

**IN FOCUS**

**LABOUR MARKET  
OF THE PUBLIC SECTOR**

Edited by  
**LÁSZLÓ NEUMANN**



## INTRODUCTION

LÁSZLÓ NEUMANN

Compared to the market sector, the public sector is a neglected area of research in terms of both the labour market and industrial relations, namely the institutions determining the terms and conditions of employment and wages. Disproportionately less attention has been given traditionally to the public sector in Hungary despite the fact that, as in other Member States of the European Union, the employer of one-third to one quarter of employees is – directly or indirectly – the state.<sup>1</sup> Such a swelling in the size of the public sector is connected historically to the expansion of the public-sector services and the emergence of the welfare state, even if sometimes we tend to forget this in the Eastern European version of it, called “premature” by János Kornai, because of the poor quality of the services and inequalities in our access to them. Regardless of the positive or negative perception of the community services, in many ways they play a key role in the reproduction of the labour force, especially through the public education sector, and in the spheres of health, cultural and social services.

The reform and modernization of the public sector has been at the centre of attention in the world of public policy ever since the 1970s. There is no doubt that the traditional Weberian “closed” model of bureaucracy and public service provision is expensive, since here public servants and public service providers have to receive reliable, sustained income of an appropriate standard, even after they retire. The price of their incorruptibility and loyalty is also to provide them with a so-called “lifelong career” – long-term promotion opportunities and ongoing training –, which, at the same time, protects them against unjustified dismissal.

Modernization was a necessity brought about by greater or lesser economic crises – such as the 2008–2010 financial and economic crisis, or more precisely the budget problems emerging as a result. The obvious way of reducing budget expenditures is by cutting public service spending. This can be achieved simply by reducing the number of civil servants, by curbing their benefits and/or improving their efficiency, for example by bringing the public service HR closer to that of the business sector. This is what the so-called *New Public Management* trend does. As a result of the reforms the “closed”, “career-based” system is replaced by hiring/dismissal, evaluation and incentives for a position or a task – in other words: the “open” public sector. The instruments of more flexible employment – already applied before the recent crisis – are not limited to fixed-term contracts, but include also the privatization of some

<sup>1</sup> Through the central government or various levels of local government apparatus or companies owned by the state/local governments.

services or outsourcing some tasks to private companies or to the appearance of atypical, precarious employment relations known from the private sector.

The public sector is also a determining entity from the perspective of the analysis of labour market phenomena. Since in the public sector the proportion of employed women, university graduates and older people is above the average, the level of earnings of public employees and its fluctuation strongly influence overall wage inequalities, the wage differentials between gender and age groups and the rate of return of higher education. Although the public sector is becoming less and less the world of lifelong “retirement jobs”, it still offers a relatively safe and predictable career. Both the civil servant body and health as well as social services require a sense of vocation and commitment from employees, for whom this provides a sense of social usefulness. This opens up particular employee preferences and selection mechanisms, whether regarding career choices, staying in the profession or leaving it.

Of course the need for commitment and maintaining the “public service ethos” – particularly within the bureaucratic body – required also some specific legal regulation of the employment conditions, and public sector labour law was born from the regulations traditionally belonging more to the administrative law. In the last decades the regulation of public sector employment has come closer to that of the private sector driven by the needs of the New Public Management, while the labour law of the private sector itself has also changed due to the reforms supporting more flexibility.

The public sector is also special from the point of view of industrial relations since here the state as employer is at the same time the creator of the rules regarding negotiations and consultations with trade unions, therefore it is difficult to ensure in labour relations – particularly in collective bargaining – the independence of the partners as required in the private sector. In fact in areas where state power is exercised in the public sector – to a different extent in various countries and ages – the collective rights of employees, the freedom of association, the right of collective bargaining and strike can be limited. The direct or indirect employer role of the state represents also a certain amount of interference in the private sector conditions – beyond the fact that public sector wages affect the private sector labour market. Therefore the state is widely considered to have a *role model* provider as an employer for the private sector, too.

