The Erosion of Compensation for Federal Executives and Judges

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by

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Summary

A crucial responsibility of the government is to recruit, hire, and retain strong candidates to serve in executive and judicial positions. For better or worse, the experience and talents of key federal officials will determine the government's success in executing policy and administering justice. The government's ability to recruit talented executives, scientists, lawyers, and judges depends on the attractions of top government jobs, including the salaries and non-wage benefits offered to the people who serve in these positions. Good candidates rarely accept senior government positions solely, or even mainly, out of a desire for personal wealth. However, many people may be deterred from public service if they are asked to make a large financial sacrifice in order to serve.

Congress is ultimately responsible for establishing pay levels in senior government positions. This obligation makes Congress vulnerable to the charge of self-interest. The problem stems from the practice of linking salaries of top executive and judicial branch officials to those of Members of Congress. This means legislators who vote in favor of good salaries for federal executives and judges are often seen as voting to give themselves a pay raise. Constituent pressure sometimes forces Congress to hold a "yes" or "no" vote on scheduled pay hikes, even when a law has been carefully crafted to allow salary increases to take place without any explicit action by Congress.

Congressional reluctance to vote in favor of pay raises has meant that the salaries of senior federal officials have followed an erratic course over the past century. Measured either in terms of purchasing power or as a ratio of the average wage of private-sector workers, the annual pay of Cabinet officers, sub-Cabinet officials, judges, and senior federal executives has fluctuated widely and trended downward over the past few decades. Federal compensation of top officials is determined by political logic rather than a clear-eyed assessment of the personnel needs of the government. The federal pay structure is not calibrated to achieve rational economic objectives. It nonetheless can have real effects on recruitment and retention.

A variety of benchmarks can be used to assess the adequacy of federal pay. One standard is the purchasing power of salaries. What standard of living can be achieved by an office-holder, assuming the official's household income while in government employment consists solely of a federal pay check? Of greater relevance are the wages of other workers, especially those who hold private-sector jobs with similar skill requirements and responsibilities. How does federal executive pay stack up against the salaries paid in similar positions outside the federal government?

The simple fact is that real wages in top federal jobs have not kept pace with inflation. In an era of increasing pay for people in key legal, scientific, and management positions, the salaries of top federal jobholders have fallen far behind the pay received by people in the private sector who hold jobs with comparable or lesser responsibility. In the short run, capable scientists, lawyers, and executives may leave public service in order to obtain more comfortable and better paid positions in the private sector. The long-term risk to the federal government is even greater. Many of the most talented and ambitious young university graduates may not consider a career in the public service because of the financial sacrifices associated with such careers.

The GAO report

The GAO has just issued an update on trends in the pay and fringe benefits of top federal positions (*Human Capital: Trends in Executive and Judicial Pay*, GAO-06-708, June 2006). The report documents the long-term erosion in the real value of pay for top federal executives and senior judges. The pay of administrative law judges, senior scientists, and managers in the Senior Executive Service has fared slightly better, but the relative pay gain obtained by these federal employees has meant there has been serious compression in pay among senior managers. Federal managers in the Senior Executive Service can now receive pay that exceeds the salaries earned by political appointees in Executive Schedule levels III and IV, presidential appointees who typically have greater management responsibility than managers in the Senior Executive Service.

Critics of the GAO report might quibble about the price deflators GAO analysts used to measure price inflation between 1970 and 2006. Even if an alternative deflator is used, however, the basic conclusion of the report cannot be challenged. Measured in dollars with constant purchasing power, the salaries of many top government positions are lower in 2006 than they were in 1970. Top federal salaries fell fastest in the 1970s and early 1980s, when price inflation was high. Real wages have recovered somewhat since the early 1980s, although for Cabinet officers, Members of Congress, and some other top officials the purchasing power of current salaries are lower than they were in 1993.

In January 1969 members of Congress were paid an annual salary of $42,500. Cabinet-level officers received a salary of $60,000. By January 2006 salaries had risen to $162,100 for members of Congress and sub-Cabinet officials in Level II of the Executive Schedule. Salaries had climbed to $180,100 for members of the president's Cabinet. While the salary increases may seem large, most indexes of the cost of living rose much faster over the period. Whereas congressional salaries increased 281 percent and Cabinet officer pay rose 200 percent between 1969 and 2006, the Bureau of Labor Statistics' Consumer Price Index for All Urban Consumers (CPI-U) increased 457 percent. Two superior measures of consumer price inflation are the Bureau of Labor Statistics' CPI-U-Research Series (CPI-U-RS) and the Bureau of Economic Analysis' Personal Consumption Expenditure (PCE) deflator. The CPI-U-RS price index rose 380 percent between January 1969 and January 2006, and the PCE deflator increased 358 percent in the same period. Every measure of inflation shows that consumer prices rose substantially faster than salaries for the top rank of federal officials.

