The economics and politics of public sector pay and the crisis

By

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# Summary

This paper examines the effect of the economic crisis on public sector pay. It first sets out the different phases of the crisis and government responses, to distinguish different kind of effects and mechanisms.

It then examines the statistical and narrative evidence of changes to pay levels both overall and in the public sector since the start of the crisis. This evidence focuses on the USA and the EU, both because the effect of the crisis has been sharpest in these countries, and because relevant statistical data exists for these countries. Evidence from Asia and Africa is also examined, but the impact of the crisis has been much more limited and little data is available from these countries for this period.

The evidence shows that public sector pay has not been rising faster than pay levels in general since the crisis began, but that there have been policy decisions to cut public sector pay in some European countries, in the majority of cases where there is an agreement with the IMF, or where there is pressure from financial markets, or both. These have been associated with a weakening of the role of trade unions.

These results are then discussed against the context of results and analyses of earlier data, with a particular focus on a recent report for the European Central Bank. The current experience confirms previous findings and experience, including the potential impact of external institutions on public sector pay.

# Introduction: the crisis and government responses

The economic crisis has had a number of different phases. It is important to distinguish these because each phase differs in the actual, or expected, effect on relative or absolute levels of public sector pay.

## Phase 1: the financial crisis and recession

The global economic crisis which began in 2008 originated as a crisis in and of the financial sector. Banks and insurance companies expanded lending to people beyond what was sustainable. The price of assets like houses were inflated and used as a way of obtaining credit which could then not be paid out of income. Companies increased their borrowing as a way of paying earlier and larger returns to investors, expecting the capital gains from rising asset values to cover the repayment of debts. At the same time the banks developed increasingly complex forms of ‘securitising’ debt, so that the risk was apparently removed from the actual lenders and sold to financial institutions, through ‘credit default swaps’ and other new instruments, who were unaware of the actual risks.

Defaults began to occur, especially in ‘sub-prime’ mortgages, where people had been given bigger loans than their incomes could support. The scale of this sub-prime borrowing was a consequence of government policies which preferred to encourage home ownership rather than use public spending to provide social housing. The financial system was unable to deal with the cost of defaults, and many of the largest banks and insurance companies in the world became insolvent. After one USA bank, Lehmann Brothers, collapsed in September 2008, the USA and other governments decided to rescue banks by nationalising them, or injecting large amounts of capital to make them solvent again.

The crisis in the financial sector led to a crisis in the rest of the economy, globally, as the banks stopped lending to people and companies, and so the level of spending and consumption by the private sector fell. The lack of credit, and the fall in spending, led to companies cutting production and going bankrupt, both of which led to increased unemployment, and further reduction in consumption.

The recession has hit northern, high income countries harder than developing countries. The banking crisis was almost entirely confined to banks in the USA and Europe. Most developing countries resumed economic growth after a short slowdown or reversal. China in particular has resumed growing at an annual rate of nearly 10%.

## Phase 2: effects on government finances

Governments in countries whose banks were at the centre of the financial crisis, especially the USA and the UK, spent very large sums of money refinancing and nationalising banks which would otherwise have failed. These rescues increased government debt and deficits.

The recession had a general effect of reducing tax revenues, for all levels of government, in nearly all countries. As consumer spending falls, indirect tax revenues fall; as unemployment increases, the volume of taxes on incomes decrease; as bankrupcies rise and profits fall, income from taxes on profits falls; as homes and properties are repossessed, income from property taxes falls. In countries with a developed social security system, the recession also increased the payment of unemployment and other benefits and services. Both the fall in taxes and the rise in benefits increased government deficits.

This increase in government deficits had a beneficial effect of limiting the fall in consumption. It is known as the ‘automatic stabiliser’. In addition to the automatic stabilisers, nearly all governments decided to counter the recession by using Keynesian policies. This involved creating extra demand by expanding government spending and/or reducing taxation, thus deliberately increasing government deficits. The increased deficits were essential to create extra demand – if increased spending was matched by increased taxation, then governments would be reducing private spending power by the same amount, thus having no impact on the overall level of demand.

In countries where the banking sector was proportionately large, the crisis itself had a particularly acute effect on public finances – for example Ireland and Iceland. Where external borrowing or trade deficits were particularly high, there was also additional pressure on public finances, for example in Latvia, Romania, Hungary and Ukraine. Beyond Europe, Pakistan also fell into this category. In all these cases, governments were given support by the IMF.

## Phase 3: market and political pressures on government deficits

In 2010, some investors began selling bonds issued by European countries. Initially this focussed on Greece, and then other southern European countries, including Portugal and Spain. These countries were criticised for the level of their government deficits and debt, although other countries had larger deficit and debt levels. These market pressures themselves increased the cost of government finance, and questioned the ability of other European governments to finance the deficits which had increased because of the crisis itself. Greece required support from the EU and an IMF loan.

This process strengthened political pressures within countries, the EU, and from international institutions, to reduce government debt and deficits, and to reinstate the political constraints of the last 20 years on fiscal deficits, mainly by cutting public spending. The EU also sought to restore the credibility of its rules which limit government deficits to 3% of GDP. By June 2010 all major international institutions – the G20, the IMF, the OECD and the EU – were calling for a reduction in public deficits and spending as a greater priority than economic stimulus to counter recession. Financial support from the IMF has been conditional on reductions in public deficits and public spending.

## Effects of different phases

As this narrative makes clear, the crisis itself did not originate in any sense from excessive government debt, borrowing, or spending. It arose from the inability of the financial system to deal with the consequences of the expansion of private and corporate debt and the basis on which it had been financed. The increases in debt and deficits arose from government action to mitigate the consequences of the crisis, both to finance the capital injected into the banks, and to create demand to counter the recession. Governments became lenders and spenders of last resort for the whole economy: higher government deficits and debt have been partly a consequence of the crisis, and partly a deliberate policy solution to the crisis, not the cause of the problems.

The following sections look at the evidence concerning comparative movements in public and private sector pay since the start of the crisis. A broad definition of public sector is used, including health and education services and publicly owned utilities. Data is drawn from official statistics published by relevant governments or international institutions, covering how earnings changed in the economy as a whole, and in predominantly public sectors, principally for the USA and European countries, in the 2-year period between early 2008 and early 2010. Reports of policy decisions on public sector pay are also used to identify crisis-related decisions.

The discussion of this data considers the possible impact of the crisis through economic mechanisms – for example through reduced demand, or through the automatic adjustment of public finances - and through political and institutional mechanisms, such as policy decisions, to create economic stimulus or to reduce deficits and spending.

# USA

## Government policy on spending and services

### National/federal level

In February 2009 the government introduced a massive stimulus package worth $787billion. This stimulus has supported employment throughout the economy through higher spending on benefits, infrastructure and support for state and local services, up to and including 2011. Details of the money and jobs supported in each state are on maps at <http://www.recovery.gov/Transparency/MapGallery/Pages/maps.aspx#z>.

However, the additional public spending in the stimulus is not being extended, due to political opposition by Republicans. The Republicans have also delayed authorising the deficit necessary for the USA government to continue its spending commitments in 2011, including the payment of civil servants’ salaries. For the same political reasons, the tax cuts introduced by the previous president Bush will be extended and made permanent – worsening the deficit by over 1% of GDP per year, without improving the money available for public services.

This is now jeopardising economic recovery: even the IMF warned in June 2011 that the USA recovery is so ‘tepid’ that reducing the deficit “should ideally be gradual and sustained, so as not to undermine growth prospects” ; this should include “revenue-raising tax reform", but "social sector spending and priority infrastructure investment must be preserved”.

If by contrast the Bush tax cuts were allowed to expire, then a return to economic growth would automatically boost tax revenues to increasingly higher levels. This would in turn match the rising public spending on old age pensions and healthcare which is forecast because of the relative ageing of the population. The chart shows how the current deficit could then be gradually eliminated by growth by about 2015, and then both spending and taxation could return to a long-term, rising but sustainable path (based on the assumption that military spending is gradually reduced over this period).

1. USA federal Government spending and revenues, if Bush tax cuts expire



Source: CBO [2011 Long-Term Budget Outlook](http://www.cbo.gov/doc.cfm?index=12212)

### State level

The recession has meant a drop in spending and incomes, which results in a fall in tax revenues for the states – at the same time as the needs for public service support increases. So when their revenue from taxes falls because of the recession. All states (except Vermont) are bound by law to have ‘balanced budgets’, so they have to rely on federal government to provide extra support to bridge the funding gap. The federal government stimulus provided about $158billion dollars to help states between 2009 and 2011, but this still only covered about 1/3 of their ‘funding gap’. The result has been a fall in spending on services: “states cut funding for services by 4.2% for fiscal year 2009 and an additional 6.8% for 2010… state spending for 2011 will remain 7.6% below 2008 levels.” (CBPP Feb 2011). The real effect on people is even greater, because the need for social services increases during a recession.

