

AMERICAN UNIVERSITY OF ARMENIA

FAIR PAY: PERCEIVED AND ACTUAL LEVELS OF WAGES AND WAGE
INEQUALITY IN ARMENIA IN COMPARISON TO SELECTED COUNTRIES

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Table of Contents

<u>Introduction</u>	6
<u>Literature Review</u>	7
<u>Pay Structures</u>	8
<u>Methodology</u>	12
Wage Inequality in Armenia in Comparison to Selected OECD Countries	13
Internal Comparison of Mean Wages Among the Civil Service System	18
The Actual and the Perceived as Fair Wage Levels of the Civil Servants	22
Perceived Pay Fairness Based on the Extent of the Satisfaction of Employee Needs	23
Fair Remuneration Based on Individual Contribution	28
<u>Conclusion</u>	30
<u>Limitations</u>	31
<u>Policy Recommendations</u>	32
<u>Appendix A</u>	33
<u>Appendix B</u>	34
<u>References</u>	35

ABSTRACT

The study discusses wage inequality through the lenses of equity and equality theories. The study considers international wage inequality; however, the main focus of the research is wage inequality in Armenian civil service system and the way the civil servants perceive the phenomenon of wage inequality.

The study explores the RA civil servants' perception of pay fairness based on different criteria and draws conclusions as to which distributive justice rule is perceived as fair.

The study has revealed that wage inequality is growing worldwide and as the societies grow more unequal they value equity over equality.

The study has also revealed a number of drawbacks in the Armenian civil service system that raise the issue of equity and fairness.

The study ends with appropriate recommendations to eliminate the drawbacks of the Armenian civil service remuneration system and suggestions for policy actions to prevent the increasing wage inequality.

INTRODUCTION

Remuneration is the basis of the employment relationship which is encompassed in the bargaining process between the employer and the employee. The central issue of reward management has been pay determination the major concern of which is the establishment of pay equity and fairness. The remuneration is considered fair if it reflects the contribution.

The pay structure within any organization is a central tool of leadership if it is designed in an effective way leading to long-term productivity. In case it is designed in a poor way, it can lead to decreased employee motivation and thus decreased efficiency. The remuneration system represents the relationship between the authorities of the organization and the employees, and consequently it should be fairly constructed to encourage good performance and loyalty to the organization.

In the Republic of Armenia the Law on the Remuneration of the Civil Servants regulates the pay structure in the civil service. Theoretically, the remuneration system of the civil service enshrined in the law is designed in a way to encourage promotion motivating the employees for better performance, and to establish fairness within the system. In practice, however, there are a number of drawbacks that contribute to the lack of motivation among the employees, and create an environment of corrupt activities.

The purpose of this study is to explore wage inequality in selected OECD countries and in Armenia focusing mainly on wage inequality within the Armenian civil service system. The study also aims to reveal the civil servants' perception of pay fairness from two theoretical perspectives, namely the equity and equality theories, and to explore which of the theories is relevant in Armenian reality. The study will also seek to reveal the drawbacks of the Armenian civil service remuneration system that raise the issue of equity and fairness.

LITERATURE REVIEW

Job evaluation is the procedure through which jobs are placed in order of their relative worth, based on what the fair pay system is constructed. It is through job evaluation that the relative worth and size of the job is defined within any organization, which later becomes a basis for establishing internal relativities, and provides the mechanism for designing an equitable pay structure. Jobs differ in many aspects and consequently it is problematic to assess their relative importance. Job evaluation is especially important for achieving “equal pay for work of equal value.” It can be analytical and non-analytical (Armstrong, 2005).

The analytical job evaluation schemes are used to analyze the extent to which various defined factors are present in a job. The main point is that those factors should be present in all jobs under comparison and the relative value of each job is determined through the different levels, at which they are present. The job evaluation mechanism is especially important as it is systematic, structured and concerns the job and not the person, i.e., what is important is the content of the job from the point of view of the demands made on the job-holder. The non-analytical job evaluation scheme is characterized by the comparison of whole jobs to rank them without analyzing them into constituent elements. In this case jobs are ranked in the order of perceived value (Armstrong, 2005).

Through job evaluation a framework is designed which enables grading and construction of pay systems. Through this framework the relative value and the size of the job becomes clear, it sets objective criteria for job grading which lead to the establishment of equitable pay structure (Armstrong, 2005).

Pay Structures

Pay structures reflect the quantified relationship between the employer and the employee. Pay systems are usually the arena where the conflict occurs raising the issue of equity. Pay determination has been the core of reward management system, the major concern of which has been to establish pay equity while simultaneously linking these pay structures to the external labor market.

Pay levels are determined through both internal and external factors. One of the challenges of designing effective compensation system is the tension between internal equity (hierarchical approach) and external labor markets. There is the need of internal market for equity and fairness, and the external market for differential price of the labor force. It is the balance of these two factors achieved by the organizations that guarantees equity and fairness and plays a significant role in reward strategy. The issue is what is more important for the employees: internal equity or external relativities (White, 2000).

Job matching is the so called internal benchmarking which is based on the comparison of a particular job with any other internal job which is fairly graded and paid, and after what placing the job under consideration in the same grade as the other one (Armstrong, 2005).

External comparability has been essential for pay determination since jobs have no absolute inherent value unless a reference is made to external comparators. Besides it is through the pay package that the applicants can compare one job offer with another (White, 2000). Market pricing is the external benchmarking embodied in the process of pay rates assessment by reference to the market rates for comparable jobs. However, the problem with market pricing is that it sets the price of the job as the market dictates, and ignores the issue of internal equity. It also does not take into account the fact that the internal value of one job in an organization may be of different value in the other one. Thus, market pricing creates

tension between the principle of internal equity and external comparability (Armstrong, 2005).

The employment relationship is based on the concept of exchange. The bargaining process is encompassed in the “*wage – rate bargain* and *effort-bargain*.” The employee perception of equitable pay will be the remuneration that will reflect the contribution (White, 2000). An effective pay structure within any organization can become either a major investment or a major waste depending on the level of employee motivation. An effective pay structure is the major tool of leadership as it represents the tangible benefit of good performance and influences job motivation. Both the amount of pay and the method of pay management play a significant role on the degree of employee satisfaction. Pay is the status of an employee both within and outside the organization and consequently it should correspond with the relative importance of jobs within an organization. In case the pay system is poorly designed, the company will face difficulties with hiring skilled professionals, and the employee turnover rate will be high which will affect negatively the output of the organization (Carey, 1994).

There exist several distributive rules that are used by the authorities of an organization when making the allocation decision. Distributive rules in organizations can be discussed through the lenses of equity and equality theories.

According to equality theory everyone should receive same remuneration regardless of contribution, while according to equity theory the received amount of remuneration should match the relative contribution to the organization. The distributive justice reflects the just evaluation of the remuneration. The decision to apply distributive justice is directly linked to the goal of maximizing long-term productivity. The application of this social rule, which specifies criteria defining certain distributions of rewards and resources as fair and just, is intended to lead to high levels of performance and motivation (Törnblom & Vermunt, 2007).

Equity theory is the most applied rule of distributive justice which is embodied in an exchange relationship involving at least two people. According to Adams' theory of Equity the employee compares the ratio of his/her contribution to the organization and the remuneration he/she receives to that of a referent and if the two ratios are equal, the person experiences a feeling of justice. The contribution to the organization may be in the form of effort, education, skills, age, etc. the issue is whether the employee receives fair remuneration reflecting the contribution (Beugre, 1998).

“The concept of fairness when applied to wages is inevitably a concept which requires comparisons. It is not possible to decide whether someone is fairly paid until one knows what other people are paid... Differentials and relativities lie at the very heart of the concept of equity as applied to wage determination” (Robinson 1973, 7 as quoted in White 2000).

