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COMPARING PUBLIC AND PRIVATE SECTOR COMPENSATION

This is the third issue of *Research Highlights* in the Human Resources in Government (HRG) Project Series. Here we summarize the results of a recent background paper commissioned by CPRN that examines issues around government compensation. We then go on to consider the implications of the study results for compensation policy with respect to government employees.

PUBLIC SECTOR WAGES – COMPETING PRESSURES

Government pay levels are determined by a complex mix of political, social, and market forces. In the 1990s, political forces were driven largely by concerns over deficits, taxes and expenditures. Tax increases have not been a realistic option, so

governments turned to expenditure reductions as one of their main alternatives. Political pressures thus tend to exert downward pressures on public sector wages.

In other cases, upward pressures are exerted by political and social forces – the motivation behind the drive for pay equity by public service unions, for example, has been to encourage governments to apply principles of fairness in compensation for groups that are often marginalized in the private sector labour market. The result of these opposing pressures on public sector wages in the 1990s was a smaller overall wage gap in the public sector between, for example, a worker in a low-skill service job¹ and the top management positions than would exist in the private sector (see box on page 2).

Getting the balance right is important because, on the one hand, excessive pay in the public sector could lead to higher taxes or budget deficits, and inflationary spillover into the private sector. On the other hand, pay that is too low can lead to problems of recruitment, retention and morale, all of which can jeopardize the effective delivery and quality of government services. Further, efforts to reform pay policy to make it more responsive to these



Competing Pressures on Public Sector Wages

Downward pressures

- Pressures to reduce deficits, taxes, expenditures;
- Considerations around the contribution of public sector efficiency to international competitiveness in a global economy;
- Concern that government not “lead the way” in terms of compensation, and thus avoid upward pressure on compensation in the private sector.

Upward pressures

- Growing need to recruit and retain skilled workers to meet expected increase in retirements;
- Need to compete with the private sector for individuals with specialized skills, such as senior managers/ executives and information technology workers;
- Issues around morale and fairness after a decade of downsizing and pay freezes in the public service;
- Pressures for governments to be “model employers” especially with respect to issues such as pay equity and treatment of lower skilled workers.

Pressures to “reinvent government”

- Increased emphasis on market forces and incentives in the design and implementation of compensation policy, leading to wider consideration of such practices as incentive-based pay, responsiveness to variations in the labour market with respect to the supply of and demand for skills;
- Need to redefine the role of unions and to introduce greater flexibility into the determination of compensation.

pressures require a close examination of the trade-offs between equity and efficiency goals.

WHAT THE DATA TELL US

Morley Gunderson, Douglas Hyatt and Craig Riddell² undertook a thorough statistical analysis of compensation levels in the public and private

sectors using the 1997 Labour Force Survey, the 1996 Census and Census data for 1971, 1981, and 1991. The data permit a detailed analysis of pay levels, but exclude such non-wage earnings as benefits packages, stock options, and so on.

The composition of employment in the public and private sectors is very different, with the differences playing an important role in determining overall compensation levels:

- unlike the private sector, which is made up of a wide variety of occupational types, almost 60 percent of employment in the public sector is in managerial and professional jobs (compared to just 30 percent in the private sector); the composition of employment in the two sectors is similar with respect to clerical and service occupations, but the share of workers in sales and processing occupations is much higher in the private sector;
- educational attainment is substantially higher in the public sector workforce compared to the private sector, with a much larger percentage of workers in the public sector holding a university degree;
- the public sector is also disproportionately older, a reflection both of the generally higher educational requirements for public sector jobs and the fact that a hiring freeze was in effect in much of the public sector through the 1990s;
- more than half the workers in the public sector are female, compared to 46 percent female in the private sector;
- public sector workers are disproportionately employed in very large organizations (over 500 employees), whereas most workers in the private sector are employed in very small organizations (fewer than 20 employees); and
- the rate of unionization is much higher in the public sector (80 percent of workers) compared to the private sector (24 percent of workers).



This report focuses on what economists refer to as a “pay premium,” which essentially refers to an average pay difference between employees in two sectors – in this case, in the public sector of the economy and the private sector. (The public sector is broadly defined to include local, provincial and federal governments; health, education; and those parts of the transportation, communications and utilities sector where government is the employer.)