The implications of consumer price changes for the purchasing power of top federal salaries are displayed in Figure 1. The top panel shows the trend in annual congressional salaries at the beginning of each presidential term from 1969 through 2005. The bottom panel shows the trend in Cabinet officers' pay. The light-colored bars show salaries measured in contemporaneous prices, while the dark bars indicate salary levels when prices are converted into constant 2005 dollars using the CPI-U-RS price index. The chart shows that, when salaries are consistently measured using 2005 dollars, congressional pay fell almost 17 percent (from $196,100 to $162,100) after 1969 while Cabinet officer pay shrank 35 percent (from $276,800 to $168,100). Because the level of congressional and Cabinet-officer salaries in turn places limits on the ceiling for salaries received by presidential appointees below Cabinet rank, it follows that most presidential appointees and many senior executives who are not presidential appointees now receive salaries that are worth substantially less than the incomes earned by their counterparts in the early Nixon administration.

Top federal officials are not the only Americans who face rising living costs, of course. Middle-class families must also struggle to pay higher prices for basic necessities, decent housing, and health care. One way to compare the situation of top officials with that of middle-class Americans is to compare the annual salaries of a senior office-holder with the annual income of a middle-class family. In 2004, the median income of a four-person American family was $66,111. In comparison, a Cabinet officer's annual salary was $175,500 – or 2.65 times the median income – and a member of Congress' pay was $158,100 – or 2.4 times the median income. Both multiples are significantly smaller than was the case in 1969, when Cabinet-level pay was 5.6 times the median income and a member of Congress pay was 4.0 times the median income.

Figure 2 shows the relationship between top office-holders' salaries and median income over the period from 1960 to 2004. It is clear in the figure that the salary increase given to top federal office-holders in 1969 pushed their incomes to a four-decade high compared with the median U.S. income. Even before the 1969 pay hike took effect, however, top federal officials received a salary that represented a large multiple of the income earned by middle-income families. From 1960 through 1968 a Cabinet officer's pay was 4.0 times the median family's income. Between 2000 and 2004 a Cabinet member's pay fell to just 2.6 times the median family income. Thus, top office-holders' pay has not only failed to keep pace with changes in the cost of living, it has also climbed more slowly than the incomes of middle-class families.

<u>Top federal salaries in comparison with wages outside the government</u>

The financial attractiveness of senior-level government jobs depends not only on the purchasing power of federal salaries but also on the wages available to federal employees if they worked in other jobs. When most voters evaluate federal executive and judicial pay, they probably consider salaries in jobs with which they are familiar, including their own. One benchmark for thinking about top federal salaries, therefore, is the pay of a typical person employed outside the federal government. .

At the time William Howard Taft became President in 1909, an average production worker in manufacturing earned slightly more than $500 a year. In that same year, President Taft received an annual salary of $75,000, members of his Cabinet earned $12,000, and members of Congress earned $7,500. Federal Cabinet secretaries thus earned an annual salary equal to 24 times the average earnings of a manufacturing worker, while members of Congress were paid a salary equal to 15 times the average manufacturing wage. Between 1909 and 2005, the average manufacturing wage increased at a compound annual rate of 4.5 percent, reflecting the effects of both productivity improvement and economy-wide price inflation. During those same decades, a Cabinet officer's pay increased 2.9 percent a year, and Congressional salaries grew 3.3 percent a year, significantly slower than average wage gains in manufacturing. By 2005, Cabinet members' pay and congressional salaries were approximately 5 times the average earnings of a production worker in manufacturing (Figure 3). If earnings trends among manufacturing workers were typical of wage gains among workers in the wider economy, the long term trend in top federal salaries has brought federal office holders much closer to the position of an average U.S. worker.

Whether the gap between top government salaries and average pay remains big enough to attract the best candidates to high-level federal positions depends on the motivations of people who are asked to serve and on the salaries offered by employers that would hire them if they were not employed by the government. It is safe to say that few people asked to serve in top federal jobs are recruited from the rank-and-file work force of manufacturing plants. Almost all top government officials have a college diploma. An overwhelming majority of presidential appointees have a post-graduate degree.