The traditional attitude of the public sector trade union – due to the special selection of the employees already described – has been less confrontational than that of the private sector. In the last few decades, however, in many Western countries – particularly ones exposed to budget problems during the recent crisis – the public sector trade unions have become stronger and more “militant” exactly because of the challenges brought about by the modernization of the public sector and the crisis management afflicting its employees.<sup>2</sup>

2 The importance of this issue is shown by the fact that the last volume of the biennial series of the European Commission, entitled *Industrial Relations in Europe*, is dedicated mainly to the public sector and the crisis.

*In Focus* views the public sector from two perspectives: the labour market processes and their institutional background. However, this duality has imposed thematic limitations: while the authors of the sub-chapters analyse several professional and sectoral areas and subdivisions, they have had to largely ignore the perspective of the policies and disciplines dealing specifically with these areas – mainly those related to the service performance, quality or effectiveness. *In Focus* is structured in four chapters.

In the first chapter *János Köllő* writes about the most important facts in the Hungarian public sector, dealing with areas such as the headcount, the composition and the trend of wage level. The most distinctive feature of the Hungarian public sector when compared internationally is the extreme fluctuation – unprecedented in the OECD countries – of wage levels relative to the private sector, and – in the light of the current trends – the increasingly significant wage disadvantage compared to private sector employees with similar (demographic, educational, labour market, etc.) characteristics. The study also deals with the impact of income hikes and cuts on wage ratios between different groups, with the specific wage-path of university graduates over their life-long career and the methodological difficulties of studying public sector statistics. In writings in boxed texts (brief highlights) *László Neumann* and *Kitti Varadovics* present the trends of state/local government owned companies' headcounts and wages, *Ágota Scharle* deals with the size and costs of a segment of the labour market of the wider public sector – that of the public works programme. These two areas deserve special attention because in recent years their size has shown a significant increase due to the government's labour market policy and property policy that has reversed the previous privatization trend.<sup>3</sup>

Chapter 2 analyses the public sector mainly from the perspective of labour economics. The majority of recent research published here addresses the interaction between the various labour markets as well as the labour market flows. Most of the studies investigate the issue of the public-private wage gap which also influences the quality of the services and workforce selection. The paper of *Szilvia Altwicker-Hámori* and *Anna Lovász* examines the differences between private and public sector wages in the various segments of wage distribution before and after the big 2002 wage hike. The writing in boxed text by *Anna Lovász* deals with labour market discrimination in the public and private sector: with the gender wage gap and with occupational segregation through hiring and promotion. The next three sub-chapters focus on the interactions between the labour markets of the public and the private sector. *Álmos Telegdy* analyses the influence of the public sector wage increase from 2001–2002 on business sector wages. *János Köllő* is concerned with the influences of the widely varying wage gap between the two sectors – particularly the large increases before and after the 2002 elections – on the number

3 It should be noted that the majority of the studies limit their analysis to the public sphere – to the civil servants referred to under changing names and public service employees – in the strict sense; it is indicated, if otherwise. It is also worth noting that within the public sector in the strict sense different laws have been applying to government and municipality civil servants as well as armed forces personnel in executive power and for employees providing public service (e.g. in health care, education, social care.) See in detail in sub-chapters 3.1 and 3.2.

and quality of professionals coming from the private to the public sector. The papers of *Péter Elek* and *Péter Szabó* show the opposite direction transitions, presenting the composition and subsequent labour market behaviour of public sector leavers, including the chances of their re-employment in positions suitable to their educational attainment. The two papers written by *György Molnár* and *Zsuzsa Kapitány* contribute to the research on the already mentioned specific selection mechanisms of the public sector. One presents those non-monetary motivations and risk-minimizing family strategies that favour the choice of jobs in the public sector. The second piece a boxed text examines whether the general trend, that public sector employees are more satisfied than other workers, is valid in Hungary.