For 2012, the stimulus is not being extended. As a result, despite some recovery in tax revenues, states still face a shortfall of $97billion in 2012, so additional cuts are being made. These cuts are made worse where there is political insistence on tax cuts. In June 2011, for example, the largest state, California, agreed on a budget for 2011-2012 which included $15billion cuts in spending across all services: Republicans refused to agree to the extension of state tax increases which would have provided an extra $11.2billion and saved most of the cuts. [[1]](#endnote-1)

1. Falling spending by states in USA on public services



Source: NGA/NASBO May 2011 [Spring 2011 Fiscal Survey of States](http://www.nga.org/files/live/sites/NGA/files/pdf/FSS1106.PDF)

## USA: statistical evidence on pay

The tables below set out data on changes in wages and salaries in the USA, drawn from the USA Bureau of Labor Statistics. They present public and private sector data, but also information on industrial sub-sectors of each category, such as educational and health workers; and additionally, for union and non-union workers in the private sector. They thus show not only the relative movements in public and private sector pay, but also if factors such as sector or unionisation affect pay trends.

The tables show a number of points about the background and trends over the 7 years preceding the crisis.

1. There had been no major divergence in public and private sector pay in the last decade as a whole. There is thus no recently created gap that is due for correction, in either direction. Overall, workers in public and private sectors experienced almost identical increases in pay in the seven year period between 2001 and 2008. This is also broadly true over the 2 year and 5 year periods before the recession (back to 2006 and 2003).
2. There were however differences linked to sector and unionisation
	1. There were variations between sub-sectors over this 7-year period. The pay of workers in manufacturing grew slightly slower than average, while the pay of workers in financial services, and in health and education, grew faster than average.
	2. There was also a variation between (i) the experience of union members and others: unionised workers in the private sector experienced somewhat slower rises than non-union workers between 2005 and 2008, and (ii) private sector workers in education and health, who experienced faster rises than others between 2003 and 2006.

The tables also show a number of points about the 3-year period since the recession (between the first quarter of 2008 and the first quarter of 2011).

1. There have not been, on average, real cuts in earnings since the recession. Neither public nor private sector pay has fallen in real terms between March 2008 and March 2011: there were rather real increases in pay, overall, in both public and private sectors, and in all sub-sectors, even financial services. While the recession has led to much greater unemployment, there has not been the same impact on wages and salaries.
2. In the 3 year period of the crisis, private sector workers as a whole experienced a slower rise in earnings - about 5.2% - than state and municipal workers – about 5.8%. There were again differences and similarities in respect of sector and unionisation.
	1. Within the private sector, workers in utilities experienced larger rises than other private sector workers, and larger than the rise in the public sector.
	2. The rise for education and health workers in the private sector, 5.6%, is similar to the rise for education and health workers in the public sector, 5.9%.
	3. Within the private sector, unionised workers experienced a 7.7% rise, compared with a 4.9% rise for non-union workers.

The second table presents indices of ‘total compensation’ including benefits, of which the most important in the USA is healthcare benefits. It shows that:

1. For all categories of workers, these benefits were rising faster than pay alone in the 7 years before the crisis, and have continued to rise faster during the crisis.
2. Public sector workers as a whole have enjoyed a clear advantage over the previous 7 years, and have continued to do so since the start of the crisis. Once again, there are differences associated with unionisation and sector:
	1. Unionised workers in the private sector have a clear advantage over non-union workers from 2001-2008, and this differential is much sharper since 2008.
	2. private sector workers in utilities have gained an even greater advantage when benefits are included, as compared with pay

The differences between public and private sectors are clearly strongly linked to the relative levels of unionisation. The public sector is much more highly unionised than the private sector – 37.4% compared with 7.2%, in 2009, a difference which has become more acute since the crisis started. [[2]](#endnote-2) The effect of unionisation is strengthened in the USA, as union workers’ pay is governed by legally binding collective agreements which cannot be broken until they expire, whereas employers can change non-union employees’ pay more quickly. One would therefore expect unionised workers pay to grow faster, or fall less rapidly, in a recession. Benefits are also likely to be greater under collective agreements.

There are also sectoral factors. In education and health pay in both public and private sectors rises more than average, both before and after the crisis, as does that of utility workers (in the USA, principally in the private sector) and public administration workers (in the public sector). In the financial sector, before the crisis, earnings grew 15% faster than the private sector overall: since the crisis it has kept pace with other workers.[[3]](#endnote-3)

1. USA: wages and salaries – all, private, union/non-union, public, selected sectors.

|  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- |
| Workers |   | March 2001 | March 2008 | March 2011 | %Rise March 2001-March 2008 | %Rise March 2008-march 2011 | real % rise March 2008-March 2011 |
| All civilian |   | 87.6 | 107.6 | 113.4 | 22.8% | 5.4% | 0.9% |
| Private sector | All | 87.6 | 107.6 | 113.2 | 22.8% | 5.2% | 0.7% |
|   | Union  | 86.5 | 105.5 | 113.6 | 22.0% | 7.7% | 3.0% |
|   | Non-union | 87.7 | 107.9 | 113.2 | 23.0% | 4.9% | 0.4% |
|   | Manufacturing | 88.2 | 105.9 | 111.4 | 20.1% | 5.2% | 0.7% |
|   | Financial services  | 84.9 | 107.2 | 113.0 | 26.3% | 5.4% | 0.9% |
|   | Education and health | 85.6 | 108.6 | 114.7 | 26.9% | 5.6% | 1.1% |
|   | Utilities |   | 108.0 | 116.9 |   | 8.2% | 3.6% |
| State and local government | All | 87.6 | 107.8 | 114.1 | 23.1% | 5.8% | 1.3% |
|   | Education and health | n/a | 107.6 | 113.9 |   | 5.9% | 1.3% |
|   | Public administration | n/a | 108.1 | 114.3 |   | 5.7% | 1.2% |
| *Memo: price inflation*  | *March 2008- march 2011* |  |  |  |  | *4.50%* |  |

Source: USA BLS 2011 . Employment Cost Index Historical Listing Current-dollar March 2001 – March 2011 (December 2005=100) <http://www.bls.gov/web/eci/echistrynaics.pdf> Table 2. Employment Cost Index for wages and salaries, by occupational group and industry (Seasonally adjusted); inflation rate from US consumer price index <http://www.usinflationcalculator.com/inflation/consumer-price-index-and-annual-percent-changes-from-1913-to-2008/>

1. USA: index of total compensation, including healthcare and other benefits

|  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- |
|   |   | March 2001 | March 2008 | March 2011 | %Rise March 2001-march 2008 | %Rise March 2008-march 2011 | real % rise March 2008-March 2011 |
| All civilian |   | 84.7 | 107.6 | 114.0 | 27.0% | 5.9% | 1.4% |
| Private sector | All | 85.0 | 107.2 | 113.3 | 26.1% | 5.7% | 1.1% |
|   | Union  | 82.0 | 105.9 | 115.6 | 29.1% | 9.2% | 4.5% |
|   | Non-union | 85.5 | 107.5 | 113.0 | 25.7% | 5.1% | 0.6% |
|   | Education and health | 83.8 | 108.6 | 115.1 | 29.6% | 6.0% | 1.4% |
|   | Utilities |   | 106.5 | 119.4 |   | 12.1% | 7.3% |
| State and local government | All | 83.6 | 109.0 | 116.7 | 30.4% | 7.1% | 2.5% |
|   | Education and health | n/a | 108.7 | 116.1 |   | 6.8% | 2.2% |
|   | Public administration | n/a | 109.6 | 117.4 |   | 7.1% | 2.5% |
| *Memo: price inflation*  | *March 2008- march 2011* |  |  |  |  | *4.50%* |  |

Source: USA BLS 2011 . Employment Cost Index Historical Listing Current-dollar March 2001 – March 2011 (December 2005=100) <http://www.bls.gov/web/eci/echistrynaics.pdf> Table 1. Employment Cost Index for total compensation1, by occupational group and industry —; Table 6. Employment Cost Index for total compensation1, for private industry workers, by bargaining status, census region and division, and metropolitan area status (Not seasonally adjusted)

## USA: pay cuts, renegotiations, pensions and union rights

As in other countries, public employees in the USA are mostly paid less than their counterparts in the private sector in similar jobs, but there are political campaigns to cut public sector salaries, as well as the real pressure of the recession.

The USA federal government continued in 2009 and 2010 to increase the pay of federal employees in line with the 1990 law on comparability. In 2010, this process resulted in a pay increase of 1.5%. [[4]](#endnote-4) Finally in December 2010 President Obama announced a 2-year freeze on the pay of nearly all 2 million federal civil servants. Republicans are calling for further cuts in pay and jobs.

State, county and municipal levels of government have experienced financial problems of reduced revenues, at least partly as a result of the crisis, and some have responded by proposing to freeze or reduce workers’ pay. At least 28 states have cut pay and conditions in various ways. One method, used by more than half the states, has been compulsory unpaid leave , known as ‘furloughs’: 250,000 workers were subject to this arbitrary layoff in New York and California alone.

