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ANALYSIS OF PUBLIC AND PRIVATE SECTOR WAGES FOR CERTAIN
PROFESSIONS WITH COMPARISON TO SELECTED COUNTRIES

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INTRODUCTION

The extent of wage comparability between the public and private sectors is both an academic question and a practical policy issue for which the surveys can be used.

The purpose in undertaking this analysis is to discuss the relation and interaction between public and private sector wages. The relevance of this issue is clear from both analytical and policy perspectives, given that the public sector employment comprises a significant share of total employment and public sector expenditures. The determination of wages paid to public employees do not necessarily follow the same rules as those prevailing in the private sector, given that public employees provide public goods and services arising from social preferences that are not normally oriented to market activities. In this sense, their productivity, and its link with wages, is more difficult to assess than the productivity of workers linked to market-oriented activities (Belman, Franklin & Heywood, 1994).

As far as productivity of both sectors is concerned, the research has shown that private sector workers are more productive due to the competitive forces. Private sector businesses face constant pressures of competition to innovate and improve their goods and services, lest they lose business to their competitors. Government agencies, by contrast, are typically monopolies protected by law, and thus are not subject to such competitive incentives and pressures. According to the U.S. Bureau of Labor Statistics National Compensation Survey, private-sector employees worked an average of 2,050 hours in 2008, 12 percent more than the 1,825 hours worked by the average public-sector employee.

The setting of wage levels in the public sector is unavoidably dominated by “administrative and political processes” (ibid., p. 79). The issue is how well these processes work. As was mentioned above, comparability stands as the accepted standard by which economists make such judgments. Both equity and efficiency arguments require that public sector wages be comparable to those of similar workers performing similar tasks in the

private sector. Equity requires that given workers not be paid differently for identical work simply because their employer is the government. Efficiency requires that the wage be adequate to attract the needed supply of workers. Too high wages waste the resources of state and local governments depriving them of the opportunity to address other objectives or reduce taxes. Too low wages make it impossible for governments to attract workers of the quality needed to provide the services citizens demand (Belman, Franklin & Heywood, 1994, p. 1).

Thus, the adoption of the principle of comparability will insure “equity for the public employee with his equals throughout the national economy and enable the government to compete fairly with private firms for qualified personnel - and provide at least a logical and factual standard for setting public salaries” (Wise, 2008, p. 162).

LITERATURE REVIEW

Analyzing the public pay in comparison with the private one is very vital and practical for appraising the economic status of the population working in the public sector.

The setting of wage levels in the public sector is unavoidably dominated by institutional, political and economic factors. Institutionally, public sector is the only place in many economies where labor unions have a significant say in wage setting. Due to political factors, governments may desire to be a good employer, offering low-skilled workers higher rates than they might get in the public sector. Or adversely, they may withstand to pay high wages to very skilled workers if the public expresses objections towards seeing public-sector workers earning too much. There are also economic factors, as spending and tax receipt limits.

The principle of comparability is assumed to “equalize wages between the public and private sectors.” Comparability stands as the accepted standard by which economists

make judgments between the wage structures and levels of the two sectors (Lewin & Fogel, 1974, p. 159).

The arguments of equity and efficiency that construct the logical basement of the principle of comparability require that public sector wages be comparable to those of similar workers performing similar tasks in the private sector. “Equity considerations dictate a worker do no better or worse in the public sector than in the private sector. Efficiency considerations imply that the public sector pays no more or less than is necessary to attract an adequate supply of employees, retain and motivate them. Equal pay, as assumed, will lead to “fair” competition for workers between the public and private sectors (Wise, 2008, p. 160).

Generally, researchers have compared for decades the earnings of public sector and private sector workers. The methodologies employed can be divided into two broad classifications. The users of the first methodology, human capital studies, usually calculate an overall wage rate for all workers and then examine the rate in terms of demographic characteristics such as age, education, race and gender. Comparability analyses weigh differences in the average pay of workers in the same occupation performing essentially the same level of work in the different sectors (Wise, 2008).

A second, older methodology is based on the comparison of narrowly defined occupations. Using this methodology, the wages of public employees such as clerk typists, accountants, or clinical psychologists are compared to those of employees in the same occupation in the private sector. (Belman, Franklin & Heywood, 1994)

Governmental wages and salaries affect the respective government budget and, therefore, the citizens’ tax burden; they influence the relative attractiveness of employment in the public and private sectors; and they are an important factor in the continuing debate over the size and role of government. These wage requirements should meet both equity and efficiency. The output of government does not pass through the marketplace where its

relative worth can be assessed by customers. In the absence of a product market discipline imposed on pay practices what could be fairer than to pay government employees what their private industry counterparts are getting? Furthermore, to attract employees of at least average quality to the government, the pay offered must be comparable to that available in the private sector. For the government to pay more than the private sector, however, would be unnecessary and would waste government revenues. Therefore, the pay comparability rule is efficient as well as equitable.

The importance of efficiency in discussing public sector wages should not be underestimated. Efficiency consideration goes in tandem with productivity argument discussed by many authors as Akerlof (1984), Krueger (1988), Pfeffer (1998) et al who postulate that however counterintuitive it may seem, often low wages are more costly to the employer, because low wages decrease employees' productivity, bringing down profitability. Workers who are paid only their opportunity costs have little incentive to perform well since losing their jobs would not be costly. Hence, low wages also increase turnover costs. Another consequence is that by paying lower wages a higher quality pool of employees cannot be attracted.

It can be concluded that comparability principle of wages is an important factor to be considered. Researchers ignoring the issue of comparability always have a research outcome that governments overpay their employees. An example is the work "America's Protected Class: Why Excess Public Employee Compensation is Bankrupting the States" by Cox and Brunelli (1992) argues that public compensation has increased so quickly over the past decade that it outstripped the increase in the private sector.

Meanwhile, public and private employment is set on the basis of very different criteria. Whereas private employment is aimed at maximizing firms' profits, public employment aims at maximizing sociopolitical or bureaucratic objectives (Gregory and Borland, 1999).

