Public-Sector Pay and Adjustment

Lessons from five countries

Edited by
Christopher Colclough

Routledge Studies in Development Economics

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This volume describes and analyses the effects of structural adjustment upon public-sector pay, based on the experience of a number of countries: Singapore, Republic of Korea, Zambia, Zimbabwe and Argentina. This selection of cases provides a variety of experience as regards paths and stages of economic and social development, the application of adjustment policies and the role of the public service in these processes. For each country a number of important issues are investigated, including:

- the relationship between macroeconomic policies and private—public-sector wage developments
- public-sector pay policies
- reaction of public-service employees to real wage trends, pay policies and pay-administration practices
- the impact of state intervention in the labour market

The evidence presented in this volume shows that, in public sectors of unsuccessful adjusting countries, productivity was negatively affected by severe market-determined declines in pay. By contrast, the successful adjusters adopted an interventionist approach to the labour market, in which pay was a strategic target for government policy. Thus the need to use careful strategic interventions, rather than entirely market-determined approaches to the labour market, may be one of the major lessons of East Asian economic success.

**Christopher Colclough** is a Professorial Fellow of the Institute of Development Studies and of the University of Sussex.
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PUBLIC-SECTOR PAY AND ADJUSTMENT

Lessons from five countries

Edited by Christopher Colclough

A study prepared for the International Labour Office

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This book is the outcome of work undertaken by the ILO Interdepartmental Project on Structural Adjustment and the Remuneration Section of the Labour Law and Labour Relations Branch of the Industrial Relations and Labour Administration Department, with assistance from the Active Labour Market Policies Branch of the Employment Department.

The aim of the Interdepartmental Project on Structural Adjustment is, in cooperation with other departments of the International Labour office, to reinforce ILO policy advice in relation to structural adjustment policies in order to render them more consistent with ILO principles and approaches. Among the areas selected during 1992–93 for specific analysis and policy advice, the role of public-sector pay in an adjustment process was an important one. The trimming of public-sector pay has been almost invariably a primary lever by which governments have sought to reduce public budget deficits under any structural adjustment programme. The issue of public-sector wage levels tends to be nationally important, not only in terms of providing adequate compensation to public employees but also in terms of the broader consequences of public-sector wage determination for the labour market as a whole. At the same time, however, debates on public-sector pay, particularly as regards developing countries, tend to be long on ideological positions and short on empirical bases. This book seeks to provide a little more of the latter, in trying to inform policy analysis in this area.1

This book describes and analyses the effects of structural adjustment on public-sector pay, based on the experience of a number of countries—Singapore, Republic of Korea, Zambia, Zimbabwe and Argentina. This selection of cases provides a variety of experience as regards paths and stages of economic and social development, the application of adjustment policies and the role of the public service in these processes. For each country a number of important issues are investigated, such as the relationship between macroeconomic policies and private-public-sector wage developments, public-sector pay policies, and the reaction of public service
employees to real wage trends as well as to different pay policies and pay administration practices. Two of the important findings might be noted here. First, it seems that the efficiency wage hypothesis is particularly relevant to the public sector in many instances. The hypothesis states that pay and productivity are positively correlated and that a decline in pay levels below a certain threshold leads to severe efficiency losses; therefore employers have an incentive to maintain pay above the feasible minimum or market rate. The evidence presented in some of the case studies in this book documents how productivity is negatively affected by a decline in pay. This has led both to distortions in civil service pay systems and to a process of ‘informalization’ occurring within the public sector, as employees seek various (more or less unorthodox and illegitimate) means of supplementing their diminishing remuneration, all with deleterious effects on the institution of the public service. A second important finding is that in adjusting countries where levels of pay and other terms and conditions of civil service employment deteriorated less, or even improved, this was due to strong intervention by the State in the labour market to maintain public-sector pay at a certain level with respect to private-sector pay. This targeted interventionist approach is in sharp contrast to that implied by the liberal economic paradigm, which has so often been (misleadingly) used to characterize the policy stance of these countries.

We are grateful to Christopher Colclough, Professorial Fellow of the Institute of Development Studies at the University of Sussex, for having selected and edited the papers for this volume in his usual perceptive, even-handed and meticulous manner, and in particular for the insightful introduction which provides a synthetic overview of theory and policy lessons relating to the subject. Professor Colclough also prepared the Zambia study. However, the present volume could not have materialized without the enthusiastic support received from many people. We would first like to thank our colleagues Andrés Marinakis and Loretta de Luca, who prepared the project outlines and oversaw the various case studies in a most effective way. Secondly, our thanks are due to Derek Robinson, from the Institute of Economics and Statistics at Oxford University and a leading international specialist on labour market and public-sector pay issues, who was involved at the earlier conceptual and methodological stages of this project. Last, and not least by any means, we are grateful to the national contributors to this book, who met the requirements of the initial outline and then responded patiently to our comments and those of Professor Colclough. These collaborators are as follows (with their institutional affiliations at the time):

Oscar Cetrángolo, Institute for Industrial Development, Buenos Aires.
David C.E. Chew, Department of Economics, University of Singapore.
We hope that the information and analysis provided in this book will contribute to a better understanding of the crucial role that public-sector pay policies can play in an adjustment strategy that combines growth with equity concerns.

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NOTE

1

PUBLIC-SECTOR PAY AND ADJUSTMENT
Theory, policies and outcomes
Christopher Colclough

INTRODUCTION
This book describes and analyses trends in the public-sector wages, salaries and allowances of five countries over the past two decades. It thus provides five separate accounts of one important aspect of public policy. However, these stories are set against a background of broader economic events which give a particular context to the details of public-sector pay and which extend their significance. The main questions asked are: how has public-sector pay reacted to the adjustment experiences of countries in different economic circumstances and, more broadly, what lessons does this comparative experience suggest for the relationship between labour market policies and the conduct of successful adjustment? We must begin by clarifying what is meant by adjustment in these circumstances, and why public-sector pay is important to it.