Adams (1963, 1965) developed the following formula of equity theory:

$$I_{ind}/OUT_{ind} \longrightarrow I_o/OUT_o$$

Where, *I_{ind}* refers to the individual's input, *OUT_{ind}* to his or her output, *I_o* refers to the comparison to other's input, and *OUT_o* to the comparison to other's output. Thus, according to Adams equity theory, an employee perception of pay fairness is reflected in his/her input – output ratio in comparison to that of a referent (Beugre 1998, 3).

An important issue central to this study is whether employees perceive their earnings as fair. Perceptions are one category of belief and are more specific and objective than ideals and attitude. Theoretically perceptions are based on factual knowledge and information, and they reflect the way an individual comprehends the issue (Aalberg, 2003). In the present research, the perception measure relative to the actual remuneration will be considered to estimate the employee's perception of fair pay.

The issue of appropriate compensation, especially in the civil service is a prominent concern in Armenia. The problem is not only the adequacy of pay levels and the extent to which they attract, motivate and retain skilled staff to the civil service, but also the

inconsistencies in the salary levels for similar positions in the civil service resulting in inequities.

Based on the theoretical perspectives discussed above, the study is going to explore whether RA Civil Servants perceive pay fairness based on the extent of satisfaction of their needs, based on the fact that everyone should receive similar remuneration regardless of contribution, or the remuneration is perceived as fair if it reflects the contribution. The study is also going to provide data on actual remuneration of the civil servants relative to the perceived as fair wage levels, and explore the question of the adequacy of pay levels. While discussing wage inequality in selected OECD countries and in Armenia the study will also seek to reveal wage inequality among different body groups in the civil service system as well as among different public services, which brings to the fore the issue of equity and fairness.

For the purposes of the study the following research questions have been developed:

RQ1: Is the gap between the actual and perceived as fair wage levels of the civil servants in the RA Civil Service large?

RQ 2: Do civil servants evaluate pay fairness based on the extent of satisfaction of their needs?

RQ 3: Is wage fairness perceived based on the criterion of individual contribution?

METHODOLOGY

The purpose of this research is to discuss wage inequality through the lenses of equity and equality theories and to reveal which of the theories is relevant in Armenian reality. The study will consider wage inequality in selected OECD countries as well as in Armenia both in public and private sectors, further the research will mainly focus on public sector and particularly civil service system wage inequality analysis. The study is going to consider wage inequality in Armenian reality and the way civil servants perceive the phenomenon of wage inequality.

The study is utilizing primary and secondary data analysis. The methodology of this study relies on a survey research and analysis of existing and primary statistics. The primary data was collected through face-to-face interviews with civil servants of the Republic of Armenia. An original questionnaire was designed based on the requirements of this study. The secondary data analysis includes review of relevant literature and legal documents.

The RA Civil Service Council (CSC) was contacted for the list of all civil servants of Government bodies.

The sampling frame includes 7,911 civil servants, out of which 128 civil servants were chosen. The margin of error is 8.3%. The sample was created using multistage cluster sampling method. The first stage encompassed 46 State governmental bodies. From these 46 Government bodies 32 were randomly selected using random number generator. For the second stage four civil servants were randomly sampled from each of those 32 Government bodies.

The resulting sample reflects the characteristics of the target population, from which it has been drawn. A total of 128 interviews were conducted in February 2011. A pretest of all measures was conducted, and adjustments were made accordingly. All data were input in SPSS for analysis.

Wage Inequality in Armenia in Comparison to Selected OECD Countries

In 2008-2009 the world faced a deep crisis and many countries throughout the world entered into recession the epicenter of which was the United States. The governments throughout the world pursued policy efforts that contributed to relative economic recovery in 2010, the outlook however remains uncertain. The crisis has affected dramatically the labor markets leading to increased unemployment rate (from 5.7 per cent of the labor force in 2007 to 6.4 per cent in 2009 (ILO, 2010)) and has had negative impact on the overall level of wages leading to decreased wage growth. Globally, the real monthly wages grew at 2.8% in 2007, 1.5% in 2008 and 1.6% in 2009 (Global Wage Report, 2011), (see figure 5, Appendix A).

Declining wage growth implies that the workers receive decreased wage share in proportion to the total GDP. In this case the larger share of the economic gains is directed into profits, which is unfair. In most of the countries throughout the world there can be observed a trend of wage share decline (Global Wage Report, 2009).

However, the decline of wage share in the countries throughout the world does not explain how wages are distributed among workers. The issue of wage distribution is very important as it helps to understand whether the wages are equally distributed among high and low wage earners and the distribution among these two extremes in comparison with median-wage earners. Wage inequality is a “natural” economic phenomenon as wage compensation reflects the employee’s contribution and performance, however too much inequality leads to economic and political costs in the light of higher rates of crime, poverty, etc.

Many advanced economies are experiencing labor market recession currently which has led to debt-led growth and decreased labor incomes leading to rising widespread income inequalities. Before the onset of the economic crisis the real disposable household incomes increased in OECD countries on average by 1.7% annually (see table 2, Appendix A),

however simultaneously household incomes of the top 10% increased faster than the incomes of the poorest 10% which led to growing income inequality. As a result the average income of the top 10% became significantly larger than those of the poorest 10%, and this gap fluctuates across OECD countries.

The Gini coefficient, which measures income inequality with a range from 0 (when everybody has identical incomes) to 1 (when all income goes to only one person) shows that income inequality has increased in 17 out of 22 OECD countries. Since 1980s there are countries like, Turkey, Greece, France, Hungary and Belgium, which experience declining income inequality (OECD, 2011), (see figure 6, Appendix B). But, what are the reasons for increasing inequality?

Wage inequality and income inequality are closely interlinked as wage comprises the largest proportion of household income. In OECD countries the wage comprises on average 75% of household income of working age population (OECD, 2011) while in Armenia it is equivalent to 50% (on average) of household income (ARMSTAT, 2011).

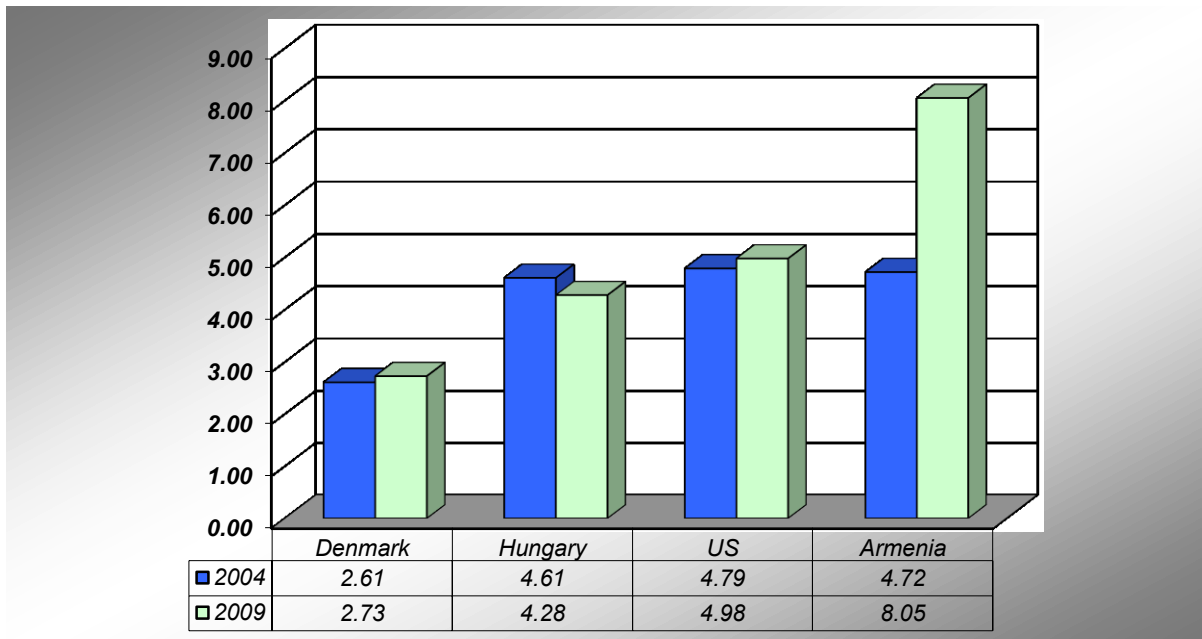
To explore the reasons why these kind of sharp changes have occurred resulting in high rate of wage differentials, the study will focus on selected OECD countries, namely, the US – with the highest wage inequality rate, Hungary– with median inequality rate, Denmark – with the lowest inequality rate, and Armenia. A comparative analysis of wage inequality in these countries with Armenia will reveal where Armenia stands in the realm of wage inequality.