Differences in the structure and objectives of the public and private sectors generate methodological and policy problems whenever attempts are made to translate wage comparability principle into wage rates. Firstly, for some public sector jobs (e.g., policemen, firemen, social workers, judges), there is either no private market or the government has a dominant employment position in these occupations. In addition, there exist a large number of occupations in the private sector that are not in the public sector. For instance, sales and delivery workers and a large number of manufacturing occupations are simply not part of the typical government work force. Thus, how should the pay for such jobs be established? (Belman, Franklin, & Heywood, 1994)

A second problem is the existence of a large range of wages paid for most private sector occupations presenting difficult administrative challenges for government wage-fixing authorities. What rules should be applied to the range in order to come up with a comparable wage? Should the average of the entire range be used, or the first quartile, or the mean, or the median? (Lewin & Fogel, 1974, p. 412)

Moreover, when the private sector wage is depressed because discrimination or other factors confine some workers to a small part of the total labor market, is it appropriate for government to pay a wage that has resulted from the market power?

As is seen, although theoretically the role of the comparability principle cannot be underestimated, there are various challenges when it is applied in practical terms. Some authors even claim that there are many reasons why public and private sectors workers should be paid differently. First, the public sector could set wages in a non-competitive way due to the monopolistic power of governments in setting prices and taxes for the provision of public services. Second, the public sector may be driven by objectives such as vote and/or budget maximization rather than profit maximization (Algan, Cahuc & Zylberberg, 2002).

The third argument against the comparability principle is that the government should be a “model employer,” rather than imitate the private sector. In this view, governments have a “role of advocating and demonstrating employment policies such as due process, merit systems, pensions, health insurance, and anti-discrimination measures” (Bender & Heywood, 2010, p. 24). The public sector will also achieve other considerations, such as equity and fairness. Thus, the public sector should serve as a yardstick for the private sector. For instance, the apparently large wage advantage for women in public employment might reflect wage discrimination against women in the private sector.

Fourth, the institutional environment for wage setting may differ between public and private sectors. For example, in many developed countries labor unions have a strong bargaining power in securing higher wages for public sector employees. Fifth, as was mentioned above, productivity-related characteristics of employees in the two sectors may be different (Cai & Liu, 2011).

Based on the theoretical perspectives discussed above, this study is going to explore whether in the Republic of Armenia public and private sector wages yield the comparability principle practiced in the developed countries. The study is also going to provide analysis of the wage relation of public and private sectors of developed and developing countries.

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

RQ1: What is the public and private sector wage relation in developed countries?

RQ2: What is the public and private sector wage relation in developing countries?

These two RQs tend to analyze to what extent the standard of comparability of setting wages is practiced in developed and developing countries, to find out whether there are differences in terms of wage differentials of public and private sectors between these 2 groups of countries.

RQ3: Is the public sector underpaid in comparison to private sector in Armenia?

After analyzing the patterns of the public-private pay relations in the developed and developing countries, it is to the purpose of this paper to see what the relation is in Armenia.

RQ4: Is the public sector underpaid in comparison to the living standards of Armenia?

RQ5: Do the benefits in the public sector make up for the low pay?

RQ6: Is the public sector considered to be a secure employer?

The last three findings come to complete the general picture relating to the pay comparability of public and private sectors.

METHODOLOGY

For the purpose of this study primary and secondary data are utilized. The methodology of this study relies on a survey research and analysis of existing and primary statistics. The primary data were 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. Out of 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 face-to-face interviews were conducted through a semi-

structured questionnaire in February 2011. A pretest of all measures was conducted, and adjustments were made accordingly. All data were input in SPSS for analysis.

COMPARISON OF PUBLIC AND PRIVATE SECTOR WAGES IN THE SELECTED COUNTRIES

A comparison of wage differentials between the countries shows a great variety of situations among developing countries and between developed and developing countries. Most of the studies on the public–private wage differentials focus mainly on the mean of the wage distribution.

International evidence suggests that in the developed countries, relative to the private sector, on average, there is a wage premium for public sector employees, and the premium is often higher for females than for males (Borland & Gregory, 1999; Cai & Liu, 2011).

In Great Britain public sector pay and reward, particularly at the top, have been the focus of media and public concern for some time now. Public sector organizations need to be able to justify how they spend public money - particularly where relatively large sums are paid to individuals as salaries. National newspapers actively discuss the need to crack down on the public sector pay. For example, two articles in “The Telegraph” state that “pay and pensions of public sector workers - which for a long-time have been better than in the private sector - but also their working hours and holidays as well” (Wallop 2010, 2011).

Nevertheless, a more considered look at the statistics and other evidence shows that the issue is not a simple one. Judged against the private sector, the public sector has exercised considerable restraint on executive pay, both in terms of the amounts paid and the rate of increase. But pay of public sector workers has been increasing far more quickly than average pay in the economy as a whole, a fact that has inevitably fuelled anger among taxpayers.

For some reason, the increases in public sector pay are directly linked to the much larger increases in private sector pay over recent decades. As the comparability principle works, rise

in the public pay is an inevitable outcome of increases in the private sector (House of Commons, 2009).

To provide an empirical estimate and compare the wages in the public and private sectors, most of the researchers divide the wage distribution in both sectors into equal quantiles. The reason for this is that the comparison of wages between the public/private sectors differs across the wage distribution curve. Quantile regressions found a significant wage premium for the public sector at the lower part of the conditional wage distribution, and a significant wage penalty at the upper part of the distribution.

Figure 1: Pay profiles by skill: Public and private sectors



Source: (Lucifora & Meurs, 2004, p.8)

Except for estimating the wage differential between public/private sectors through dividing the wage distribution into quantiles, or equal part and observing the difference in each of those parts, researchers also consider the averaged wages of the two sectors. The averages wage differential shows that public sector overpays its employees as compared to the private sector.