For a variety of reasons, the wages earned by such workers have increased significantly faster than wages paid to rank-and-file workers, especially in the years since 1980. Figure 4 shows trends in the relative earnings of Executive Schedule office-holders compared with average American workers who have a post-college degree. The top line shows the relative earnings of Executive Schedule I officials, and the bottom line shows relative earnings of Executive Schedule II office holders. The wages of highly educated and highly compensated workers have increased significantly since the 1970s compared with the wages earned by workers with average educational credentials who earn average wages. For example, in 1973 the 95th percentile wage was 2.4 times the median U.S. wage. By 2009 it was almost 3 times the median wage. People with advanced schooling have obtained faster wage gains than workers with average or below-average schooling. People with high levels of schooling and exceptional talents have seen their bargaining position improve. They command higher wages relative to the median wage than was the case in the 1960s and 1970s.

The implication of these trends for recruiting high-level federal employees is straightforward. The wages of people who are most likely to take demanding government positions have increased much faster than those of typical workers. Thus, the relative decline in compensation for top-level federal appointees has been greater than is implied by Figures 3 and 4, because the market wages available to highly educated and exceptionally talented workers have increased considerably faster than the average wage.

Consider earnings trends among men who have obtained a post-college degree, who work in a full-time, year-round job, and who are between 45 and 54 years old. From 1977 through 2000, the average annual earnings of this highly educated group increased 5.2 percent a year. This was faster than the wage gain of production workers in manufacturing, who saw their earnings climb 4.5 percent a year during the same period. It was considerably faster than salary gains for Cabinet-level positions, which averaged just 3.8 percent a year between 1977 and 2000. Although these differences in the rate of wage gain may seem small, over a two-decade period they make a big difference in relative pay. For example, if the wages of two workers are initially the same but one worker receives pay increases that are 1.4 percent faster than the other, at the end of 20 years the worker with faster wage gains will earn one-third more income than the worker who receives smaller raises.

To determine how top federal salaries compare to salaries in high-level positions outside of government, it is useful to consider salaries in specific government jobs and contrast them with the salaries earned in comparable positions outside of the federal government. This kind of comparison highlights the financial sacrifices that highly qualified candidates make in order to accept a senior federal job.

Table 1 shows job titles and salaries of six senior executive branch positions as well as typical salaries of positions from which appointees might be drawn. The first position on the list is assistant secretary for tax policy in the Department of Treasury. The person who holds this job is responsible for developing and analyzing the administration's tax proposals. Candidates are drawn from both legal and academic backgrounds. The job is an Executive Schedule Level IV position, which in 2005 paid an annual salary of $140,300. In comparison, equity partners in the nation's 100 largest law firms could expect to earn more than $1.1 million as their share of partnership profits, roughly 8 times the salary received by an assistant secretary of the Treasury. Note that the 100 largest law firms employ more than 70,000 partners. In 2005 major law firms offered starting salaries to new law school graduates, not including bonuses, that were just slightly lower than the assistant secretary's pay. The Executive Level IV salary is more competitive in recruiting university professors, whose annual salaries are often close to those of senior government officials. For example, the 2004-05 average salary of full professors in private research universities was $159,000, only about 14 percent higher than the salary paid to the assistant secretary of Treasury. However, the academic salary shown in Table 1 understates the income that candidates would have to give up to accept the assistant secretary position. Many academics who are knowledgeable about tax policy have sizeable consulting incomes in addition to their university salaries. People who accept senior government jobs must give up most or all their outside labor income while they hold office.

The commissioner of the Internal Revenue service is responsible for administering an agency with roughly 100,000 employees and an annual budget of about $10 billion. The commissioner holds a Level III Executive Schedule position, which in 2005 entitled the commissioner to receive a salary of $149,200. This is roughly one-eighth the average net income of a partner in a large law firm and 7 percent of the salary and bonus received by the general counsel of a major U.S. corporation. When compared with a partner's income in a U.S. accounting firm, however, the commissioner's pay seems more competitive. The commissioner of Internal Revenue earns about 14 percent less than the average partner of a major accounting firm.

When a top federal job requires detailed knowledge about science or medicine, federal salaries do not seem particularly attractive. The National Institutes of Health (NIH) provides financial support for much of the nation's research on the prevention, detection, diagnosis, and treatment of disease. Though four-fifths of its budget supports research outside the federal government, the NIH also has a large staff that conducts biological and medical research in government laboratories. Five members of its staff have been awarded the Nobel Prize since 1968. It had an annual budget of $29 billion in 2005, and a staff of 17,500, including more than 3,000 research scientists. All directors of the NIH have been physicians, but the size and scope of the NIH are more like those of major universities than of a health institution. Presidents of selective private research universities received an average salary that was more than $600,000 in 2003-04, more than four times the pay of the NIH director. The median salary of a public university president is also much higher than that of the NIH director. The director's salary is less than half the average compensation paid to physician-CEOs placed by Witt/Kieffer, the leading executive search firm specializing in recruitment of managers for health care, managed care, and educational institutions. A physician placed as a CEO will typically be responsible for managing a hospital or a health care company, institutions that are far smaller than the NIH.