The changes in wage and salary distribution have led to income inequality in OECD countries as well as in Armenia. To measure the wage inequality among the selected OECD countries in comparison to Armenia such measure as the ratio of the top to bottom decile (D9/D1) that considers the two extremes of distribution, as well as the top (D9/D5) and the

bottom (D5/D1) deciles relative to the median will be used. These indicators will help understand the widening gap between wage inequalities leading to polarization.

To observe the trend in overall earnings inequality in the selected countries the ratio of D9/D1 will be considered. To simultaneously observe the effects of the financial crisis, the decile ratios of 2004 and 2009 will be used (see figure 8).

Figure 8: *The Evolution of the Inequality Ratio D9/D1*



Data Source: Armenian Statistical Service, 2011; OECD Statistics, 2010.

As the figure above illustrates, Denmark and the US have both experienced a slight increase in wage inequality while in case of Hungary there can be observed a significant decline. The case of Armenia is exceptional in the light of widening inequality as a result of a huge gap between the top and bottom wage earners. The increasing incoming inequality in Armenia can, thus, be explained by the unequal wage distribution. The wide difference in wage between top and bottom jobs affects the rate of poverty and overall economic inequality.

Another important point is to see whether the inequality is growing at the bottom of wage distribution (increase in $D5/D1$) – “collapsing bottom,” or at the top (increase in $D9/D5$) – “flying top”, and thus changes at the top and at the bottom of wage distribution should be analyzed separately (see figure 9a, 9b). Taking into consideration the classification above, the countries under consideration will fall into different groupings.

Figure 9a: Ratio of Earnings Inequality $D9/D5$

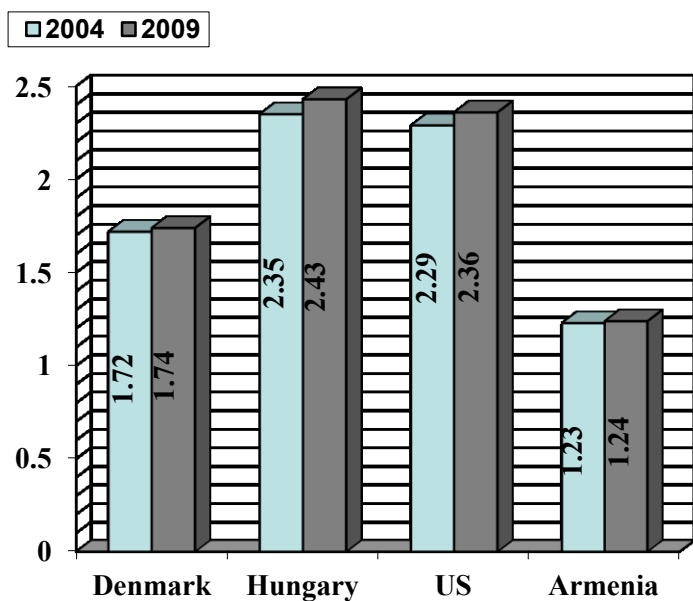
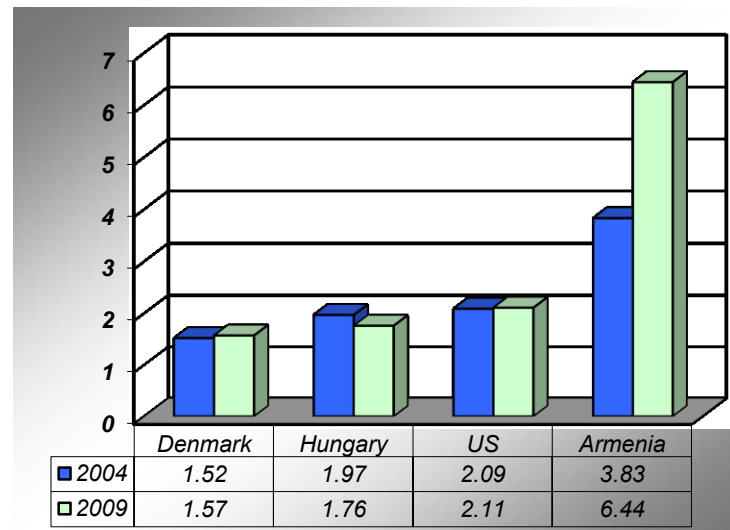


Figure 9b: Ratio of Earnings Inequality $D5/D1$



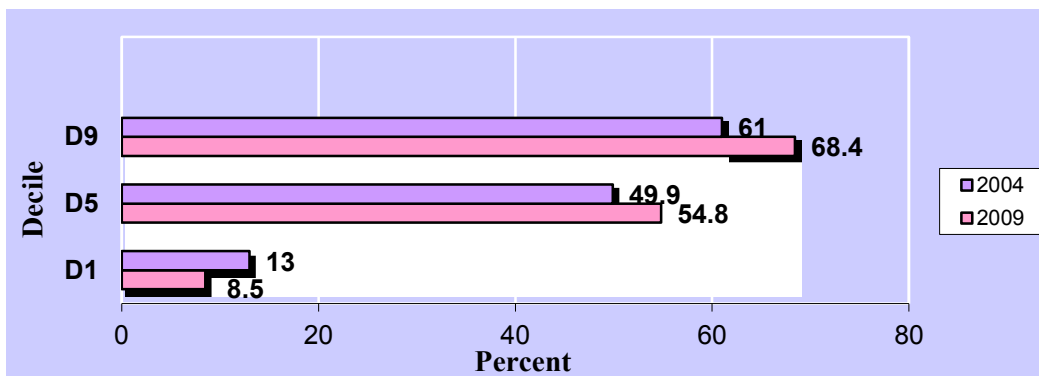
Data Source: Armenian Statistical Service, 2011; OECD Statistics, 2010.

From the figures above it can be concluded that the wages of the top earners relative to median earners ($D9/D5$) have increased in Hungary and in the US even more sharply than the wages of median earners relative to lowest earners ($D5/D1$). In Hungary there can even be observed a decline in the wages of median earners relative to lowest earners. In case of Denmark, the wages of median earners relative to lowest earners has increased slightly more than the wages of top earners relative to median earners. In Armenia the gap between the wages of median earners relative to lowest earners has grown dramatically (almost two times)

which is a clear illustration of unequal wage distribution. Consequently, the US and Hungary fall into the grouping of “flying tops” which means that in these countries the earnings of highly paid workers are increasing faster than the earnings of other wage groups. In contrast, Denmark and Armenia can thus be categorized into the grouping of “collapsing bottom” which looks at the level of changes in the wages received by the poorest 10% relative to the median.