The above given diagram widely depicts the wage distribution relation in most of the developed countries, such as US (CBO, 2007), UK (Danzer & Dolton, 2011), EU countries (Lucifora & Meurs, 2006), Australia (Cai & Liu, 2011), etc.

The public wage premium at the lower end of the conditional wage distribution might be due to the more effective implementation of equal opportunity and anti-discriminatory

policies in the public sector, because governments may use public sector pay to achieve objectives such as equity and to be a ‘good’ employer (Bender & Heywood, 2010). A commonly cited reason for public wage penalty at the upper end of the conditional wage distribution is public opposition to high pay for public servants, while the private sector is not subject to such opposition. This allows the private sector to use high pay to attract high-skilled workers (Lucifora & Meurs, 2006).

One of the research questions of this study intends to find out whether the benefits in kind or non-pecuniary benefits make any significant supplement to the wages in the public/private sectors. Studies in the developed countries suggest that private sector workers have lower pension contributions, fewer and less valuable fringe benefits and harsher employment risks. The value of benefits in kind as a fraction of annual earnings ranges between 15% in the private sector and 20% in the public sector. These shares are relatively stable over the life cycle indicating that benefit growth keeps pace with earnings growth.

To sum up evidence on earnings reveals that there is an apparent dominance of the private sector earnings profile at mid-career and a clear advantage of public sector employees at the beginning and last stages of the working (Danzer & Dolton, 2011).

Higher private sector remuneration could also be compensating differentials that private sector employers use to reduce the turnover rate of high-skilled employees and/or for less pleasant work environment. For example, some studies find that overall satisfaction in the public sector is higher than in the private sector (Gardner & Oswald, 1999).

Historic Overview of Developed Countries

Before we move to the more technical analysis, an examination of the patterns of wages and wage growth in the public and private sectors over time, and across countries, would be informative. Looking at the public-to-private wage ratio, while there is significant heterogeneity across countries, some common patterns are nonetheless evident. In most

countries, the 1970s marked a significant decline in relative public-sector wages, as compared to the private sector. This is possibly because in many countries public employment increased overall, most notably regarding low-skilled segments of the labor force. The ratio of public-to-private wages subsequently remained broadly stable or increased somewhat in the 1980s and 1990s. This latter pattern is seen very clearly in most developed countries, where privatization of government services and public enterprises using low-skilled labor might have contributed to a gradual rise in the public-to-private wage ratio. The picture begins to change somewhat in the late 1990s and early 2000s. While most countries continue to display a broadly stable or slightly increasing public-to-private wage ratio, a number of mainly euro area countries display a strong increase. In Ireland, Greece, Italy, Portugal, and to a lesser extent the UK, relative public wages rise steeply to levels well above those in most other sample countries and the euro area aggregate. The Nordic countries show a particularly marked decline in wage growth in 1990s. The Australian differential ranges from 12 to 23 per cent, but most of it is due to the better qualifications of public sector workers. (Lamo, P´erez & Schuknecht, 2011).

Early estimates for the US by Fogel and Lewin (1974), who were among the first to investigate the size of the wage differential, show that the public sector wage premium exists primarily for low skilled workers and is computed to be up to 15% of wages. Using occupational-level wage data from the BLS and the Census, they found that low skill level federal government workers earned between a 1% lower and 13% higher wage than their private sector counterparts. On the other hand, high level government workers earn wages between 19% lower and 1% higher than occupationally comparable private sector workers. They also found substantial queues for some types of low level government jobs, suggesting that the level of total compensation received by some public sector workers was relatively high (Bender, 1998, p. 188).

Again in an early study for Canada, Gunderson (1978) uses several data sources to examine movements in the differential from the 1950s to the late 1970s. He interestingly finds that there was no significant difference in average public and private sector wages through the 1960s. However, in the mid to late 1970s the public sector earned a premium of 5-15%, with public sector women and low level occupations doing relatively better.

During the 1970s in the UK public sector workers earned 12.3-17.4% higher hourly earnings than private sector workers between 1983 and 1993. The reason for such a picture is that public sector employees worked fewer hours than private sector employees. It is women working in the public sector in 1970s that have the largest premium as compared to their private counterparts.

Smith (1996) investigates average wage differentials in Australia since the early 1980s. He finds that since the early 1980s, the average private/public differential has been falling, although it recovered slightly in the early 1990s accounting for 12.3% for male and 22.5% for female workers in May 1993. The author indicates that by looking at the differentials over time, government-private sector differentials are tending to become smaller (Bender, 1998).

It can be generalized that during the last four decades the public-to-private wage differential in the developed countries have been rising and falling depending on various economic situations, however showing the inclination to become smaller over time.

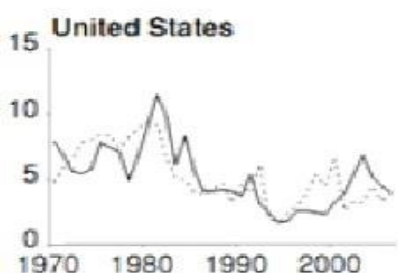
Analysis of Developed Countries

Cross-national comparison of the developed countries suggests that public-sector employment is highest in Canada (51.6%) followed by Australia (50%) and Norway (44.0%). In all countries, men outnumber women in managerial positions mainly in the private sector. The differences are less pronounced in public-sector employment with Canada having the lowest difference between men (51.4%) and women (48.6%) followed by Norway (55.2% men, 44.8% women) (Mano-Negrin, 2004, p. 464).

In the US each of the major governmental pay systems is linked to private sector rates of pay. Reasons for doing so are set forth in the Federal Salary Reform Act of 1962 which established the comparability principle for public workers covered by the GS¹: Adoption of the principle of comparability “will insure equity for the federal employee with his equals throughout the national economy and enable the government to compete fairly with private firms for qualified personnel-and provide at least a logical and factual standard for setting Federal Salaries.” Having set this objective, an elaborate mechanism was established to annually adjust federal pay to private pay rates. In March of each year the Bureau of Labor Statistics undertakes a national white-collar salary survey. This information is used to assign rates of pay to jobs in the public sector such that federal pay rates are comparable to “private enterprise pay rates for the same levels of work.”

