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WORKING PAPERS

Wages in the second half of nineties

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WAGES IN THE SECOND HALF OF NINETIES

(Velimir Bole)

I. PERFORMANCE

Real wages have steadily increased since 1995. After acceleration in 1996, wages grew at roughly 1.8% per year (Figure 1). There was enough growth in productivity to accommodate such real growth in wages. In the same period, the average growth rates of GDP and employment were respectively 4.2% and 0.8%.

There were no significant differences in wage dynamics of the non-market and the market sector. Non-market sector wages attained an advantage in 1996; since then, the average wage in the non-market sector overshot the average wage in the market sector by almost 30%. Differences between wages in the market and the non-market sector depend on labour market conditions as well as on the employment structure. Nevertheless, relative wages in the non-market sector in Slovenia are quite high in comparison with other more developed countries in transition as well as the OECD economies¹

Considerable wage dispersion (measured by the ninth over the first decile ratio) characterized main sectors of standard classification (Table 1). While, it is obvious that wage dispersion in the non-financial market sectors is rather high (even in comparison with developed economies), it is necessary to stress the genuinely outstanding position of public sector wage dispersion. Specifically, such a low wage compression (ratio of the ninth over the first decile at around 3.3) is much lower than in developed economies. It is even low in comparison with countries, which recently reformed their public pay system to increase pay flexibility (e.g. Australia, Sweden and the United Kingdom).²

Neither wage dispersion nor the median wage changed significantly across sectors during the period studied. In comparison with other economic sectors, only manufacturing and construction made considerable progress by both criteria of wage incentive structure. Such a change corroborates that the size of

¹ See, Bole.V. (2001), "Empirical characteristics of the general government pay system", (in Slovene), Gospodarska Gibanja, EIPF, Ljubljana, 24-41.

² See, OECD (1995), "Pay reform in the public service, initial impact on pay dispersion in Australia, Sweden and the United Kingdom", Public Management Occasional Papers, No.10, OECD.

average wage as well as the wage dispersion are linked to the relative performance of the activity sectors. To be more precise, value added in manufacturing and construction increased substantially more (respectively by 17.2% and 24.5%) than GDP (14.2%), in the period 1997-2000.

To further increase labour productivity, returns on investment in human capital have to be sufficiently high. So, changes in the distribution of earnings by the level of education and skill, indicate possible longer-term performances of the economy. Wage dispersion increased since 1995 but so also did the return on the increase of educational skills (see Figure 2). In the period from 1996 to 1999, two groups of qualifications increased their wages significantly more than others: holders of university and the non-university degrees as well as those with lower professional degrees and highly skilled workers.

Widening pay differentials between high-skill and low-skill workers, and consequently increasing wage dispersion, characterizes the private sector in developed economies. By contrast, in the public sector of the same economies, wage differentials remain more compressed than in the private sector. While highly educated workers in the public sector are paid less than their counterparts in the private sector, less qualified workers in the public sector are better paid than corresponding workers in the private sector. The crucial question is, whether such a phenomenon, known as “double imbalance”, could pose problems in recruiting and retaining workers for the public sector.³

To detect a possible double imbalance effect, in Figure 3, gross wages of different categories of qualification are presented in terms of GDP per capita, both for the market and the non-market sector. In Slovenia, in contrast to many developed economies, there is no significant difference in distribution of wages by the level of education and skill, between the market and the non-market sector. Therefore, in the public sector there should be no problem recruiting highly qualified workers.

The dispersion of wages by qualification also does not substantiate the arguments of public sector trade unions that they are paid significantly less than workers with similar qualifications in the market sector. These unions when bargaining to support demands for large wage increases of specific groups of highly skilled workers often use such arguments. The dispersion of wages by qualifications makes even more credible the tough bargaining position of the government when negotiating with particular, occupational based public sector trade unions.

³ See, for example, Schager, N. H. (1993), “An overview and evaluation of flexible pay policies in the Swedish public sector”, in “Pay flexibility in the public sector”, Public Management Studies, OECD.