The Food and Drug Administration (FDA) is the federal regulatory agency responsible for ensuring that ingredients in the nation's food supply are not harmful and that drugs and devices used in medical practice are safe and effective. FDA's regulatory mandate requires great technical competence and imposes enormous responsibilities on its staff. The commissioner of the FDA oversees 10,400 employees and an annual budget of about $1.8 billion, equivalent to that of a large university. In 2005, the commissioner was paid $140,300. This was 3 percent of the average total compensation received by chief executive officers in the pharmaceutical companies whose products are regulated by the FDA. The executive search firm Witt/Kieffer helps recruit physicians to serve as heads of departments of clinical medicine in medical schools and universities. The average base pay of physicians placed in these positions in 2004 was $325,000. The average pay of department heads in medical schools and universities is more than twice that of the FDA commissioner.

The last two federal positions shown in Table 1 are in the Department of Education. The two assistant secretaries are responsible for administering a combined total of more than $50 billion in annual spending on the nation's schools, colleges, and universities. Their annual salaries would place them in the lower ranks of public and private university presidents and superintendents of big municipal school systems.

The attractions of senior federal jobs

Most people willing to accept a senior government job recognize that the pay in such a job cannot match that provided by a comparable position in the for-profit sector. Legislators who are answerable to voters cannot allow top salaries to exceed some hard-to-define limit that American voters regard as tolerable. If voters had any say in determining top salaries in the private sector, many would probably vote against most of the pay packages displayed in Table 1. Voters' sense of fairness has only a small impact on the salary structure of private employers, but it is crucial in determining pay at the top of the federal organizational chart.

Lack of voter knowledge may play a role in shaping public attitudes toward compensating high-level government employees. More than three-quarters of American adults believe the financial rewards of federal employment play a big or moderate role in the decision of high-level appointees to serve in administration jobs. Forty-three percent think Cabinet appointees, such as the Secretary of State or Secretary of Defense, obtain salaries in top administration jobs that are equal to or greater than those they would receive in a senior position outside of government.[1] In view of the salary comparisons displayed in Table 1, this view is clearly erroneous, but it is one held by a large minority of voters. Many Americans are apparently unaware of the compensation received by senior executives, doctors, lawyers, and scientists in the private sector. Some may have little knowledge of the actual salaries earned by judges and top federal scientists and executives.

One puzzle is voters' unwillingness to accept top federal pay levels that past generations of Americans were willing to accept. Based on the evidence in Figure 3, it is plain that Americans were once willing to tolerate much higher levels of compensation in top federal jobs. The big drop in relative compensation that occurred after the Great Depression can probably be explained by a general compression of American wages during and after World War II. The salaries in top federal jobs fell in comparison with ordinary workers' wages, but a similar compression in pay also occurred in the private sector.

It is a little harder to explain government pay trends since 1970. U.S. wage inequality increased dramatically after the 1960s, especially in the two and a half decades after 1980. Private-sector employers have moved toward a pay system in which workers with the broadest management responsibilities and the most highly prized technical skills command an outsize share of a firm's total compensation. Some observers argue that these key workers are now also exposed to an outsize risk that their incomes will fall. The risk of job loss is obviously smaller in some top government jobs, but it is not lower in all of them. Political appointees serve at the pleasure of the President, and their job will almost certainly end when an administration leaves office. These

[1] Judith M. Labiner, *A Vote of No Confidence: How Americans View Presidential Appointees* (Washington, DC: The Presidential Appointee Initiative, 2001), pp. 16-17.

appointees serve in top administration jobs for an average of less than two years. The responsibilities of top federal jobs have not shrunk, but, unlike salaries for top private-sector jobs, the pay has. It is curious that Americans appear willing to tolerate bigger pay disparities in private markets, while insisting in the voting booth – or at least on talk radio – that top government salaries should be severely curbed.

