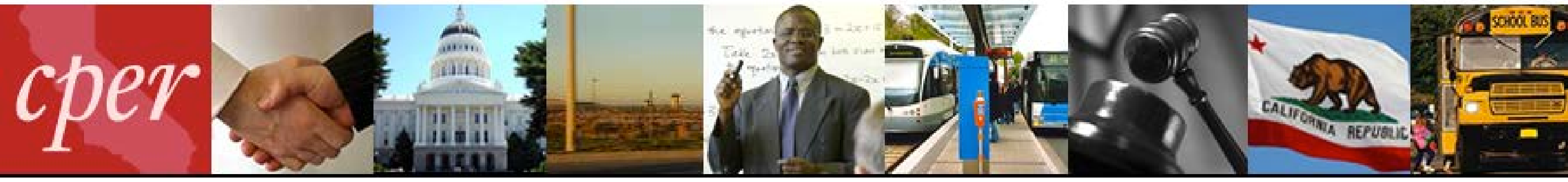
California Public Employee Relations



Shrunken Public Sector Stunts California's Recovery

Sylvia A. Allegretto and Luke Reidenbach

Since the onset of the Great Recession five years ago, we have been experiencing the fallout from the bursting of an $8 trillion housing bubble, the collapse of the financial sector, and the loss of 8.7 million jobs in the United States. During the crisis, many economists and policy analysts called for aggressive federal fiscal policy — a massive Keynesian-style stimulus on the scale of a new New Deal. To stop the hemorrhaging of jobs and prevent further economic deterioration, Keynesian macroeconomics posits that the government should offset decreases in private consumption and investment with an increase in public spending.

The $787 billion American Recovery and Reinvestment Act (ARRA), passed in 2009, was not large enough to pull us quickly or entirely from the grips of the worst recession since the Great Depression. Yet it did help. Estimates from a range of sources indicate that absent ARRA, the economy would have had far fewer jobs and weaker growth. The Congressional Budget Office estimated that ARRA created from 500,000 to 2.9 million jobs as of June 2011, while IHS Global and Macroeconomic Advisors estimated between 2.4 and 2.6 million more jobs.[1]

In 2010, political and policy discourse shifted to the deficit and debt. Even President Obama took a hawkish stance in 2010 when he froze the pay of federal workers for two years, a policy move that played into the notion that the deficit was the central economic problem, not lack of aggregate demand due to the recession. [2] As the economy remained weak, many economists advised another round of fiscal stimulus, especially to struggling state governments, but the deficit hawks won the day.

Not only was Keynesianism pushed aside, but also austerity measures were implemented by choice at the federal level, and because of balanced budget requirements, at the state level. As a result, from 2009 through 2011, the stimulus of ARRA *and* the anti-stimulus of austerity were conflicting policies. In California, it is clear which policy won out.

Since the state budget experienced the largest shortfalls on record, and without the option of deficit spending, the result was significant cuts to much needed programs. With no possibility of passing new legislation to increase state revenues, California enacted program cutbacks to many areas — health care, public safety, education, child care, elder care, and care for the disabled —which resulted in substantial layoffs of the public sector workforce, including significant numbers of teachers.[3]

Enough time has now passed to assess some outcomes of these austerity policies. Indeed, new research has documented the harmful effects that austerity has had on the U.S. economy. An Economic Policy Institute analysis estimated that without state and local austerity in the U.S., there would be 2.3 million more jobs today — with half of them in the private sector.[4]

This article looks at how measures of austerity have affected the economic recovery in California. It is not our intent to debate the merits of the state's reaction to the recession and the state's budget decisions, but to document and assess the outcomes of the policies on jobs and economic growth.

Highlights include:

- The housing bust in California was huge. Average home prices around the country declined by 24 percent from peak to trough, while the decline in California cities was 45 percent.
- State budget cuts have weakened the U.S. recovery as decreases in government outlays shaved off up to a percentage point in quarterly economic growth.
- Surprisingly, private sector job growth in California, at this point into recovery, is better than it was following the 2001 and 1990 recessions. However, the huge cuts in the non-federal government workforce have severely mitigated overall employment growth.
- It is estimated that without the state budget cuts, reductions to public sector employment, and the resultant ripple effects into the broader economy, California would have over half-a-million more jobs today — with half of them being in the private sector.
- In sum, this brief suggests that austerity pursuits at a time of high unemployment and negative or low growth only lead to a more weakened economy and a delay in economic recovery.