II. WAGE DETERMINATION

In Slovenia, the formal wage determination process has four phases. In the first phase, the social partners make an agreement. The Corresponding Social Agreement provides the most general determinants of conditions on the labour market; it is accepted conditionally based on government commitments about crucial economic performances. Because of unfinished privatization, the Social Agreement was essential in the first years of transition, when pressures on labour costs were high and corporate governance was weak. Determined by the government, the representatives of employees and the employers, the Social Agreement diminished uncertainty about the future path of crucial economic variables (labour costs and cost of living). It therefore provided a more stable economic environment. It was also valuable later, when possible larger distortions on the labour market, could endanger the stability of macroeconomic performances.

The wage determination process in the market sector differs from that in the non-market sector. Even in the first phase, there is a difference between the two, since representatives of non-market sector employees do not take part in the agreement.

The second phase of the market sector wage determination process results in the General Collective Agreement. It makes broad conditions on the labour market and commitments of the government (on crucial economic performances) outlined in the Social Agreement more concrete. The General Collective Agreement regulates, not only the pay process, but also employment and work conditions (i.e. working hours, holidays, trade union activity, guaranteed allowances, training, etc.).

Collective agreements are also prepared on the activity sector and enterprise level. There are 26 sector and over 1000 collective agreements on the enterprise level (most in enterprises with more than 100 employees). Only representatives of employers and employees (trade unions) take part in the bargaining on these levels. Collective agreements on the enterprise and sector levels enable individual allowances, bonuses and overtime payments to become part of the pay process. Participation of employees in the results of the enterprises (for example, the ever more popular "Christmas wage") is also regulated on that level.

In principle, collective agreements remain in force for four years, while pay scales change every year.

The institutional structure of the wage determination process was implemented only partially after 1996, since in that year the representatives of employers refused to participate as the General Collective Agreement implied

nonsustainable levels of non-cash allowances. As a result, the social Agreement also expired. Only the pay scale remained in force after 1996

While a new Social Agreement was not reached in 1997, some crucial items (minimum wage and the adjustment mechanism of gross wages) were acceptable to all the social partners. In 1997, the government codified these items in the law “On Minimum Wage and the Adjustment of Wages”. Later in 1999, the same effect was achieved by the “Agreement on Wage Policy”. The law and the agreement both included two crucial elements in the wage determination process. First, starting-level wage could be adjusted once a year up to 85% of past inflation. Only if inflation overshoot the upper limit set for inflation, could starting-level wage be adjusted for the complete difference. Second, the mechanism for increasing the minimum wage was the same as for the starting-level wage, but every year it had to increase additionally also for the rate of the increase in GDP. This process of accelerating the growth of the minimum wage was established so as to attain the level of 58% of the average wage in manufacturing.

When VAT was introduced in 1999, a special adjustment mechanism was used to prevent an increase in the inflation rate and to mitigate the corresponding pressures on wages. (Two adjustments were made in a year.)

To upgrade the “Agreement on Wage Policy”, a new forward-looking formula for inflation adjustment was suggested in 2001 to take into account the anticipated inflation and growth in GDP. Such a formula would be utilized in 2002.

Because of considerable differences in the economic performances between sectors of activity, the starting-level wage determined by the Collective Agreement do not have any significant relevance for actual starting-level wages used in the sectors of activity. Differences in the actual starting-level wages were high but decreasing, after 1995 (see, Figure 4).

Because of individual allowances and differences in performance of enterprises, the starting-level wage set in the Collective Agreement was even less important for the actual average wages. Only the worst performing enterprises were constrained by the starting-level wage.

The formal wage determination process in the public (non-market) sector is separated from that of the market sector. Representatives of employees in the non-market sector do not even take part in the preparation of the Social Agreement, although it presents the general framework for setting pay policy. The only connection between the wage determination process in the market and the non-market sector is the role of the Government. The Government plays the role of employer in the non-market wage determination process and also takes

part in the preparation of the Social Agreement by establishing its commitments for crucial economic performances

The law of 1994 regulating the structure of wages in the general government was the formal basis of the wage determination process in the non-market sector for the period after 1995. The level of wages was determined (in every year) by starting-level wage. Curbing general government spending had a direct affect on the low relative level of starting-level wage in the non-market sector. While indexation was similar, starting level wage were much lower than in the market sector. Because of this, pressure from public sector trade unions increased. These pressures increased even more, since for part of the public sector (mostly employees of the central government), the wage determination process was different. It was linked to the minimum wage, which increased faster because it was also adjusted to increases in the GDP.