Chapter 3 covers the institutional background of the public sector labour market. Due to limited space we could not aim to present public sector labour law and the interest reconciliation system as separate treatises, instead here too, we focussed on the latest trends. *Beáta Nacsá's* sub-chapter reviews the most important changes since 2010 from the perspective of labour law: the rules of dismissal without justification, their repeal by the Constitutional Court, the new regulations from 2011, which has in essence re-established – through the dismissal cause of loss of confidence and indignity – the pre-repeal situation. *Erzsébet Berki's* paper presents the mechanisms of interest reconciliation and wage determination in the public sector, also highlighting the post-2010 changes. The collective agreements' coverage data of the *Statistical Data* chapter referring to the public service employees' field are related to this sub-chapter (*Table 10.9*). The boxed text looks at collective bargaining in the state-local government owned business sector. It also deals with the expected effect of the new law that limits the possible themes of collective bargaining at "community owned" companies. The next sub-chapters present an outlook on the reform efforts of the public sector taking place in Europe. *László Váradi* writes from a human resource management approach to describe the objectives and instruments of the *new public management*, and the neo-Weberian approaches that seek to simultaneously comply with the requirements of efficiency and of impartiality that ensure a professional and fair functioning of the public service. *Márk Edelényi* and *László Neumann* give an overview of the European Union countries' public sector labour law models and wage determination systems and the role of social dialogue, respectively their recent changes, including the reactions following the 2008 economic and financial crisis. *László Neumann* and *Márk Edelényi's* other study focuses on the local government sector. Firstly, it introduces the efforts of privatization, outsourcing and reorganizing within the European Union countries, as well as their effects on employment and the regulatory attempts connected to this. Secondly, it gives a brief review of similar efforts in Hungary and an insight into the labour relations of the local government-run in-

stitutions and local government-owned companies. This is complemented by a boxed text with two case studies from 2012 connected to the sub-chapter describing the labour-related consequences of outsourcing – in-sourcing and of handing over to the church.

Chapter 4 of *In Focus* presents the sub-markets of some principal occupations of the public sphere, combining the institutional approach with that of labour economics. *Júlia Varga* writes about teachers' wages, selection and those leaving the profession, while *János Köllő* and *Imre Szabó* consider the situation of physicians. The first deals with wages, tips and gratuities and with leaving the career path, the latter about the peculiarities of the interest reconciliations of the health sector, also providing, at the same time, a regional outlook on similar processes in the Czech Republic, Poland and Slovakia. *Erzsébet Berki*, *Éva Czethoffer* and *Endre Szabó* also publish two papers about the labour market position of those leaving their profession. They analyse the occupational trajectory of nurses and other health care professionals after their departure from the state health care-system and they also look at law enforcement employees after their retirement, whether they worked, and if so, in what field and how much they earned. In both cases they present the regulation changes within the field: the new pay scale in the area of health care and the abolition of the early retirement scheme, which triggered perhaps the biggest wave of protests of the post-2010 government measures in the public sector.

\*

The studies in *In Focus* have various time frames: labour economics analyses are largely from 2008 to 2010, the statistics generally are available until 2013, and some descriptive studies were also able to attempt to deal with the latest developments. Each chapter, then, where possible, shows the main statistical data on time series up until 2013 and analyses the changes in the interest reconciliation institutions also up to 2013. In addition – following the tradition of the annals – we publish in *In Focus* the results of previous research that have already been published by their authors in professional journals. Their publication here is justified by our endeavour to share their important findings on the processes of the public sector in a more comprehensible form with the wider public. Although these studies explore the period between 2008 and 2010, or are based on international data collection that does not have a more recent available database, the results – according to the opinion of the editors – are still relevant today. Where possible, the authors have updated their previous studies with assessments that take into account the changes (for example, the effects of the crisis, the growing disadvantage of public sector salaries against the private sector, the erosion of the job security advantages due to the frequent reorganizations and the further impairment of the

principle of irremovability), and have evaluated their relevance in the light of these results, respectively the likely deviations resulting from the changes.

The studies do not seek to directly make public policy recommendations, although, of course, their approach is far from being value-neutral. *In Focus* is not homogenous in this respect either: the various authors do not only touch upon public policy decisions to a different extent, and approach the public sector from different disciplines, but they also have different attitudes to the very same phenomenon (for example to the modernization of employment relations). The aim of the editors of the book was to bring the authors' different approaches into contention in order to present a diverse picture to the readers interested in public policy. Of course, as always in science, and on this occasion too, the authors are the only ones responsible for the views expressed in their study and for the possible factual errors and mistakes.