These comparisons are made after taking account of the variations in the factors noted above, such as education and age. In their analysis, Gunderson, Hyatt and Riddell find that, after taking account of these differences, there is an overall government pay “premium” of about 9 percent. Based on both data from the 1997 Labour Force Survey and the 1996 Census, the federal government pay premium was calculated at 8.5 percent; at the provincial level, it was 10.0 percent; and at the local government level, it was 9.4 percent (Table 1). Public sector pay premiums were substantially smaller in the education and health sectors. The public sector pay premium, at 10.5 percent, was highest in the case of the transportation, communications, and utilities sector.

The average pay premium for all of government of about 9 percent masks considerable differences in the size of the premium both across occupations and for women compared to men, however. The analysis finds that, in fact, the premium is significantly higher for women and for workers in low-skill occupations, while managers, especially male managers, receive little or no wage premium compared to what they would earn in the private sector.

Based on analysis of public-private sector differences in wage premiums by gender and occupation, Gunderson, Hyatt and Riddell reach the following conclusions:

The male-female wage gap in the public sector is considerably smaller than it is in the private

Table 1

Summary: Average Public Sector Pay Premiums, 1997 Labour Force Survey and 1996 Census

	Labour Force Survey	Census	Unweighted average ¹
Percent			
Federal government	7.0	9.90	8.5
Provincial government	11.4	8.70	10.0
Local government	10.3	8.50	9.4
All government (unweighted average)	9.6	9.00	9.3
Education	6.9	2.50	2.2
Health	0.8	-0.07	0.4
Transportation, communications, and utilities	9.2	11.70	10.5

¹ The unweighted average is the simple average of Columns (1) and (2). The unweighted average of the three levels of government is the simple average of the figures for the federal, provincial, and local levels of government.

Source: Morley Gunderson, Douglas Hyatt and Craig Riddell, “Pay Differences between the Government and Private Sectors: Labour Force Survey and Census Estimates,” CPRN Discussion Paper No. W/10, Table 10.

sector: in the private sector in 1997, men earned on average 18 percent more than women, whereas in government, men earned about 14 percent more than women. As a result, the pay premium is higher for public sector women compared to women in the private sector than it is for public sector men (compared to men in the private sector).

- The public sector wage premium is highest for service occupations (protective services, food and beverage preparation, lodging and accommodations, and other services). This premium is mainly the result of large premiums for women in service occupations in



government, possibly reflecting the impact of pay equity in those jobs.

- The public sector premium for clerical workers is very modest, tending to be similar to the public sector pay premium for all jobs. Within the private sector, clerical workers earned, on average, about 16 percent more than workers in service occupations. Within the government sector, however, clerical workers earned 9 percent *less* than workers in service occupations (and 13 percent less in the federal government only).
- Overall, the tendency to pay less than the private sector is most prominent for managers, especially male managers. Within the private sector, managerial workers earned 41 percent more than workers in service occupations; within the government sector, managers earned only about 10 percent more than workers in service occupations.
- Occupational skill premiums are considerably smaller in the government sector compared to the private sector. The pay premium for employees in the managerial/administrative/professional occupations compared to employees in service occupations is only 10 percent in the government sector compared to 41 percent in the private sector.

A combination of factors explains government-private sector pay differences. Notable in this regard are 1) pay equity policies, which, over time, have worked to narrow (though not eliminate) the male-female pay differentials in governments, and 2) the tendency for governments to pay more than the private sector does for service jobs and less than the private sector for managers. In other words, the spread between the top and the bottom of the pay scale is substantially smaller in government than in the private sector, likely a result of political, social, and collective bargaining pressures.

Overall, the historical Census figures portray a picture of a moderate government pay premium

that increased very slightly from 4.6 percent in 1971 to 5.5 percent in 1981, and more substantially to 8.5 percent by 1991. Analysis of Census data for the 1991-96 period indicate that a stabilization took place, with the government premium being in the 9 percent range. Limitations of the historical Census data make it difficult to determine the extent to which the changes in the size of the premium are influenced by factors such as collective agreement coverage, firm size, narrowly defined occupational distributions and increases in the technological intensity and overall skill requirements of government employment. Notably, governments underwent significant changes in the composition of employment over this period. Very large numbers of lower-paying clerical positions were eliminated, while the share of employment in the higher-paying professional and managerial jobs increased. Government workforces have also aged more rapidly as a result of a “hiring freeze” over much of this period – as a general rule, earnings rise with age, experience and tenure.