At this point, the degree of unionisation becomes significant. Where unions have negotiated labor contracts, which are legally binding collective agreements covering a number of years, states may be able to impose cuts for non-union employees, but the unilateral imposition of such cuts is not possible for unionised employees covered by such agreements. Thus in Nebraska, “About 2,900 non-union state employees will have their pay frozen for the 2010-2011 fiscal year…..The Republican governor is also asking the union representing about 11,000 Nebraska state workers to reconsider a pay freeze for union employees.”[[5]](#endnote-5) In San Jose, California, public transport workers were awarded a 3% pay increase in June 2010, in line with the collective agreement.[[6]](#endnote-6)

When labor contracts expire, however, new agreements have to be negotiated, and since 2008 unions have sometimes been settling for very low or zero pay increases. The stated reason for these settlements is to protect jobs. In Akron Ohio, where a new pay agreement the was due for renegotiation, the union AFSCME agreed a new 3-year deal including a pay freeze for 2 years, the deferral of seniority increments, and 4 unpaid days leave per year- as well as the introduction of monthly contributions for the health insurance which had previously been free. [[7]](#endnote-7) In San Bernardino, California, the teachers union agreed to a pay cut of nearly 2%. [[8]](#endnote-8) In New York the mayor sought to anticipate the outcome of negotiations on a new pay agreement for teachers by announcing a 2-year pay freeze.[[9]](#endnote-9)

Such negotiation of temporary pay freezes has happened previously, and been followed by pay increases linked to fiscal results.. In Delaware, state employees pay was cut by 2.5% in 2009, but this was restored in 2010 as tax revenues were higher than forecast.[[10]](#endnote-10) In Virginia, state employees agreed a pay freeze since 2006 in the context of a deficit: in 2010, as the state moved into surplus, the employees became entitled to a 3% bonus.[[11]](#endnote-11) In the Bay area of California, the transport workers’ union has agreed such freezes on two previous occasions: “In 1992, at the request of the AC Transit District, front-line workers accepted a two-year wage freeze to meet another budget crisis. In 2004, we saved the district up to $3 million by again freezing wages, this time in exchange for improvements to workers' retirement benefits.” [[12]](#endnote-12) US unions have negotiated many such deals in the public sector at times of crisis, as far back as the crisis in New York City in the 1970s)

In all these individual cases, the reported driving force is the effect of the crisis on government tax revenues, not a ‘knock-on’ labour market effect.

*This pattern confirms the findings of an earlier study of local government pay in the USA, which found widespread fiscal constraints*

Pension funds for state and municipal employees have deficits which are a result of the recession or past underfunding by employers, which can be dealt with by long-term solutions over many years. But in some states these deficits have been used as an excuse to cut the pensions of public employees or increase their contributions: in the first nine months of 2010 alone, 19 states implemented such cuts. In Illinois, proposals to impose big increases for pensions and healthcare benefits were abandoned in June 2011, after a state-wide campaign generated tens of thousands of phone calls and letters to elected legislators. In June 2011 the federal government was also reported to be considering increasing the pension contributions of federal civil servants.

### Union bargaining rights

In Wisconsin, Ohio and a few other states, right-wing republicans have used the crisis as an excuse for removing union collective bargaining rights. The governor of Wisconsin, Scott Walker, introduced a budget in 2011 which removes the right of collective bargaining from nearly all state employees, and imposed extra pension contributions equivalent to a 8% pay cut. Since February the unions in Wisconsin waged a lengthy campaign, including demonstrations, legal challenges and political campaigns, which won a remarkable level of public support. Tens of thousands of people have attended demonstrations supporting the right to collective bargaining, with students in particular actively maintaining a camp outside the state legislature. Most public opinion polls show a majority of people oppose what the republicans are doing. Unions from all over the world have sent messages of support.

Ohio has introduced similar legislation to remove or restrict the bargaining right, and the right to strike, of state employees, but a campaign to submit it to a referendum has been supported by over 700,000 signatures – 3 times the number required – so the law may yet be rejected by voters in November 2011.[[13]](#endnote-13)

## USA: public sector jobs

At federal level, where there are just over 2million civil servants, there has been no formal cut or freeze in recruitment. However, the expected growth in civil service is not producing many new vacancies. At state level, loss of tax revenues due to the recession has meant that states still faced a ‘funding gap’ even after the stimulus package money. There were some tax increases in some states, but nearly all have reduced spending on services.

As a result, the number of people employed by state and local governments in the USA fell by 535,000 from August 2008 to May 2011. For example, New Jersey and Tennessee have each cut 2000 jobs through early retirements and layoffs; the state of Washington is cutting 4,000 jobs as the result of a recruitment freeze. Cuts in 2012 could lead to the loss of a further 650,000 jobs unless federal government support is continued.

The charts below show this decline, and show the clear difference between the level of jobs in federal government – which were able to continue growing as a result of the stimulus package, which itself was possible because of the freedom to adopt Keynesian deficit-financing to maintain demand – and the falls in state and municipal employment (a much larger part of the public sector in the USA), where such deficit-financing is illegal.

1. Employment in government in USA June 2007-December 2010



Source: BLS 2011 Employment loss and the 2007–09 recession: an overview <http://www.bls.gov/opub/mlr/2011/04/art1full.pdf>

1. Decline in state and municipal jobs



These job trends are not related to demand for services – in a recession, demand for public services increases.

These trends are now have a demonstrable negative effect on economic recovery in the USA. The June 2011 employment figures showed a rise of 57,000 jobs in the private sector in the previous month, offset by a proportionately sharper fall in public sector jobs. The private sector employed nearly 1.7 million extra people compared with 12 months earlier, but in that period the public sector had shed nearly 660,000 jobs, thus offsetting about 40% of the job gains in the private sector.

1. Job changes in USA June 2010-June 2011 (thousands) (seasonally adjusted)

|  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- |
|  | June 2010 | May 2011 | June 2011 | % change annual | Nos. Change annual | Nos. Change month |
| Private sector | 107,258 | 108,896 | 108,953 | +1.6% | 1,695 | +57 |
| Government | 22,723 | 22,103 | 22,064 | -2.9% | -659 | -39 |

Source: BLS July 2011 Employees on nonfarm payrolls by industry sector and selected industry detail <http://www.bls.gov/news.release/empsit.t17.htm>

## Impact on public services

### Healthcare

President Obama succeeded in introducing some improvements in public spending on healthcare in the USA, but with little expansion of public sector services. In 2011 the Republican party opposition are attempting to cut federal spending on healthcare.

The pressure on states and local government has already led to cuts various healthcare programs in over 31 states. For example:

* California cut nearly all funding for services for HIV/AIDS patients, the state’s domestic violence shelter program and maternal, child, and adolescent health programs. It also cut funding for the medical needs of the poorest: according to CBPP “to make up for the lost funds, the nearly 1 million children in the program will have to pay more for visits to health care providers, and many will have to pay higher premiums as well.”
* Massachusetts cut HIV/AIDS prevention programs and cut support for dental care for 700,000 people on low incomes.

### Pensions

In the USA old age pensions are part of the social security programme, funded by social insurance contributions. Under laws passed in 1983, the retirement age is being gradually increased from 65 to 67. As of June 2011, social security benefits have not been reduced, but social insurance contributions have been cut to provide ‘tax breaks’ for workers and employers. There is now growing pressure to cut pensions too, by measures such as raising retirement age, cutting benefits.

### Other services

States have also cut other services, including services to the elderly and disabled , education, and higher education. Examples include:

* Arizona “eliminated a host of behavioral health services for 4,000 children ineligible to receive such services through Medicaid, and has also cut case management, therapy, and transportation services for 14,500 individuals participating in a non-Medicaid program for the seriously mentally ill.”, according to CBPP.
* Michigan froze enrollment for long term care and supports to help the developmentally disabled avoid institutionalization, so 300 people were instead placed on a waiting list.
* Hawaii cut the school year by 17 days and laid teachers off without pay for those days.
* Virginia saved $500 million by cutting 13,000 support staff such as janitors, school nurses, and school psychologists
* The South Carolina Department of Juvenile Justice has lost almost one-fourth of its state funding, resulting in over 260 layoffs and the closing of five group homes, two dormitories, and 25 after-school programs.[[14]](#endnote-14)

## Privatisation

Privatisation has not been a major part of the cuts programmes, but there is a constant threat of contracting-out of services like garbage collection. One city in California dismissed all its 100 employees and contracted-out all services in 2010. In Ohio, the state budget includes privatisation of 5 prisons and a major toll road. Unions succeeded in preventing the threat of privatisation of the service in Memphis, Tennessee, where Martin Luther King was assassinated in 1968 while supporting garbage workers on strike for safer working conditions.[[15]](#endnote-15)

# Europe

## Europe: pay rises in public and private sector in the recession

The table below sets out data for European countries on the changes in wages and salaries costs for the public and private sectors, from data of Eurostat, the EU statistics agency.

The pay increases in each sector have been calculated from Eurostat data on wages and salaries. Data is incomplete for a number of countries: the table includes only the 20countries with data covering the whole of the public/private sectors, as defined above, for both 2008 Q1 and 2011 Q1 (except for the Netherlands, where data covers a period one quarter earlier i.e 2007Q4 to 2010Q4).

The money pay increases have then been adjusted for inflation using the average annual rises for 2008, 2009, and 2010 in the Eurostat harmonised consumer price index data. This removes the wide variations in money pay rises due to varying levels of inflation, and so enables meaningful comparison of cross-country data.

The private sector is defined as Eurostat’s ‘business economy’ (B-N in the NACE2 classification), which includes the whole of sectors from mining to administrative services, including all utilities such as electricity and telecoms. The public sector is defined as public administration, education, healthcare and others (NACE2 codes O-S). This is a rough approximation of the boundary of the public sector, and ignores the overlaps of public and private ownership in different sectors e.g. the electricity sector is assigned entirely to the ‘business economy’, and ‘health’ entirely to the public sector, although there are both public and private employers in these sectors in most European countries.