Adjustment is defined here as a process of achieving rapid structural change in an economy, so as to secure stable growth of national income over the long term. This definition presupposes that, at least in some countries, merely seeking growth in the context of the existing structure of production will be unlikely to succeed. This may be for a variety of reasons. Historically, the most important reason—which has been dominant in the countries of Africa and Latin America during the 1980s and early 1990s—is that economic growth became blocked, mainly owing to the presence of unsustainable imbalances in the national economy between aggregate demand and aggregate supply. Such imbalances typically resulted in growing deficits in the balance of payments and high levels of domestic inflation. They were also often associated with large and growing public-sector deficits. In such circumstances it became necessary to secure short-term economic stabilization—by sharply restricting domestic demand, using a range of monetary and fiscal instruments. The attempt to secure longer-term adjustment usually involved the application of
supply-side policies to promote the production of exports and import substitutes, with a particular emphasis upon the use of the exchange rate instrument, and upon the reduction of tariffs and subsidies. The experience with stabilization and adjustment policies has been mixed in that, for many such countries, the major goal of such policies—the realization of stable economic growth—has so far remained elusive.

Three of the case studies in this volume—Zambia, Zimbabwe and Argentina—are drawn from this first category of countries where, using most relevant criteria, adjustment has not yet been a success. Each of them faced, over the 1980s, profound and unsustainable balance-of-payments deficits which necessitated the introduction of stabilization and adjustment measures, designed to restructure domestic production and demand. These were implemented with varying degrees of consistency, and subsequent economic performance has been mixed. Zimbabwe came closest of the three to containing its problems on external account and returning to economic stability, but progress even there was modest, and per capita incomes in each country continued to decline.

A second group of countries have been pursuing adjustment policies in very different circumstances, and with much greater success over the past three decades. These are the so-called ‘newly industrializing countries’ (NICs) of East Asia, which have achieved rapid and sustained growth mainly by diversifying their economies in favour of the production of manufactured exports. Here, the style of economic management has been sharply different from that which has characterized the countries of Africa and Latin America. Their emphasis upon export-led growth was secured by a system of domestic incentives which, throughout most of their period of rapid growth, attempted not to discriminate in favour of production for the home market, and where economies were liberalized such that most of the relevant pricing and institutional barriers to trade were removed. Governments still adopted an active role in economic management, but their interventions appear to have been much more strategically successful in achieving structural change than those in most of Africa and Latin America. Although there is much debate about which are the critical features accounting for East Asian success, there is no doubt that their adjustment record provides many important lessons for other states. The remaining two case-studies in this volume—Singapore and the Republic of Korea—are drawn from amongst this second group of high-growth economies.

All the countries selected for study in this volume, then, have been pursuing ‘adjustment’ in the sense earlier defined—a process of achieving rapid structural change, so as to secure stable growth of national income over the long term. Indeed, it was partly with reference to the apparent lessons for economic policy provided by Singapore, the Republic of Korea and the other NICs that the particular mix of structural adjustment policies advocated by the international financial institutions and Northern aid agencies—essentially
a fairly unmitigated shift to liberal economic regimes together with a much reduced role for government as a provider of goods and services—was justified.

The advocacy of state contraction and of market liberalization, as paired solutions to national economic demise, has been heavily influenced by the view that the slow progress made by many developing countries has been caused mainly by excessive economic intervention by their own governments. Neo-liberal economists have argued that the costs of this intervention have been large, and that the price distortions to which it has led have resulted in the market being hindered in promoting efficient resource allocation. The aim of state contraction has thus become independently influential in policy reforms advocated by the North, in addition to whatever corrective action may be needed to remove fiscal deficits in individual country circumstances. The level of government spending is, on this interpretation, an important variable to monitor during the process of adjustment. It is implied that successful adjustment, for countries with unsustainable imbalances on external account, will be unlikely in the absence of some reduction in the level of government spending relative to gross national product (GNP). The wage and salary bill, accounting, as it does, for a high proportion of total public spending, represents one of the main ways in which such expenditure reductions may be secured.

An additional reason for being interested in public-sector pay, in this context, is that the theory which underpins orthodox approaches to securing economic adjustment accords a fairly central role to movements in relative wages between different economic sectors. Here, the main aim is to increase the incentives for the domestic production of traded (export-and import-competing) goods and services so as to correct the balance of payments, and, ultimately, to seek long-term growth of production based upon national comparative advantage. Public-sector employees, in most countries, are engaged almost entirely in non-traded activities. There is therefore a question as to what approach should be taken towards wages and salaries in this important non-traded sector of the economy. We shall see that there is a certain tension—and perhaps even a contradiction—between the lessons of experience and those suggested by theory on this matter.

The relevant conclusions from the theoretical literature on the role of wages in adjustment, including those which have particular significance for the public sector, are reviewed in section 2 of this chapter. Alternative explanations for sectoral income differences, which have been widely observed in developing countries, are then examined. This is followed by a summary of the evidence on national trends in average wages and in pay differentials in the South over the past two decades. Finally, against this background, section 3 reviews the main results from the five case studies of public-sector pay, and section 4 draws some lessons for policy in adjusting countries.
THE ROLE OF WAGES IN ADJUSTMENT

The small-country, perfectly competitive case

A major aim of structural adjustment programmes, introduced in response to prolonged deficits in the balance of payments, has been to increase the production of tradable goods and services, relative to those of non-tradables. The small-country, open-economy model is usually employed in defence of this strategy (Bruno, 1976; Corden, 1977). This model assumes that the country’s own actions cannot affect the international prices for the goods in which it trades, i.e. it is a price-taker on international markets. It also assumes that it can sell (or buy) as many goods or services, internationally, as it cares to at these prices.

Under these assumptions, the immediate objective has been to raise the price of tradables \( P_t \), relative to non-tradables \( P_n \), in order to increase the incentives to produce the former relative to the latter. A range of fiscal and monetary measures are typically assigned as instruments to achieve this change. These aim to reduce domestic demand in general—thereby releasing more resources for export production—and to reduce the amount of government activity in particular, in part to reduce demand for non-tradables.