Trade unions in the public sector are highly decentralized but organized on a professional and occupational basis (that is unions of doctors, nurses, teachers, etc). Therefore, the enforcement of their demands was strong, for some of them. Moreover, the government accepted the policy of bargaining separately with each different trade union. This resulted in completely decentralized bargaining.

Spending ministers usually were part of the government bargaining teams. The high moral hazard of these spending ministers "to blow with the wind" further eroded and weakened the bargaining position of the government. Because the law, regulating the structure of wages, and the adjustment mechanism of the starting-level wage, was formally still in place, such occupational based bargaining resulted in enormous increases in fixed and variable allowances and non-cash bonuses for some professions. The spill over effects of these increases also led to rapid increases in the average wage in the non-market sector as well. Such a "high skill driven" process therefore resulted in a permanent wage drift.

The process of "high skill driven" wage drift in the non-market sector was triggered by a one-time increase in the wages of judges, in 1996. By the end of 2000, the increased fixed and variable allowances pushed wages for occupations with the strongest trade unions more than 50% over the level determined by the regular pay rules. Differences were the highest for the top scale occupations (e.g. for doctors, the differences were up by 70% and for university professors by over 60%). The "high skill driven" changes in the wage determination are illustrated in the Figure 5; the upper compression index (the ninth decile over the median earnings) and lower compression index (the median over the first decile earnings) are given.

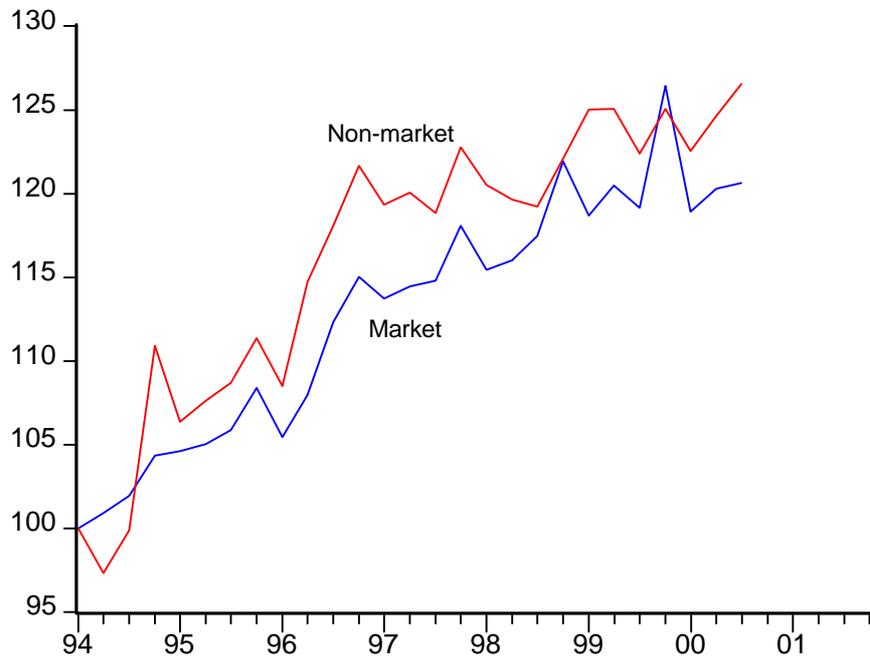
STATISTICAL APPENDIX

Table 1
Wage dispersion
(per unit of BDP/pc)