1. Change in real wages and salaries, Europe, 2008Q1-2011Q1

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
|  | Business sector | Public sector | Public sector differential | IMF programme in 2008 or 2009  |
| Bulgaria | 21.8% | 14.1% | -7.7% |  |
| Cyprus | 0.7% | 2.9% | 2.2% |  |
| Czech Republic | 2.2% | 4.4% | 2.2% |  |
| Estonia | -12.3% | -12.2% | 0.1% |  |
| France | 1.3% | 1.6% | 0.3% |  |
| Germany | 1.5% | 1.9% | 0.4% |  |
| Greece | -6.7% | -17.2% | -10.5% | 2009 |
| Hungary | -0.9% | -21.2% | -20.3% | 2008 |
| Latvia | -13.1% | -26.8% | -13.7% | 2008 |
| Lithuania | -21.6% | -17.8% | 3.9% |  |
| Luxembourg | 3.5% | 3.7% | 0.2% |  |
| Malta | -5.3% | -7.5% | -2.1% |  |
| Netherlands\*q4 | 0.0% | 4.0% | 3.9% |  |
| Poland | 0.9% | 7.2% | 6.2% |  |
| Portugal | 1.4% | -5.0% | -6.4% |  |
| Romania | 8.9% | -25.1% | -34.0% | 2009 |
| Slovakia | 3.4% | 8.1% | 4.7% |  |
| Slovenia | 5.9% | 6.0% | 0.1% |  |
| Spain | 2.8% | -2.5% | -5.3% |  |
| United Kingdom | -7.7% | -6.6% | 1.1% |  |

Sources: Eurostat Labour Cost Index - Wages and salaries – quarterly data - Seasonally adjusted and adjusted data by working days - Index, 2008=100 NACE 2.0 sector classifications (lc\_lci\_r2\_q). Downloaded 07-07-11 <http://epp.eurostat.ec.europa.eu/portal/page/portal/labour_market/labour_costs/database> ;

Eurostat Harmonized Indices of Consumer Prices (HICP) HICP - all items - annual average inflation rate 2008,2009,2010 Downloaded 07-07-11 <http://epp.eurostat.ec.europa.eu/tgm/table.do?tab=table&init=1&plugin=1&language=en&pcode=tsieb060> ; and PSIRU calculations

The table below shows the resulting real pay increases for the business and public sectors, and the third column shows the ‘difference between the two figures. There are a number of striking features in these differentials. Firstly, there is a strong clustering around zero – in 5 countries out of 20, including two of the large economies, Germany and France, the difference is actually less than 1 percentage point; in another 4, including the UK, the difference is less than 2.5 percentage points. Secondly, there are two countries where the public sector has more than 4 percentage points advantage over the Business sector – Slovakia and Poland – and three countries where the Business sector did better by between 5 and 8 percentage points: Spain, Portugal and Bulgaria. Thirdly, there are four ‘outlying’ countries where the Public sector has fallen more than 10 percentage points behind: Greece, Latvia, Hungary and Romania. These four countries were all subject to the conditions of IMF programmes for much of this period, and the only countries in the table which were subject to IMF programmes during the period (the IMF programme for Portugal was not applied until 2011).

The graphs show these aspects visually, with a strong clustering around a trend line, and four marked outliers well below this line. The second graph omits the four outlying countries, and shows the very strong trendline passing through zero and almost exactly balanced at 45 degrees.

The position of the outliers can be interpreted as showing the potentially dramatic effect of political action by an institution, in this case the IMF, as The 3 countries with the next largest gaps may also be considered to have been influenced by the possibility of an IMF programme: Bulgaria, Portugal and Spain.

1. Real wage increases business vs. public sector

2008Q1-2011Q1 (20 EU countries)

1. Real wage increases business vs. public sector (excluding IMF countries)

2008Q1-2011Q1 (16 EU countries)

Sources: see Table

## EIRO: agreed increases

Further data comes from the EIRO survey of collective agreements in the EU in 2009. This shows that, for the whole economy, the average nominal increase agreed was 4.2% in 2009, Although this was a fall from a level of 5.0% in 2008, it represented a higher level of increase in real pay rates, of 2.9% compared with a rise of only 0.5% on real terms in 2008. This was consistent across all countries: except for Norway, real increases were higher in 2009 than 2008. The EIRO data for 2009 excludes Ireland, Estonia, Latvia, Lithuania – which would be expected to have a downward effect on the figures – but also Bulgaria, which would have had an upward effect, and France.

Data on earnings, taken from national sources, shows a much lower average nominal rise of only 1.8% in 2009. In some countries – Lithuania, Latvia, Estonia, Ireland, and, slightly, Germany, there was a fall in nominal average earnings. This is far below the average rise in earnings of 8.5% in 2008, and means that earnings are growing more slowly than agreed rises, for the first time in some years. As EIRO comments, this is consistent with a growth in short-time working and similar measures to reduce the effects on employment..

EIRO also examines sector specific agreements in retail, chemicals and for civil servants. The increases agreed in 2009 for civil servants were the lowest of the three sectors, at an average nominal increase of 2.9%, 1.3% below the average for all agreements (they had also been below average in 2008). In some cases there were explicit pay freezes for government workers, including Belgium, Bulgaria, Estonia, Hungary, Greece, Ireland and Slovenia (and Latvia and Lithuania were not included in the data). EIRO does not compare earnings figures for civil servants, but notes that the further measures taken in countries such as Hungary and Ireland to cut bonuses and other elements of earnings.

1. Pay increases in collective agreements in EU (27 countries)

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
|  | 2008 |  | 2009 |  |
|  | Nominal increase % | Real increase % | Nominal increase % | Real increase % |
| All sectors | 5.0 | 0.5 | 4.2 | 2.9 |
| Civil servants | 4.2 |  | 2.9 |  |

Source: EIRO Pay developments – 2009 <http://www.eurofound.europa.eu/eiro/studies/tn1004029s/tn1004029s.htm>

EIRO comments that the recession “was undoubtedly a factor” in the 0.8 percentage point fall in agreed nominal pay increases in the whole economy, but it is not clear how this fits with a significantly higher level of settlement in real terms. It then adds that “there was generally no simple correlation between the severity of the recession and the degree of pay moderation, with agreed increases falling back only slightly in some countries suffering protracted and deep downturns, such as Hungary and Spain.”

A further EIRO study on working time confirms the importance of reduced working time as a way of limiting redundancies caused by falling demand. [[16]](#endnote-16) Average actual hours worked in the EU in the 4th quarter of 2009 were 39.3, a fall of 0.3 in the year since the 4th quarter of 2008. This use of short-time working relies on state subsidies to maintain workers’ income, and is implemented by negotiation with unions:

“The most prominent working time issue in 2009 was undoubtedly the use of short-time work as a means of responding to falling demand during the recession and preventing redundancies, usually relying on state-subsidised schemes that compensate employees for part of their loss of earnings resulting from reduced working hours. Short-time work was used extensively in most countries, and was an issue for collective bargaining in many cases, sometimes at national intersectoral level (as in France and Poland) or sectoral level (for example, in the Swedish manufacturing industry, or a number of German industries, such as metalworking), but mainly at company level (as, for example, in Belgium, the Czech Republic, Denmark, Germany, Italy and Sweden).” [[17]](#endnote-17)

## Europe: employment in private and public sectors

The overall picture in Europe is set out in the table below. The Eurostat quarterly data does not have a public-private sector classification, so the table sets out data assuming that all jobs in public administration, education and healthcare are public sector. This in effect exaggerates the size of the public sector, as some of this work is done privately. In the UK for example this approach assigns nearly 9 million workers to the public sector, whereas official statistics assign less than 6 million.

The table shows that on this broad definition public sector job growth has partly offset the job losses suffered in the private sector. Even in Germany, where there are 414,000 more jobs than there years ago, all these have come in the (broad) public sector – in no country has the private sector yet recovered to the same level of employment as in 2007. In contrast to the USA, public employment in Europe is higher than before the crisis.

However, this picture is already changing in some countries with sharp ‘exit strategies’ : n the Uk for example employment in government sectors peaked at the end of 2009 and has fallen by 120,000 a year later.