Where international prices \( P_t \) are fixed, these measures require \( P_n \) to be flexible downwards, in response to reductions in demand, in order for \( P_t/P_n \) to rise, i.e. product markets have to be fully competitive. Where labour markets are also fully competitive no sustained differential can occur between the wages paid in the tradables and non-tradables sectors. Thus, wages in tradables may rise in the short run in response to the increase in demand for labour in that sector as production increases, but these are quickly reduced again, as the transfer of labour from non-tradables is effected. The net result is a rise in the real product wage \( (RPW) \) in non-tradables and a fall in tradables, owing to the rise in \( P_t/P_n \) relative to the wage \( (W) \). Employment in the two sectors will have moved in opposite directions to the real product wage. However, the impact of all of this upon the real consumption wage is indeterminate because, whilst the prices of tradable goods will have risen, those of non-tradables will have fallen. Thus the outcome for the real consumption wage depends upon the extent to which tradables relative to non-tradables feature in the average consumption basket of wage earners. In a perfectly competitive world, therefore, the real resource shifts consequent on changes in relative prices do not imply necessarily adverse consequences for income distribution.

The impact of imperfections

The picture is different if we allow for the existence of imperfections, or—to put it in a different way—for the structural realities facing most developing
countries. If, for example, the price of non-tradables is inflexible downwards, fiscal and monetary measures alone are likely to prove insufficient, and a devaluation of the exchange rate will typically be needed in order to raise $P_t$ relative to $P_n$. Here, then, $P_n$ — and thus the real product wage in non-tradables — remains unchanged, whilst $P_t$ rises and $RPW$ falls. In this case, the value of the real consumption wage for all workers declines to the extent that they consume traded commodities.

A major form of imperfection in the labour markets of developing countries is segmentation. This occurs when some workers receive higher wages than others with similar human capital characteristics, purely because of the sector or industry in which they work. At the very least there is usually a significant difference between the earnings of those in informal self-employment (or in wage employment in the small-scale unregulated sector) and those in regular, formally contracted jobs. The former typically include many workers who are producing traded goods, and who would be beneficiaries of a rise in their relative price. How does the introduction of wage segmentation affect the analysis?

The classic case of this is an economy in which non-tradables (dominated by public service) are mainly the province of the formal sector, and where tradables (primary products and small manufactures) are mainly the province of the informal sector. If we adopt the simplifying assumption that employment is exclusively formal in the non-tradables sector and exclusively informal in the case of tradables, it can be shown that a devaluation, with formal wages remaining unchanged in nominal terms, would allow a higher level of informal employment than in the pre-devaluation case. The impact upon informal sector real incomes would be uncertain: nominal incomes would have risen from the production of the traded commodity, but so, also, would the prices of all other tradables consumed. On the other hand, the incomes of formal sector workers would have fallen, since nominal wages would remain unchanged. This case, therefore, would be consistent with devaluation achieving a redistribution of income from wage earners in non-tradables production towards informal sector workers in the tradables sector.

Of course, even in African economies, which perhaps fit the above stylized facts more closely than countries in other regions, the above model is likely to prove fallible in predicting outcomes. This is because, within both sectors, there are informal producers owning some capital, but producing on a small scale; and there are formal, capital-intensive, largescale producers characterized by wage employment. In African agriculture, for example, self-employed peasant producers are easily the most numerous, yet capitalist farmers often account for a higher proportion of marketed production. The question as to whether the rich or the poor are likely to gain from a particular adjustment strategy is therefore answerable only by analysing the specific circumstances of individual countries.
Second, however, there may be real wage inflexibility throughout the formal sector, arising from union power, indexation agreements or other causes (see later). If this were the case, the burden of adjustment in the non-tradables sector would fall not upon wages, but upon profits, and the extent to which ‘normal’ profits in that sector could be sustained would become critical. If price rises could be passed on to the consumer, there might be a tendency towards real, and not just nominal, inflexibility in the prices of non-tradable goods. In these circumstances, the initial price advantage in the tradables sector, consequent upon devaluation, would soon be eroded by price inflation in the non-tradable sector, and the resource-switching effects of devaluation would not in these circumstances be sustained. If, on the other hand, price rises could not be passed on, the rise in nominal wages in the non-tradables sector would lead to a fall in employment in that sector and a lower level of output.

It seems, then, that the sectoral response of real wages is at the heart of the adjustment process. If the real wage in the non-tradable sector remained constant, with $P_n$ flexible downwards, labour demand would fall to a greater extent than would otherwise be the case, and some workers would be able to protect their own wages and jobs at the expense of others. If, on the other hand, real wage inflexibility led to the rigidity of $P_n$, the adjustment process would be likely to be undermined, since the rise in wages induced by the increase in $P_t$ would increase $P_n$ until the original price ratio $P_t/P_n$ was restored. Finally, if real wages were flexible, a differential would open up between wages paid in tradable and non-tradable sectors. The extent to which this would be removed in the longer run depends upon the degree of inter-sectoral labour mobility, and upon the relative intensity of factor-use between the two sectors.

Wage rigidity versus wage flexibility

In contrast to the orthodox theoretical underpinnings of adjustment theory, which, as indicated above, are centrally concerned with the notion of wage flexibility, much of the earlier debates about wage determination in the South focused upon explanations for the apparent rigidity of wage levels, and of wage differentials, between different economic sectors. For example, a whole class of dual-economy growth models used the existence of a fixed urban wage, set at a higher rate than average rural incomes, as a central instrument for elucidating the development process (Lewis, 1954; Ranis and Fei, 1961; Jorgensen, 1961). According to this literature, the reasons for urban wages appearing to be set at levels higher than the opportunity costs of labour were to be found in the higher costs of urban living, the distance and costs of getting to the urban centres, and the need to compensate job-seekers for the time and effort involved in seeking urban work. Under these circumstances, the urban wage would provide an unlimited supply of
unskilled workers to the urban sector, until such a time as the rural labour surplus were removed (after which point urban and rural living standards would rise together).