People who serve in top federal jobs obtain non-monetary benefits from their service, of course, and these benefits help to explain why government jobs continue to attract many outstanding candidates. Public-spirited Americans are eager to serve in influential or high-profile positions, even if the financial rewards are far below those obtainable in a private-sector job. Experience in a senior government job allows workers to acquire skills, knowledge, and reputation that have considerable value outside the government. Few political appointees say they are forced to accept a big cut in pay when they leave federal office. More than one-third of the political appointees who served between 1984 and 1999 say they modestly or significantly increased their earning power as a result of holding a senior administration job.[2]

On balance, however, the non-monetary advantages of serving in senior federal jobs are no larger today than they were 35 years ago, when top federal salaries were substantially higher in constant dollars. The economic rewards of federal service have fallen, especially in comparison with wages and benefits offered to highly qualified candidates in the private marketplace. No one can be sure whether these trends in pay, inside and outside the government, have affected the caliber of people willing to serve in top federal positions.

The basic question facing voters is simple. Do we want the federal government to be deprived of the talents of highly competent people who may be deterred from public service by the financial sacrifice they must accept in order to serve? No careful observer would claim the best public servants are motivated solely by monetary rewards, but no sensible person should assume the decision to serve in a top-level position is totally divorced from financial considerations. For the past quarter century top executives, doctors, lawyers, and scientists in the business and academic worlds have seen their compensation climb much faster than the wages of ordinary workers. Over the same period, top federal appointees have seen their pay shrink, both in purchasing power and in relation to the pay of comparable workers. Talented people who are concerned about their families' well-being may be deterred from accepting top federal jobs under these circumstances. If financial considerations play any role at all in candidates' decisions to serve an administration, the long-term decline in top federal pay has deprived the federal government of an ever-larger fraction of the nation's most talented people.

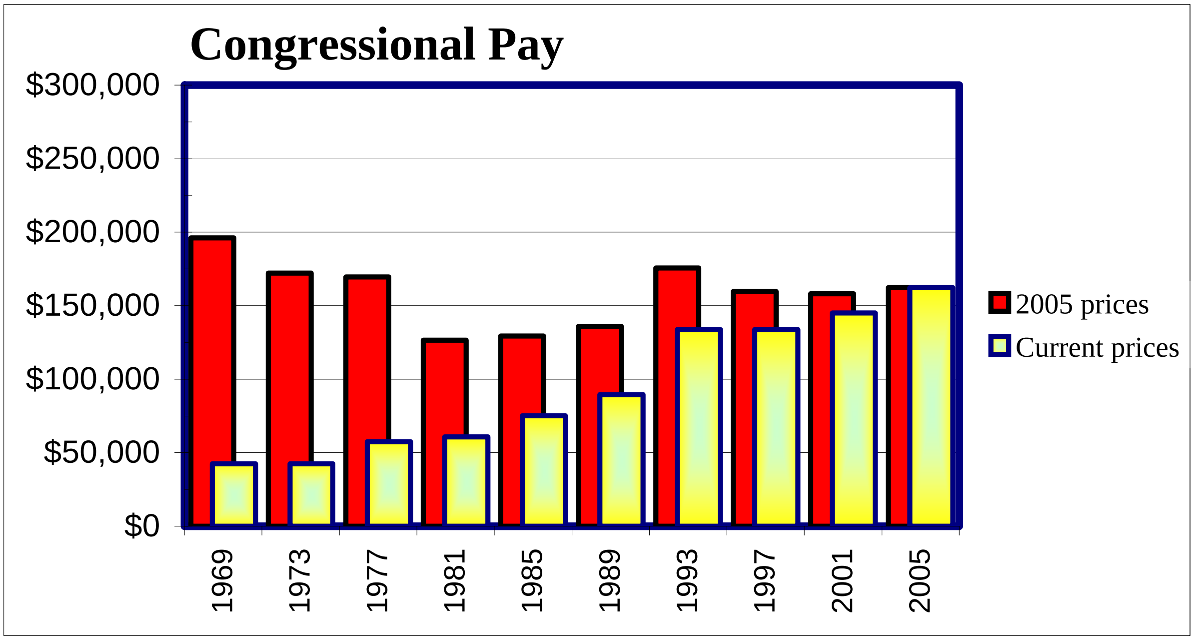
[2] Paul C. Light and Virginia L. Thomas, *Posts of Honor: How America's Corporate and Civic Leaders View Presidential Appointments* (Washington, DC: Brookings and Heritage, 2001), p. 35.