1. Employment changes in EU during crisis

Changes between 2007 Q$ and 2010 Q4

|  |  |  |
| --- | --- | --- |
|  | Numbers (‘000s) | % |
|  |  |  |
| Total | -3,679 | -1.7% |
| Private | -5,790 | -3.5% |
| Public sector | 2,111 | 3.9% |
| *of which:* |  |  |
| *Public administration and defence; compulsory social security* | -54 | -0.3% |
| *Education* | 884 | 5.8% |
| *Human health and social work activities* | 1,256 | 5.9% |
| *Water, sewerage, waste management and remediation activities* | 25 | 1.6% |

Sources: Eurostat database Employment (lfsq\_egan2, lfsq\_egana) downloaded 08/07/2011 <http://epp.eurostat.ec.europa.eu/portal/page/portal/employment_unemployment_lfs/data/database>

## Greece

### The 2010 and 2011 packages

Between February and July 2010, the government of Greece adopted a series of packages of cuts in public spending which cuts in earnings for all public sector employees. These were connected with the agreement in March 2010 by the EC, the IMF, and the European Central Bank on a support package for Greece which included a ‘Memorandum of understanding’ on economic and fiscal policies. [[18]](#endnote-18) The effects were summarised by the ETUI: “It is estimated that cuts in wages and bonuses will result in a de facto loss of income for public sector workers of 12 to 20%. Trade unions strongly rejected the ‘emergency package’ and repeatedly took industrial action, including several general strikes in 2010, with the most recent in October.” (ETUI 2010 Vera Glassner [The public sector in the crisis](http://www.etui.org/research/activities/Employment-and-social-policies/Reports-and-working-papers/WP-2010.07) Working Paper 2010.07)

In June 2011 the Greek government agreed to impose a set of cuts required by the European Commission and the IMF as a condition for supporting the value of Greek sovereign debt. In total, this and the previous package amount to a re-adjustment of 15% of GDP

1. Impact of cuts and tax rises as % of GDP 2011 package

cumulative impact as % of GDP by 2014

|  |  |  |
| --- | --- | --- |
|  |  | **change by 2014 as % of GDP**  |
| **Total**  |  | 10.5  |
| **Spending cuts** |  |  |
|  | Social benefits  | 1.9  |
|  |  |  |
|  | Wage bill  | 0.9  |
|  |  |  |
|  | Pharmaceutical spending  | 0.5  |
|  | Health care  | 0.3  |
|  |  |  |
|  | Extra-budgetary funds (finance for non-government agencies) | 0.5  |
|  | Other expenditure (finance for local government) | 0.4  |
|  | State-owned enterprises (subsidies) | 0.4  |
|  |  |  |
|  | Operational expenses  | 0.3  |
|  | Investment spending  | 0.2  |
|  | Defence expenditure  | 0.1  |
| **Tax increases** |  |  |
|  | Tax policy  | 3.6  |
|  | Tax compliance  | 1.4  |

Source: European Commission 2011

### Jobs, pay and conditions

Through recruitment freezes and other measures, over 157,000 jobs will be cut: “From 2010 to 2015, the total number of government employees is expected to be cut by 20 percent, from 727 thousand to 577 thousand.” The package also includes 7,000 jobs to be cut as a result of closing or merging over 150 quangos.

In addition to the pay cuts of 2010, there will be “an increase in the weekly working hours for public sector employees from 37½ to 40 hours and a reduction in overtime payments.” The increase in hours is equivalent to a pay cut of 6.25%.

### Privatisation

Privatisation of a specific list of public sector operations is a core part of the measures. This is expected to raise €50billion by 2014, equivalent to over 20% of GDP. The list of those to be partly or wholly privatised includes: water services in Athens and the second city Thessaloniki, rail, gas, mobile telecoms, airports, motorways, the state electricity company,

Greece has been forced to give up its sovereignty over this process: it will be managed by a specially created private company overseen by EU appointees, with quarterly targets for the amounts to be sold. The proceeds are expected to be used to pay off the west European banks who hold Greek bonds.

Sources:

* European Commission 2011 [The Economic Adjustment Programme for Greece - Fourth Review - spring 2011](http://ec.europa.eu/economy_finance/publications/occasional_paper/2011/pdf/ocp82_en.pdf) European Economy. Occasional Papers. **82**. July 2011.
* Athens News 5 July 2011 [Warning: The memorandum could damage your health](http://www.athensnews.gr/issue/13450/44199) )

## EU: other countries

Nevertheless, a number of EU countries (plus Iceland) have taken policy decisions to cut the pay of government and/or public sector employees between 2008-2010. They are listed in the table below, which also indicates which countries have reached IMF deals and which have been subject to pressures from bond markets refusing to buy government debt. The bond market pressures may reasonably be seen as a proxy for an IMF loan, with governments such as Ireland, Portugal and Spain taking measures which are expected to re-assure markets, partly because they are thought to be the kind of measures the IMF would insist on. Only Lithuania does not fall into either category.

The experiences in each country are summarised in the following paragraphs. They include some other recurrent features: the prioritisation of reducing deficits over defeating recession; the active role of employers in general; the dismantling and restructuring of pay bargaining systems; and the relative weakness of trade unions. The cuts in pay have usually involved a fundamental break from social partnership agreements, and high levels of social conflict. In all cases the governments have been strongly aware of the significance of their actions in relation to the role and power of unions, so that the cuts can be seen as conscious attempts to reduce union power as well as fiscal policies.

This approach contrasts with the conclusions of a recent study that trade unions, social partnerships and employee protection and support, have generally played a positive role in recent economic developments. Argentina's recovery from a severe economic collapse in 2001 depended on working with unions and prioritising the protection of workers over repayment of international creditors: “these institutions helped Argentina maintain its democracy and social stability.” [[19]](#endnote-19)

1. EU countries cutting public sector pay during 2008-2010

|  |  |  |
| --- | --- | --- |
| **Country** | **IMF deal** | **Bond market pressures** |
| Hungary | x |  |
| Greece | x | x |
| Iceland | x |  |
| Ireland |  | x |
| Latvia | x |  |
| Lithuania |  |  |
| Portugal |  | x |
| Romania | x | x |
| Spain |  | x |

### Hungary

Hungary received a support loan from the IMF in October 2008. Part of the agreement was originally that public sector workers would lose their bonus, worth 8% of their pay, and face a pay freeze; the cut in earnings was later restored. However, in June 2010 a newly elected government announced a new package of measures designed to reduce the deficit to the level of 3.8% required by the EU/IMF, which included a 15% cut in the salaries of all 700,000 public sector employees. [[20]](#endnote-20)

### Ireland

The effects of the 'automatic stabiliser' mechanism were much greater in Ireland because of the relative scale of the property and financial bubble. The collapse of the property bubble resulted in a collapse in revenue, which was then worsened by a sharp rise in unemployment from 4% in 2007 to 12.5% in 2009. Spending on benefits and public services increased as a result of increased demand on welfare services, and the government deficit grew in response to these effects of the crisis.

These effects happened against the background of a national pay system involving multi-year agreements between employers, government and unions, which had operated since 1987. The current agreement was negotiated in 2006 with a series of increases agreed over a number of years. Private employers began to attack the agreement, arguing that the crisis had made the agreed increases unaffordable; and public sector pay was identified as an element of spending which could be cut in order to reduce the government deficit. In February 2009 the government imposed a special deduction of between 3% and 9.6% on the pay of public employees. This led to months of conflict with the unions, including demonstrations of over 100,000 people, while private employers called for the pay agreement to be ignored or abolished: the state-owned electricity company ESB was attacked for implementing the increase required under the agreement. The government confirmed unilateral pay cuts in the budget of December 2009, which specified that from 1st January 2010 basic salaries of public employees would be reduced by 5% on salaries of €30,000, rising to 8% on salaries of €125,000, and 15% on salaries of €200,000 or more. This was expected to raise €1.4billion per year, out of a total €4 billion cuts package In January 2010 the private sector employers formally rescinded their participation in the pay agreement. [[21]](#endnote-21)

This process represented a fundamental break in the social relations with the trade union movement: “Ireland’s 22-year-old system of social partnership effectively fell apart on 4 December 2009, after the government announced that talks with the public sector trade unions on an agreed method of securing a €1 billion reduction in the public pay bill had failed.” (Eurofound ); “This intervention effectively ended the model of social partnership agreements in place since 1987.” (Considine and Dukelow 2009 ); “the whole process of social partnership came unstuck in December 2009.” (Hardiman 2010 )In summer 2010 talks resumed with the unions, who are seeking a gradual reversal of the wage reductions from 2011. [[22]](#endnote-22)

### Latvia

Latvia faced acute problems arising from the financial crisis in 2008, which led to it securing an IMF stand-by arrangement worth more than $2.3 billion at the end of 2008. Public sector pay was cut by a succession of measures in 2008 and 2009:

* in mid-2008 additional payments and bonuses were cut
* Conditionalities for the IMF deal included a 15 per cent reduction in local government employees’ wages, and a 30% cut in the wage bill in 2009
* in July 2009 salaries of state sector workers were cut by between 15% and 20%
* from September 2009 teachers pay was cut by 28% [[23]](#endnote-23)

### Lithuania

In June 2009 the Lithuanian government announced unilaterally that it was planning to cut the basic salaries of public sector employees by 10%, with effect from August. The trade union confederation rejected the decision and organised action, including a hunger strike: the government then entered discussions with the unions, and agreed to suspend the unilateral decision.

An agreement was signed in October 2009 between the government, private employers and a number of trade union organisations. It includes an obligation not to reduce basic salaries for civil servants, but also an overall austerity agreement involving general reductions in wages and social benefits.

The prime minister claims that the austerity measures have been successful because they are based on 'social consensus': However, some independent trade unions and civil society groups refused to sign the 2009 agreement because of the plans to cut pensions, and criticise the process for lack of transparency and for agreeing that the burden of the crisis should fall on ordinary people. [[24]](#endnote-24)

### Portugal

In early 2010, as a way of reducing the budget deficit, the government proposed a general freeze on wages, cuts in public sector pensions, 5% pay cuts for senior civil servants and politicians only, and unilaterally decided to cut unemployment benefit and the minimum wage. This was strongly opposed by the unions and others, including a strike of 300,000 workers in March, and one of the largest demonstrations ever recorded in Portugal, in May 2010. The private employers also opposed an increase in the national minimum wage, as agreed in the 2006 tri-partite agreement: the government approved the increase, but provided a subsidy for employers. [[25]](#endnote-25)

### Spain

In response to international markets' forcing up the cost of borrowing by Spain, the government introduced a number of measures in 2010 to try to reduce the budget deficit. In May 2010 the government announced a cut in public sector pay of 5% on average, a freeze on civil service pay in 2011, a freeze on pensions, and reductions in some benefits. [[26]](#endnote-26)

### Romania

Romania was given a loan from the IMF in 2009. The agreement with the IMF specifies a ceiling of RON 39 billion on the paybill for government personnel, with a commitment to cutting 74,000 jobs in 2010 and a further 15,000 in 2011. The government announced further measures in May 2010 including a cut in all public sector wages of 25% from June 2010; pensions and other benefits were also cut by 15%.