These market-based explanations for persistently high rural-urban differentials were not universally accepted. Todaro (1969), for example, accepted as inevitable the downward rigidity of the urban-rural wage differential, and explained the decision to migrate from rural to urban areas in terms not only of perceived cost and income differentials, but also of the probability of finding an urban job: the higher the differential between rural and urban wages, the higher the ‘natural’ rate of urban unemployment. He, and many other observers, pointed to a range of institutional factors, or imperfections, which led to inflexibility of the urban or, more broadly, the formal sector wage. These factors, on the one hand, pushed the average level of wages well above those which could be justified on opportunity-cost grounds and, on the other, presented a formidable array of constraints which were likely to hamper any market-based attempts to reduce wages in the cause of adjustment and economic restructuring.

The range of actual interventions in labour markets of developing (and industrialized) countries is wide. They include the impact of collective bargaining and the influence of unions on the structure of wages and non-wage costs (e.g. social security benefits, pensions, severance pay, etc.); minimum-wage legislation, reflecting a wish on the part of governments to protect workers from poverty-level wages; and the broader wage-policy stance of the government which, according to some authors in the new political economy (NPE) tradition (e.g. Bates, 1981), is likely to be strongly informed by the interests of the urban classes, suggesting a pre-disposition towards high wages by governments wanting to retain political power. Some advocates of the NPE have gone further, to argue that politicians and bureaucrats are motivated only by individual self-interest. If true, this would seem to carry particular implications for wage policy, and for the continued privileged position of public-sector wages within it.

Empirical estimates of the extent of wage ‘distortion’ caused by these interventions are more scarce than one might expect in view of the frequency with which they are criticized in neo-liberal writings. For example, one recent review (Freeman, 1992) found little empirical evidence to suggest that minimum wages in general have deleteriously affected levels of employment, or indeed that they have had a strong upward influence on average wages in many countries. More generally, it concluded that studies designed to support the distortionist view of labour markets in developing countries failed to make a convincing empirical case. Nevertheless, whether distorting or not, the very existence of such interventions could be expected to provide an obstacle to the downward flexibility of real wages in response to the introduction of stabilization and adjustment measures. Rather more empirical
evidence exists with which to address this question, as will be seen from the next section of this chapter.

A rather different, and potentially powerful, set of explanations for the downward rigidity of wages in the formal sector is given by 'efficiency wages' theories. These take the view—contrary to standard wage theory—that wage-setting is not exogenous to the firm (i.e. not determined by supply and demand in the broader labour market), but that it is part and parcel of its own optimizing behaviour. This is because the productivity of labour is viewed to be a positive function of the wage—that, in an important sense, the wage rate determines labour productivity.\(^\text{10}\)

If this were generally true, it would present a strong challenge to the likely effectiveness of standard adjustment policies, and to the validity of the theory upon which they are based. This is because an attempt to lower real wages using macroeconomic instruments would be unlikely to succeed, because to allow it would be contrary to the interests of individual firms. Thus, where efficiency wages held, a nominal devaluation would be followed by increases in nominal wages in both tradable and non-tradable sectors to preserve the value of the consumption wage and thereby to preserve previous levels of profitability. This would not necessarily completely undermine the differential emerging between real product wages in tradables, compared with non-tradables, depending upon the extent to which non-tradables featured in average consumption baskets. But it would certainly reduce the power of the exchange rate instrument to change the cost structure in favour of tradables production, and thereby at the very least slow down the process of inter-sectoral labour transfer. A corollary would be that if wages were, in fact, reduced in these ways, the net impact upon output and profitability in the production of both tradables and non-tradables would be negative.

What do we know about wage and employment flexibility in developing countries?

From the early 1960s until the mid–1970s wages in most developing countries rose. Their rise was generally faster than that of per capita incomes, and faster also than the growth of incomes from agriculture. Thus, differentials between urban and rural, and formal and informal sectors increased, in favour of the former in each case. These facts suggested that the institutional factors mentioned earlier—unions, minimum wages, etc.—were influencing wage outcomes, often rather strongly.

As regards employment, labour was reallocated during the 1970s, away from primary sectors towards secondary and tertiary activities—in most countries the employment share of agriculture and mining fell, whilst that of services increased (Fallon and Riveros, 1989, p. 18). This pattern of growth is argued by some to be a natural concomitant of development—indeed that
structural change away from primary activities is one test of whether development is taking place (Chenery and Syrquin, 1975). Others, however, emphasized that in many countries, and particularly in sub-Saharan Africa, it was tertiary employment which had grown most rapidly. This was interpreted as symptomatic not of healthy diversification, but of an inappropriate growth of the public sector which had become the main source of structural change (World Bank, 1981). More generally, it was argued that in many countries domestic absorption (or total national expenditure) increased faster than production capacity, thereby increasing both the costs and resources involved in the production of non-tradables. These were often strongly dominated by public-sector activities.

During the 1980s, however, things changed dramatically. In most countries of Asia, real wages continued to rise—particularly in the newly industrializing countries and in China. Elsewhere, however, they fell. In Latin America, the falls were initially modest and some countries (Brazil, Colombia, Peru) continued to register gains, but in Africa wages fell in almost every country for which data are available and in some (Ghana, United Republic of Tanzania, Sierra Leone, Zambia) the decline was extremely sharp, resulting in a pauperization of large sections of the population. By consequence, real wages in sub-Saharan Africa were typically halved between 1970 and 1985.11

The decline in wages was fully shared by those working in the public sector. Indeed there is evidence to suggest that public servants were particular casualties of the economic decline. In Africa, for example, for 11 countries where the data are available, the real earnings of public-sector workers declined considerably faster than per capita income over the years 1975 to the mid–1980s. Furthermore, income differentials within the public service also declined markedly over this period: in every case, senior officers in the public service had significantly greater reductions in real salaries than unskilled and semi-skilled workers in the junior grades.12

Thus, the fears of those who doubted that wages would adjust in response to economic adversity have been shown to be unfounded. During the 1980s, the pattern throughout Africa and much of Latin America was one of sharp earnings decline—often led by wages and salaries in the public service—in response to the adjustment measures which were introduced. Wages have, then, proved flexible. Whether this has in fact helped the process of economic adjustment, however, is a different and much more complex question.