## 1. WHAT DO WE KNOW ABOUT PUBLIC SECTOR EMPLOYMENT?

JÁNOS KÖLLŐ

There have been surprisingly few studies looking at the public sector both in Hungary and internationally. One of the reasons is the absence of strong exogenous shocks: the size and relative earnings in the public sector have changed little in most countries and over time and this makes it difficult to differentiate between real and spurious differences, as well as cause and effect. Another barrier is the lack of information: data often does not even allow us to distinguish between the public and private sectors. Another factor that quite possibly contributes to the lack of research interest is the fact that the objectives of decision makers in the public sector are more difficult to define than those in the private sector and therefore it is difficult to put forward and test behavioural models (that are not based on *ad hoc* assumptions), and this is a serious competitive disadvantage to getting published.

Economists in Hungary are in a favourable position: measures of consecutive governments – including the “Bokros package”, large pay rises before and after the 2002 general elections, pay cuts implemented after 2004 and recent austerity measures that also affect employment – created quasi experimental situations that allow the examination of a range of relationships which would be difficult to analyse under more stable circumstances. At the same time the availability of statistical data is relatively good. However, as will be argued below, even finding the key facts is a challenging task.

### Size of the public sector

It is not easy to define who is part of the public sector. The law distinguishes between *those with a work contract* on the one hand, and *public servants, civil servants, judges and prosecutors*, or more recently *governmental employees* and *public workers* on the other. Those in employment are categorised according to the legal source of regulation (i.e. the Labour Code, Public Service Act etc.). A similar approach is adopted in the labour statistics of the Hungarian Central Statistical Office (CSO), and the Wage Tariff Survey of the National Labour Office. Other sources of economic data distinguish the *publicly-funded sector* and the *business sector*, the latter including publicly-owned companies. International comparison is made practically impossible by the fact that most datasets that would be potentially suitable for this only differentiate entire sectors that are predominantly public (education, health care, social care), however there is a large number of private companies operating in these sectors.<sup>1</sup> At the same time there are many companies in the private sector that are fully

<sup>1</sup> With the exception of public administration where there are some international comparative studies (for example *OECD*, 2011).

dependent *on public institutions*, either because they carry out outsourced activities or because they only supply central or local government organisations. In Hungary, the picture is further complicated by an unusually large number of workers involved in publicly useful work programs. Where possible, they are excluded from analysis, however in some datasets it is impossible to separate them from regular employees.

Table 1.1 shows that according to the CSO's labour statistics and the Wage Tariff Survey public sector employees made up approximately 30% of the total number of people working in companies with 5 or more employees and government-funded organisations in 2013. Other types of data are available from the CSO's Labour Force Survey. This makes no distinction between civil servants and public servants, however it does differentiate based on sector and ownership. According to this, employees of state-owned corporations and public institutions make up 27% of employment as defined by the ILO-OECD and 33% of employees in 2011. (See Box 1.2 for an estimate of the workforce in public/local government-owned corporations). People employed in public administration, public education, health care and social care constituted 28% of employees and 22% of total employment. Although the figures vary with the definitions of "public sector" and "employment", and affected by the inclusion or exclusion of public workers, the differences are relatively small: *according to the latest available figures, approximately 30% of all employees and around one in four of those in employment worked in the public sector.*

**Table 1.1: Percentage of public sector workers in total employment and employee jobs in 2013 based on various sources**

	As % of total employment	As % of employees	Time period
<b>Institutional labour statistics</b>			
Public sector employees	-	29.1 <sup>a</sup>	2013
Wage Tariff Survey			
Civil servants, public servants, judges, prosecutors, public workers	-	31.4 <sup>b</sup>	May, 2013
Civil servants, public servants, judges, prosecutors	-	27.2 <sup>b</sup>	May, 2013
<b>Labour Force Survey</b>			
Employees of public corporations, public institutions, local governments <sup>c</sup>	27.2	32.5	1 <sup>st</sup> quarter, 2013
Employees of central or local government institutions in education, health care or social care	22.4	27.8	1 <sup>st</sup> quarter, 2013

<sup>a</sup> CSO Stadat Table 2.1.33 (Data from June 23, 2014). The target population is public institutions, companies with five or more employees and some non-profit organisations.

<sup>b</sup> Author's own calculation, observations weighted with coefficients provided by the National Labour Office. The target population is public institutions and businesses with five or more employees and non-profit organisations.