To understand the underlying causes the further step will be to explore whether the widening gap between the top and bottom of earnings experienced in Armenia is the result of disproportionate increase in top and median earnings, or a decline of median and bottom earnings. Thus the nominal values of top (D9), median (D5) and bottom (D1) deciles must be considered (see figure 10).

Figure 10: Percentage changes in the nominal values of D1, D5 and D9 in Armenia



Data Source: Armenian Statistical Service, 2011; OECD Statistics, 2010.

The figure above shows that Armenia has experienced the highest growth in the top decile, followed by the median which has increased much less, while the bottom decile has dramatically stagnated. Thus, it can be clearly observed that the gap between the top and bottom decile has widened dramatically between 2004 and 2009 which illustrates the unequal and disproportionate wage distribution. The gap between the top 10% and the bottom 10%

has increased dramatically and the distance between the median and low-paid workers has sharply widened.

The rising wage inequality in Armenia in comparison to the selected OECD countries is thus characterized by rising wages at the top and at the median of distribution and stagnating wages at the bottom of the distribution. This means that the increase in inequality is driven not by changes in top earnings relative to the median, but due to the deterioration in the bottom earnings.

Wage inequality in Armenia is rising with the highest rate and with the bottom 10% collapsing further. In the selected OECD countries the gap is not as significant and wide as in case of Armenia. The financial crisis has contributed to the further increase of wage inequality in the majority of countries throughout the world and especially in Armenia. As wage comprises the significant part of household income, the trend of rising wage inequality contributes to greater income inequality and thus overall economic inequality. This process resembles a chain reaction which further leads to the ramification in other spheres of economy having direct impact on the development of poverty and migration.

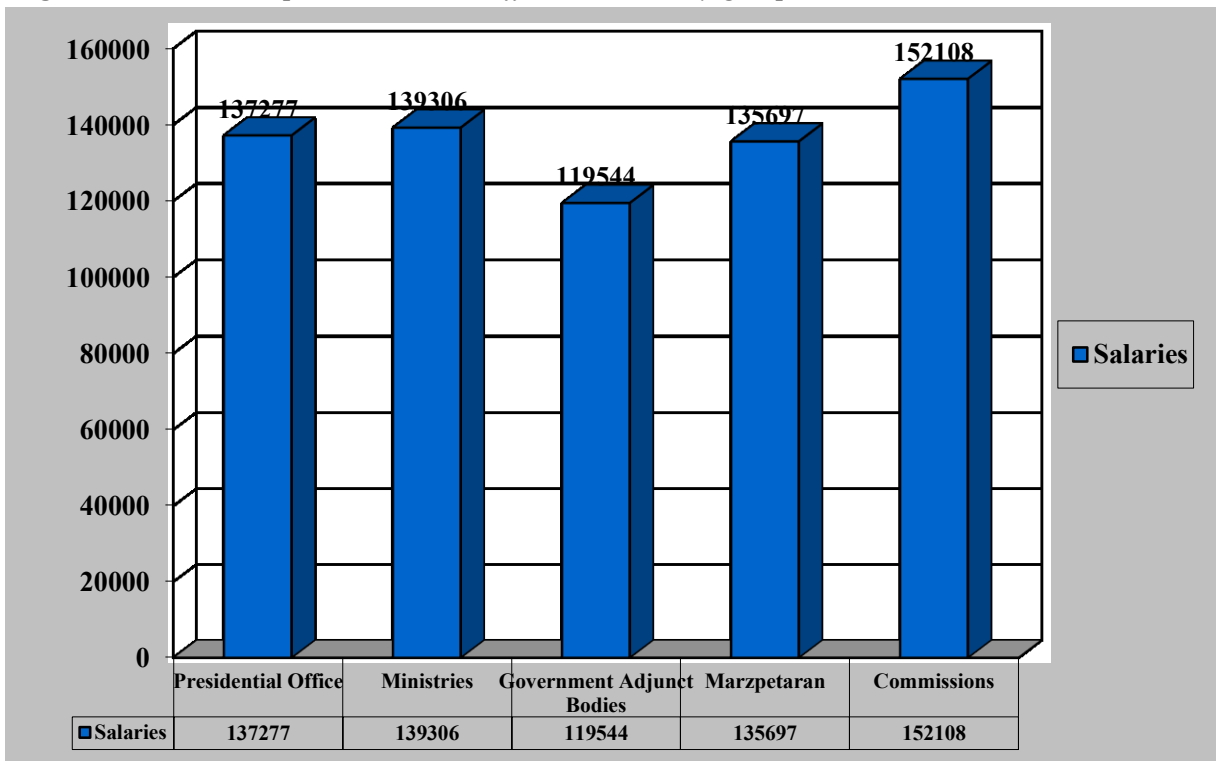
Thus, wage inequality is continuously growing throughout the world both in public and private sectors. However, further research will focus on the Armenian public sector discussing particularly the civil service system inequality trends.

Internal Comparison of Mean Wages among the Civil Service System

There is a lack of coherence and inconsistency in the mean wages among the civil service system resulting in inequities. The issue is the degree of inequities in the system and the extent to which the mean wages differ. According to the data from National Institute of Labor and Social Research, variance of mean wages between different State body groups is not as significant at first glance. As it can be observed from the figure below, in the

presidential office the mean wage of the civil servants is 137,277AMD, while in the ministries it equals 139,306AMD. The mean wage of the civil servants is 119544AMD in the Government adjunct bodies and it equals the amount of 135,697AMD and 152,108AMD in Marzpetarans and Commissions respectively (see figure 3).

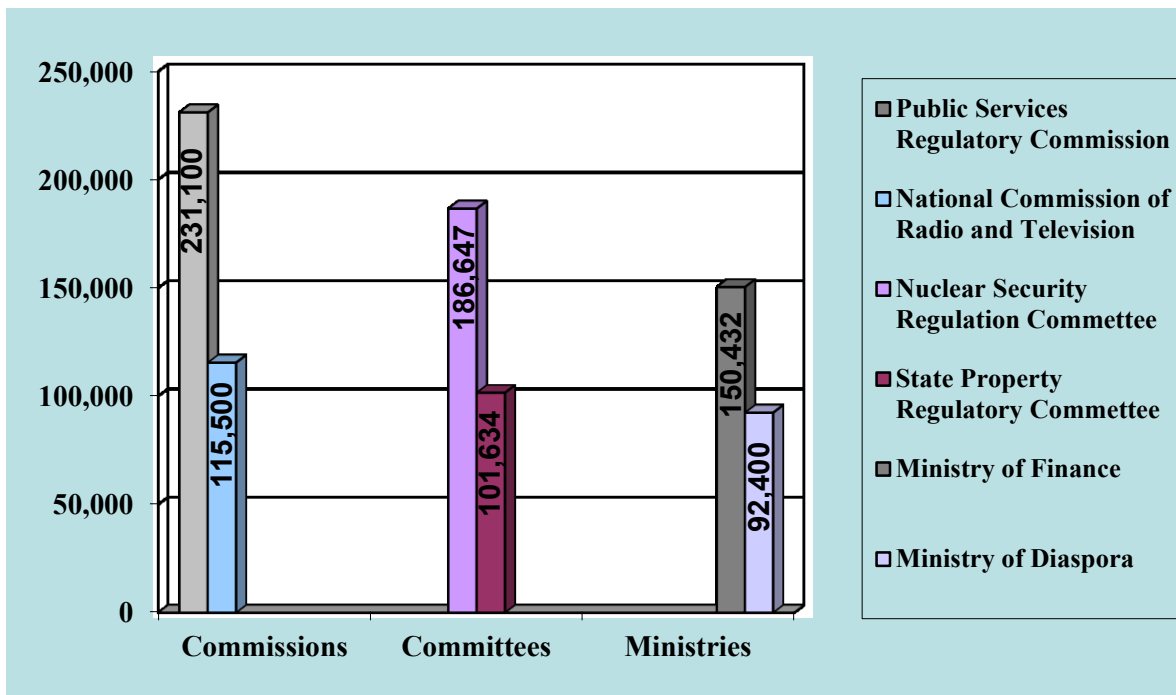
Figure 3: Internal comparison between different State body groups



Source: National Institute of Labor and Social Research of the RA, 2010

The difference is not as significant when considering different state body groups. However, the image becomes different when the mean wages within those state body groups are being considered. In case we compare, for instance, two different bodies within the Commissions, or the Committees and the Ministries, the inconsistency among the mean wages of the civil servants will be revealed (see figure 4).