	1997		
	1.decile	median	9.decile
Manufacturing(D)	0.525	0.790	1.499
Electricity, gas and water(E)	0.786	1.147	2.086
Construction(F)	0.525	0.800	1.499
Wholesale and retail(G)	0.586	0.873	1.922
Hotels an restaurants (H)	0.555	0.818	2.111
Transport (I)	0.732	1.114	1.791
Financial intermediation (J)	0.917	1.351	2.793
Public sector (L+M+N)	0.694	1.216	2.316
		2000	
	1.decile	median	9.decile
Manufacturing(D)	0.551	0.855	1.616
Electricity, gas and water(E)	0.829	1.183	2.018
Construction(F)	0.525	0.825	1.580
Wholesale and retail(G)	0.587	0.772	1.857
Hotels an restaurants (H)	0.544	0.804	1.517
Transport (I)	0.730	1.125	1.802
Financial intermediation (J)	0.909	1.316	2.972
Public sector (L+M+N)	0.693	1.251	2.284

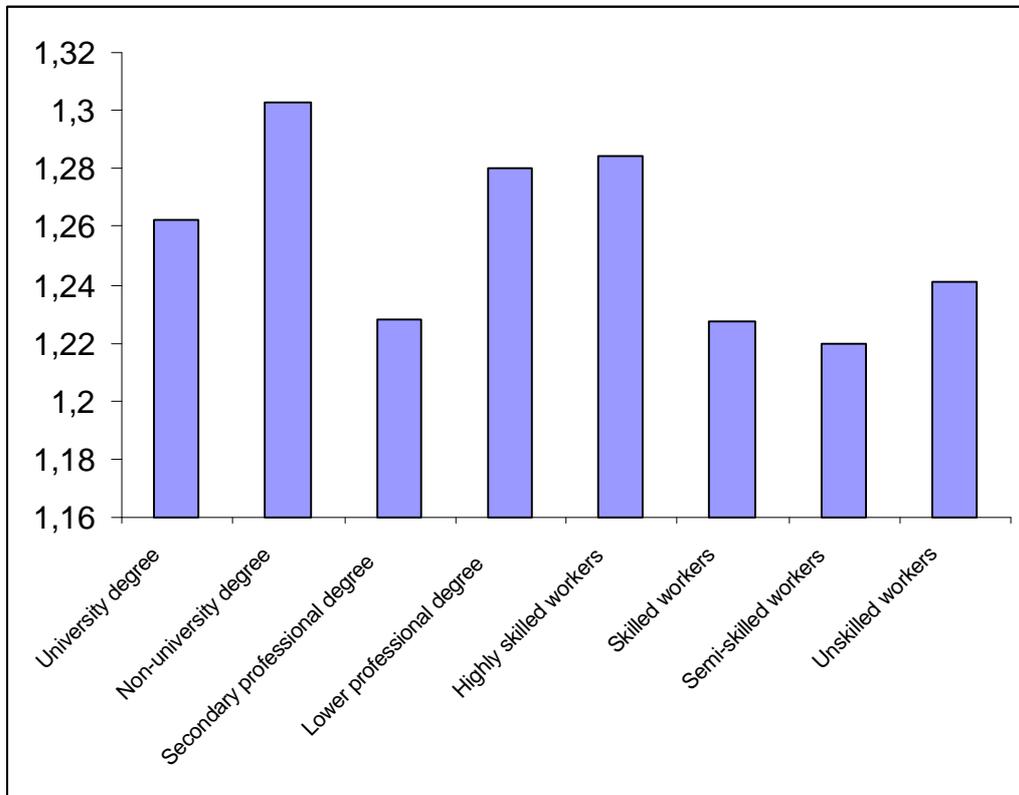
Source: Statistical Office of the Republic of Slovenia; Bole(2001).

