

The Economics of Public Employment: An Overview for Policy Makers and Informed Readers

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Policy Proposals

Quantities are policy variables, wages should not!

- Government should have flexibility in choosing employment, but setting wages should be left out of the political space.
- The goal is simple: a better (not perfect) alignment of public wages with the private sector.
- Two steps reform:
 - **Step 1: set a pay schedule and progression structure**
 - **Step 2: yearly wage growth decision**

Step 1: getting a balance across sectors

- Benchmark should be private sector wages by occupation, **education, experience and region**, but not gender (implement specific policies to reduce wage differential in private sector).
- Adjust downwards for job security differential, hours, work-life balance, pensions premium and health care.
- Flexible to reward unobservable skills and effort (micro).
- In occupations with low private employment, the wages should match occupations with similar careers and education.
- An useful indicator to monitor the pay structure is the length of queues.

A by-product of wage adjustments

- In most countries, this requires a reduction of public-sector wage premia for: low educated or young workers or in poorer regions.
- Theory predicts an endogenous adjustment of employment to changes in wage premium: quantities respond.
- Demand by the government of these workers will increase.

Political implementation

- Governments should not implement this reform overnight.
- Direct wage cuts are not politically feasible nor socially desirable.
- We need a longer implementation horizon, not by cutting wages, but by changing the expectation of evolution of the whole wage schedule, together with regional top-ups.
- A government should use two hands: wage growth changes should be accompanied by an announcement of “quantity increase” in employment offering better public services.

Step 2: yearly wage growth decision

Delegate to a “*Public Wage Commission*” the setting of the annual growth rate of public wages, inspired by the Low Pay Commission of the UK.

- Set the growth rate of public wages to maintain a target ratio of the wage bill relative to its employment in the public and private sectors.
- Could be done within existing Fiscal Councils
- Can be forward looking, or based on current year.
- Every 5 to 10 years, evaluate again the pay schedule and progression structure by occupation and adjust targets for composition.

Advantages of reform

- Maintains parity between the two sectors in good and bad times.
- Reduces scope of government to use wages for electoral purposes.
- The government maintains control of all instruments related with the supply of public goods.
- Requires low tax burden in recessions.
- Simple, fair and easy for economic agents to understand.
- Brings some predictability in one of the most important decisions of governments.

Four possible objections

1) How about inequality?

Key insight:

- The government has a redistributive role, but it does not mean that all instruments have to be redistributive (Mirlees report).
- If the government wants to fight inequality, it should use the income tax system to do it, or other regulatory policy (minimum wage).
- Using public sector wages does not solve the problem (it possibly amplifies it), and creates inefficiencies in the labour market.

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2) Does it make sense to hire low skilled workers in the public sector?

Answer:

- Do we need a college graduate to put notes in a machine? We should have a better skill mix.
- Hiring cheaper unskilled workers to free more qualified worker to do more complex tasks, will improve productivity.
- For allocating talents across occupations, we believe the market is a more efficient mechanism than the electoral and political games of politicians.

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3) Politicians lose control (influence) over one useful instrument.

Answer:

- The objective is to tie the hands of bad politicians.
- The government maintains control of all instruments regarding supply of public goods or insurance (purchases of intermediate goods, investment, employment and transfers).
- It reduces the importance of unions, but it offers a fair deal for public workers.

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