Figure 4: Internal comparison within state body groups



Source: National Institute of Labor and Social Research of the RA, 2010

As it can be observed from the figure above, the difference is rather significant which serves as a clear illustration of inequities present in the system. The mean wage of the civil servants in the Public Service Regulatory Commission is 231,104AMD, while in the National Commission of Radio and Television it is equivalent to 115,552AMD. Similarly, the civil servants' mean wage in the State Property Regulatory Committee is 101,634AMD and in the Nuclear Security Regulation Committee it is 186,647AMD. Finally, in the Ministry of Finance the mean wage of the civil servants is equivalent to the amount of 150,432AMD, while in the Ministry of Diaspora it comprises 82,400AMD¹.

The salaries of the civil servants differ in various state bodies raising the issue of equity and fairness. In practice the civil servants do not get same remuneration for the same job done which serves as another major reason for the lack of motivation and loyalty to the

¹ National Institute of Labor and Social Research, 2010.

organization. The inconsistency among the wage levels is almost two times which is too large and intolerable.

The reason for the lack of coherence in the wages of the civil servants among those bodies is the difference in the mechanism for pay determination: different base pay levels and bonus systems. In some state body groups the base pay level is set higher (Public Services Regulatory Commission) than in others and it is due to this fact that the salary inconsistencies occur. In other bodies like, Nuclear Security Regulation Committee and the Ministry of Finance, in parallel to reward fund and salary funds, there exist other types of additional funds like bonuses for specific conditions of job in the Nuclear Security Regulation Committee, and system development funds in the Ministry of Finance which serve as another source of payment becoming the major reason for salary differentials in the bodies within the civil service system.

Thus, there exist different levels of base and additional pay within the civil service system leading to high variance of mean wages among the civil service system that result in inequities between different state bodies within the same system. This is one of the major drawbacks of the civil service system that contributes to higher rates of turnover and lack of motivation among the employees as well as creates an environment of corrupt activities.

Wage inequality is growing worldwide and it is the international as well as Armenian reality. However, the issue is the way people perceive the phenomenon of wage inequality: whether they consider it to be a natural economic phenomenon approaching from the perspective of position classification, or interpret it to be unfair and want to get same remuneration regardless of contribution.

For the purpose of the study the perception of fair wage levels will be investigated in Armenian Civil Service system to reveal whether equity or equality is the perceived as fair distributive rule.

The Actual and the Perceived as Fair Wage Levels of the Civil Servants

According to article 7 of RA Law on Remuneration of Civil Servants, the salary of the civil servant is determined in accordance with the appropriate position grade in the scheme based on the lowest pay grade that is set in the annual budget law. The remuneration of a civil servant is comprised of a monthly salary which is calculated on a common base that reflects the position and work experience of a civil servant, multiplied by a coefficient set for each position group. The bonus that is paid once a year is equivalent to the monthly salary of a civil servant, and there is also an additional pay for specific conditions of a job. The salary consists of 11 scales that correspond to the subgroups of the 4 position levels (see table 1). Each scale encompasses 11 steps of around 3 %, the first 4 annually, the following 3 biannually and the last 3 triannually². The structure below is applied to a base of 40,000AMD, which is set according to the budget law, and the average salary is defined by assuming a position.

Table 1: The Pay Structure of RA Civil Service

Levels of the salaries		Junior positions			Leading positions			Chief positions			Highest positions	
		3-rd subgroup scale	2-nd subgroup scale	1-st subgroup scale	3-rd subgroup scale	2-nd subgroup scale	1-st subgroup scale	3-rd subgroup scale	2-nd subgroup scale	1-st subgroup scale	2-nd subgroup scale	1-st subgroup scale
11	No increase	1.34	1.56	1.81	2.09	2.43	2.81	3.26	3.78	4.38	5.08	5.89
10	3 years	1.30	1.51	1.75	2.03	2.36	2.73	3.17	3.67	4.26	4.93	5.72
9		1.27	1.47	1.70	1.97	2.29	2.65	3.07	3.56	4.13	4.79	5.55
8		1.23	1.43	1.65	1.92	2.22	2.58	2.99	3.46	4.01	4.65	5.39
7	2 years	1.19	1.38	1.60	1.86	2.16	2.50	2.90	3.36	3.90	4.52	5.23
6		1.16	1.34	1.56	1.81	2.09	2.43	2.81	3.26	3.78	4.38	5.08
5		1.13	1.30	1.51	1.75	2.03	2.36	2.73	3.17	3.67	4.26	4.93
4	1 year	1.09	1.27	1.47	1.70	1.97	2.29	2.65	3.07	3.56	4.13	4.79
3		1.06	1.23	1.43	1.65	1.92	2.22	2.58	2.99	3.46	4.01	4.65
2		1.03	1.19	1.38	1.60	1.86	2.16	2.50	2.90	3.36	3.90	4.52
1		1.00	1.16	1.34	1.56	1.81	2.09	2.43	2.81	3.26	3.78	4.38

Source: RA Law on Remuneration of Civil Servants

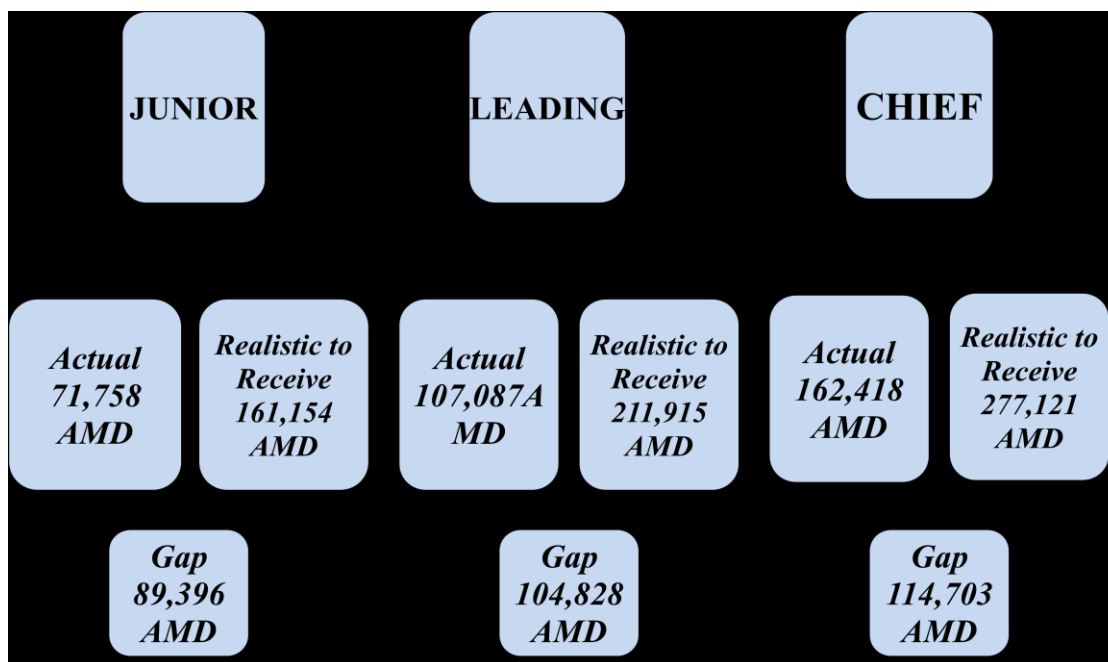
²Law on the Remuneration of Civil Servants with Amendments, 2011

In the current study the actual wage levels in comparison to the wage levels that the respondents have indicated they perceive to be realistic to get in the public sector are being considered. To measure the perception of realistic pay several questions have been asked on what is the proper pay for sustaining the minimal as well as normal living standards of their families, how much their salary should be to be able to fund a four- member family, and how much it should be not to take bribes, and what is the pay level that they consider realistic to get in the public sector. The concept of “realistic pay” is understood as the pay level that may not be fully sufficient for them to meet all their needs but will be the minimal tolerable boundary of perceived as fair pay. The realistic pay is thus the pay level that will ensure at least the minimal needs of the civil servants.