The Financial Times described this as leading to a “storm of public anger”. The unions said that “the government is trying to shift the burden of the economic crisis on to the shoulders of workers, pensioners and other vulnerable sections of the community”. Employers' associations “withdrew their support, arguing that lowering individual earnings would only worsen the recession. They have now asked the government to institute measures to create jobs and generate economic growth.” The main unions have been strongly criticised for not responding strongly enough, and for having leaders who are too concerned with preserving their own high incomes: “the violence and radicalism of impromptu protests exceed the organisational ability of [the union] leaders, whose current statements show their being mediators rather than significant leaders“

In August 2010 the government said that civil service salaries may increase by 10% in 2011, but only if the '13th month' payment is abolished; an IMF spokesperson then advised Romania not to reverse the pay cut of 25%: “a salary increase may only happen if the layoff process is accelerated.” Government policies are monitored by a joint team of the EU, IMF and World Bank, who decide whether the next tranche of the standby credit will be released. [[27]](#endnote-27)

### Other

Elsewhere in Europe pay rises have been agreed by negotiation, even where strike action has been involved. In Germany, for example, a new pay agreement was reached in March 2009 for 650,000 employees of the regional Lander, after waves of one-day strikes, providing for increases of 3% in March 2009 and a further 1.2% in March 2010. In Slovakia, after 4 months of negotiations, government and unions agreed in October 2009 to a pay increase of just 1% for public sector employees in January 2010. In Slovenia, in February 2009, the government and the public sector trade unions agreed to various measures which reduced pay rises in 2009-2010 of 7.1% - a reduction from the previously agreed figure of 9.9%. In Italy, in May 2010 the government imposed a salary freeze for state employees in general; the UK government did the same in June 2010. [[28]](#endnote-28)

# EU-USA similarities and differences

The statistical evidence on post-crisis pay in the EU is similar to the USA data in a number of respects.

* Firstly, there is no evidence of a general fall in pay levels, across the whole economy, in the 2 years of the crisis from 2008 to 2010
* Secondly, public sector pay has not risen significantly faster than pay in the private sector, either since the crisis or in the medium term
* Thirdly, there is evidence that union membership and collective agreements provide some protection for earnings – an effect which is greatest in the public sector, where trade union membership is now significantly higher than in the private sector.

This analysis is consistent with comments by the consultancy firm Kienbaum, in their forecast of pay rises in Europe in 2010.[[29]](#endnote-29) Kienbaum expected salaries to rise in real terms in all EU countries in 2010 (except Italy, where real rises would be zero), and identified two factors which are maintaining real earnings levels. Firstly, employers wish to retain qualified labour as a competitive advantage as soon as the economy recovers, and so want to avoid losing or demoralising workers through cutting pay. Secondly, the extent of collective agreements: in sectors not covered, it expects that “one-third of all European companies are expected to freeze their salaries on last year’s level.”

There is however a clear difference between the USA and European countries, in that a number of European countries have now introduced or attempted to introduce pay freezes or pay cuts specifically in the public sector.

Most of the countries involved have been the subject of external economic pressures, including (a) pressure from the European Commission to keep deficits below the level of 3% specified in the Maastricht Treaty (b) market pressures from investors in bonds, who have sold or refused to buy,bonds from countries until policy changes and guarantees are given (c ) policies required by the IMF as condition for loans supporting national currencies.

The USA is clearly different from European countries in all these respects. There is no formal continental agency enforcing formal fiscal rules, nor is the USA likely to be the subject of an IMF loan. And in practice, despite a higher government deficit (10.7% of GDP) than many European countries, the USA remains able to sell all its bonds at very low rates of interest. As a result, it is not exposed to the same external pressures as European countries:

“The dollar’s place at the heart of the global financial system means the US has the luxury of tightening fiscal policy at its own pace. While the US has a bigger fiscal deficit than the eurozone – the Paris-based Organisation for Economic Co-operation and Development expects it to be 10.7 per cent of output in 2010 – the Greek crisis has prompted a flight to, rather than from, the dollar and US Treasury paper. The yield on 10-year Treasuries has fallen from 4 per cent at the start of April to around 3.3 per cent. As a result, Washington is feeling little market pressure to cut its deficit, and few economists expect that to change as long as US finances look healthy relative to others around the world. Instead of bond market fears, the US has an intense political debate about deficits and whether to spend more on fiscal stimulus.”[[30]](#endnote-30)

# Other regions

There is less systematic evidence from other regions, for three reasons. Firstly, the economic impact of the recession itself has been much less than in northern countries. Secondly, there is less evidence of a political reaction against the government deficits incurred to combat recession. Thirdly, systematic data on public sector pay, is not available except for a minority of countries.

The evidence for Asia and Africa, set out below, broadly confirms the USA and European picture of relatively little general impact of recession on pay, with no major divergence apparent between public and private sector experience. However, there does not appear to be any country outside the group of Europeans discussed above, which has actually cut the pay levels of public sector employees (as of July 2010). This cannot be because of absence of external pressure – the countries of the global south have historically been most vulnerable to, and most affected by, policy requirements of international institutions and private investors. The reasons may rather be linked to the relatively lesser direct impact of the crisis, with less political pressures against the higher levels of public spending and borrowing.

## Asia

The major high income country in Asia, Japan, has experienced a long period of economic stagnation before the recent crisis, so the new crisis is interacting with a different context. The official statistics of Japan do not show earnings for the public sector, or government sector, but the monthly earnings index does provide separate data for education, healthcare. The table shows that earnings in general stagnated or fell in the years from 2000-2007, ; earnings in manufacturing did better than average; but earnings in education and healthcare fell faster than average. Earnings in general have fallen sharply between 2008 and 2009, but earnings in education actually fell faster than average (in healthcare slightly slower). There is no clear evidence here of public sector pay 'uncoupling' from the private sector in recession.

In June 2010 Japan announced a strategy to try and reduce its government deficit and debt over the next 10 years, but the measures did not include cuts in public sector pay. [[31]](#endnote-31)

1. Earnings in Japan, 2000-2009

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
|  | All workers | Manu-facturing | Education | Healthcare |
|  |  |  |  |  |
| 2000 | 103.9 | 96.4 | 106.1 | 107.9 |
| 2001 | 102.9 | 96.3 | 108.4 | 107.2 |
| 2002 | 99.9 | 95.2 | 104.8 | 103.6 |
| 2003 | 99.8 | 97.6 | 103 | 101.9 |
| 2004 | 99 | 99.2 | 99.4 | 99.5 |
| 2005 | 100 | 100 | 100 | 100 |
| 2006 | 101 | 101.3 | 99.8 | 100.6 |
| 2007 | 100.1 | 100.9 | 97.9 | 99.9 |
| 2008 | 99.6 | 101 | 96 | 96.9 |
| 2009 | 94.8 | 92.9 | 89.9 | 94.4 |

Source: Japan Monthly Statistics, wage index by industry, nominal terms (2005=100)

<http://www.stat.go.jp/data/getujidb/zuhyou/g12.xls>

The other large Asian economy, China, has continued to experience much faster growth rates both before and after the crisis (the same is broadly true of India) The pattern of earnings should thus be considered in the context of relatively slight impact on the economy as a whole.

Official data on earnings of urban workers in China by type of employer show that in 2008 the pay of urban workers in state-owned and collective-owned enterprises rose slightly more slowly than that of workers in other (privately owned) enterprises. The latest data shows that earnings of private sector workers had risen less rapidly in the year to the 3rd quarter of 2009. It is worth noting that in both periods the significant growth in employment has taken place entirely in the private sector, with a net reduction in employment in the state and collective sectors. Similar data is not available for India.

Again, this does not provide any strong evidence of a tendency for public sector pay to leap ahead in recession, especially given the different impact of the crisis and the different economic structure - China has a relatively large public sector, which employs a majority of urban workers.