In the US, there exists a central government-private sector earnings premium of between 5 and 20 per cent, although it depends upon the occupation, gender and race of the sample. Women, non-whites and low skill level occupations have the highest premiums. The premiums have been falling since the 1970s.

Figure 2: Nominal compensation per employee: public (solid line) and private (dotted line) sectors



Source: (Lamo, P´erez & Schuknecht, 2011)

Generally, the pattern is similar to the one characteristic of the developed countries, at the bottom of skill and responsibility hierarchies, state and local government employees had an advantage, but in the middle and upper portions, private workers had an advantage. Indeed, among the 80 comparisons possible among the white-collar jobs, private industry

¹ General Schedule (GS) is a pay system that covers half of all federal civilian employees, mostly white collar.

paid better than state and local governments in four out of five positions. This line of research can be contrasted with the second broad methodology of detailed “position” comparisons. In these studies, efforts are made to compare duties of each job and to find positions with comparable duties in the both public and private sectors. Thus, junior accountants are compared with junior accountants, and computer operators with computer operators. The earnings differences across sectors within these narrow positions are then aggregated to construct an average difference (Bender & Heywood, 2010).

In many OECD countries public sector employment accounts for a significant share of total employment and public sector expenditures, as well as playing an important role in economic performance. In Italy and France public servants are still generally recruited through open, competitive examinations - for which a given level of education is required - and, once hired, enjoy life-time contracts in which seniority plays a major role. In general, public servants in the above countries cannot be discharged, except for misconduct, and the statutory terms apply regardless of whether the individual is employed at the national, regional or local authority level. Conversely, in Great Britain the process of decentralization has determined greater variation in both recruitment criteria and pay levels of civil servants across different Departments within the public sector and a number of services have been progressively contracted out.

In the French public sector the same pay scales apply to all public sector workers, and while unions do play a role in national wage negotiations the outcome of the bargaining process is not legally binding for the government (Guillotin and Meurs, 1999). In Italy, public sector wage levels and wage adjustments are largely decided at the central level (Dell’Arima and Della Rocca, 1999).

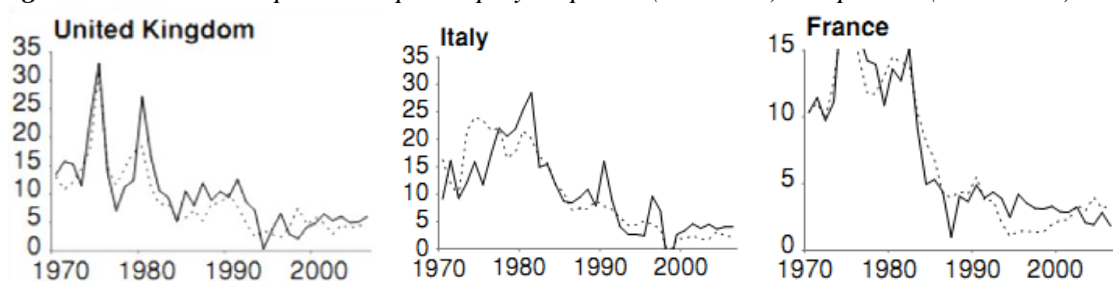
In Great Britain private sector pay is used as a reference point for pay determination in the public service, France and Italy lack any application of this comparability principle and

the reference is, in general, given by cost of living and public budget conditions (Lucifora & Meurs, 2006).

In the private sector, as opposed to the public, the degree of regulation is generally much lower in all countries. Italy and France, however, are still characterized by quite strict job protection measures, extensive coverage of collective agreements and a rather centralized system of pay determination. Conversely, in Great Britain pay determination is highly decentralized, unions are weaker and job protection is fairly low. As might be expected, pay inequality is greater and low pay employment is larger in Great Britain as compared to both.

Thus, the general finding for the UK, France and Italy is that, on average, public workers earn more than comparable workers in the private sector. The average differential for the UK is 2-5% for men and 15-18% for females. Evidence for Italy also suggests a relatively larger differential between the public and the private sector: 10% for men and higher for females (18–20%). Finally, in France too there is a public sector average wage positive premium.

Figure 3: *Nominal compensation per employee: public (solid line) and private (dotted line) sectors*



Source: (Lamo, P´erez & Schuknecht, 2011)

However, as was mentioned, given the differences in the distribution and dispersion of pay between the sectors, the standard approach based on the analysis of the conditional mean of the distribution has been criticized because of not giving a clear picture of the wage distribution differential. Hence the alternative methods to analyze pay differentials based on quantile regression better serve this purpose.

The main set of results from quantile regressions shows that the public sector pay, as was mentioned above for the developed countries generally, for the selected countries specifically declines along the wage distribution. In France, Great Britain and Italy low skilled public sector workers are paid higher wages with respect to their private sector counterparts, whilst the reverse is true for high skilled workers. Wage gap estimates suggest that females are better off being in the public sector, particularly at the lowest deciles, whilst the opposite is true for men at the highest deciles. In general, institutional differences in wage regulation seem to play an important role: in Italy and France, collective bargaining and union presence impose lower returns to productive characteristics and favor a more egalitarian wage structure based on observable characteristics which explain the largest part of the pay gap; conversely, in Great Britain, decentralization in wage setting and higher employer discretion in wage setting contribute to increasing pay dispersion as well as public - private wage differences (Lucifora & Meurs, 2006).

Developing Countries

I selected to discuss developed and developing countries separately because quite interestingly public-private wage relationship differs, or in fact is contrary in the two groups of countries. In the selected developing countries, like the other group, public sector employment is also of high importance for policy makers for at least two main reasons. Firstly, spending on earnings of employees in the public sector has a significant share in the overall government spending; secondly, the public sector is employer for a large number of wage earners (Ognjenović, 2011).