The findings suggest that the average base salary of the civil servants is 98.190AMD per month and the annual mean bonus is 211.144AMD that is the monthly mean bonus is 17.595AMD and thus the average monthly salary is 115.785AMD.

The average monthly salary of the juniors is 71.758 AMD, of the leading specialists is 107.087AMD and of the chief specialists is 162.418AMD (see scheme 2). The respondents have indicated that they consider it realistic to get on average 240.375AMD as a monthly salary in the public sector. The juniors consider that it is possible to get a monthly salary of 161.154AMD in the public sector, while the leading specialists believe in the possibility of getting 211,915AMD as a monthly salary. The Chief specialists perceive it realistic to get a monthly salary of 277.121AMD³. If deducted the gap between the actual and the perceived wage levels will be observed which is rather significant and is an indicator of dissatisfaction and absence of motivation. This is one of the major reasons why the civil servants lack the motivation and the incentive to work hard and to stay committed to the system and consider the option of looking for a job in the private sector.

³ Ministry of Finance Survey Research, 2011



Scheme 2: Data Source: Ministry of Finance Survey Research, 2011 National Institute of Labor and Social Research, 2011.

It is worth mentioning that the base pay level upon which the salary is calculated is very low and non-competitive with the private sector. The 3% increments are also considered as a rather low rate, and in the end the salary turns not to meet employee needs. Thus, the employees lack the motivation to work hard and become non-efficient for the organization. The low salary level may also create an environment of corrupt activities which will impact negatively the organization and weaken it overall. Such a low salary level is not appropriate for Armenian reality as there is a significant difference in the salary levels of the public and private sectors which gives a comparable advantage to the private sector and contributes to high levels of turnover in the public sector.

Another important point is that the Civil Service Law (Article 24(1)) prohibits civil servants to perform other paid job with the exception of scientific, pedagogical, and creative work. However, the low salaries of civil servants and the low standard of living could stipulate some civil servants to violate the rules and perform other paid jobs, which could decrease the productivity of the civil servants.

Thus, taking into consideration the analysis above, the gap between the actual and the perceived as fair wage levels of the civil servants is rather significant and the possible options left for the employees is either to leave the service and find a better paid job in the private sector, to engage in corrupt activities, or to get along with the low salary levels.

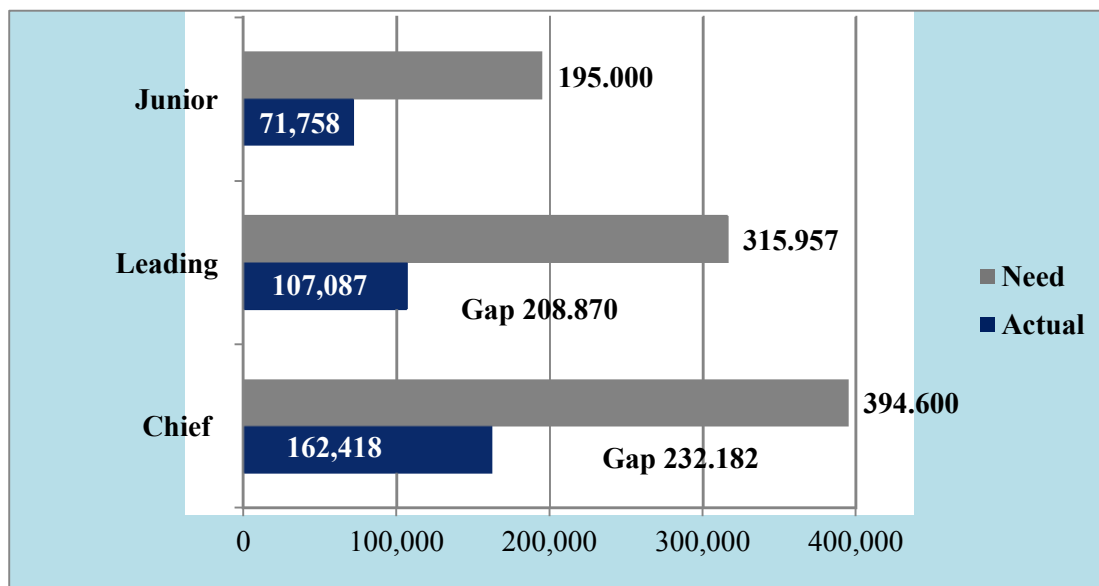
Perceived Pay Fairness Based on the Extent of the Satisfaction of Employee Needs

In Armenian reality the employees perceive pay fairness reflected in the satisfaction of their needs. Asking whether they are satisfied with their own pay, for instance, people will mainly take into consideration whether pay satisfies their needs. But in answering that question people may also take into account whether or not their pay is seen as fair.

The findings of the survey conducted illustrate that 94% of the total respondents have indicated that the civil servants cannot live by the salaries they get and 74% of the total respondents have indicated that if their salaries increased by 100,000AMD they would still spend the entire amount and would not be able to save a penny. To the question “what the civil servant is then supposed to do?” 53% of the total respondents have answered “to look for a job in the private sector.” This is a clear illustration of the fact that the remuneration system is not effective and fair enough to motivate the employees to remain loyal to the organization and the service. The pay levels are not adequate enough to attract new employees as well as retain and motivate skilled staff to the civil service.

The respondents have indicated that they need on average 348,815AMD as monthly salary to ensure the normal living standards for their families. Out of the total respondents the juniors which constitute the 10% of the respondents need on average 195,000AMD as a monthly salary, the leading specialists (38% of the total respondents) need on average 315,957AMD and the chief specialists (53% of total respondents) on average 394,600AMD as a monthly salary to secure the normal living standards of their families (see figure 1).

Figure 1: The Actual and Needed Pay Levels of the Civil Servants



Data Source: Ministry of Finance Survey Research, 2011. National Institute of Labor and Social Research, 2011

From the chart above it can be observed that the gap between the actual wage levels and the wage levels that the civil servants need is large. This means that the take home pay of a civil servant is not sufficient to meet the minimum standards of living, which serves as one reason why the employees perceive to be not fairly paid.

There is another interesting finding here (see figure 1): the fact that the gap is different for each group is a clear rejection of equality theory in Armenian reality. The employees do not even think of getting same remuneration, rather they approach the issue from hierarchical perspective that is, from the perspective of position classification, thus valuing the level of contribution to the organization, which is the core principle of equity theory.