1. Changes in earnings and employment , urban workers in China, 2008 and 2009 Q3

|  |  |  |
| --- | --- | --- |
|  | average remuneration: % change over same period in previous year | change in number of employees ('000s) over same period in previous year  |
|  | 2008 | 2009 Q3 | 2008 | 2009 Q3 |
| All units | 16.9 | 12.4 | 1681 | 1211 |
| State-owned | 16.0 | 13.6 | 235 | 199 |
| Collective | 17.2 | 15.2 | -566 | -522 |
| Others | 17.6 | 10.1 | 2012 | 1534 |

Source: National Bureau of Statistics of China Labor Remuneration of Persons Employed in Urban Units (Year 2008, 2009 3rd quarter). <http://www.stats.gov.cn/english/statisticaldata/Quarterlydata/t20100202_402618894.htm>

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## Africa

A search for reports of public sector or civil service pay cuts in African countries revealed no cases of general pay cuts or even pay freezes for public employees or civil servants. The possible exception is Zimbabwe, where a salary freeze was announced by Finance Minister Tendai Biti in April 2010. The main motivation for the freeze was said to be the long-term problems of the economy, rather than a response to the current economic crisis. At a May Day rally, Prime Minister Morgan Tsvangirai caused considerable confusion by denying that there was a salary freeze.[[32]](#endnote-32) In Nigeria, selective cuts in pay and various benefits were applied to certain high level office bearers in mid-2009, but not to government or public sector workers in general. These targeted cuts were publicly supported by trade unions, including the Nigeria Labour Council.[[33]](#endnote-33) President Yar'Adua reassured civil servants that they would not be affected. [[34]](#endnote-34)

On the contrary, there are clear indications from a number of countries that public sector pay is rising. In Angola, in August 2010, the government decided to increase civil service pay by 5.4% as part of the 2010 budget.[[35]](#endnote-35) Even the anti-democratic Swazi government has imposed a 4.5% increase for civil servants (a rise opposed by the World Bank and the IMF).[[36]](#endnote-36) In South Africa in August 2010 public sector unions rejected a salary increase of 6.5 per cent and called a national strike in support of an increase of 8.6% more than twice the rate of inflation.[[37]](#endnote-37)

Public employees have been affected in other ways, with the international institutions once again being influential. For example, in July 2009 the government of Ghana was planning to freeze employment in the public sector for at least 2 years, because of conditions attached to a loan from the IDA (World Bank).

## Russia and central Asia

Despite the economic crisis, the health workers’ unions in Russia, Kazakhstan and Tajikistan have all won substantial real pay increases for their members since 2009. Their pay had fallen far behind the pay of other workers, and these increases partly reduce that gap. In all three countries the unions are also in the process of establishing better collective bargaining rights. And in all countries, public spending on healthcare is rising in real terms and as a percentage of GDP, although the systems are still distorted by ideological attempts to encourage private healthcare.

### Russia

The pay of healthcare workers in Russia had fallen behind average pay, with no increase for 2 years despite inflation. By 2010 health workers pay was only about 60% of average pay levels, with the lowest grades paid about €170 per month and doctors paid about €600 per month. The pay of medical interns had also been drastically reduced in real terms.

One reason for this was the lack of a formal system of pay determination for public service workers. In 2010 the Association of the Non-Manufacturing Trade Union Workers of the Russian Federation agreed three key demands to address this problem: indexation of state and municipal workers’ salaries; agreement of formal pay scales for specific occupations in public services; and legislation to clarify that basic pay rates – before counting bonuses or other extra payments - had to match the minimum wage.

In November 2010 the healthcare union launched a campaign of action which included rallies, strikes and public demonstrations in front of parliament. The campaign lasted for 5 months, until the government agreed to negotiate. As a result, the government agreed a rise of 6.5% from June 2011 – the first one for over 2 years - followed by an additional increase of 6.5% being voted through parliament.

The union maintained the pressure through meetings with the government on its new law on modernising the healthcare system in Russia, which provided for a large increase of an extra 460 billion roubles in state healthcare spending. As part of this, the union negotiated a further increase, of 35%, to be paid over the next year. The total increases are thus worth about 50%, against the background of annual inflation of around 10%. The government also announced it would double the pay of interns and resident trainees as of 1 June 2011, up to the national subsistence minimum.

The future of public healthcare is improving in Russia but slowly. Following the collapse of the Soviet Union, Russia introduced private health insurance and private providers. Public spending on healthcare fell, but the private systems made things worse - people’s health, including life expectancy, got worse. Since 2000 public spending on healthcare has increased, and  life expectancy and infant mortality have improved. Under the Russian constitution healthcare has to be provided free by the state, but still only about 30% of the system is financed by public spending, so the rest is paid for privately. Hospitals can use the same equipment to provide services paid for by the state, and also to sell private care to individuals. In 2011 the government announced an extra $10 billion on healthcare ‘over the next few years’, paid for by increasing social insurance contributions from 3.1% to 5.1%.  The new law will lead to improvements in terms of equipment, and salaries, but it still fails to install a clear system based on public provision for healthcare objectives, not for profit. The unions are now becoming more involved in political action as one of the main groups forming the United Popular Front, which also includes NGOs, formed to support the United Russia party.

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* Russia: healthcare, pensions, and privatisation PSIRU Brief May 2011 <http://www.psiru.org/node/1603>
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### Kazakhstan

The pay of health workers in Kazakhstan was amongst the lowest in the country. A basic problem has been the lack of a pay determination system for public sector workers, so that pay rises depended on the personal decision of the president. The unions in health, education, and cultural services combined to demand a new system, and threatened public demonstrations, which persuaded ministers to set up a working party with the unions.

The unions won two major improvements. Firstly, the government agreed to the doubling of health workers pay in 3 stages between 2009 and 2011. In January 2009, for the first time, the Labour Code included a pay increase of 25% for health workers, representing the first stage of this increase.

Secondly, a new system of pay determination for public service workers was agreed, based on indexation, together with ratification of ILO conventions 26 and 131 (on a minimum wage), and convention 95 (on payment of wages). This new system is to be introduced from 2012 after the new pay level has been established.

The government attempted to use the economic crisis as an excuse for postponing the second stage of the pay rise, also of 25%, but the threat of public demonstrations convinced them to pay the rise in 2010, in accordance with the agreement. In 2011 the deputy prime minister again attempted to postpone the final stage, of 30%, and with it the new system of pay determination, until 2014. Again, the threat of public demonstrations persuaded him to agree to make the final payment in 2011, as planned, and to promise the signing of ILO convention 95.

The sectoral agreement for 2009-11also improved the terms of paid holidays, and explicitly confirmed the right of public sector workers to 30 days paid annual leave. The sectoral agreement is binding on all healthcare employers, and is supplemented by bargaining at local level, and the union has now signed agreements with 1,232 establishments, covering 95.6% of union members. Effective bargaining at this level is heavily dependent on the strength of local branch organisation and leadership.

Public spending on healthcare in Kazakhstan is growing, not only in terms of money – from $1.4billion in 2005 to $3.9billion in 2010, but also as a percentage of GDP, from 2.5% in 2005 to 3.2% in 2010. A programme of investment in cardiology and preventative measures has succeeded in reducing the mortality rate form heart diseases from 5.4 per 1,000 in 2005 to 4.1 per thousand in 2010. A further 5 year programme of investment in modern technology started in 2011. The health services also gained from Kazakhstan’s ‘Roadmap Strategy’, the $1billion stimulus programme introduced in 2009 to counter the effects of economic recession, and included renovations at 264 clinics and hospitals.

1. Average salary of healthworkers in Kazakhstan 2009-2011. US dollars

(@ exchange rate 146 Kazakh Tenge = $1 USD)

|  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- |
| Occupation | Average | Doctor | Nursing staff | Junior doctors | Other health workers | Medical institute teachers |
| 2008 |  | 295 | 216 | 147 | 139 | 273 |
| From January 2009 |  | 369 | 270 | 184 | 174 | 341 |
| from April 2010 |  | 462 | 337 | 230 | 218 | 426 |
| from 1 July 2011 |  | 656 | 480 | 326 | 309 | 605 |
| Pay Increase 2008-2011 | +122% |  |  |  |  |  |
| Inflation 2008-2011 | +26% |  |  |  |  |  |
| Real pay increase 2008-2011 | +77% |  |  |  |  |  |
| Real GDP increase 2008-2011 | +15% |  |  |  |  |  |

Source: EPSU sub-regional report, IMF World Economic Outlook, PSIRU calculations

* [Interview (part 1) with Mereke Butina, President, Trade Union of Health Workers of Kazakhstan](http://www.youtube.com/watch?v=tugAcPb1e9I&feature=channel_video_title) 31/05/2011
* [Interview (part 2) with Mereke Butina, President, Trade Union of Health Workers of Kazakhstan](http://www.youtube.com/watch?v=3gIJMXJyPfk&feature=channel_video_title) 31/05/2011

### Tajikistan

The health workers union in Takjikistan has made progress on a number of fronts – real pay increases of about 50% in just over two years, a better system of pay determination, better coverage for collective bargaining, and better holidays and shorter hours for some workers.

There is a sectoral agreement between the ministry of health and the THWTU, which is binding on all healthcare employers, supplemented by collective bargaining at the level of each healthcare establishment, hospital or clinic. The union has now signed agreements with 71% of these establishments, a small but significant rise since 2009, when there was 67% coverage.

The pay of health workers had fallen so low that a number of skilled health workers were emigrating, and there was a shortage of over 10,000 workers in the healthcare system. In July 2009 a new system for determining the pay of health workers was introduced, based on a single salary scale. There was an immediate general pay increase of 33%, which brought sector pay to about 70% of the national average, and there will be a further increase of 30% in October 2011. These rises are equivalent to a real pay increase of about 34% over 3 years, a growth rate nearly twice as fast as the economy as a whole.

The union has also succeeded in eliminating the problem of late payment of wages: as of January 2011, there were no pay arrears. Finally, the union has won an increase in holidays and reduction in working hours for workers in a number of health occupations.