California's Nightmare

The precursor to the Great Recession was the bursting of the housing bubble. California's bubble was one of the biggest. As cited above, average home prices around the country declined by 24 percent, while the decline in California cities was 45 percent, according to Moody's Investor Services analysis of housing price data from the National Association of Realtors. The hardest hit cities, such as Stockton, Riverside, and Modesto, experienced 60 percent declines, on average.[5] State revenues declined as workers lost their jobs, consumer spending fell, business activity waned, and, in turn, tax receipts fell. As state revenue dropped, the demand for safety-net spending increased — which is expected during times of recession. California implemented deep cuts, which in turn added to already stressed local budgets. Estimated 2012-13 state spending is $11.6 billion below the 2007-08 level, a sizable decline (-11.3 percent).

The true size of the budget cuts is actually understated because it does not take into account state spending trends expected prior to the Great Recession. In 2007, the Legislative Analyst's Office projected that 2012 General Fund spending would be $135.6 billion, based on the economic and demographic trends at the time. Instead, this year's budget agreement put state spending at just $91.3 billion, a difference of $44.2 billion. This gap, which is more than what we currently spend on K-12 education, represents a massive decline relative to the underlying baseline trend.[6]

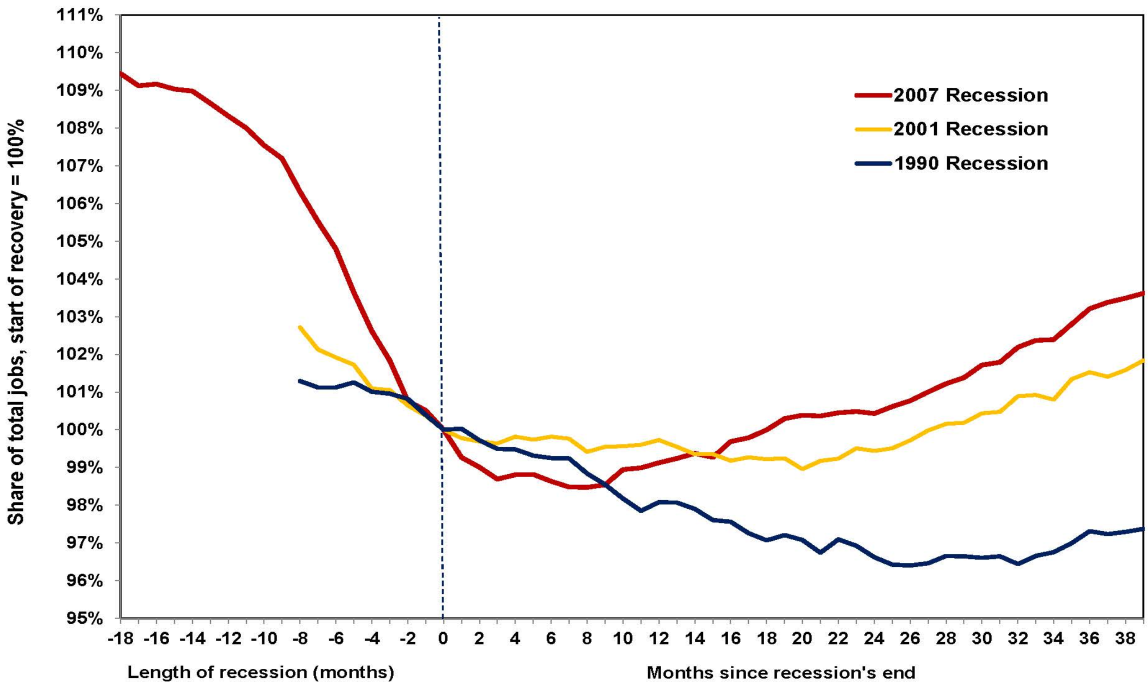
It isn't just Sacramento's economy that is affected. Much of California's state budget flows to local communities and individuals. According to the California Budget Project, nearly three-quarters of state spending goes directly to local communities and individuals, meaning that these cuts have put tremendous strain across the entire state as local budgets were hit hard.[7]