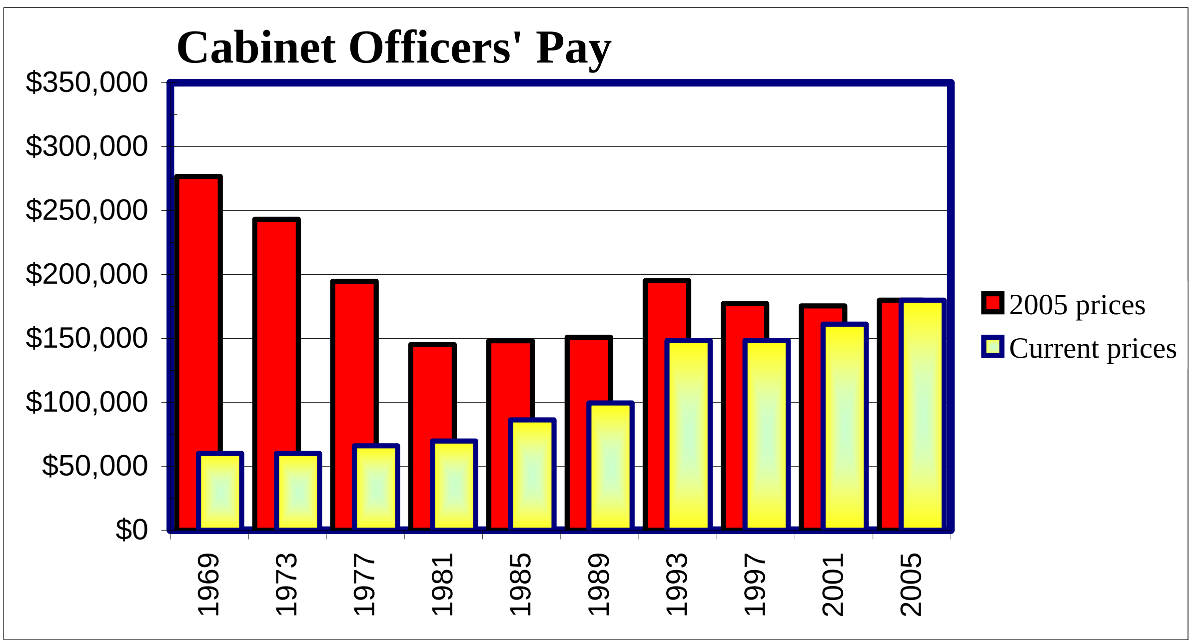
Table 1. Comparison of Salaries in Presidentially Appointed Positions and in Positions Outside the Federal Government, 2005

	Federal position / Comparison position	Compensation	Federal salary as % of outside salary	Year
1.	*Assistant Secretary for Tax Policy, Department of Treasury*	140,300		2005
a	Partner's profit share, 100 largest law firms	1,120,000	13%	2005
b	First-year base salary of associates, firms with 500+ lawyers	135,000	104%	2005
c	Full professor, private research university	159,045	88%	2004-05
2.	*Commissioner of the IRS, Department of Treasury*	149,200		2005
a	Partner's profit share, 100 largest U.S. law firms	1,120,000	13%	2005
b	General counsel, *Fortune* 500 company (salary plus bonus)	2,025,000	7%	2005
c	Partner in accounting firm	173,053	86%	2005
3.	*Director of National Institutes of Health, DHHS*	140,300		2005
a	Average salary, president of private research university	613,994	23%	2003-04
b	Median salary, president of public university	360,000	39%	2003-04
c	Base pay of a CEO physician	278,744	50%	2004
4.	*Commissioner of FDA, DHHS*	140,300		2005
a	Total compensation, CEO of pharmaceutical company in S&P 500	5,271,423	3%	2005
b	Base pay of a CEO physician	278,744	50%	2004
c	Average base pay, clinical department heads, university medical schools	325,000	43%	2004
5.	*Assistant Secretary for Postsecondary Education, Dept. of Educ.*	140,300		2005
a	Average salary, president of private research university	613,994	23%	2003-04
b	Median salary, president of public university	360,000	39%	2003-04
c	Full professor, private research university	159,045	88%	2004-05
6.	*Assistant Secretary for Elementary and Secondary Educ., Dept. of Educ.*	140,300		2005
a	School district superintendents, districts with 200,000 or more students	207,547	68%	2005

Sources: *American Lawyer*; American Association of University Professors; *Chronicle of Higher Education*; Witt/Keiffer; AFL-CIO.

Figure 1. Annual Congressional and Cabinet Officer Pay Measured in Current and Constant Prices, 1969-2005





Note: Price levels are calculated using the U.S. Bureau of Labor Statistics' Consumer Price Index for All Urban Consumers (CPI-U-RS).

Sources: Author's calculations.

Figure 2.