This has been achieved despite government policy favouring private rather than public healthcare. Public spending on healthcare has only just reached 2% of GDP, for the first time since independence in 1993, which is still inadequate to meet the needs of a public health service. The government, with the active encouragement of international financial institutions including the World Bank, continues to restructure the system along the failed USA model of private insurance and private provision. The constitution, which originally guaranteed the right of citizens to free publicly funded healthcare, has been amended to permit private healthcare as well. The stated objective is that the system should become ‘self-financing’, paid for entirely by private insurance or patient fees: but the system still depends on government spending for 40% of its income (as does the system in the USA itself). It is the government – not the private sector – which has made significant new investments in modern equipment.

1. Healthworkers pay, inflation and GDP in Tajikistan (Index 2008=100)

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
|  | Health workers pay | Inflation | Real pay | Real GDP |
| 2008 | 100 | 100 | 100 | 100 |
| 2009 | 133 | 107 | 125 | 104 |
| 2010 | 133 | 113 | 117 | 111 |
| 2011 | 173 | 129 | 134 | 118 |

Source: EPSU sub-regional report, IMF World Economic Outlook, PSIRU calculations

# Theory and implications

Much of the academic literature on this subject consists of attempts to find neo-classical economic explanations of relations between public sector pay and economic recession.

The evidence examined above, however, suggests that there is no such observable phenomenon. Institutions and political processes are instead the features with most explanatory power – the role of union organisation, the political complexion of governments, the legal status of collective agreements, the role of external actors such as the IMF or the bond markets. Political positions also clearly matter, especially in the context of a macroeconomic policies where there is no consensus on if or when government deficits should be maintained or cut – even within international business papers there is no consensus on the relative desirability of cutting deficits in 2010. [[38]](#endnote-38)

## ECB paper on public wages

A paper published by the ECB in June 2010 [[39]](#endnote-39) is based on the familiar political position associated with neo-classical economics: that the role of the public sector should be minimised – and therefore public sector pay, as part of public spending, should also be minimised. Although it does not examine any data later than 2008, and so offers no information on the impact of the current recession, the paper is interesting because it asks, in effect, what evidence can be found to support the argument that public sector pay in itself has a damaging economic influence.

However, it finds little evidence of any systematic problem. Its own analysis of OECD empirical data finds that public and private sector pay levels move closely together:

“The empirical findings for the Euro area and its member countries show a strong, positive correlation over the business cycle for both real and nominal wages. The correlation is mostly of a contemporaneous nature. Correlation coeffi cients are significant and typically very high (in most cases above 0.8; see Table 5), indicating a common pattern of private and public wage correlation across countries. These findings are consistent with both the stylised facts and the theoretical arguments presented above and point to strong cross-sectoral linkages in wage setting, as public and private wage developments do not diverge significantly (in other words they do not decouple) even in the short run. Wages in both sectors also share a common long-run trend.” (p.25)

It also notes that there is no empirical evidence that there is any consistent link between total public sector wage bills and the business cycle. There is no evidence that recessions systematically cause public sector pay bills to rise, for example.

It is therefore surprising that the paper nevertheless offers universal recommendations for “less coordinated wage bargaining and more decentralised wage setting, as well as product market liberalisation” - although it has not reviewed any empirical evidence on these policies. The assumed gains are rated as greater than the risk of creating social and political conflict:

“The implementation of such reforms may well be associated with political opposition. However, the 'double dividend' of greater economic stability and a lower risk of intra-euro area competitiveness losses should encourage policy-makers to undertake the necessary adjustments” (p.5).

The lack of empirical evidence for this conclusion is compensated for by a clear re-statement of the political anxieties about the use of public deficits to combat recessions:

“while fiscal expansion might still be relatively easy to implement in the case of most spending items, the phasing-out of the respective programmes usually meets fierce political opposition. This may lead to a gradual increase in the government sector after each expansionary episode rather than symmetric expenditure expansions and contractions over the cycle.”

The paper adds that this risk is particularly high because of “the high degree of coordination among public employees (e.g. through unionisation) which facilitates political opposition”, although it offers no evidence on this issue.

This conclusion itself demonstrates how political positions may affect policies and economic realities in this area. This is reinforced by the fact that it ignores other evidence, noted in the paper itself, that political and institutional factors may be highly relevant.

Firstly, it notes considerable medium-term variation in the ratio between public and private sector wages per employee. These movements surely merit discussion, especially in view of the general evidence of closely linked trends in public and private sector wage levels. Possible explanations include political and institutional factors such as a growth in forms of privatisation and liberalisation which remove lower paid employees into the private sector, or a sustained weakening of trade unionism in the private sector.

1. Ratio of public to private wages per employee, Euro area, 1970-2010

Source: ECB 2010, p.10



Secondly, the conclusions ignore evidence that the ratio of public to private wage ratio is closely linked to the share of the workforce in the public sector. In countries with a higher proportion of employment in the public sector, like France and Finland, public sector wages per employee are almost identical to private sector wages: whereas in countries where public sector employment is a much lower percentage – Netherlands, Portugal and Italy – the average public sector wage is more than 50% higher than the private sector wage. Moreover, this correlation is much more statistically significant than that between public sector pay and the economic cycle. [[40]](#footnote-1)

1. Ratio of public/private wages and share of public employment, 2008

Source: ECB 2010, p.12

Thirdly, the conclusions also fail to refer to the finding that public sector pay determination is much less likely to affect private sector wage settlements where “stricter *employment protection legislation* gives unions greater bargaining power in the private sector, independent of public sector outcomes, and therefore coincides with a weaker influence of public wages.” (p.27) One possible conclusion from this would be to strengthen employment rights.

## Other

The ECB paper effectively confirms previous findings that there is no simple economic factors at work. Freeman's study in the USA from 1970-1982 found that the public sector responded to recessions by increasing employment, while private sector jobs fell, but that public sector pay tends to fall more in recessions, relative to the private sector. A study of the UK from 1950 to 1975 found the opposite:: “public sector earnings generally increasing faster than than private sector earnings during the downswing, and vice versa during the upswing”. (Freeman 1987, Dean 1975)

The significance of institutions, on the other hand, especially international institutions, is clear in other recent accounts. In the 1970s and 1980s there was a sharp earnings decline in African and Latin American countries following the structural adjustment policies advocated by the international institutions. This resulted in “a real pauperisation of large sections of the population. ….Real wages in sub-Saharan Africa were typically halved between 1970 and 1985”.

Public employees were not exempt, indeed they were at the forefront of policy-induced wage cuts:

“The decline in wages was fully shared by those working in the public sector. Indeed there is evidence to suggest that public servants were particular casualties of the economic decline. In Africa for example for 11 countries where the data are available, the real earnings of public-sector workers declined considerably faster than per capita income over the years 1975 to the mid-1980s.” This had predictable negative effects on efficiency: “Public-sector pay fell more sharply than elsewhere in the formal sector, often with disastrous effects upon the productivity of civil servants.“ (Colclough 1997 p.9, 18) [[41]](#endnote-40)

These policies had a lasting effect, especially in Africa, where low pay levels were identified as a major cause” of poor government capacity:

“Many countries have suffered a steady drain of talent from the public sector*—*especially the core civil service*—*to foreign corporations, nongovernment organisations, and even those very aid agencies that are supposed to be helping governments rebuild their capacity (Wuyts 1996). It can be very difficult to close the public–private pay gap, even when economic conditions become more favourable, because of the expense involved. Uganda has yet to achieve its proclaimed objective of a minimum living wage*—*that is, paying civil servants enough to survive on*—*after nearly a decade of reform, and this in spite of reducing civil service employment by more than half.” (Polidano 1999)[[42]](#endnote-41)

In the same period Asian governments limited pay rises in general, and “the main vehicle for this was public-sector wage settlements”. In countries such as Korea and Singapore, the policy also involved suppression of unions: “labour rights were denied by the government , and trade unions were prevented from having any role in wage determination” - although Singapore later changed policies in favour of capital-intensive activities and high skills, with a positive effect on civil service pay as well: “public-sector salaries attained a significant premium in comparison with those for similar jobs in the private sector”. (Colclough 1997 p.11)

Finally, on the question of the 'public sector premium', there are studies which confirm the significance of politics. A European study of public-private relativities in 2001 found that, after adjusting for industrial and occupational differences, public employees enjoy relatively higher pay than their private sector counterparts only at the lower end of the pay scale - for higher paid workers, “the wage differential between public and private sector decreases and becomes close to zero”. [[43]](#endnote-42) A detailed survey of relative movements in public and private sector pay in the USA found that relative pay varies over time, and that public sector pay varies as much as private sector pay. Employment policies also make a difference: “….the public sector workers who tend to be most highly paid in the the US relative to private sector workers are blacks and women, suggesting that the public sector has a better equal employment/affirmative action record than does the private sector.” (Freeman 1987) [[44]](#endnote-43)

# Conclusions

The introduction set out three stages of the crisis. The examination of the data, and the discussion of previous work, supports the clear conclusion that there is no direct economic impact on the relative level of public sector pay, either from the financial crisis or the more general recession. Government responses to recessions are only indirectly relevant, too, as economic stimulus would be at worst neutral on pay levels.

The impact on public sector pay rather comes from the political responses to the government stimulus measures, most notably in countries where there are either IMF programmes, or market pressures, or EU programmes (or a combination). These responses are inherently political because they involve simple choices between different policy objectives - employment levels or fiscal discipline. They are also political because the measures to reduce public sector pay – and other public spending on services and benefits, - and/or measures to increase taxes, and/or maintenance of high deficits, are generally and correctly understood as a way of redistributing the 'pain' of the recesssion.

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