<sup>c</sup> Labour Force Survey, author's own calculation. People in employment includes everyone who had done at least one hour of paid work in the previous week or who did not do any paid work but were away from work only temporarily.

Naturally, it is considerably more difficult to estimate the number of private companies that are closely linked to the public sector. Using data from the CSO's labour force survey *Elek and Szabó* (2013) concluded that 40% of shifts from the public to the private sector between 1998–2002 did not involve a job change, suggesting large-scale outsourcing (for a summary of their study see Chapter 2.4 of this *In Focus*). Later, between 2002–2008, this was a lot less common. The number of private companies dependent on government purchases cannot be estimated without specialised surveys.

Within the public sector, the share of public administration and education is 39 and 36 per cent respectively, while health and social care make up 25 per cent. Fifty-seven per cent of public sector workers were employed by local governments in 2011, however this share had shrunk to 45 per cent by 2013. Currently, central government constitutes the largest segment of the public sector (*Table 1.2*).

**Table 1.2: Distribution of public sector employees by sector and level in the first quarter of 2013, in sectors dominated by public provision**

	Central Government	Local Government	Total
Public administration	25.2	14.0	39.2
Education	16.3	19.6	35.9
Health care	12.2	8.3	20.5
Social care	1.4	2.9	4.3
Total	55.1	44.8	100.0

Note: The definition of public sector is based on the sector and the ownership status of the employer. Figures also include the number of public workers.

Source: CSO Labour Force Survey, 1<sup>st</sup> quarter, 2013. Author's calculation.

The probability of employment in the public sector largely depends on gender, education and age: in 2011 the share of public sector workers was 19% among men and 45% among women; 15% among those with completed primary education and a vocational qualification, 27% among those with completed secondary education, 54% among those with higher education and 82% among those who did not complete primary education. The latter figure is so high because it includes people in public works programmes. Data from the Wage Tariff Survey show that the share of public sector employment increases with age (it is 22% among people in their twenties, 26% for those in their thirties, 36% in their forties and it is 40% among those aged over 50).

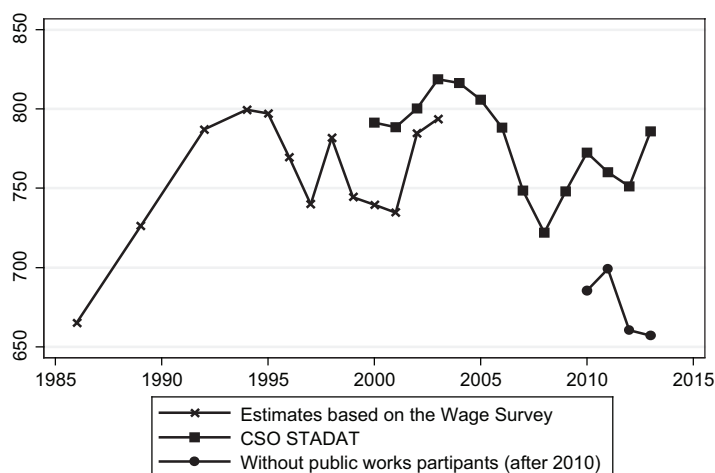
### **Trends in employment and pay over time**

The size of the public sector increased from 650 thousand to 800 thousand during the years of political transition when a number of activities previously carried out by the Party apparatus or state-owned enterprises were transferred to publicly-funded institutions (inspection, planning, supervision, welfare and

children's services) and when new types of services were also created. The expansion was halted by the "Bokros package" launched in March 1995 that also resulted in a 10-per cent decrease in the number of public sector employees.

After the turn of the millennium their number started to increase again until 2006 when a high budget deficit resulted in measures to reduce employment (*Figure 1.1*). However, the size of the public sector declined only up to 2008 and during the years of the crisis it stabilised – it even increased considerably if the number of public workers is taken into account. The number of employees was 3% higher in the public sector in January – March 2011 than in the same period three years earlier, while in the private sector there was a 4.8% fall. Nonetheless, the size of the public sector also later started to decline. Its current size is best compared to its 2000 level when the number of public workers was still negligible: data indicates a loss of 130 thousand people since that time. If the number of public works participants is included in the public sector workforce then an *increase* can be observed since 2008 and particularly since 2013 when public works programmes did not decline during the cold season in November and December.