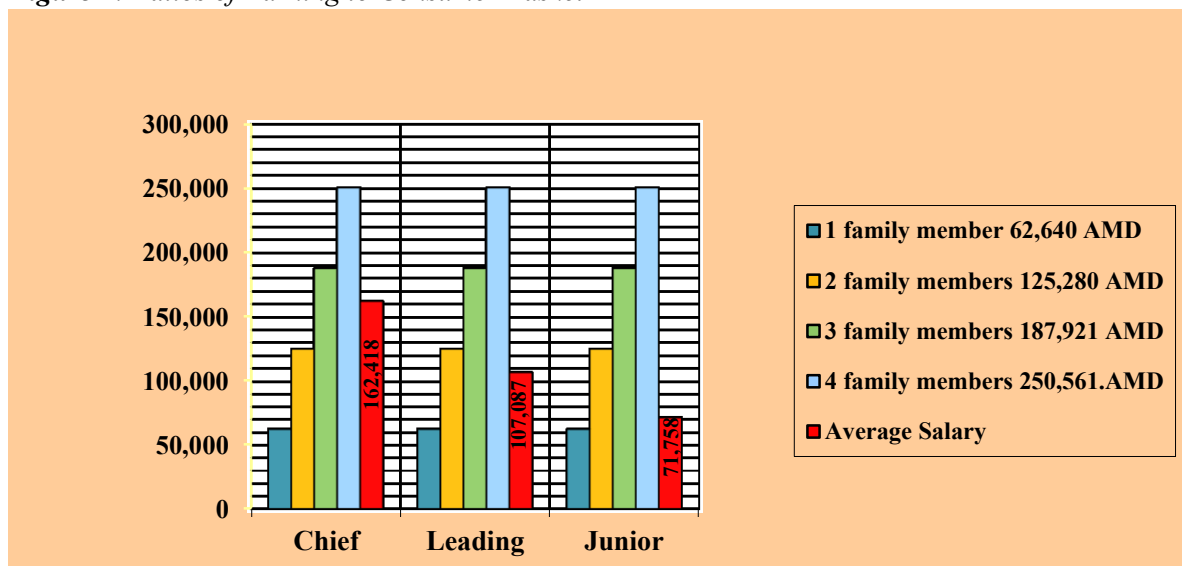
Another measure that relates pay to a measure of living expenses is the ratio of earnings to consumption. Is pay generally sufficient for a reasonable standard of living?

Using the data from the Armenian Statistical Service on minimum consumer basket (62.640AMD), it is possible to estimate how much of the average consumption expenditures

for up to four-member household could be financed from the net earnings of a civil servant. The four member family has been considered as a maximum threshold in our analysis as according to Armenian Statistical Service it is the average family size in Armenia.

This perspective suggests that, while the take-home pay (162.418AMD) for the chief group of the civil service is sufficient to fund a one, two – member families and it is roughly sufficient to fund a three – member family, it is still insufficient to fund a four-member family (see figure 2).

Figure 2: Ratios of Earning to Consumer Basket



Source: National Institute of Labor and Social Research, 2011, Armenian Statistical Service, 2011

The leading specialist who gets 107.087AMD as a monthly salary can fund a one member family, can hardly fund a two-member family and is incapable to fund a three and a four-member family. The salary of the junior specialist (71.758AMD) is roughly sufficient to fund even a one-member family.

The base salary level of civil servants is lower than the minimal consumer basket, which means the salary is not enough to ensure a minimal living standard for a civil servant and thus is not enough to cover the expenses for professional development.

Thus taking into consideration the analysis above, the pay structure of the civil service in Armenia is not designed in an effective way to motivate the employees to work hard. There is no connection between expenses necessary for civil servants' wage size and labor force productivity. The salary level is not appropriate because it is not enough for the employees to be able to secure the normal and sometimes even the minimal living standards of their families.

From theoretical perspective, the equality theory is not relevant in Armenian reality. Instead employees evaluate pay fairness based on the extent of satisfaction of their needs. And as the employees have strictly differentiated need levels based on hierarchy, it implies that they want a remuneration system based on equity criterion.

Fair Remuneration Based on Individual Contribution

Armenian civil servants value contribution to an organizational setting. In an exchange relationship they want an outcome that will reflect the contribution, that is, what each person brings to the relationship, and not the fact of being compared with other employees. When asked whether the pay should be determined based on individual contribution (how well the job has been accomplished) or in comparison with the contribution of other employees, 82% of the total respondents think that the pay should be determined taking into consideration individual contribution.

In hierarchical relations as well Armenian civil servants are inclined to think that the gap between the salary of their immediate supervisor and their own salary should be significant as 70% of the total respondents have indicated that their supervisors work harder and have more responsibilities. When asked about the differential between their and the immediate supervisor's salary, 50% of the employees responded from 30,000AMD – 70,000AMD, and to the question how much this differential should be 45% of the total

respondents have answered from 30,000AMD to 70,000AMD and 26% think that the differential should be from 70,000AMD to 120,000AMD, which is a clear indicator that Armenian civil servants consider pay to be related to the relative input to the organization.

The theoretical perspective suggests that “differentials and relativities lie at the very heart of the concept of equity as applied to wage determination” (Robinson 1973, 7 as quoted in White 2000). The civil servants think that the pay structure should be determined taking into consideration the different duties, responsibilities, and the relative contribution the employees have to the organization. Although the civil servants measure their level of pay satisfaction based on the extent to which they are able to meet their needs and secure the normal living conditions for their families, they still consider pay level to be fair based on the criterion of input/output ratio.

Once again, the equality theory proves to be non applicable in Armenian reality, as the civil servants approach the issue from the perspective of position classification. This approach creates the relationship between the salary received and the job performed not only for similar positions, but also for the employees occupying different positions. This is important to create internal equity and fairness within an organization to raise employee motivation and ensure long-term productivity.

Thus, the distributive justice rule that is applied in the Armenian civil service system is the equity rule, as the remuneration is perceived as fair if it is determined based on the relative contribution, duties and responsibilities that an employee has occupying a particular position within an organization.

CONCLUSION

Growing wage inequality is a common feature for the countries throughout the world and for Armenia in particular. In Armenia the gap between the top and bottom of distribution has sharply widened during recent years, as a result of rising wages at the top and median of distribution and simultaneously collapsing bottom of distribution. Wage inequality exists in every sector and within each system, and it is the reality of contemporary labor markets.

The research revealed that there exist significant salary differentials within different bodies of the civil service system, which raises the issue of equity and fairness. These differences occur because of the different base pay levels set in those civil service bodies. As a result the salaries among the same grade positions differ depending on a sector of the civil service.

However, as the societies throughout the world grow unequal, people value equity over equality. As in other countries, in Armenia as well fair remuneration system is perceived to be based on position classification, that is, higher positions imply higher wages. The research has indicated that Armenian civil servants value the relative contribution to the organization and they want to be rewarded accordingly. The research also indicates that the civil servants want a remuneration system based on need satisfaction which is a relative phenomenon, as the civil servants have strictly differentiated need levels, based on hierarchy. Thus, Armenian civil servants view the distributive rules in an organization through the lenses of equity theory. The remuneration system based on equity rules is the system that the civil servants perceive as fair and just.

Equity rule is the applied rule of distributive justice in Armenian reality and it is the perceived as fair rule upon which the civil service remuneration system is constructed. Thus wage inequality is perceived as a natural economic phenomenon, however, the issue is the extent of inequality, that is, the gap between the successive positions which in case not

controlled can lead to economic, political and social risks and consequently to widespread poverty and high rates of migration.

The issue of remuneration in the public sector is linked to the guarantees of living standards of public service employees. The fact that the classic system of career civil servants assumes that the employee devotes his/her entire working life to the public service, the laws governing the public service pay system should be designed in a way to keep the employee in that service. They should reflect the human capital requirements of the position; they should be competitive and fiscally sustainable as well as transparent and fair.

There are a number of drawbacks in the Armenian civil service system and one of them, as the analysis indicates, is that there is no appropriate appraisal system. The bonuses that are paid to the employees are one-time payments and are not directly linked to the actual contribution of the employee within the organization. The reward system is not designed in a way to create an incentive for the workers to achieve high levels of performance and be rewarded accordingly.