Jobs: The Story of Two Sectors

Officially the recession lasted 18 months (December 2007-June 2009). During that time, the U.S. lost 7.5 million jobs (a drop of 5.4 percent), and 1.1 million of those jobs lost were in California (representing a 7.3 percent decline of jobs in the state). Since the end of that period, California's jobs picture has become the story of two sectors: a slowly strengthening private sector and a perpetually weak public sector. As the labor market gradually recovered, job losses in the public sector mitigated gains in the private sector. Two figures contextualize the dynamics of the two sectors in California.

First, **Chart 1**, below, illustrates private sector employment growth for the Great Recession (red line) relative to the previous two recessions that occurred in 2001 (yellow line) and 1990 (blue line).[8] The first thing to notice is the severe and lengthy decline of jobs in the private sector associated with the Great Recession — much more so than the previous two recessions. Though the recession officially ended in June 2009 (the onset of recovery is represented by the dotted line), California's private sector continued to shed jobs for an additional eight months — bottoming out at just over 1.3 million private sector jobs, an unprecedented 10.4 percent decline. In other words, one of every ten private sector jobs simply disappeared. Private sector job growth did not turn positive until nine months into recovery. Since then, private sector job growth has been outpacing that of the previous two recoveries at this stage.

Chart 1 California's private-sector job growth over the last three recessions



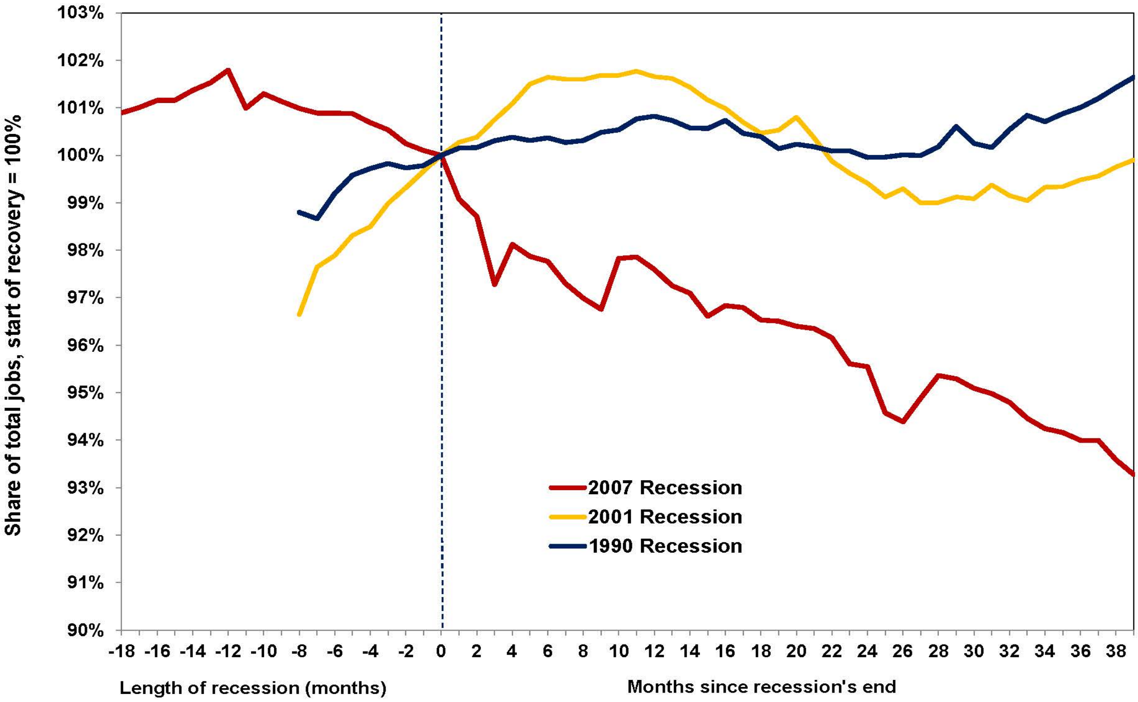
Source: Authors' analysis of U.S. Bureau of Labor Statistics, CES data.

