PUBLIC SECTOR WAGE GAP: THE TAXPAYER FUNDED PREMIUM FOR WORKING FOR THE GOVERNMENT

New Zealand Taxpayers’ Union
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INTRODUCTION AND CONCLUSIONS

After nine years of restraint in public sector wages, taxpayers should expect the pay gap between bureaucrats and private sector employees to grow in coming years. Teachers and nurses are expected to go on strike later this year, and if they are successful, other public-sector unions may feel emboldened.

Despite recent restraint, the average worker in the public sector still earns a 34.6 percent premium than the average private sector employee. In contrast, the public sector earnings premium was only 20 percent in the early 1990s. If the Government had retained that historical pay premium level, taxpayers would save approximately $2.5 billion each year.

Government workers also take significantly more sick leave than private sector workers – 8.6 days of sick leave on average per year for the public sector, compared to fewer than five days per year for the private sector. Except in special circumstances (hospital workers, for example) sick leave is just a different kind of employee compensation. If Government departments set private sector expectations for sick leave, taxpayers would save $173 million per year – or $100 per household each year.

There are costs to the economy of a large public sector pay premium on top of the financial cost to taxpayers. Research on public sector wages indicates that a higher public-sector wage premium results in higher unemployment as a result of crowding out effects in the labour market. Higher unemployment rates

We believe the Government should strive to return the public-sector wage gap to 20 percent, as it was in the early 1990s. Even better would be to link public sector wage increases to those in the private sector. Aligning the incentives of public sector workers and unions to real wage growth would help to shift preferences to a high growth, high productivity economy.

Increases in industrial action from public sector unions coupled with commitments for collective bargaining from the new Government is likely to see public sector wages rise.
Public sector employees earn a substantial premium compared to the private sector.

That premium is equal to:

- 38.2 percent measured in hourly earnings
- 34.6 percent measured in weekly earnings

This is larger than the public-sector earnings premium in the United Kingdom, which was 32.6 percent when measured hourly, and 11.1 percent when measured annually. The substantial difference in premiums when using different time measurements is largely a product of the public sector working reduced hours compared to the private sector.

The smaller difference in premiums when measured hourly and weekly in New Zealand indicates that public servants work hours much closer to their private sector equivalents, which is evident in data from the State Services Commission. There’s still a small gap (as evidenced by data on working hours, and the difference between hourly and weekly earnings premiums) but it’s much better than the United Kingdom.

IMPLICATIONS OF THE WAGE GAP

Cost to taxpayers

Total Crown personnel spending was $23.6 billion in the 2017 financial year, or $13,650 a year for every household in higher taxes or Government debt.

If we assume Crown personnel spending is subject to the public sector wage premiums we calculate earlier, there are significant savings available to taxpayers if we returned to the premiums offered during the post reform era in the early 1990s.

During that period of time, the public-sector wage premium was approximately 20%. If we cut public sector wages to levels that restored that premium, taxpayers would save more than $2.5 billion a year – or $1445 a year per household.

Unemployment

Economic research shows that higher public sector wages may be associated with higher levels of unemployment.

Caponi (2017) highlights this issue:

“This occurs when wages in the public sector are so attractive and the probability of finding a job is sufficiently high, that unemployed workers prefer to wait longer to find a public sector job. Moreover, when wages in the public sector show more rigidity with respect to fluctuations in productivity, the crowding-out effect becomes stronger when productivity is lower, which in turn amplifies the effect of real business cycles on unemployment. The amplification, or destabilizing, role of the public sector is stronger the higher the wage gap is in favor of the public sector and the larger its size.”

Allowing the public sector wage gap to grow in coming years will worsen unemployment by driving employees out of the private sector. Note that if the economy went into recession, any resulting unemployment would be exacerbated due to the typical reduction in private sector productivity.

Higher levels of unemployment also reduce Government tax revenue, meaning any increases to public sector wages has a larger fiscal impact than the wage increases themselves.
Sick leave is effectively another kind of compensation from employers to employees. If there are any disparities between the public and private sector then that effectively represents an additional gap in pay between sectors.

Government departments on average take significantly more sick leave than the private sector. The average number of days taken across public sector organisations was 8.6 in 2016 and 6.8 in 2017, whereas the average private sector worker only takes 4.7 days of sick leave per year.

Only five government departments took fewer days of sick leave than the private sector on average in 2016: Crown Law; Ministry of Arts, Culture and Heritage; Ministry for the Environment; Ministry of Foreign Affairs and Trade; and Ministry of Transport.

In 2017, that number dropped to four, with the Ministry of Transport falling behind the private sector.