WHAT DO THE CASE STUDIES SHOW?

We have two groups of countries, to which we shall refer as high-growth adjusters and low-growth adjusters, respectively. These labels usefully emphasize the major difference between the recent economic histories of
Singapore and the Republic of Korea, on the one hand, and Zambia, Zimbabwe and Argentina on the other—that, in economic terms, the former have grown much more rapidly than the latter. Although the first group are now at much higher income levels than the second—with Singapore having, in 1992, a per capita income which was only marginally behind that of the United Kingdom—this has not always been so. As recently as 1980, the per capita income of the Republic of Korea was less than two-thirds that of Argentina, whilst Singapore and Argentina had similar levels of per capita income around 1970. It is important, therefore, to ask whether our case studies provide any evidence, however suggestive, for differences in labour market policies, or outcomes, which may be associated with the sharply different economic performance which continues to be revealed.

The high-growth adjusters

Singapore and the Republic of Korea, in common with the other high-growth economies of East Asia, each experienced strong increases in real average annual earnings during the 1970–90 period. The Republic of Korea was in fact one of the East Asian countries in which the growth of real wages was highest—running at close to 10 per cent per year during the 1970s and at about 6 per cent over the following decade. In Singapore, annual real wage growth was 3 per cent and 5 per cent for the two periods, respectively. As indicated earlier, these were years during which real wage growth in most countries of sub-Saharan Africa, and many of Latin America, was negligible.

Of course, such widely different performance stems from the high economic growth enjoyed in East Asia, which caused the demand for labour to rise steadily, and allowed rapid real wage growth to occur. Equally, rates of growth of the population, and thus of the labour force, were much lower in East Asia than elsewhere, which meant that the transition from labour surplus to labour shortage economies was within closer grasp.

As regards economic policies, however, the East Asian economies have often been characterized as cases where rapid growth has been facilitated by governments not intervening in the process of market allocation as much as happened in other developing regions. In terms of the labour market, the argument is advanced that a high level of efficiency in the allocation of labour was achieved by allowing wages and employment to be determined largely by the interaction of supply and demand.

According to this view, the main contrast in policies is thus that in East Asia wages were pulled up by increases in the demand for labour, whereas elsewhere they tended to be increased ‘artificially’. Furthermore, in the East Asian countries there were generally few, if any, wage premiums offered to the elite, and segmentation in the labour market was low: inter-sectoral
earnings differentials between agriculture and non-agriculture were small compared to other countries, and skilled-unskilled differentials were also low. These small gaps did not arise from unskilled wages being pushed upwards by minimum wage legislation or other interventions—rather, they were mainly a product of the large and growing supplies of educated labour, which compressed both the educational and occupational structure of relative wage rates. Finally, the size of public sectors was sharply controlled, rather than being increased in response to the job-creating demands of the unemployed, or of those in low-wage jobs. Thus, whereas in many African countries the share of the public sector dominated the increase in total wage employment in the 1965–80 period, in East Asia the role of the public sector was much less.

Although the above account contains some important generalizations which are undoubtedly accurate, our case studies for Singapore and the Republic of Korea indicate the need for some qualification of these stylized facts. First, and most important, is the observation that the governments of both countries have intervened very strongly in the labour market over many years. In Singapore, the Government repressed wages sharply until 1979, which led to the emergence of an acute labour shortage and to unsupportably high levels of imported labour from surrounding countries. And in the Republic of Korea, during the 1970s and early 1980s, when surplus labour no longer acted as a brake on real wages, labour rights were denied by the Government, and trade unions were prevented from having any role in wage determination. Thus, the sense in which wages were shaped by supply and demand refers in this case to the rather special market outcomes which attend an absence of labour rights to collective association. These were undoubtedly lower than would have occurred if labour rights had not been denied.

Second, government intervention went well beyond the ‘freeing’ of the labour market by curtailing union activities. Beginning in 1979, the Government of Singapore changed its development strategy away from seeking a labour-intensive growth path towards the encouragement of more capital- and skill-intensive development. It assigned wages policy a central role in this process. The annual wage guidelines promulgated by the Government for the whole economy became deliberately generous, which led to higher labour costs and strong incentives to economize in the use of labour. This led to a closer balance between labour demand and supply, and to a rapid change in the skill composition of the employed labour force.

In the case of the Republic of Korea, wages policy has also been judged by the Government as being critical for the country’s continued economic success. Throughout the 1980s attempts were made to moderate the rapid rates of increase in real wages which were occurring throughout the formal sector. The main vehicle for this was public-sector wage settlements, which were
held back as a means of imposing restraint upon the private sector—a policy which had only limited success.

Third, the case studies suggest that, at least in the Republic of Korea, there appears to be considerable labour market segmentation—in part a product of the wage policy pursued by the Government. In recent years, the private sector has offered considerably higher salaries to university graduates and to high-school leavers than have been available in the public sector. However, closer analysis shows that, in the case of gross earnings, the balance of advantage is reversed in favour of the public sector. It appears that the restraint upon public-sector wages imposed by the Government resulted in a significant increase in the number and value of allowances, and that these more than compensated for the higher basic wages paid outside the public sector. Thus the gross earnings of public servants were between 20 and 50 per cent greater than their counterparts in the private sector by 1991.

Fourth, there is a strong contrast between the size of wage and salary differentials which exist within sectors in Singapore and the Republic of Korea. In the case of the latter, there was a significant shift towards greater equality in the wage distribution during the 1980s. For example, in the public sector, differentials between the highest- and lowest-paid officers decreased from the already modest level of 11:1 in 1977 to 4:1 by 1991. On the other hand, in Singapore individual incentives were held to be of great importance, and differentials within the civil service, already very wide in 1977 (when a salary ratio of 45:1 between those at the top and bottom of the service obtained), widened further over the years to 1992.