But with more than two years of consecutive month-to-month private sector growth, why is the labor market still so weak and unemployment so high? First, job losses in the 2007 recession were very deep and it will take longer to recoup them — this is clearly visible in Chart 1. Employment in California is still 842,000 jobs short of what it was prior to the recession. Second, population and the number of workers who need jobs both increased over the past five years. If population growth is factored in, California's labor market is unlikely to reach pre-recession strength until sometime between 2018 and 2023.[9]

Moreover, job growth performance was stronger this time only compared to weak prior recoveries. The previous two recessions were hampered by 'jobless recoveries' (an expanding economy with continued job losses) in the U.S. and more severely in the Golden State. As shown in Chart 1, it was not until 32 and 20 months into recovery that private sector job growth resumed following the 1990 and 2001 recessions, respectively. Job growth in the previous two recessions was late coming and quite tepid.

Another significant factor dampening employment growth has been the severe decline in government jobs at the state and local (S&L) level, including education, in California. **Chart 2**, below, illustrates the trajectory of public sector jobs for the last three downturns and recoveries in the state. Public sector jobs at the local level (which account for the lion's share of all government jobs[10]) are currently down 359,000 in the U.S. compared to prior to the downturn. Remarkably, 45 percent of those losses have been California.

Chart 2 California's state and local government job growth for three recessions

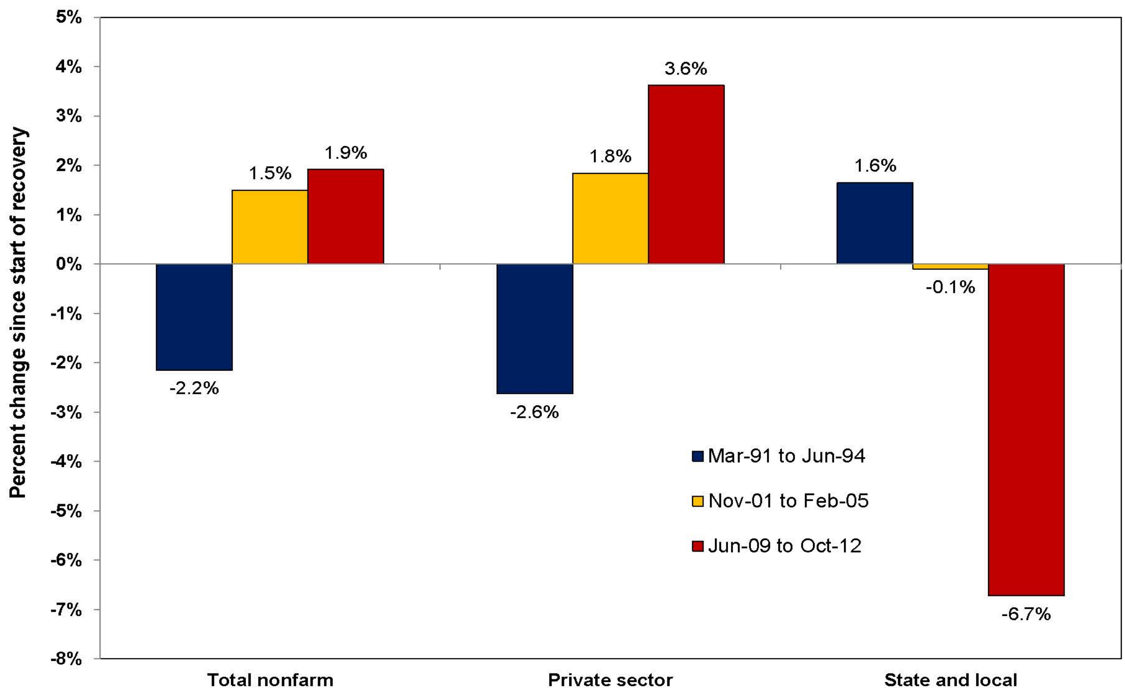


Source: Authors' analysis of U.S. Bureau of Labor Statistics, CES data.

