

POLICY BRIEF 205

Relating public and private remuneration

The private sector has a role to play in reducing excessive wage growth, given its effect on public-sector remuneration

What does the paper say?

A recent paper¹ finds that:

- In South Africa, **private-sector earnings influence wages in the public sector**, but not the other way around.
- Earnings in the **mining sector** have grown the most in recent years. While this growth **does not influence remuneration in any other private sub-sector**, it does significantly affect public-sector remuneration.

About the research

The study explores remuneration patterns in South Africa between 2000 and 2017, with a focus on the relationship between public- and private-sector earnings. Although remuneration is likely to increase over time in both sectors, this does not necessarily mean these increases are related to each other.

The authors conducted an empirical investigation into remuneration patterns to answer two questions:

- Is there a **causal relationship** between aggregate remuneration in the public and private sectors?
- Is remuneration in the **mining sector** affecting remuneration in other sectors?

What is the research context?

An unsustainable public wage bill poses a significant risk to South Africa's economy. Government's compensation spending more than tripled between 2006/07 and 2018/19, from R154 billion to more than R500 billion. This growth is largely the result of large wage increases and inflation. Compensation patterns play an important role in labour market performance and the economy, affecting inflation, job creation, economic growth, productivity, competitiveness and the real costs of keeping prices stable. Wage growth should be in line with productivity growth.

¹ A. Wörgötter and S. Nomdebevana (2019). Aggregate and sectoral public-private remuneration patterns in South Africa. ERSA Working Paper 786. Available at <https://econrsa.org/publications/working-papers/aggregate-and-sectoral-public-private-remuneration-patterns-south-africa>

How does it get to these findings?

There is a strong link **between private- and public-sector earnings** (see Figure 1), but remuneration in the public sector tends to be more volatile. Looking at remuneration data for 2001 to 2017, the authors **confirmed a stable, long-term relationship** between remuneration in the sectors.²

The study also looked at five sub-sectors in the public sector and six sub-sectors in the private sector (Table 1).

Figure 1: Real public- and private-sector earnings

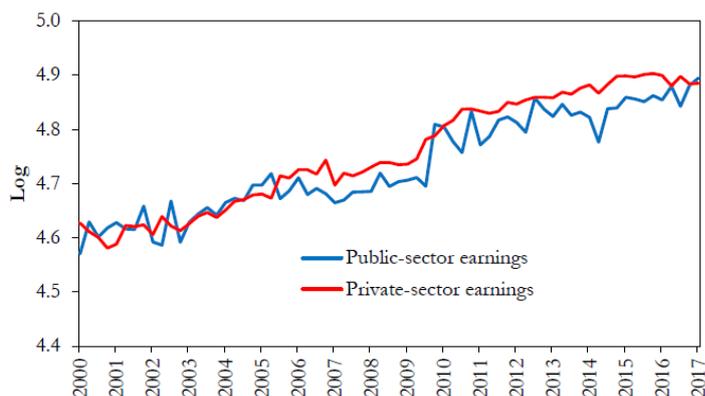


Table 1: Public and private sub-sectors analysed

Public sub-sector	Private sub-sector
National departments	Mining
Provinces	Construction
Local authorities	Manufacturing
Other public enterprises	Trade, catering and accommodation
Transport and communications	Private transport and communications
	Financial intermediation and institutions

The authors compared average public-sector earnings against individual private sub-sector earnings. They found that **only the financial and road transport sub-sectors are significantly affected by public-sector earnings in the long term**. In contrast, **average private-sector earnings have a significant long-term effect on individual public-sector earnings**, except for local authorities.

At the level of individual sub-sectors, it is easier to see considerable differences in remuneration. Private-sector earnings have a strong influence on remuneration in national departments, provinces, and public transport and communications. Earnings in municipalities and other public enterprises, on the other hand, are better explained by growth in public-sector earnings alone. In summary, the analysis reveals that, over the long term, **average remuneration in the public sector follows developments in the private sector**.

The mining sector is an important contributor to South Africa's economy. Unlike most other sub-sectors, **the profitability of mining is largely driven by international forces** rather than domestic developments. The authors investigated whether higher mining earnings spilled over to public or private sub-sectors, such as manufacturing or private transport. In the private sector, such spillovers in sub-sectors that cannot sustain high wage growth often lead to job losses. The authors found a **strong long-term relationship between the mining sub-sector and public-sector earnings, but not between mining and any other private sub-sector**.

So what?

Compensation accounts for more than 35% of consolidated public spending and has contributed significantly to the shortfall between government's income and spending. **It is important to understand what drives the public wage bill in order to contain it effectively**. If public-sector remuneration follows private-sector remuneration, then this implies that domestic market forces

² The authors used Granger causality tests to assess the direction of causality and vector error correction models to investigate the possibility of long-run equilibrium relationships between the variables.

(and, perhaps, international competitiveness) influence the public wage bill. The findings suggest that the private sector should be involved in national efforts to reduce excessive wage growth.