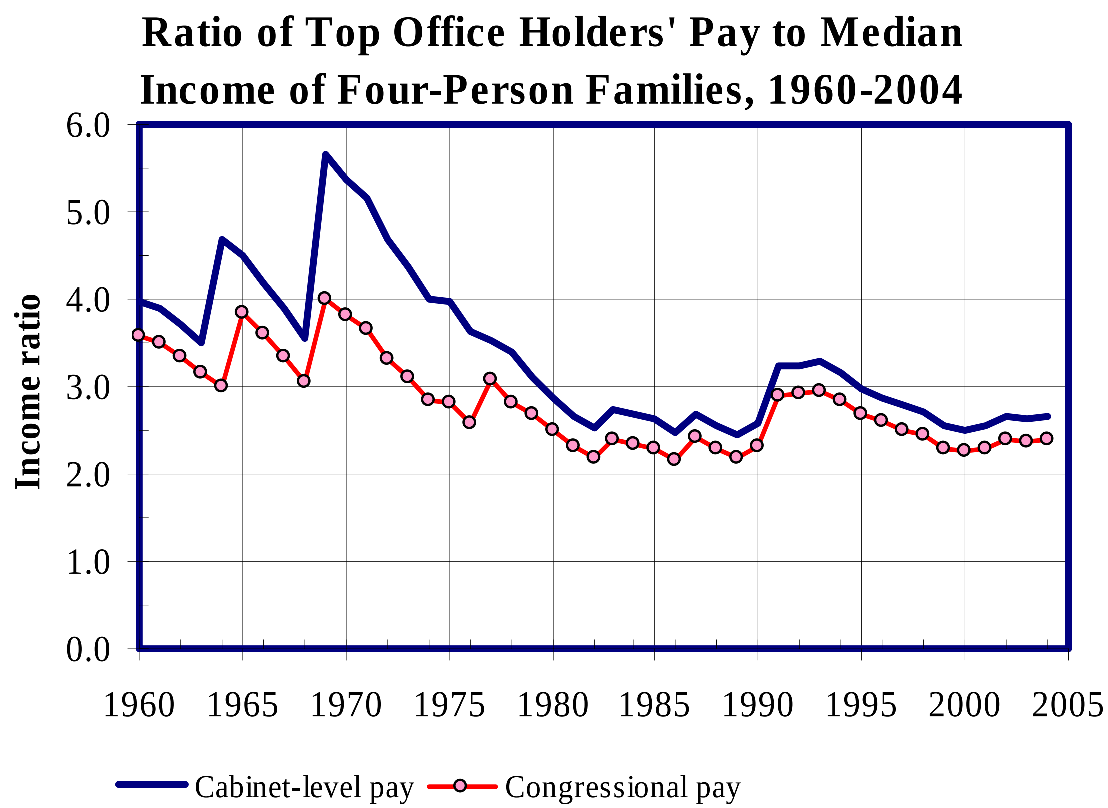

Ratio of Top Office Holders' Pay to Median Income of Four-Person Families, 1960-2004
Income ratio
6.0
5.0
4.0
3.0
2.0
1.0
0.0
1960
1965
1970
1975
1980
1985
1990
1995
2000
2005
Cabinet-level pay
Congressional pay

Figure 3.
Salaries of Cabinet Officers and Members of Congress Compared with Average Manufacturing Worker's Pay (1909-2005)