As Chart 2 shows, public sector job losses in the current recovery are significantly more severe than they were for the two previous periods of economic recovery. This sector is down 6.7 percent since the beginning of the recovery (right side of dotted line). But, if losses that occurred during the recession are added (left side of dotted line), the sector is down 7.5 percent. This was not the case in the two previous recoveries when public sector growth was increasing slightly this far into recovery.

Chart 3, below, sums California's employment growth by sector (total, private, and S&L) 39 months into the recovery. In total, employment is up 1.9 percent, which is not far from the 1.5 percent increase to this point following the 2001 recession, and much more than the -2.2 percent associated with the early-1990s recovery. Significant differences become evident when the private sector is compared to the public sector. Gains in the private sector (3.6 percent) are far outstripping the last two recoveries, but these gains are diminished by the unusually large decline (6.7 percent) in the S&L workforce. These are the steepest losses in public sector employment on record for California. California now has as many employed non-federal public employees as it did in the spring of 2001, even though the state's population grew by at least 8.5 percent.[11]

Chart 3 Change in California's employment 39 months into recovery, by sector



Source: Authors' analysis of U.S. Bureau of Labor Statistics, CES data.

Job declines have hit many sectors of government, but especially education, as funds for education were slashed by $18 billion over the last four years.[12] According to the Bureau of Labor Statistics, 49.5 percent of S&L job losses from 2008 through 2011 occurred in education in California.[13] A second source of data from the Census Bureau's Survey of Public Employment corroborates these losses.[14] According to the latter survey, there were 70,787 (-7.9 percent) fewer people working in K-12 schools in 2011 than in 2006 in California, including 38,703 fewer teachers. The side box has other examples of how cuts affect public services and employment.

Side Box: The Impact on Core Government Services

This article focuses primarily on the immediate economic impact of California's austerity measures. However, it is worth noting that these cuts have put tremendous strain on California's core public services such as education, public safety, and access to the judicial system.

The bulk of the public sector's duties are related to either education or keeping the public safe. Data from the U.S. Census Bureau's annual survey of the state and local government workforce show that education-related jobs represent by far the largest share of California's public workforce, making up 56.7 percent of public workers in 2011.[15] Of the 1.2 million employees working in education, a little over half (51.8 percent) were instructors. The next-largest group of public workers is employed in public safety, which includes firefighters, police officers, and other emergency responders. This group represented an additional 10.7 percent of the California public sector workforce in 2011.

Spending cuts have taken a toll on the ability of governments to do their jobs well. For example, spending on California's court system has been significantly reduced. Contra Costa County Superior Court announced in October 2012 that it will close six courtrooms in the poorest parts of the county, citing the loss of millions in state funding.[16] In the spring of 2012, Los Angeles County announced the closure of over 50 courtrooms.[17] In the case of education, class sizes have continued to grow as cuts to K-12 schools persist. Half of California's largest school districts now have 30 or more students per teacher in a K-3 grade class, compared to 20 students per teacher in 2008-09.[18] Teacher layoffs in California resulted in a rank of 50th in the nation with respect to the number of students per teacher.[19]

Public safety has felt the impact as well. In 2011, Sacramento cut $12.2 million from its police department's budget, and, in response, the department laid off police officers and eliminated entire divisions of the police force, including narcotics, financial crimes, and undercover gang squads.[20] Elsewhere, Oakland's police department cut staffing levels of sworn officers from 830 in 2009 to 640 in 2012.[21]

Budget cuts have consequences for how public services are rendered. It may take years to fully realize all the implications.

Was California's Public Sector Bloated?

Was the public sector workforce bloated, a "bubble" that needed to be popped? Writing in the *Wall Street Journal*, Stephen Moore states: "Today in America there are nearly twice as many people working for the government (22.5 million) than in all of manufacturing (11.5 million). This is an almost exact reversal of the situation in 1960, when there were 15 million workers in manufacturing and 8.7 million collecting a paycheck from the government."[22] Moore also argues that this trend is driving state fiscal crises, especially in states such as California.

