likely than not that the projections will be met.

Finally, in the words of an earlier governor of California, Ronald Reagan, it is always good to "trust, but verify."[4] The deal leaves it to the governor's finance director to determine if revenue projections will be met. Certification could have been instead made by the state controller – an independently elected

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[2] The story is more complicated than a simple more-or-less level of spending since under formulas approved by voters under two ballot propositions, a good chunk of state spending is devoted to K-14 which tends to gobble up increases in revenue.

[3] At this writing, the legislature's enacted budget is before the governor who can exercise line-item vetoes. Thus, there is as yet no final state budget.

[4] http://www.youtube.com/watch?v=As6y5eI01XE.

official – who keeps track of cash inflows and outflows. Basing the contingent clause on actual cash receipts rather than fuzzy accrual revenues would have been a sounder methodology. The SEIU deal in short has more trust than verification.