In developing countries, the public-private wage differential, as compared to the developed ones, is interestingly very often negative. It is also often quite large, with some estimated differentials over 500%. However, public sector jobs frequently have the

compensating differential of access to pensions, better working conditions, etc. The differentials are found to be quite variable over the years (Bender, 1998, p. 37).

In Russia, according to official quotes, there are 14.4 million employees, or about 22% of total employment, who receive their wages from the budgets of various levels. In the beginning of economic transition in 1992, real wages in the public sector dropped more dramatically than in the rest of economy. The same pattern of drastic fall was repeatedly observed after the 1994 and 1998 macro-shocks. By 1999, the real wage in the three major sub-sectors of the public sector made just one third of the 1991 level. However, the wage growth in the public sector has accelerated since that and by 2004 it has increased threefold compared to the 1999 level. Nevertheless, the inter-sectoral difference in the wage growth rates was not sufficient to compensate for the wage gaps that emerged earlier.

Underpayment of public sector workers relative to private sector workers with comparable characteristics sends feedback signals to the commercial sector stimulating wage containment. This drives all wages down in exchange for excessive employment.

The data for 2000 suggest that wages in the Russian public sector are on average 40% lower than in the private sector. In 2002, the wage gap contracted to 34% but later on it returned to the initial level. For the whole period under consideration, "the magnitude of the sectoral wage differential hardly changed in spite of regular increases in the minimum wage, which is the nominal anchor for public sector wages" (Gimpelson & Lukiyanova, 2009, p. 10).

Differences in earnings can vary depending on the level of experience, education and skill of a worker, and on the demand and supply conditions for various types of labor. The sectoral gap tends to diminish with workers' age reflecting the fact that wage ladders in the public sector are to a greater extent dependent on seniority and tenure. Larger negative differential is observed among the workers with lower education and skills as compared to

high-skilled workers. The public-private wage differentials are higher in urban as compared to rural areas. Premiums for employment in the private sector increase with the size of the settlement (Gimpelson & Lukiyanova, 2009).

In Ukraine too, taken as another developing country, many in the public sector earn “little more than the minimum wage” (Raiser, 2007, p. 2). Politicians are concerned that many public sector workers would find it difficult to make a decent living based on the salary they earn. This may prevent the public sector from attracting workers with the appropriate set of skills, and in turn make it more difficult to deliver improvements in the quality of public services. In several professional areas (teachers, doctors, senior administrative personnel) the public sector may not be able to pay enough to attract high skills, with negative impact on the quality of public services. While the private sector, including not only the bulk of industry but also financial and other market services, has recorded rapid wage growth that is justified by fast productivity growth that justifies; the same is not true in the public sector (Raiser, 2007).

ARMENIA: CIVIL SERVICE REMUNERATION

In the Republic of Armenia, public service is codified as a professional activity, which is directed at the implementation of the objectives and functions reserved to the state bodies by the legislation of the Republic of Armenia; state service includes Civil Service, Judicial Service, the special services, namely in the Republican Executive Bodies of Defense, National Security, Police, Tax, Customs, Emergencies, as well as Diplomatic and other Services envisaged by the laws.

Armenia’s civilian government totals roughly 185,000 individuals with an estimated 74,586 in central government and an additional 110,624 at sub-national levels (2006). The civil service – which comprises core white-collar administrative staff - is a small component of public sector employment: approximately 8,000 individuals.

Civil service remuneration system is regulated by the Law “On remuneration of civil servants.” According to article 7, 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 (e.g. in mountainous regions, hazardous or especially difficult work). The salary consists of 11 scales that correspond to the subgroups of the 4 position levels. Each scale encompasses 11 steps of around 3 %, the first 4 annually, the following 3 biannually and the last 3 triannually². A fixed structure 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.

Appropriate compensation, especially for civil servants, is a prominent concern in Armenia. To understand the pay level of civil servants of the RA, it will be discussed from two perspectives: 1) comparing the public and private sector remunerations and 2) comparing the public sector wages to the cost of living/price level of Armenia.

One start to investigating the comparability of public and private sector earnings might be to simply calculate the wage average for each sector using all occupations available in each sector (Belman, Franklin & Heywood, 1994). Thus, the findings suggest that the average base salary of the civil servants is 93.215AMD per month, with minimum base salary of 40,000AMD and the maximum base salary of 235,600AMD³.

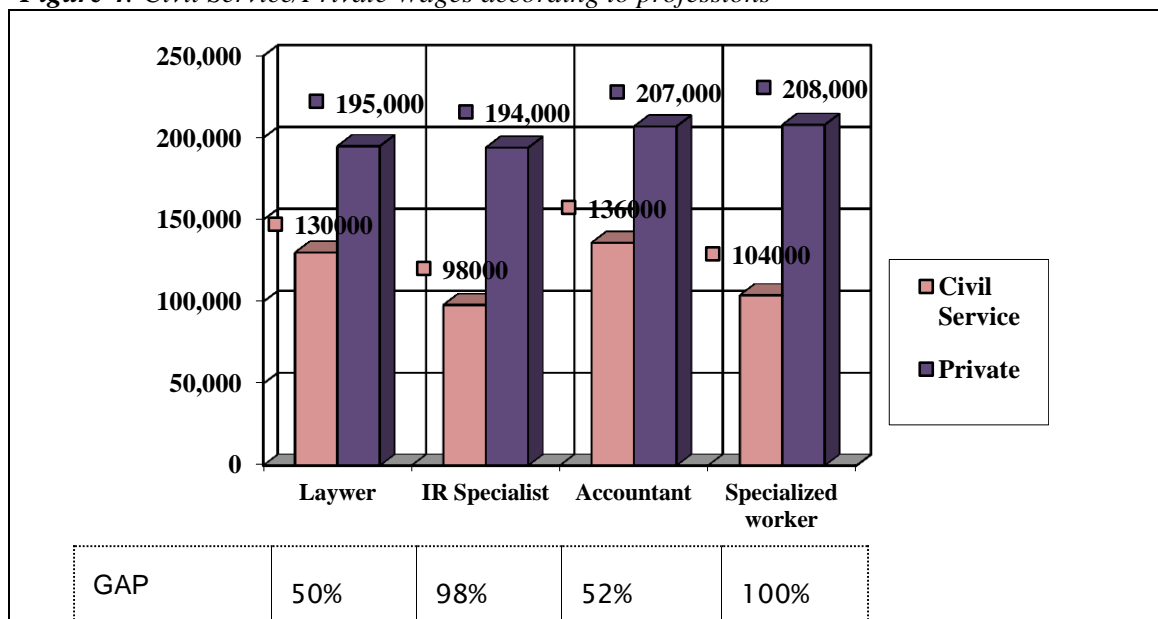
²Law on the Remuneration of Civil Servants with Amendments, 2011