Such statistics are deeply misleading, as the comparison is simply not relevant. First, manufacturing employment has been declining as a share of the workforce and in raw numbers for over three decades. This decline has nothing to do with the size of the public sector workforce. Second, population growth alone accounts for the increase in demand for public sector workers. Historical data show that, as a share of the labor force or of the population, state and local government employment has remained stable for well over 30 years. Simply put, the size of the public sector — which serves all of California's residents — has been remarkably stable, making up anywhere between 6.8 percent and 7.9 percent of the population for decades. That share dropped 0.5 percentage points from 7.5 percent to 7.0 percent in 2011, and has likely declined further throughout 2012.[23] There just isn't a public sector bubble.[24]

The effects of budget cuts and job losses go beyond laid-off workers or residents now lacking access to public services. Public cuts in outlays and employment to the degree experienced in California seep into the private sector and the larger economy in several ways.

First, direct job losses do not take into account the growth of government employment that would have occurred without the downturn and cuts. Normally, as the population increases, the public workforce grows proportionally. However, during the period of steep public sector job losses, California's population continued to grow without a corresponding increase in the number of public workers. Since 2009, California's population has grown by around 1.6 percent, or 601,259.[25] In June 2009, when the recession officially ended, there were 6.05 state and local workers for every 100 California residents. In the subsequent three years, that ratio has dropped to 5.55. If California had maintained the same ratio as it when the economic recovery *began*, it would have added 187,307 new S&L workers. This is a conservative estimate because when the economic recovery began in the summer of 2009, thousands of public sector jobs already had been lost. So, California public sector employment is down 338,200 jobs relative to the normal economic trend.

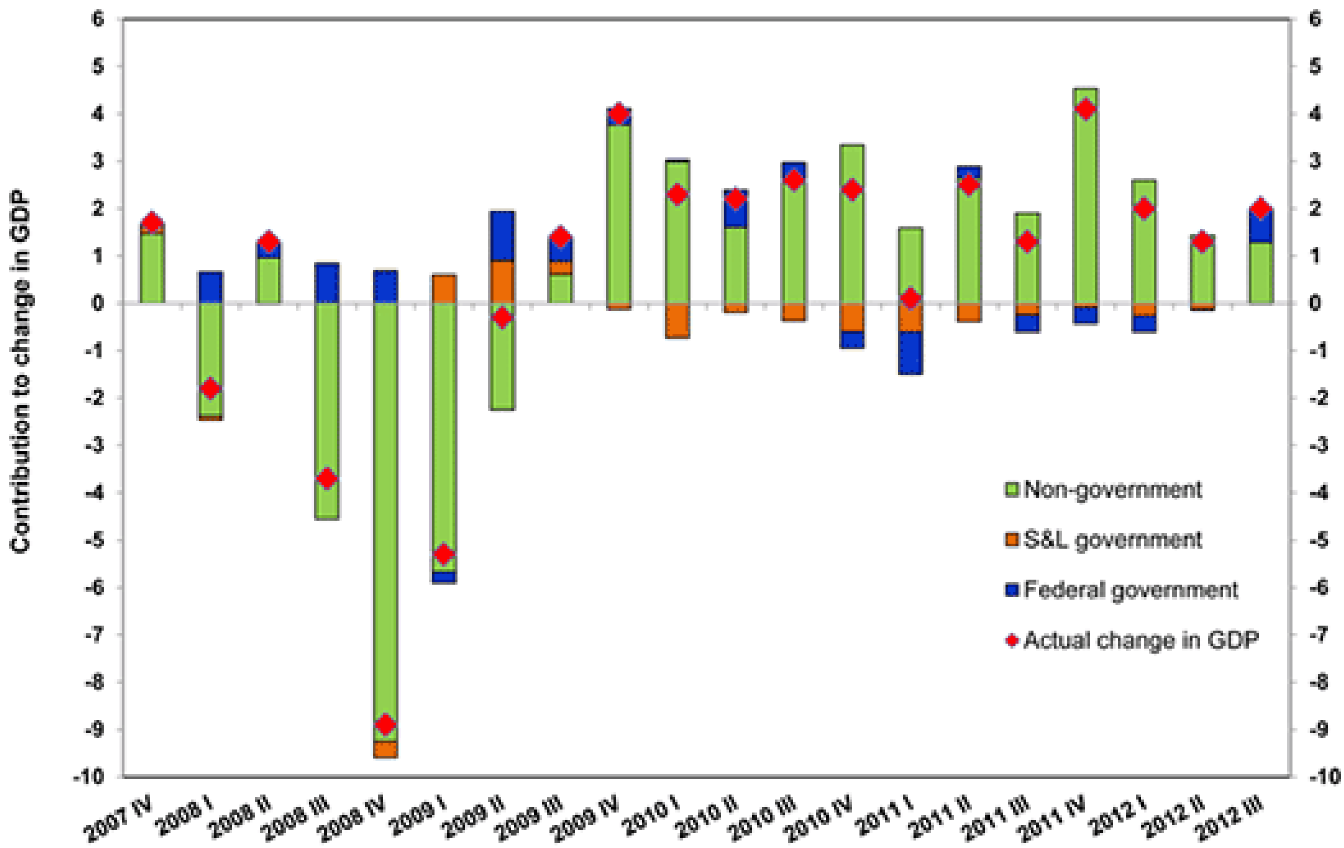
Second, economic impacts are often measured through "multipliers," which are quantified estimates of how certain economic activities impact economic growth. This multiplier takes into account the effect of the decline in S&L spending on suppliers (mostly in the private sector) and the effect of the decline in spending by unemployed public sector workers who previously spent most of their income at private sector businesses. The Economic Policy Institute, working from multipliers developed by Moody's economist Mark Zandi, estimated that the multiplier for public sector jobs is 0.67.[26] In other words, for every public sector job lost, about 0.67 jobs are lost in the private sector. Using this multiplier as a rough estimate, California has not only lost 338,200 public sector jobs relative to economic trend, but that impact has meant 226,594 fewer private sector jobs as well.[27]

