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## Journal of The Japanese and International Economies

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# A comparison of the wage structure between the public and private sectors in Japan



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### ARTICLE INFO

#### Article history:

Received 14 January 2015

Revised 10 January 2016

Available online 19 January 2016

#### JEL classifications:

H83

J31

J45

R23

#### Keywords:

Public sector

Wage gap

Age-wage profile

Regional wage differential

### ABSTRACT

**Morikawa, Masayuki**—A comparison of the wage structure between the public and private sectors in Japan

This study compares the wages in the public and private sectors in Japan. In addition to comparing overall wage levels, we examine the differences in the wage structures, specifically, the relative wages by gender, age, education, and region. The size of the public sector wage premium depends crucially on the size of the private companies chosen as the comparison group. Wage gaps by gender and educational attainment are smaller in the public sector than they are in private companies. The public sector's age-wage profile is steeper than that of the private sector. Public sector wages are more compressed. In other words, the wages are relatively higher at the lower end of the wage distribution and relatively lower at the higher end. The regional wage differentials are smaller in the public sector. Here, the wage levels of public sector workers are relatively higher in rural regions and relatively lower in large metropolitan regions. To ensure the efficient provision of public services, it is inappropriate to compare only mean wages. *J. Japanese Int. Economies* **39** (2016) 73–90. Research Institute of Economy, Trade and Industry (RIETI), 1-3-1 Kasumigaseki, Chiyoda-ku, Tokyo 100-8901, Japan.

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## 1. Introduction

After the Global Financial Crisis, some countries reduced their public sector wages to ensure fiscal sustainability. In Japan, after the Great East Japan Earthquake, the wages of central government officials were cut for two years to finance the subsequent reconstruction. Even in normal times, the appropriate level of public sector wages is debated frequently in every country. Because wages are an important incentive for workers, irrespective of their sector, appropriate public sector wage levels and structures are essential to ensuring high-quality and efficient public services. Several empirical studies have indicated that the wage levels of public sector employees (Borjas, 2002; Nickell and Quintini, 2002; Dal Bo et al., 2013) and politicians (Besley, 2004; Gagliarducci and Nannicini, 2013; Mocan and Altindag, 2013) affect the quality of workers and services in the public sector.

Similarly to other advanced countries, the wages of government officials in Japan are determined by the principle of “equal pay” with those of the private sector. In other words, the overall wage level of the public sector must be balanced with that of the private sector. One reason behind the equal pay principle is the perception of fairness from the viewpoint of nationals and citizens, though equal pay is also important for ensuring efficiency in the labor market. In practice, however, the wage structure of the public sector has often diverged from that of private sector. As shown in the next section, wages in the public sector are generally less dispersed in major countries. Wages in the public sector tend to be higher at the lower end of the wage/skill distribution and lower at the higher end of the distribution. If the wage level is excessive for some worker types in the public sector, then inefficient rationing is inevitable. In contrast, if the wage level of skilled workers is too low for some worker types in the public sector, the government has difficulty in hiring people with the necessary skills, which may negatively influence the quality of public services (Borjas, 2002; Nickell and Quintini, 2002).

As reviewed in the next section, many studies have examined whether the wage level of the public sector is balanced with that of the private sector (see Ehrenberg and Schwarz, 1986; Bender, 1998; Gregory and Borland, 1999 for surveys). However, past studies have also noted various difficulties in making accurate comparisons between the two sectors, including (1) the choice of appropriate comparison groups (occupation, size of the organizations, etc.), (2) the control of non-random sorting of individuals between the sectors, and (3) the treatment of compensations other than ordinary salaries, such as pensions and workplace amenities.

In parallel with the comparison of mean wage levels, past studies have identified various features of public sector wage structures by gender, educational attainment, and age group. However, somewhat surprisingly, there have been no formal empirical studies employing micro data covering both public and private sector workers in Japan.

Against this background, this study uses micro data from the 2007 Employment Status Survey (ESS) to compare the wage levels and structures of the public and private sectors in Japan. Specifically, we focus on the differences in the relative wages by gender, education, age, tenure, and region to present evidence on the differences in the wage structures of the two sectors. The ESS provides representative government statistics and surveys approximately one million people. A distinct advantage of the survey is its coverage of individuals in the public and private sectors.<sup>1</sup> Furthermore, employees in both the central government and in the local governments are included in the survey. As far as the author is aware, this is the first study to compare the wage structures of the public and private sectors by employing micro data from this large data set.<sup>2</sup> In addition, empirical studies on urban wage premiums that cover both public and private sector workers have been scarce, irrespective of the countries. Here, we present new evidence by comparing the patterns of the regional wage differentials of the two sectors.

<sup>1</sup> The Basic Survey on Wage Structure (Ministry of Health, Labor, and Welfare), which is the most frequently used source for estimating wage functions in Japan, does not include public sector workers.

<sup>2</sup> The National Personnel Authority (2006) combines two different surveys for government and private companies, and reports wage comparisons of central government and private sector workers. However, local government workers, who comprise the majority of public sector workers, are not covered by the survey.

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