Raises and cuts in public sector salaries have a direct effect on the private sector

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Raises and increases in the salaries of public sector workers put pressure on the private sector in the same year. Credit: J. P. Alcubilla

A joint study of the Bank of Spain and the Pablo de Olavide University (UPO) confirms that public salaries are clearly influential throughout the whole of Europe's economy. For the study, researchers chose a representative sample of four EU countries: Italy, Spain, Germany and France. According to the Organisation for Economic Cooperation and Development (OECD), the public sector employs an average of 20% of Europe's working population.

"The rises and cuts in the salaries of public sector workers put pressure on the private sector in the same financial year," states A. Jesús Sánchez Fuentes, co-author of the study by the Pablo de Olavide University and the Bank of Spain which is published in the *Empirical Economics* journal.

Sanchez points out that one of the main new discoveries of the study "is that it determines the extent to which the changes in public sector salaries influence private sector salaries in the short term." The researcher also goes on to add that "public sector salaries become a kind of referent when negotiating collective agreements between companies."

Economic models tend to consider public sector salaries as being exogenous in nature. In other words, they function on the basis that there is no link between private company wages and productivity. In a robust way this study determines whether this influence exists," outlines the expert, who is currently a researcher at the Complutense University of Madrid (UCM).

According to Sánchez, the conclusions drawn from this study are found in the analysis of different periods of time in four countries: Italy, Spain, Germany and France.

The study focused on two periods in its analysis of economic figures: the first being from 1980 to 2007 and the second being from 1991 to 2007. Its aims was to isolate the period that corresponds to the creation of the eurozone and, in turn, conduct an annual and quarterly analysis (intra-annual) of the impact of changes in salary. The starting point of the study lay in data from the European System of National Accounts (ESA-95), the European Statistical System (Eurostat) and from the database on OECD's Economic Outlook.

A 'thermometer' for the economy

The expert warns that "those in government should know that when they decide to raise or cut public sector wages, this affects the rest of the economy."

When a government decides to freeze or reduce the wages of civil servants, this gives a subtle warning to society at large. The researcher outlines that "many governments, like in the case of Spain, are implementing cuts in public sector salaries at a time of economic crisis. Amongst many other things, this measure sends out the message that the time has come for salaries in general, including those in the private sector, to experience only moderate increases."

Institutional design also matters

The study also included costs and productivity, two endogenous variables when determining salaries, in order to observe the force flow that exists between the two. Sánchez points out that "if we enter into the casuistry of each country, we see how institutional design also has an influence." For example, employment protection legislation has the opposite effect on the productivity of workers in different countries.

According to the analysis, existing employment legislation protection in Spain has negative effects on productivity but the opposite is true in the case of Germany. Sánchez believes that this could be attributed to the duality of fixed and temporary contracts that exists in Spain. The expert concludes that "when the workforce needs to be reduced, it is more economically viable to sack the temporary workers after analysing which are the least productive."

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