Impact on Economic Growth

National data confirm that state and local austerity has been a drag on total economic output, or gross domestic product (GDP). GDP measures the total market value of all goods and services produced in the economy. One component of GDP is public sector outlays, which includes how much the government spends on goods and services and the salaries of its workers. Government spending — and how it changes over time — can either add or subtract from total GDP.

Chart 4, below, shows the change in quarterly GDP since the onset of recession, broken down by S&L government (orange bar), federal government (blue bar), and non-governmental (green bar) contributions to that change. The red diamonds mark the percent change in total GDP.

Chart 4 Contributions to U.S. gross domestic product



Source: Authors' analysis of U.S. Bureau of Economic Analysis data.

The depth of the recession can be seen in the 2008 figures. The four consecutive quarters of negative growth were all mitigated somewhat by a net positive in public sector contributions — especially in quarter two of 2009. GDP trend turned positive in the third quarter of 2009, but cutbacks at the S&L level, as was often the case for federal contributions, mitigated growth. Throughout the recovery (which officially began 2009, third quarter), average quarterly GDP growth has been just 2.2 percent. Keep in mind that GDP growth below 4 percent is not enough to bring down unemployment and keep up with new entrants into the workforce. As depicted in Chart 4, at a time of tepid growth, decreases in government outlays directly shaved off up to 1.5 percentage points of quarterly GDP.

This drag on total GDP comes from the decrease in public expenditures, and state-level data show that California's state and local government sector shrank more than in the nation as a whole. Detailed data on state-level GDP is only available in annual averages through 2010, thus giving us a limited view into how the state's economy fared in recent years during continued government austerity. The data that are available confirm that California's state and local government sector contracted much more sharply than the nation as a whole. From 2008 to 2009, California's S&L outlays shrank by 4 percent compared to 0.37 percent for the nation. And in the following year, California's public spending contracted another 3.4 percent while nationally the sector declined by 0.68 percent. Without this decline, California's total GDP would have been 0.4 percent larger in 2009 and 0.3 percent larger in 2010.[28]

Final Thoughts

This article documents the severity of the Great Recession, especially in California. In response to a housing crisis and the resulting deep recession, ARRA was passed, which helped mitigate the fall. But, soon afterwards the federal government pivoted towards austerity. As foreclosures, job losses, and unemployment mounted, the economy contracted and revenues tanked in the U.S overall, but more so in California. Steep budget cuts were implemented in efforts to balance the state budget, which in turn weakened an already faltering economy and added thousands of government workers to the already expanding ranks of the unemployed. By our estimates, assuming normal economic trends and the resulting ripple effect on the economy, California would have roughly half a million more jobs than it does now if budget cuts could have been avoided.

