AN ANALYSIS OF REAL WAGES IN THE GOVERNMENT SECTOR 1971-76

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PREFACE

The present study seeks to analyse the trends of real wages in the government sector during the period 1971—1976. The most important characteristic of this period was a runaway inflation, which gained momentum in late 1971—in fact in early 1972—and reached a peak in 1974-75 petering out in 1975-76. Thus the period under review enclosed most of an important inflationary cycle.

The worst sufferer was the fixed income group, the real value of whose cash balances was reduced drastically by such a substantial and persistent price rise. The government did respond to the situation and sought consciously to repair the damage by raising the money wages of its own employees.

The main objective of this study has been to measure the adequacy of this wage effort. Accordingly, the focus has been on tracing the movement of *real* wages over this period. The results of the study broadly confirm the widely felt *impression* of the government employees that theirs has been a losing fight against the onslaughts of inflation.

One of the policy implication of our analysis is that the situation *can* be remedied by an adequate rise in the *money* wages of the government employees, to keep the *real* wages *constant* over the inflationary cycle. However, any increase in the latter can be allowed only if the real GNP also shows enough improvement. That this effort will not be self-defeating in the sense of provoking a proportionate price rise, is clear from two "facts": (i) inflation is more properly a function of *real* wages rather than money wages; (ii) the wages of its own employees form only a relatively small proportion of total government expenditure. The present study provides a satisfactory documentation of this second "fact", which has seldom been noticed.

The present study departs from the other wage studies, published from time to time in the *PDR*, in its consistent use of the Implicit GNP deflator both to measure inflation and also to estimate the real wages of the government-sector employees. This preference over the Consumer Price and the Wholesale Price Indices, used generally for such purpose, is based on the fact that the GNP deflator is the most comprehensive index of inflation in the economy. Since the welfare of the government employees is most properly seen in the context of economy-wide changes, consistency demands that this index should also be used to estimate changes in their real wages.

The limitations of this study, in particular those flowing from the inadequacy of data, have been noted in the following pages. It is, however, the belief of the author that most of the results of this study will hold even if more satisfactory data were available. However, it is hoped that a fuller analysis will be undertaken by others of the various matters touched upon in this study.

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INTRODUCTION

The wage studies done so far in Pakistan [1,3] have been restricted to an analysis of wage policy in the large-scale manufacturing sector. The present study, on the other hand, focuses on government's wage policy. The importance of such a study cannot be over-emphasized. The government is the largest employer and its wage policy may influence the wage structure in the rest of the economy, particularly in the organized large-scale manufacturing sector; and is believed to have important direct and indirect effects on the general price level. Such a study is all the more warranted by prevalent misunderstandings on the subject. For instance, it is widely believed that wages paid to its own employees form an over-whelming proportion of total government expenditure, which is simply not true.

However, unfortunately, the data required for such a study are hard to come by. There is no single source, like the Census of Manufacturing Industries (CMI), where all the relevant material can be found about the government sector. The only systematic information on wages paid by the government sector to its own employees is available for that area of government which comes under the umbrella term: Civil Administration. Even here the data have to be culled from five different sources—from the budget documents of the federal government and the four provincial governments. Furthermore, the wages paid to defence personnel are not included in our estimates since this information is considered "classified" material. This is a substantial exclusion. The data on employment in the government sector needed for the computation of per capita wages are also not available from any published sources. Fortunately, the Establishment Division has conducted recently a census on employment in the federal government; while the information on employment by provincial governments has been obtained from a similar survey done by the office of the Special Assistant to the Prime Minister. As a result, most of the data in this paper have been drawn either from unpublished sources or from documents published by different government agencies.

Within the limitations imposed by the availability of data, the present study provides for the first time a comprehensive overview of wage trends in the government sector. The period had to be restricted to five years since comparable information did not exist for earlier years on all the aspects of wage policy we have tried to highlight in this study. For instance, the data on employment in the government sector go only as far back as 1971. While the application of econometric methods has been precluded by the very small number of 'observations, only five, effective use has been made in this paper of compound growth rates and simple arithmatic percentages to highlight many interesting, but seldom-noticed, aspects of government's wage policy.

It may be noted that the analysis in this study has been conducted in a macro-framework—i.e., dealing with broad magnitudes and changes in them. Specifically, we have been concerned with the behaviour of overall changes in the wages of the government employees, rather than with the changes in the shares of individual sub-groups of government employees furthermore, the analysis of this paper centres primarily on the "growth" aspects of wage policy; but throws valuable side-light on the vertical "equity" aspect—i.e., the question of maintaining the salary scales in a certain balance along a vertical line. Any scheme which aims at distributive justice will have a greater chance of success in an expansionary than in a contractionary situation. For, according to the well-known principle of Pareto-optimality, net gains are secured only when it is possible for one person in a group to get more while no one else gets less. During the period covered in this study the maxim of Pareto-optimality could not be met, since real wages in general declined.

The focus of this study has been on the computation of real wages in view of the fact that inflation is more appropriately a function of real wages and not money wages. A novel feature of this study is the use of the implicit GNP deflator as a measure of inflation and for computing real wages in preference to the Consumer Price Index, used widely for such purposes. This preference is based on the well-known fact that the implicit GNP deflator provides the most comprehensive measure of inflation. The estimates of real wages based on the implicit GNP deflator reported in this study are broadly in accord with those based on the Consumer Price Index. (Estimates based on the Consumer Price Index and the Wholesale Price Index have also been presented in the Appendix.)

The evidence marshalled in this paper also highlights the important relationship between price inflation and given wage increases. The limited evidence of the past five years indicates that increase in money wages should more properly be considered transmitter of inflation rather than the cause of it. Furthermore, the objective of controlling inflation is best achieved by a properly-devised fiscal and monetary policy. This should help dispel the popular misconception that any increases in the money wages paid by the government tend to push the general price level by *equal* proportion.[1]

It is hoped that the findings of this study will provide a rational basis for the formulation of a realistic wage policy for the government sector. These findings strongly suggest that "realism" dictates a relatively more liberal wage policy than has been followed so far. For instance, it may come as a surprise to many that increases in per capita real wages have lagged behind even the growth of per capita real GNP; or that real wages have grown at a rate slower than real GNP in the past five years!

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The general thrust of the argument in these sections is to provide a realistic estimate of the real wages, which is the crucial variable to watch in a regime of widespread inflation. The statistical information has been organized to: (i) provide an objective measure of the adequacy of the "wage effort" by the government; (ii) estimate the erosion of this wage effort by inflation; and

[1]It is indeed surprising that anyone these days should be holding such primitive views on inflation. This is exactly what the long-discarded Quantity Theory of Money had preached. Even the modern "monetarist" school does not subscribe to such ideas. This reminds one of Keynes's observation that ideas of "defunct economists" of distant past sometimes get reflected in government policy.