³ This numbers don't include the base salaries in the Chamber of commerce or the Public Services Regulatory Commission as according to the Article 7 of the RA Law on Civil Service the maximum coefficient is 5.89 and the minimum base salaries in these 2 bodies is 111,000AMD. Thus the maximum base salary theoretically could be 5.89 times 111,000=653,790 AMD. Therefore remuneration of the civil servants who work at this 2 bodies changes the real picture of statistics of remuneration of civil servants working in other 44 state bodies.

According to National Statistical Service of the RA, 2011, the average wage rate of the private sector is 141,206 AMD. As is seen the average wage difference between public and private sectors is 66%.

For the purpose of comparing public/private wage rates, the average wage rates of several professions, namely that of the lawyer, international relations specialist, accountant, and specialized worker are selected and their average wage rates are compared.

Figure 4: Civil Service/Private Wages according to professions



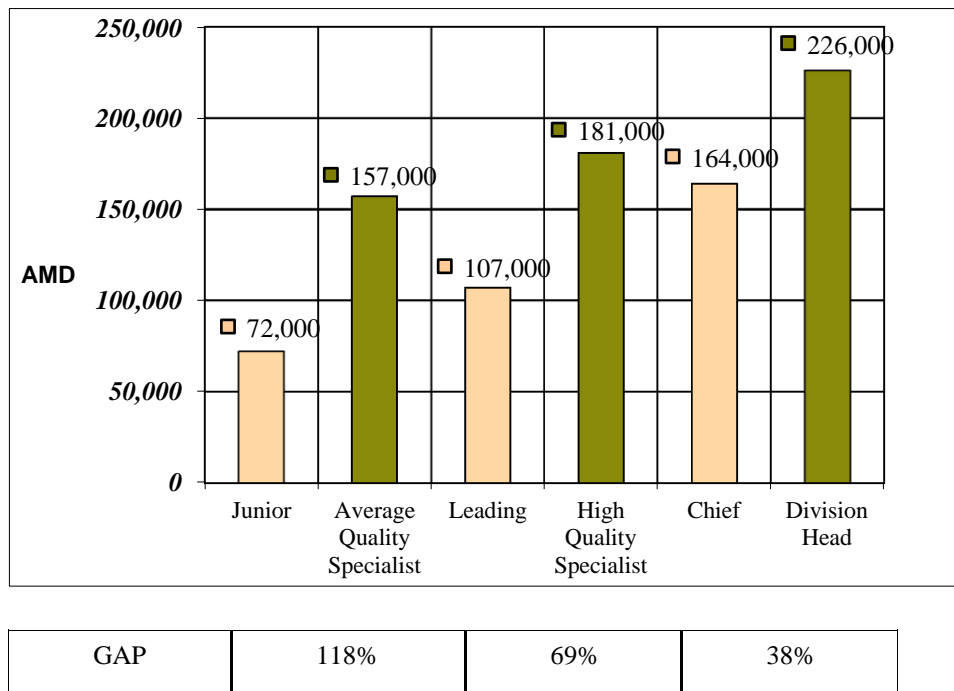
Data Source: Ministry of Finance Survey Research, 2011. National Institute of Labor and Social Research, 2010)

Comparing Civil Service professions' average pays with private salary average, it is observed that all the professions as compared to private counterparts' average salaries, are underpaid (see Fig. 1). It is worth noting the wage differentials between the selected professions is very high, 50 - 100%.

For the purposes of the research it is useful to compare the pay differences of Civil Service three positions to position groupings in the private sector. The reason for this is also the absence of a private market for some government occupations. Therefore, it is purposeful to compare the average pay rates of Junior, Leading and Chief Positions of Civil Service to

the average pays of private sector positions grouped as average quality specialist, high quality specialist and division head. According to the data of National Institute of Labor and Social Research the following are the average pays of the enlisted position groups:

Figure 5: *Civil Service/Private Wages according to professions*



Data Source: National Institute of Labor and Social Research, 2010

In the case of considering the wage rates of public and private sectors through position groupings, the results again convey that there is a huge gap between the sectors. In this variant of comparison it is interesting to note that as the position groups increase, the wage differential decreases. This observed pattern of Armenian Civil Service deviates from the one discussed for the selected developed countries, as in the latter public sector holds large advantage over the private sector for the initial stages of the working. Also, the wages of the public sector of the developed countries tend to diminish and even stay behind the private sector for mid-career workers. On the contrary, the wage differential of Armenian public/private wages tends to decrease across the higher levels of the career path.

The reason for this pattern can be the very low level of the base salary upon which the salary of the whole Civil Service is calculated. Another evidence for a very low base salary is

that additional salary has a substantial weight in the Civil Service average pay averaging 20,1%, that creates disproportionateness. Moreover, 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 job performance and be rewarded accordingly.