IMPLICATIONS FOR GOVERNMENT COMPENSATION POLICY

The analysis of pay differences between the public and private sectors by Gunderson, Hyatt and Riddell is valuable in giving us detailed information on how such differences vary by occupation and for women compared to men. This information provides a springboard for us to move beyond the numbers as reported in this study to begin to consider the policy implications associated with the observed differences.

We note at the outset that governments face a number of challenges when setting appropriate pay levels for their employees. And, given broader labour market and demographic trends, it can be expected that the compensation determination



process will only become more complex in the next few years. So, what are the implications of these results for both government and union policy with respect to employee compensation?

Governments and unions face a number of dilemmas:

- First, after a long freeze on hiring, governments must begin recruiting relatively large numbers of new workers to replace older workers who are reaching retirement age. Governments' needs in this respect are greater than in the case of the private sector, since the demographic profile of employment in government is significantly older than it is in the private sector.
- Second, many of the new recruits needed by government are for positions requiring specialized skills. The same is true of the private sector, placing the two sets of employers in direct competition.
- Third, however, the demographic composition of the labour market as a whole is such that there is a smaller pool of young people from whom to recruit than in earlier decades.
- Fourth, the private sector faces many fewer constraints than governments when it comes to earnings opportunities – governments cannot compete with the extraordinary financial rewards associated with successful high-tech companies, for example. And the potential associated with such non-salary benefits as stock options only makes these differences larger.

Governments face many of the same dilemmas when designing compensation packages that will attract and retain senior managers. Male managers, especially, are paid significantly less in government than they are in the private sector. Yet, we know that the extremes that prevail in the earnings distribution in the private sector would not be acceptable in government – for one thing, taxpayers would not stand for paying salaries that match those of senior corporate executives.

On the other hand, nor should government adopt discriminatory pay practices. Hence we find that the pay gap between men and women in government is somewhat smaller than it is in the private sector – and smaller still when considering the federal government alone. This suggests that the so-called government pay premium is not a “premium” at all, but rather a step toward redressing systemic and inequitable biases in the labour market that unfairly penalize specific groups – in this case, women.

This discussion around wages has taken place thus far without reference to the wider range of rewards that make up overall compensation. Situating wages within a more broadly defined context – which would include everything from the kind of work environment and opportunities provided to the contents of the benefits package – creates more scope for satisfying both efficiency and equity goals in responding to wage reform pressures.

There is now a growing body of evidence showing that compensation is not the only factor driving job decisions. Most workers also place a high value on having interesting and challenging work that allows opportunities for skill and career development, as well as opportunities to balance their work and family lives. Moreover, much of the research points to gaps in government employees' fulfilment in these areas (see for example, Duxbury, Dyke and Lam, 1999; Lowe, 2000; and Smith and Snider, 1998).

A federal public service career development study conducted in 1998 showed that among the most important factors contributing to a sense of career success were: doing work that was enjoyable; having a sense of accomplishment; learning and developing skills; salary; and having a balance between work and family. Also important were: having stimulating co-workers; contributing to society; having some influence on the direction of the organization; and increasing financial rewards. Too often, however, there was “... a considerable gap between ‘dreams’ and ‘reality’” (Duxbury,



Dyke and Lam, 1999, p. xii), with smaller percentages of respondents reporting that such achievements were actually available to them. Just under half of survey respondents indicated they were very satisfied with their career progress to date and only about one-third believed it likely that they would be able to meet their career goals if they stayed with the public service.

A recent federal public service employee survey conducted by Treasury Board (1999), although revealing many positive aspects of civil-service work, also revealed a number of concerns. Fewer than half of the respondents to the survey reported such factors as: being encouraged to be innovative or to take initiative; having a say in decisions and actions that impact their work; getting help from their immediate supervisor or department in determining learning needs or getting career development support; or having had a promotion or believe they have a fair chance of getting one. Further, only 37 percent thought that senior management will try to resolve these concerns.

In summary, the turbulence in public sector labour markets in the 1990s seems to have slowed the tendency for public sector premiums to rise over time. The pay premium can be explained mainly

by the public sector's emphasis on closing pay equity gaps between workers. For example, women are more often paid the same as men, if they are doing the same kind of work.

While compensation is important for both efficiency and equity reasons, it is only one part of the equation. Recognition when good work is done, quality of working conditions, autonomy, access to information, the opportunity to work on interesting and relevant issues, to use one's skills and to develop new skills, and a number of other factors all have an important influence on the choices people make about where to work.