Federal officials got it backwards when they pursued austerity at a time of high unemployment, deep problems in the labor market, and severely reduced aggregate demand. Government spending should have expanded sufficiently to fill the void and provide sufficient funds to the states to assist a solid recovery. A sufficiently healthy economy must be in place before a discussion on debt can be reasonably debated. This paper supports the belief that budget cuts implemented during the most severe recession since the Great Depression led only to a deeper, more prolonged slump.

Looking forward, while it is impossible to quantify the long-term impact the cuts will have on economic growth and on the ability of the public sector to provide necessary services efficiently and/or effectively, it is clear that the short-term effects are negative. One of the best ways a state can set itself up for sustained economic growth is through investments it makes in its public institutions, especially education and infrastructure.[29] As Minneapolis Federal Reserve researchers Rob Grunewald and Arthur Rolnick wrote, “investment in human capital breeds economic success not only for those being educated, but also for the overall economy.”[30]

California must have a solid educational system from pre-school through graduate school, as students are the workers of the future. Further investments in the state’s infrastructure, such as roads, the electrical grid, water systems, and telecommunications that commerce depends on to provide goods and services, is also crucial. Hanging in the balance is whether California’s future will be Golden or not.

Sylvia A. Allegretto, Ph.D. is an economist and co-chair of the Center on Wage and Employment Dynamics at the Institute for Research on Labor and Employment, University of California, Berkeley. Luke Reidenbach is a graduate student at the Goldman School of Public Policy. The authors thank Laurel Lucia and Michael Reich for helpful suggestions.

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Notes

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[1]Council of Economic Advisers 2011.

[2] Baker and Calmes 2010.

[3] Legislative Analyst’s Office 2012.

[4] Bivens and Shierholz 2012.

[5] Moody's Investor Services 2012.

[6] Legislative Analyst's Office 2007; Legislative Analyst's Office 2012; California Budget Project 2012.

[7] California Budget Project 2012.

[8] Recessions are dated by the National Bureau of Economic Research's business cycle dating committee. See here for business cycle dates: http://www.nber.org/cycles/cyclesmain.html.

[9] Allegretto and Reidenbach 2012.

[10] In December 2007, public sector employment in California as a share of all employment was: 1.6 percent federal, 3.2 percent state, and 11.7 percent local.

[11] Population estimates are from the California Department of Finance's Demographic Research Unit. The estimated change in population between January 1, 2012, and January 1, 2002.

[12] California Teachers Association 2012.

[13] U.S. Bureau of Labor Statistics, Current Employment Survey.

[14] U.S. Census Bureau, 2011 Annual Survey of Public Employment and Payroll.

[15] U.S. Census Bureau, 2011 Annual Survey of Public Employment and Payroll.

[16] Lee 2012.

[17] Los Angeles Superior Court 2012.

[18] EdSource 2012.

[19] Kaplan, Jonathan 2011.

[20] Goode 2012.

[21] *San Francisco Chronicle* 2012.

[22] Moore 2011.

[23] Estimate from U.S. Census Bureau's Current Population Survey (CPS). Calculated as the ratio of all state and local government workers to the entire civilian population.

[24] For more see: Allegretto, Jacobs, and Lucia 2011.

[25] California Department of Finance, Demographic Research Unit.

[26] Bivens and Shierholz, 2012.

[27] There are other indirect effects when large numbers of government workers are relegated to the ranks of the unemployed, such as the jobs likely lost due to state spending cutbacks on transfer programs.

[28] U.S. Bureau of Economic Analysis, National Income and Product Account (NIPA) tables.

[29] Lynch 2004; Mofidi and Stone 1990; Abel and Deitz, 2009.

[30] Grunewald and Rolnick 2003.