To find out what the civil servants think about the pay level they have, they were asked during the survey how much their professions are paid in the private sector. The respondents' indicated average wage rate for the same professions is about 300,170 AMD. To compare what they actually get, which is 115,785 AMD, to how much they think their professions are paid in the public sector, there is a huge gap of 261%. Evidently, it is perceived that the professions in Civil Service are paid less than the similar professions in the private sector. This finding suggests that the civil servants think of being paid about 2, 6 times less than their private counterparts, lack motivation to work hard and loyalty to the organization, become less productive. There is a constant shift of qualified specialists to the private sector, resulting into high turnover rates in the public sector that in the short run affects negatively on the output or performance of the public body, and in the long run, it is costly to recruit new employees.

Additionally, 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.

The low salary level may also create an environment of corrupt activities which will impact negatively the organization and weaken it overall. According to 2010 Armenia

Corruption Survey of Households by the Caucasus Research and Resource Center (CRRC) 82% of the respondents consider corruption a serious or very serious problem with the public sector of Armenia (CRRC, 2010, p. 15).

Thus, the fact that there is a significant difference in the salary levels of the public and private sectors giving a comparable advantage to the private sector also sheds light to the absence of the comparability principle as an accepted standards for setting wages of the public and private sectors of the Republic of Armenia. The absence of the comparability standard in its turn generates lack of efficiency, equity and productivity of public sector workers. Also, given the low level of wages the public sector will not be able to attract employees of good quality to the government.

As a final note it would be of interest to add that according to the survey of Human Resource Management Issues in European and Central Asian (ECA) Countries Armenia has the lowest General Government Wage Bill per Capita (the survey is conducted for 1996-2004 period) among the countries studied (Reid & Orac, 2004, p. 16). Moreover, Armenia continuously reduced an already quite modest wage bill, from a high of 3.7% in 1996 to the level of 1.7% of GDP in 2004.

Job Security

The notion that public employees are significantly undercompensated begs the question: if they are so underpaid, why would they agree to take government jobs when they could earn more by performing similar jobs in the private sector? This question cannot be answered univocally and there are different factors causing the situation. Foremost, unemployment is a real problem in Armenia; according to the CRRC data 69% of the respondents of the nation-wide survey identify unemployment as the most important problems facing Armenia. This fact implies that the employment opportunity is not high in the Armenian private sector,

making highly important the chances of not losing the job in the public sector despite the fact of low remuneration.

As research suggests, among the most important factors distinguishing public and private sectors are not only issues of remuneration, but also those of job security and status to which values cannot be easily ascribed. Many would agree that public jobs provide the security of lifetime employment that would unambiguously add a lot to the benefits of the public sector.

As the Global wage report 2011 by International Labor Office suggests the fact that public sector is a secure employer is true in most countries of the world and Armenia is not an exception. Worldwide, government job security is “famously, and sometimes notoriously, ironclad, often making it practically impossible to fire or lay off public-sector workers for the same reasons employees are terminated in the private sector,” even in cases of poor performance or unethical activity (Summers, 2010). This is also true for Armenia as the RA Law on Civil Service with the Civil Service Council defend the rights of the civil servants, especially in case of firing. This is true also for some other public services.

Also, country-specific data suggest that wages may have been more adversely affected in the private sector than in the public sector. According to calculations by the Public Services International Research Unit, based on Eurostat’s Labour Cost Index dataset, “nominal earnings in the public sector have risen faster – or fallen less – than earnings in the private sector in 11 out of 18 European countries for which data are available. The same is true in the United States, where, in the two-year period from March 2008 to March 2010, private sector workers were found to have experienced a slower rise in earnings than state and municipal workers” (ILO, 2011, p. 11).

The more robust nature of public sector wages is also linked to the higher level of unionization in the public sector than in the private sector. Thus, government employees’ labor unions are constantly pressuring legislators to increase workers’ wages and benefits,

and legislators are always creating or expanding government programs that may or may not be needed or effective. These pressures are “independent of economic constraints, and are limited only to the extent that taxpayers refuse to consent to tax increases.” This has allowed governments at all levels to continue to add employees even during the severe recession that has forced a significant contraction in the private sector (Summers, 2010).

Another attribute of public sector job security is the more complete enforcement of social guarantees in the public sector. Nearly all public sector workers report getting vacation payments, sickness payments and maternity leave allowances, while in the private sector these provisions are far from being universal. Higher fraction of public sector workers has access to free or subsidized health care, training, vouchers for vacation trips, etc. The recently adopted Social Package for civil servants in Armenia also adds social type of non-pecuniary benefits to civil service remuneration.

To sum up, monetary earnings are, reportedly, only part of the compensation package and overall appeal of a job. Less tangible factors such as job satisfaction and opportunities for career development, as well as benefits, employment stability and working hours are also important. What’s more, preferences towards the public sector are often motivated by risk aversion behavior at the labor market, i.e. unemployment fears and uncertainty about one’s chances to find a new job.

Civil Service Wage Rates and the Cost of Living

It seems at the outset that there is no particular correlation between changes in labor market rates and the cost of living as the two are based upon very different measures. “Market wages and their changes are based upon the supply and demand for labor which often changes without any consideration of the cost of living. The cost of living is a measure based upon the area’s cost of goods and services as surveyed by the government” (Atchison,

2010, p. 11). It is interesting to note, however, that the correlation between these two measures has recently been considered by researchers and analysts.

Besides, cost of living is emphasized by workers and their unions as a wage level consideration when it is rising rapidly. In such times, they pressure employers to adjust wages to compensate the rise. Wage pressures resulting from changes in the cost of living fluctuate with the rapidity with which living costs rise; however, price rises in most years have produced employee expectations of at least annual pay increases. To employees a satisfactory pay plan must reflect the effect of inflation on financial needs (Atchison, 2010).

The research showed that as compared to the private sector the public sector is underpaid. But what if the private sector is highly paid and the public sector though paying less than the private one, has a normal wage level for the living standards of the country. One of the goals of this research is also to consider the public sector average wage rate in comparison to the price level or cost of living of the Republic of Armenia.