All other government departments took more sick leave than the private sector on average in each respective year.

The worst three departments in 2016 were Customs, Inland Revenue, and the Ministry for Social Development. Each of these departments took on average more than twice the private sector average.

In 2017, the worst performing departments were the Education Review Office, Inland Revenue, and...
and the Ministry of Social Development. Employees at these organisations took more than twice the private sector average for sick leave.

While it’s good to see that the average quantity of sick leave fell between 2016 and 2017, some agencies performed just as poorly in 2017 as 2016. However, taking a simple average of public sector agencies without weighting for the size of these agencies could provide an unfair interpretation of the data.

When we weight for the size of the department, we see that the average public sector worker in fact took 8.6 days of sick leave in 2016 and 8.4 days of sick leave in 2017. That reveals that while some smaller departments and agencies may have improved their approach to sick leave significantly, larger agencies are failing to do so.

The cost of sick leave to the economy, as measured in 2013, was $1.26 billion. While the public sector only comprises 20 percent of total employment, it is responsible for nearly a third of this cost.

If the public sector could reduce its use of annual sick leave to private sector levels, taxpayers would save an average of $176 million a year – or about $100 per household each year.
The public sector wage premium increases when public sector wage growth outstrips private sector wage growth.

In order for the premium to fall, the Government must ensure the economy and wages continue to grow, but not continue to fuel public sector wage growth.

In an alternate world, where the economy entered recession, and wages stagnated or declined in the private sector, the Government would have to be willing to match that with cuts to public sector wages.

We fear public sector industrial action will increase under the current Government with public sector unions having significant sway in the Labour Party by virtue of their voting position and financial contribution.

Any attempt to limit proposed pay increases or improved benefits could be viewed negatively by union leadership, who have voting rights over the leadership of the Labour Party.

This is a dangerous incentive.

Ministers with future leadership ambitions, or Members of Parliament located in close fought seats who require campaign funding, may feel obliged to meet the demands of unions, in case they require their support in the future. While Andrew Little did not receive majority support amongst the Labour Party caucus and membership in 2014, he won the leadership of the party due to winning the vote of the affiliated unions by a substantial margin.

Further, any fiscal constraints which might have prevented pay rises (due to the global financial crisis, or the Christchurch Earthquake) have dissipated. While the Minister of Finance has placed fiscal limits on the Government, there is still some room in the operating allowances for the next four years to pay for public sector wage rises.

The analysis in this report demonstrates that the money should be used elsewhere.

Teachers unions are planning strike action later this year in pursuit of a 14.5 percent pay rise. Even if the Government negotiated the PPTA and NZEI down to half of that, the increase in wages to teachers would be significantly larger than the average pay rise in the private sector. If teachers unions are successful, other unions may feel emboldened and accelerate any planned industrial action, or seek higher pay increases.

In the event of a recession where wages stagnated or declined, it’s unlikely the Government would support public sector wage cuts. In that event, we should expect the public sector wage gap to grow further.

While some people will argue that the Government could increase taxes in order to fund public sector wage increases, this would widen the public sector wage gap.

Higher income taxes (on either personal or business income) dampen productivity growth with the effect of reduced private sector wage growth, and a larger public sector wage gap.
The Government should aim to return the public sector wage gap to approximately 20%, as it was in the early 1990s. In order to do that, the Government needs to commit to lifting wages in the private sector and placing constraints on public sector wage growth.

Sustainable private sector real wage increases largely depends on higher productivity levels. Productivity growth would require the Government to make difficult decisions, including corporate tax cuts, deregulation, and privatising a number of State Owned Enterprises.

The Government should also place a cap on public sector wage growth until the wage gap returns to 20%, at which point public sector wages should only be allowed to increase at the rate of private sector wages, so the margin is maintained. Importantly, that would align the incentives of public sector workers and unions on the side of private sector wage growth.
Public sector sick leave data is obtained from the State Services Commission. Private sector sick leave data for the private sector is obtained from Southern Cross’s Wellbeing in the Workplace Survey 2015.

While Southern Cross has an updated version of the private sector data published in 2017, this report chooses to conservatively use the higher, more often-cited, figure from 2015 (4.7 rather than 4.1, days per year).

Human Resource Capability Surveys 2016 & 2017 – State Services Commission


Southern Cross’s Wellness in the Workplace surveys are available at:


Earnings data for public and private sectors are derived from Earnings and Employment Survey data, available through Infoshare provided by Statistics New Zealand. This report uses hourly and weekly sectoral income data from Q1 1989 through to Q2 2017, which is then annualised.