Looking ahead, as governments become more concerned about retaining their best workers and recruiting new workers to replace the large number of people coming up to retirement, they will be facing a much more competitive labour market setting. With highly skilled people being in a position to choose, government employers will need to re-examine their strategies regarding both compensation structures, especially for key occupations, and the wider range of human resource and workplace practices that shape the work context and the quality of working life within the public sector.

NOTES

1. Service occupations in government include workers in protective services, food and beverage preparation, lodging and accommodations, and "other" services.
2. Morley Gunderson is the CIBC Professor of Youth Employment at the University of Toronto, and a Professor at the Centre for Industrial Relations and the Department of Economics, University of Toronto. He is a Research Associate of the Institute for Policy Analysis, the Centre for International Studies and the Institute for

Human Development, Life Course and Ageing, and an Adjunct Scientist of the Institute for Work and Health. Douglas Hyatt is an Associate Professor at Scarborough College, the Rotman School of Management, and the Centre for Industrial Relations, University of Toronto. He is also a Research Associate of the Institute for Policy Analysis at the University of Toronto and a Research Scientist at the Institute for Work and Health. Craig Riddell is a Professor in the Department of Economics at the University of British Columbia and an Associate of the Canadian Institute for Advanced Research.



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- "Pay Differences between the Government and Private Sectors: Labour Force Survey and Census Estimates," by Morley Gunderson, Douglas Hyatt and Craig Riddell, Discussion Paper No. W|10, Human Resources in Government Series, February 2000, 73 pp.
- "Outsourcing of the Engineering Design Process in the Alberta Transportation and Utilities Department," by Sandra Rastin, Discussion Paper No. W|09, Human Resources in Government Series, December 1999, 43 pp.
- "Aeronautical and Technical Services – Natural Resources Canada," by Joseph Peters and Katie Davidman, Discussion Paper No. W|08, Human Resources in Government Series, December 1999, 30 pp.
- "'Industry Self-Management' as a Strategy for Restructuring Government: The Case of the Ministry of Consumer and Commercial Relations (MCCR) and the Technical Standards and Safety Authority (TSSA) in Ontario," by Zsuzsanna Lonti and Anil Verma, Discussion Paper No. W|07, Human Resources in Government Series, December 1999, 43 pp.
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- An Era of Change: Government Employment Trends in the 1980s and 1990s*, by Joseph Peters, CPRN Study No. W|03, Human Resources in Government Series, 1999, 84 pp., \$9.95, ISBN 1-896703-39-9.
- Forthcoming:*
- Public Service Labour Relations in an Era of Restraint and Restructuring*, edited by Gene Swimmer (Summer 2000).



HUMAN RESOURCES IN GOVERNMENT PROJECT

Governments in Canada have undergone a period of unprecedented change throughout the 1990s. External pressures and the need for fiscal restraint have led them to re-evaluate their services to the public, to restructure, and to make substantial workforce reductions. Each of these has significant human resource implications for governments, for public sector unions, and for employees.

The overriding goal of the Human Resources in Government Project is to generate new applied knowledge that will help the federal and provincial governments to redefine the strategies, policies, and procedures needed to transform the public service. A fundamental tenet is that this transformation must include the development of both efficient and innovative workplaces and a healthy, motivated, and skilled workforce.

The research is organized into three key research areas. The first group of studies set the context by describing how the environment shaping human resources in government is changing. They provide a statistical profile of employment trends, an analysis of trends in labour-management relations, and a comparative analysis of public-private sector compensation trends.

The next set of studies are generated from two large-scale surveys, one of managers responsible for workgroups of up to about 100 employees, and the other of public service union representatives. Reports on these surveys will address technological change in the workplace, organizational change and human resource management innovation, flexible work arrangements, and industrial relations issues.

The final stage of this project will address the issue of renewal and will culminate in a synthesis report that integrates the research findings to assist in the development of renewal strategies for government.

This project is funded at the federal level by Human Resources Development Canada, the Public Service Commission, and the Treasury Board Secretariat; at the provincial level by the governments of Alberta, Manitoba, Nova Scotia, and Ontario; and by the Public Service Alliance of Canada. The studies are guided by an advisory committee composed of representatives from each of the sponsoring agencies, along with a number of experts in the field.