Figure 1
Real gross wages
(1994=100)



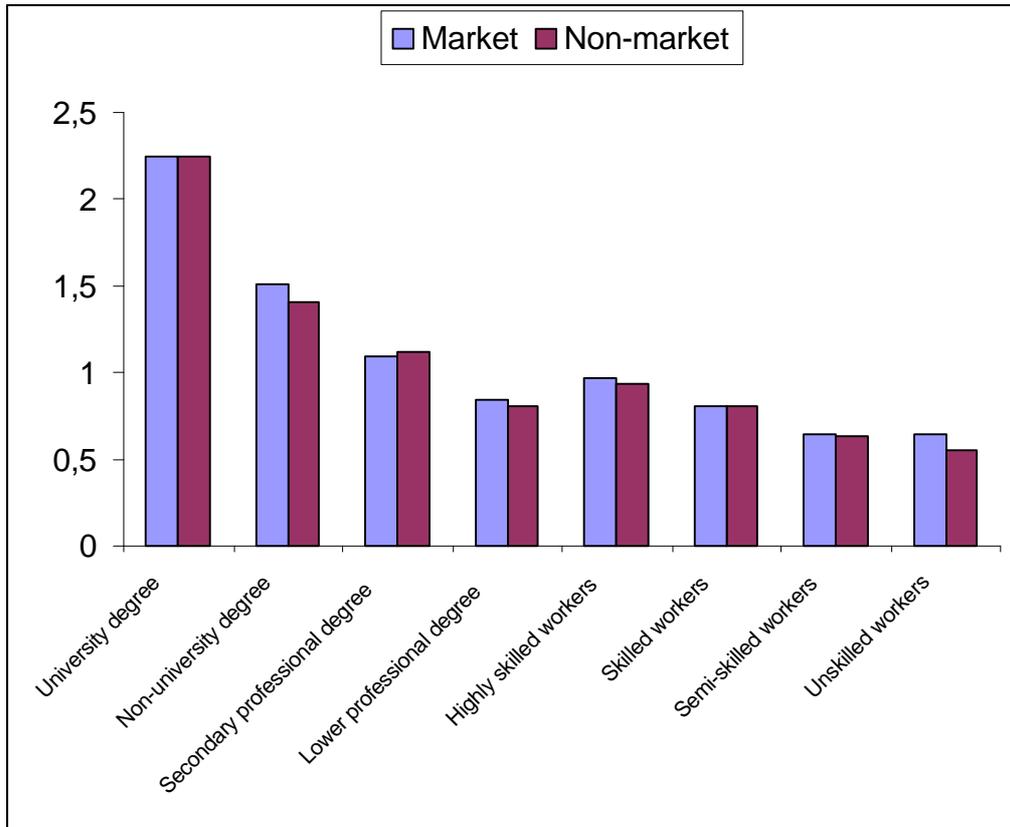
Note: costs of living deflator is used.
Source: Statistical Office of the Republic of Slovenia.

Figure 2
Gross wages by qualifications in 1999
(1996=1)



Source; Statistical Office of the Republic of Slovenia.