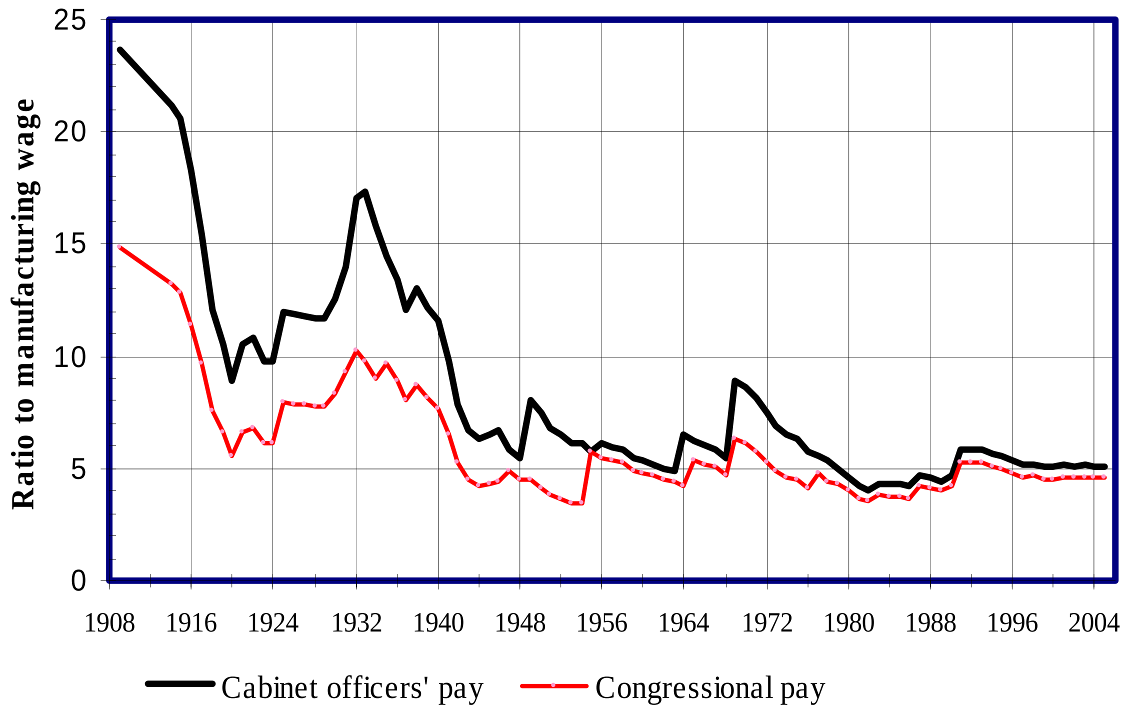
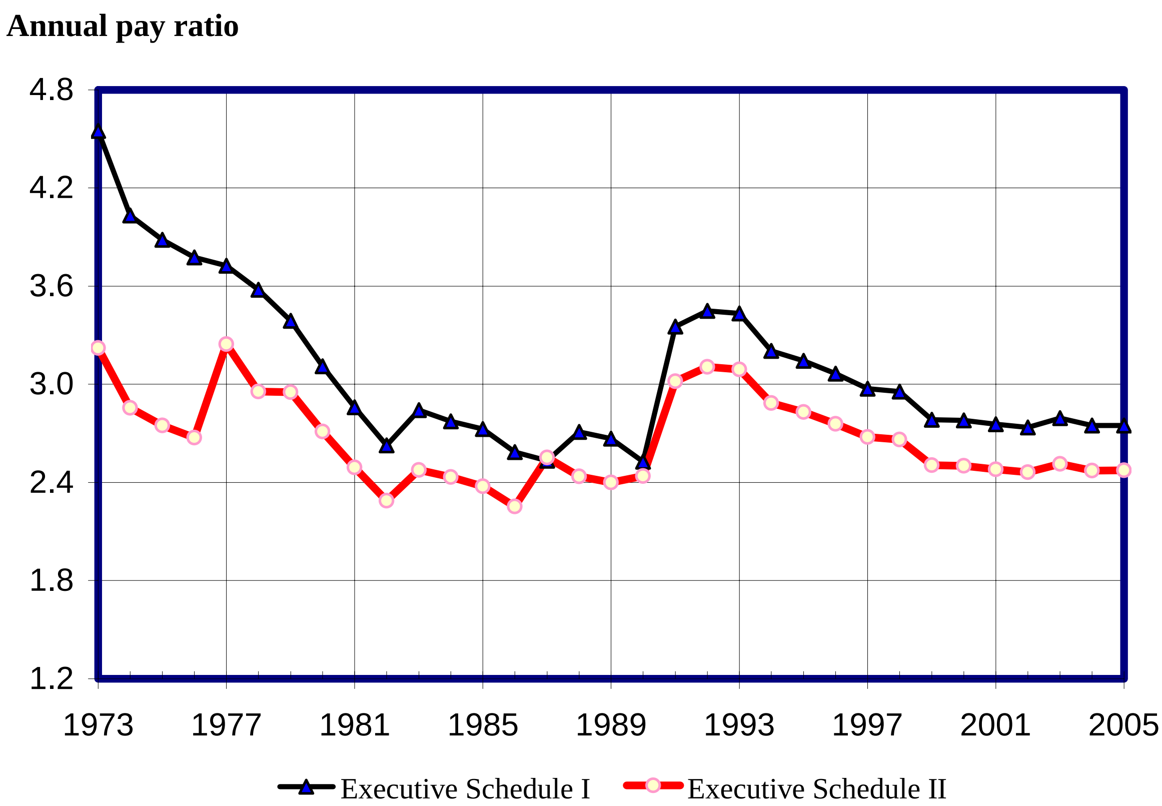


Figure 4. Relative Earnings of Federal Executives Compared with Average Workers with Post-College Degrees 1973-2005



Source: Wage data on post-college earners derived from Economic Policy Institute tabulations of CPS hourly earnings data.