Finally, the case studies of the high-growth adjusters confirm that the size of the public service was kept slim, accounting for about 4 per cent of total employment in Singapore and about 6 per cent in the Republic of Korea. On the other hand, whilst public employment in the Republic of Korea expanded slightly faster than that in the rest of the economy between 1975 and 1991, in Singapore, after increasing by 15 per cent between 1977 and 1979, civil service employment actually fell back to its 1977 levels by 1992. The evidence suggests that this reduction in the size of the public sector in Singapore was carefully managed. Rather than being a product of recruitment freezes, or ‘blanket’ redundancy policies, a highly selective approach was employed. Over the period 1986–92 the number of public officers in the lowest-skilled grades was reduced by 40 per cent, and the number of daily paid manual workers was halved. Yet the number of generalist administrators and professionals employed increased by 70 per cent over those years. Thus the wish to achieve structural change in the general composition of employment was reflected in the Government’s approach to the public-sector: the proportion of professional and administrative officers rose from 8 to 20 per cent of government employment over the years 1977–92. This, together with a wages policy which paid public
officers 10–20 per cent more than their private sector counterparts, very large seniority differentials, and an annual variable bonus for public officials which linked up to 20 per cent of their total pay to the performance of the economy, implicitly put a very high premium on the importance of achieving an effective and efficient public service.

The low-growth adjusters

The economic circumstances facing the group of ‘low-growth adjusters’ have been completely different from those facing Singapore and the Republic of Korea. Both Zambia and Argentina have exhibited long-term secular decline, and Zimbabwe’s economic difficulties—although more minor—also proved intractable over the decade beginning in 1982. Each of these economies faced the classic adjustment challenge of restructuring domestic production towards exportables, and thus of changing the balance of internal incentives in ways which would encourage that to happen. In response to severe balance-of-payments crises, each of these countries introduced elements of the ‘orthodox’ adjustment package. These included exchange rate devaluation and measures to liberalize trade and to reduce the growth of public spending. This section addresses the following questions: was the wage response to adjustment policy in the direction predicted by theory, and what have been the effects of the observed wage response in these three countries, in broader economic terms?

There is a well-established theme in the literature—and in many diagnoses of the adjustment challenge facing sub-Saharan Africa and Latin America—that governments are too big and that public-sector wages are too high. This may have been the case until the end of the 1970s or so, but things have changed dramatically since that time. As indicated earlier, it is now well established that the reduction in real wages, particularly in Africa, and particularly in African public sectors, has been extremely sharp over the 1980s and 1990s—so much so that current levels of remuneration seem often to be incompatible with maintaining minimal levels of efficiency (Lindauer et al., 1988; Colclough, 1991b; Robinson, 1990; Jamal and Weeks, 1993).

The case studies of the low-growth adjusters are no exception: they show that the real value of public-sector wages fell dramatically over the period 1975–90. This is seen most vividly in the case of Zambia, where the real value of salaries for most public-sector workers had declined, by 1991, to less than one-quarter of their value in 1975. But wage declines in the public services of Argentina and Zimbabwe were also sharp. In Argentina, average real wages of civil servants fell by 50 per cent between 1974 and 1980, and by a further 33 per cent over the following decade, whilst in Zimbabwe they had declined by 1990 to about 60 per cent of their 1980 values.
Changes in the wage structure in the low-growth adjusters have often exacerbated the problems caused by declining real wages. Differentials between the pay of senior and more junior staff have narrowed very substantially. For example, the ratio between highest and lowest salaries in Zambia declined from 18:1 to 5:1 between 1975 and 1991, and from 22:1 to 14:1 in Zimbabwe between 1980 and 1989. Differentials in Argentina were also reduced. Consequently, the average wage reductions mentioned above very substantially understate the income losses incurred by officers in the more senior professional, technical and administrative grades: for example, senior staff in the Zambian public service were, by 1991, drawing salaries equivalent in value to only 11–15 per cent of those paid to their counterparts in 1975. In Zimbabwe and Argentina salary decline for those in the highest grades was also much sharper than the average for all.

As mentioned in an earlier section of this chapter, the process of adjustment in Africa and Latin America has been driven by two separate—yet strongly intertwined—necessities. The first of these was to increase the relative incentives to produce tradable goods and services, which was partly, and most importantly, pursued via exchange rate devaluation. One consequence of this has been a decline in the real consumption wage, not only in government, but throughout the formal sector. The second influence was the need to secure a tolerable medium-run relationship between government revenues and expenditures. The high level of fiscal deficits was in many countries a source of accelerating inflation, and also a separate cause of balance-of-payments problems. In addition, it was argued by many analysts, including those in the international financial institutions, that a reduction in the share of government spending in GDP was also necessary in order to free up resources for more productive uses elsewhere in the economy. Accordingly, government expenditures became subject to sharp downward pressures from a number of sources, which have led to the result, documented by the cases in this book, that public employees have borne more of the wage adjustment than workers in other sectors of the economy.

Given that there was a need to move productive resources from non-tradable to tradable production, and that the public sector is mainly non-tradable, this result is not necessarily undesirable. But the evidence from these and other studies strongly suggests that the outcome has, in fact, been counterproductive from the point of view of achieving successful adjustment (as defined earlier in this chapter). It seems, first, that both the speed and extent of salary decline have been too great and, second, that in the public-sector too much attention has been focused upon reductions in the value of the real wage, and not enough has been given to restructuring the level of public employment.

In the three cases examined here there was remarkably little reduction in the level or change in the structure of public employment throughout the
years of salary decline. In none of the countries did public employment show signs of being reduced until the very end of the periods studied. In the case of Zimbabwe, employment in the public sector actually grew much faster than total employment throughout the 1980s increasing its share of total employment by 50 per cent over the decade. Even in Argentina, where the political pressures to expand the state provision of services were not so pressing as in post-independence Zimbabwe, the growth of employment in the public sector proceeded at a similar rate to that of formal employment as a whole. Thus, at least until 1990/91, governments in these, as in many other adjusting countries, had chosen to place almost the entire emphasis of fiscal restraint upon the reduction in the level of the real wage, rather than spreading it in a more balanced fashion between the number of people employed and their levels of pay.