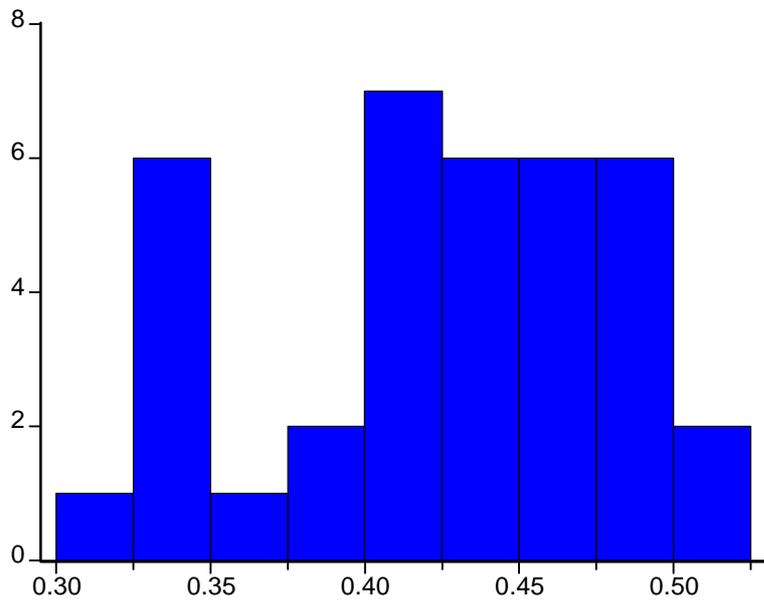
Figure 3
Gross wages by qualifications



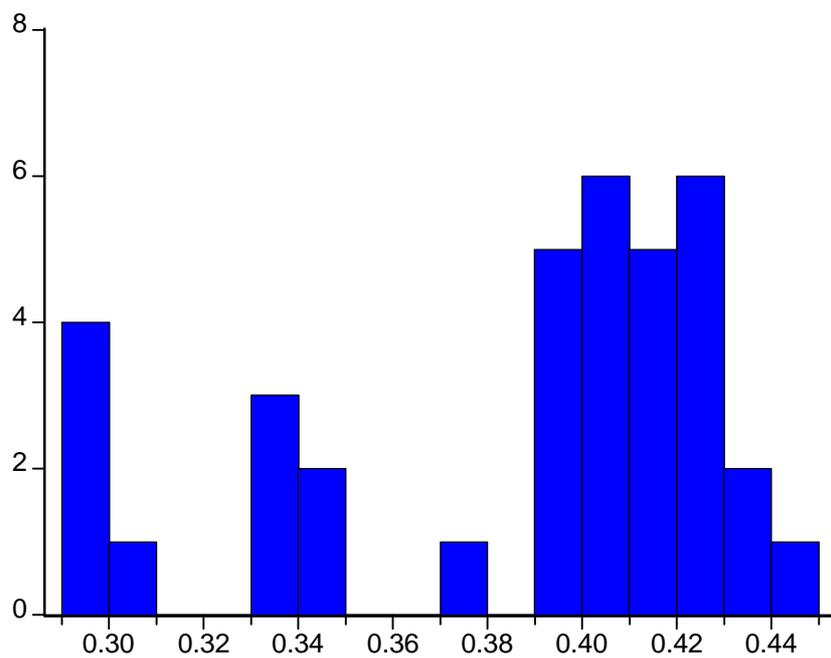
Note: gross wages are in units of GDP/pc.
Source: Statistical Office of the Republic of Slovenia.

Figure 4
Frequency distribution of the sectors actual starting-level wages

1996

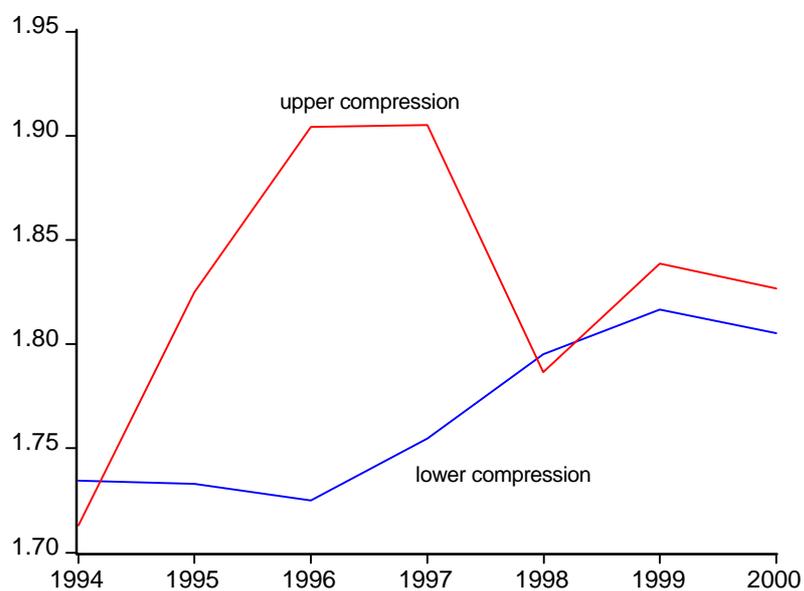


2000



Note: actual starting-level wages are in units of GDP/pc.
Source: Statistical Office of the Republic of Slovenia.

Figure 5
Dynamics of wage compression in the general government



Note: the upper compression index is defined as the ratio of ninth decile over the median; the lower compression index is defined as the ratio of the median and the first decile.

Source: Statistical Office of the Republic of Slovenia; Bole (2001).