Another major drawback of the civil service reward system is the low base pay level. The civil servants cannot satisfy their basic needs and cannot sustain their families because of the low pay level. The base pay level upon which the salary is calculated is too low, not even being equivalent to the minimum consumer budget. This can be a major contributor to corrupt activities within the system entailing negative impact both on the organization and the overall economy.

Limitations

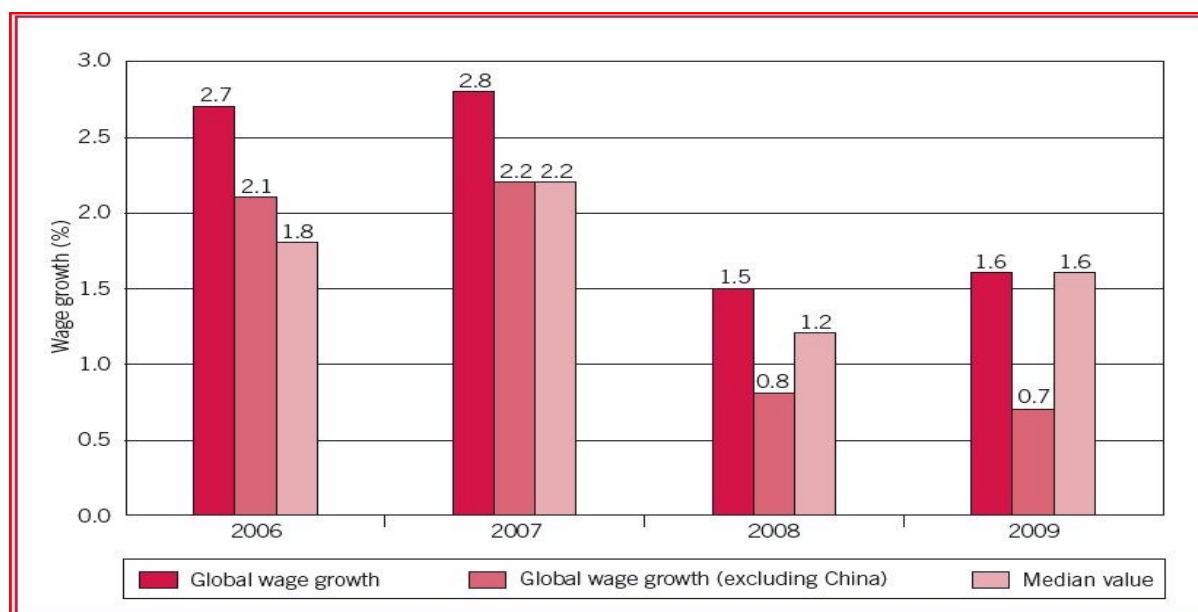
Further research is needed in this field to reveal the drawbacks and contribute to their improvement. There are several limitations to the current study that can be improved in the further studies. Because of the fact that the sample was non-representative, more generalized conclusions could not be drawn. The measures and the instruments of the study can also be improved in further studies.

POLICY RECOMMENDATIONS

1. To design and implement an affordable remuneration system with a base salary level matching at least the minimal consumer budget for every employee (this will provide the employees with the opportunity to satisfy their basic needs) and only after what appraise the contribution of each employee through a system of pay based on contribution.
2. To establish a performance related remuneration system contributing to the promotion of motivation, healthy competition and loyalty to the organization. This system will help to focus the staff on individual performance leading to long-term productivity.
3. To set up Civil Servants' Union which will involve representatives from Ministries, regional administrations (Marzpetarans) of the RA, and State Committees and Commissions. Among main issues of the Union should be provision of support to the activities addressing increase of civil servants' competitiveness in the labor market and address the issue of competitive remuneration.
4. To eliminate the wage disparities within the different bodies of the civil service system by establishing common base and bonus systems within the civil service. This will lead to the establishment of equitable and fair pay system.
5. To mitigate the gap between the top wage earners relative to the bottom wage earners by raising the salaries of the lowest paid employees through the introduction of increased minimum wage policies taking into consideration the experience of other countries like in the US and UK. Policies should be pursued to improve low-paid workers' pay by building institutions of collective bargaining.

APPENDIX A

Figure 5: Global wage growth, 2006–09 (year-on-year changes, real terms, in per cent)



Source: *Global Wage Report 2011*.

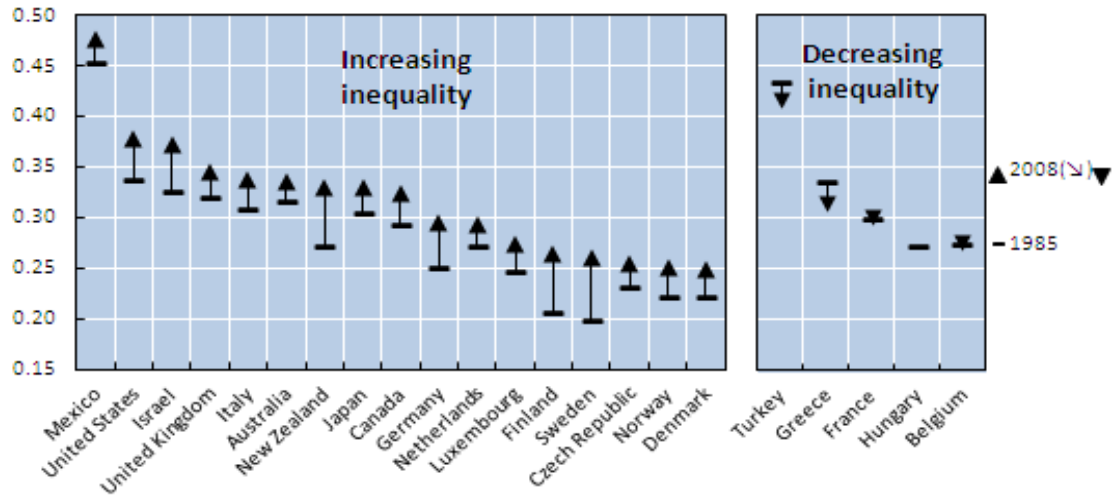
Table 2. Trends in real household income by income group, mid-1980s to late 2000s

	Average annual change, in percentages		
	Total population	Bottom decile	Top decile
Australia	3.6	3.0	4.5
Austria	1.4	0.4	1.6
Belgium	1.0	1.7	1.5
Canada	1.1	0.9	1.6
Chile	1.5	2.5	1.0
Czech Republic	2.7	1.8	3.0
Denmark	1.0	0.7	1.5
Finland	1.8	1.3	2.7
France	1.2	1.6	1.3
Germany	0.9	0.1	1.6
Greece	2.1	3.4	1.8
Hungary	0.6	0.4	0.6
Ireland	4.7	4.5	3.7
Israel	1.7	-1.1	2.4
Italy	0.8	0.2	1.1
Japan	0.3	-0.5	0.3
Luxembourg	2.3	1.8	2.8
Mexico	1.4	0.8	1.7
Netherlands	1.4	0.5	1.6
New Zealand	1.5	1.1	2.5
Norway	2.3	1.4	2.7
Portugal	2.2	2.4	2.3
Spain	3.7	6.0	3.0
Sweden	1.8	0.4	2.4
Turkey	0.5	0.8	0.1
United Kingdom	1.9	0.9	2.1
United States	1.3	0.5	1.9
OECD-29	1.7	1.4	2.0

Source: *OECD Income Distribution and Poverty Database*.

APPENDIX B

Figure 6. Gini coefficients of income inequality, mid-1980s and late 2000s



Source: OECD Income Distribution and Poverty Database.

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