To analyze the relation of wage level of Civil Servants to the cost of living of Armenia, a comparison should be carried out between the Civil Servants' actual average wages and how much they think they need to keep up with the living standards of RA. The findings yield that for sustaining the normal living of the family Civil Servants think they need 348,815 AMD. As compared to their average wage rate of 115,785 AMD, there is a difference of 201.5% of what people actually get and what they need to get to maintain normal living.

Whether Civil Servants can sustain their living with their monthly salary, 94.4% of the respondents answered that it is impossible to. To the question of what the respondents should do in that case, 53% found a solution in looking for a job in the private sector, 15.2% thought that getting a remittance from relatives abroad is a way out, 7.2% think that they should get along with low standards of living.

It is worth considering whether in case of increasing the Civil Servants' salaries by 100,000AMD, how much of that amount will be spent. 73.6% of the respondents answered that they would spend 90-100% of that amount. This finding suggests that even in the case of 100,000 pay raise, the majority of Civil Servants will not be able to save. The reason for this fact can both be the low level of public sector wages and the high price level in Armenia or can be the evidence that they hardly make ends meet, i.e. they really have shortage of money to spend.

In this case it is useful to observe whether it makes a difference for the Civil Servants if their salaries were indexed by the inflation rate. Quite interestingly, 51% of the respondents think that in general this will not change anything, 44% thinks that it will help but is not a solution. Thus, this finding illustrates that the wage rate in the public sector is perceived to be so low, or the average consumer basket is so high that even adjusted by the inflation rate doesn't make much difference to Civil Servants.

Another finding is that the civil servants' base salary (40,000AMD) is lower than the minimum consumer basket (55,327AMD), 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 it can be deducted that the Civil service is underpaid in comparison to the living standards of our country. The vast majority thinks that the Civil Servant cannot live with their monthly salary, and thus expects support from relatives, gets along with low living standards, or tries to find a job in the private sector.

Employee turnover rate is another important index revealing the effectiveness and dynamics of human resource management. High turnover rates are not desirable and may be harmful to the organization's productivity. According to the NILSR data of 2010 the turnover rate of the Civil Service is 9% as opposed to the 2% of the private sector (National Institute

of Labour and Social Research, 2010). Taking into consideration that the recruitment for a position in a civil service takes in average 1.5 to 3 months, it is implacable that high turnover rates are costly and as was said impact negatively on the personnel productivity and effectiveness.

As a brief summary, there is a clear illustration of the fact that the remuneration system is not constructed and run in a way 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 maintain skilled staff in the civil service and prompt to professional development.

CONCLUSION

When considering earnings in the public and private sectors, it should be considered that wage-setting decisions are different for these two sectors. On the one hand, the determination of earnings in the public sector is controlled by regulations that put limits on the wage bill through the budget constraints, while on the other hand wage setting in the private sector depends on productivity. Nevertheless, the standard of comparability serves as a bridge between the two sectors for setting or adjusting wages. The standard of comparability provides more certainty, precision and applicability to be referred to as a wage-setting method. Additionally, both equity and efficiency arguments require that public sector wages be comparable to those of similar workers performing similar tasks in the private sector. Otherwise, the former will not be able to recruit and maintain qualified and loyal personnel.

The comparability of wages between the public and private sectors in the developed countries is examined through two perspectives. The first perspective analyzed the average wages of the two sectors of the selected countries that revealed that the public sector is overcompensated than the private one. The second perspective looked at the wages of the two

sectors by dividing the wage distribution in both sectors into equal quantiles, thus enabling the comparison of different parts of the wage distribution. One common feature shared by most countries is that minimum rates of pay for least skilled workers are higher in the public sector. This is the result of a wider and more effective union presence as well as “fair” rates of pay offered by the State as “good employer” to the least skilled. Conversely, the rates paid to the most senior public servants have often been reported to be substantially lower than those paid to individuals with comparable skills and responsibility in the private sector: public opposition to high rates of pay for public servants seems to account for this feature.

The research also revealed that countries in transition demonstrate a different pattern of public and private wage relation; the private sector wages are higher than the public one. The sectoral gap tends to diminish with workers’ age and the gap is larger in urban rather than in rural areas.

Armenia is similar to the transition countries in the public-private wage relation. Considering the average wages of the two sectors, the civil service average is 68, 5% lower. The comparison between the same professions in both sectors reveals that the same professions are paid less in the civil service. Further comparison between the position groupings of the two sectors also reinstates civil service underpayment. The findings discover the absence of the comparability principle as an accepted standard for setting wages between the private and public sectors. The lack of comparability in its turn generates issue of efficiency, equity and productivity of public sector workers. As a result the civil servants work with less motivation and loyalty, there is a constant shift of qualified specialists to the private sector, the performance of the public sector is reduced.

As the research yields the public sector of RA is also underpaid in comparison to the country’s living standards. Public sector employees think they rightly deserve thrice more than what they actually get to sustain normal living. The vast majority of the respondents

think that the civil servants cannot live with their monthly salary, and thus expect support from relatives, get along with low living standards, or try to find a job in the private sector.

However, the public sector is considered a secure employer oftentimes providing the security of lifetime employment. Public sector wages are in nature more robust during economic-financial crises which affect directly on those of the private sector. Job security is the more complete because of the enforcement of social guarantees in the public sector.

POLICY RECOMMENDATIONS

- ❖ Emphasize the importance of incorporating the principle of comparability into setting the wage levels in the public service. Establish a special body that will conduct annual surveys comparing the compensation of the public and private sector employees, keep track of the wage differential between the two sectors, alarm and take measure if the wage differential between the two sectors grows into a gap.
- ❖ Provision support to the activities addressing increase of civil servants' competitiveness in the labor market and address the issue of competitive remuneration.
- ❖ Design and implement an affordable remuneration system with a base salary level matching at least the minimal consumer budget for every employee.
- ❖ Appraise the contribution of each employee through a system of pay based on contribution contributing to the promotion of motivation, healthy competition and loyalty to the organization. This system will foster efficiency and productivity in the public service.

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