This is partly because governments have found it hard, for obvious political reasons, to make workers redundant. Where this did occur, it was often concentrated (as in Zambia) amongst daily paid employees, where redundancy costs were minimal, and where articulate opposition was least strong. It was not usually a product of a thorough audit of existing staffing levels aimed at identifying surplus or low-priority posts. Such audits are critically needed in many countries, where low wages have caused major productivity declines, and where non-salary recurrent support is too low to allow many public officers to carry out their jobs effectively.

An equally interesting question concerns why it is that public sectors have not contracted as a result of the supply-side pressures caused by lower wages. There was some loss of the most skilled and experienced government workers to jobs in the private sector, which created particular problems in Zimbabwe and in Argentina. Yet, notwithstanding salary decline, those with jobs in the public sector have usually preferred to keep them rather than to leave for jobs elsewhere. This was partly because these economies suffer from high levels of unemployment and because public sector jobs, even at much lower levels of real wages, remained attractive, compared with the alternative of unemployment. But other factors were also at work.

The first reason for this was that the real cost of public employment fell much less sharply than the real wage, owing to an increase in the number of allowances, and to a major increase in their relative value in total remuneration. For example, in the Zambian case, the value of housing benefits for most public officers, amounted, by 1991/92, to more than the value of the salaries they received. The retention of housing benefits by Zambian civil servants was one of the more important factors which slowed the attrition of skilled and professional workers to the private sector. In general, in each of the low-growth adjusters, real earnings from government jobs dropped less sharply than real salaries, and total earnings differentials between the public and private sectors also deteriorated more slowly than relative wages.

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Second, the extent of salary decline in the public sector was such that many employees were forced to find additional means of raising cash incomes. Standards of management and control in the public services of all three countries were undermined by the pressures which this implied. Public employees began to engage in a wide range of income-generating activities, whilst retaining their jobs in the public sector, with relative impunity. This led to an alarming increase in absenteeism as a result of officials conducting other work during office hours. In all three countries there was also increased incidence of trading activities within government premises, and of the use of public equipment—workshops, repair facilities, typewriters—in the conduct of private work. Corruption increased sharply, and a culture of bribes became established, particularly in the Zambian case. Accordingly, retaining a job in the public sector was, for most people, a more profitable strategy than taking up employment in the private sector, where systems of personnel management and control were in less disarray.

By consequence, productivity in public service was deleteriously affected, in ways not anticipated by most packages of policy reform. Public employees spent less time doing their jobs, in order to supplement their incomes. Motivation was seriously undermined by the massively reduced rewards from work. Inefficiency was increased by a breakdown of management authority, and by the widespread incidence of corrupt practices. Thus the output of the government sector fell, whilst the incomes of those in its employ remained above the levels which their salaries would otherwise suggest.

Here, then, there appears to have been a process of ‘informalization’ occurring within the public sector. The reduction in real wages and salaries paid by governments has proceeded to levels which, in some countries, appear to be well below the reservation wages of many categories of worker in their employ. However, the particular mix of job security and fringe benefits—particularly housing—which still attend public office, together with lax standards of discipline and management which tolerate additional income-earning activities amongst employees, have substantially reduced the supply-side outflow from public employment which would otherwise have occurred. The public sector has itself become a significant locus for the ‘black’ economy. In this distorted, and entirely unintended sense, then, there has been a shift of employees in the public-sector towards working in informal, and often in tradable, activities—but this shift has been additional to, rather than substituting for, their public sector roles. This implies that, although the pay objectives set by these adjusting governments have perhaps been achieved, the employment and output effects of these policies, partly because of their flawed design, and partly because of the ways in which they have been implemented, have fallen well short of their stated goals: economic reforms to enhance competitiveness, such as devaluation or trade liberalization, will do little to induce civil service reform; judged by the
experience of these three countries, they may, indeed, set up pressures which tend to countermand it.

Civil service reform in Africa and Latin America requires the resolution of at least three important structural issues: first the question of the appropriate balance between wage and non-wage recurrent spending; second, the question of how many civil servants are required to meet the objectives of the government, at given levels of skill and pay; third, the need to develop a total compensation package that is conducive of good performance (Schiller, 1988, p.3). The difficult matter of making progress on all these fronts is likely to be further complicated if attempted within a macro setting of severe and unstructured real salary decline within the public service. Thus, the design of civil service reform packages needs to be completed alongside, or even prior to that of other adjustment measures. Their later introduction will be more difficult, and the belief that they will emerge as an automatic correlate of the general adjustment process is likely to prove seriously wrong.

CONCLUSIONS

Amongst the low-growth adjusting countries, Argentina and Zambia provide classic examples of countries following models of development which have been heavily criticized by neo-liberals. Over many years, resources earned by the export sector were transferred to the urban economy by highly interventionist governments. One result of these policies was a system of incentives which favoured the production of goods for the domestic market at prices which, protected by high tariff barriers and over-valued exchange rates, could not be competitive internationally. Zimbabwe, too, stagnated over much of the 1980s, although the genesis of that country’s problems was rather more to do with the impact of drought, international recession, and very large increases in public expenditure in the immediate post-independence years, than to the more structural problems faced by the other two countries.

The speed and nature of response to economic crisis made by the governments in these countries varied sharply. However, each of them introduced elements of the orthodox adjustment package, particularly over the second half of the 1980s and early 1990s. These included fiscal and monetary measures to reduce domestic demand, devaluation, and the introduction of measures to reduce public expenditure.

In each country wages fell substantially, particularly so for those in more senior jobs. Public-sector pay fell more sharply than elsewhere in the formal sector—often with disastrous effects upon the productivity of civil servants. Public employment, on the other hand, remained broadly unchanged or even increased. These experiences demonstrate that sharp downward flexibility in the real wage can certainly be achieved, and they are at least consistent with
the view that relative wages as between the non-tradables and tradables sectors also fell: thus, institutional rigidities in the labour market are not so pronounced as to confound the adjustment process. However, they also show that the speed and extent of wage decline imposed by an entirely market-determined approach can often be counter-productive. Wages, under these circumstances, can fall too far and too fast to be able to sustain important parts of the production structure.

Particularly in the public sector the efficiency wages hypothesis, which states that wages and productivity are positively correlated and endogenously determined, appears to be relevant. If employees react to lower pay by working less hard, or by spending less time in their main job in order to earn other income, the effects of salary decline can be negative. At very low levels of wages, or when wage decline has been particularly sharp, these effects can be magnified, since the perceived need to protect earlier standards will be the more urgent. The theories of labour market response to structural adjustment assume that the productivity of labour is largely unaffected by relative income decline. The evidence from the case studies presented here raises serious questions about the validity of that assumption.

One of the main lessons afforded by the experience of the high-growth adjusters is that they adopted a strongly interventionist approach to the labour market. Wages were one of the key strategic targets for government policy. Both Singapore and the Republic of Korea experienced large increases in real earnings during the 1980s. The Government of the Republic of Korea initially resisted wage inflation, in order to remain competitive in the older export industries. One strategy used was to disguise the extent of public-sector pay increases by shifting more of the increments to allowances, whilst using ‘moral persuasion’ to inhibit wage increases in the private sector. Although this strategy worked reasonably well under authoritarianism, it became much less effective as the economy opened up. In Singapore, on the other hand, wage increases were welcomed and, indeed, promoted by the Government—in contrast to its earlier low-wage approach of the 1970s—as a means of changing the country’s comparative advantage towards more high-technology, capital-intensive, skill-based export production. The civil service, already small, was reduced further in size; its skill structure was shifted sharply upwards; wages rose, pay differentials increased, and public-sector salaries attained a significant premium in comparison with those for similar jobs in the private sector.

Thus, contrary to the conventional wisdom, far from their pursuing a ‘hands-off’, market-determined approach, governments in the high-growth adjusting countries deliberately promoted both low-wage, labour-intensive and high-wage, skill-intensive development strategies at different times. It is important to note that the nature of these interventions was different to those made in many other countries. In particular, they were better timed, better planned and their effects were more strategically sensitive to market
circumstances, and to the development path selected and promoted by these and other government policies, than was typically the case elsewhere. The general desirability of this type of intervention, rather than of an entirely short-term, market-determined approach, seems clear on the basis of the evidence in this book. In that sense the lessons from the experience of the high-growth adjusters have often been misinterpreted, with consequent negative implications for adjustment policies in the poorer countries, as these have so far been pursued.

NOTES

1 This is a major area of current debate, and the balance of available empirical evidence cannot be taken to support the neo-liberal case. A review and assessment is given in Colclough (1991a).

2 The real product wage (RPW) is defined as the wage paid by an employer to his employees expressed in terms of the value of his product. It is measured by deflating the nominal wage by the unit price of the product. Thus, if nominal wages remain constant as output prices rise, the real product wage falls. Reductions in the real product wage imply—ceteris paribus—increased profitability of production in the sectors concerned. This, therefore, is the most useful of the various ‘real wage’ concepts, if our main interest lies with the demand side relationship between wages and employment. The real consumption wage, on the other hand (i.e. the wage deflated by an index of consumer prices), is of most interest for analysis of the supply side of the labour market (e.g. how the wage level affects workers’ participation).

3 See Addison and Demery (1993) for a formal presentation of this result.

4 Unlike Latin America, for example, African agricultural products—the mainstay of tradables production in both cases—are predominantly produced by family farmers, and small-scale manufacturing and services remain in their infancy.

5 See also Streeten (1987, pp. 1476–1477) on the limitations of two-sector models in this context.

6 This, in turn, would be likely to be influenced mainly by the fiscal and monetary instruments in the adjustment package rather than the exchange rate.

7 Note that \(P_t/P_n\) provides one definition of the real exchange rate (Edwards, 1989). A restoration of the original price ratio between traded and non-traded goods would imply that the attempt to change the real exchange rate via devaluation had failed. In order to support the downward movement of real wages, and of \(P_n/P_t\), demand management policies such as reduced public expenditures and tighter credit controls are usually advocated (Fallon and Riveros, 1989, p. 11).

8 On these latter points, see Johnson and Salop (1980) and Knight (1976).

9 Examples of such strong advocacy can be found in Buchanan et al. (1980). See also Findlay (1989) and, for a critique, Toye (1991).

10 For a brief review of efficiency wage theories, and of their possible relevance to the adjustment debate, see Riveros and Bouton (1994).

11 The generalizations in this paragraph are based on data shown in Colclough (1991b, table 2). The extent of salary decline, for different periods ending in the mid/late 1980s, has also been documented for more than 20 countries in Africa by Lindauer et al. (1988), Robinson (1990) and Jamal and Weeks (1993).

12 The countries are Botswana, Gambia, Ghana, Kenya, Malawi, Nigeria, Senegal, Sierra Leone, the Sudan, Uganda and Zambia. Botswana is an exception to the
general trend in that it alone experienced rapid per capita income growth over the 1975–85 period. However, during this time the real earnings of unskilled workers remained roughly unchanged, whilst those of senior government officials fell by around 7 per cent. Here too, then, differentials within the civil service narrowed. Data are from Colclough (1991b, table 3), and Lindauer et al. (1988, table 3).

13 A forcefully put example of the following argument can be found in World Bank (1993, pp.261–273).

14 For other evidence from 14 African countries, which supports this statement, see Harris et al. (1987).

15 More recently, in 1991/92, there was evidence that the Governments of both Argentina and Zambia had become more determined to reduce the levels of public employment, but the effects of these policies had still to be revealed.

16 This phenomenon is sometimes called ‘daylighting’, in contrast to ‘moonlighting’, which refers to additional work conducted outside office hours. For a useful account of the prevalence of these and other income-earning strategies in the Ugandan public service, see Chew (1990). For a demonstration that the incidence of moonlighting increases with the size of the private/public wage differential for public-sector workers in Côte d’Ivoire and Peru, see van der Gaag, Stelcner and Vijverberg (1989).

17 Van der Gaag et al. (1989) report similar conclusions for Côte d’Ivoire and Peru.

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