**Figure 1.1: Employment in the public sector, 1986–2013 (thousand people)**

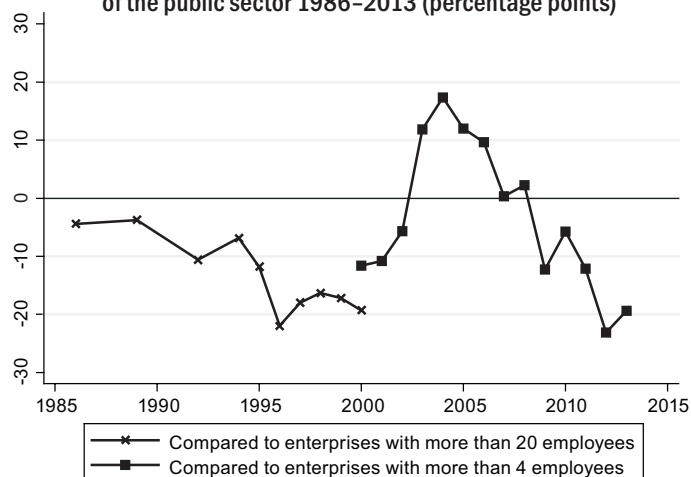


Note: No comparable data is available on the numbers of the workforce in public works programmes before 2010.

Source: CSO Stadat and Wage Tariff Survey 1986, 1989, 1992, 1994–2003.

The employment statistics suggest a high level of instability – a 130-thousand increase after transition, followed by a decline of 60 thousand, and then an increase of the same magnitude, followed by another decrease by nearly 150 thousand – but fluctuations in the level of *public sector pay* were even more marked. The public sector pay advantage or disadvantage compared to similar employees in terms of gender, age and education in the private sector fluctuated within the range of –22 and +17 percentage points (*Figure 1.2*).

Figure 1.2: Regression-adjusted pay advantage/disadvantage of the public sector 1986–2013 (percentage points)



Note: Regression estimates: on the left side of the equation it is the logarithm of pay and on the right side it is gender, number of years in education, labour market experience, its square and a public sector variable. The points measure the effect of the latter in percentage points.

Source: *Wage Tariff Survey*, 1986, 1989, 1992, 1994–2011. (Data is from May for each year. Prior to 1995 the Wage Tariff Survey only included companies with more than 20 employees, and until 2000 with more than 10 employees.)

The “Bokros package” worsened the pay position of the public sector by more than 10 percentage points relative to the private sector. The narrowing of the pay gap continued between 1997–2000 but was later followed by a sharp increase. The increase of the minimum wage by Mr. Orbán’s first Government had a strong impact on the public sector because in 2000, 60% of non-graduate public sector workers were earning less than 50 thousand forints per month, the minimum wage in 2002. (The same number was 40% in companies with more than four employees in the private sector.) Secondly, before the general election in May 2002, the Orbán Government significantly increased the pay of civil servants. As a result the average real pay increased by 17% in the public sector between May 2001 and 2002, compared to seven per cent in the private sector. Thirdly and most importantly, when the Medgyessy-led Government entered into office in May 2002 they increased the basic pay of public servants by 50% in line with their pre-election pledge (the increase was endorsed by all parliamentary parties). As a result the average pay of public servants increased by 29% in real terms between May 2002 and 2003, compared to an increase of “only” 11% in the private sector. The pay disadvantage of the public sector (–6 percentage points in 2002) turned into a substantial pay premium: 11-percentage points in 2003 and 17 per cent in 2004.

The pay advantage, however, disappeared within three years. On the one hand, as is shown by *Telegdy* (2013) – summarised in Chapter 2.2 of this *In*

*Focus* – pay in the private sector, particularly in jobs where workers can easily move between sectors, increased faster than average after 2003. On the other hand, the austerity measures introduced to reduce the large internal and external deficit in 2006 rapidly eroded the pay advantage of the public sector. Finally, the abolition of the additional 13<sup>th</sup> month pay of civil and public servants in 2009 meant an immediate drop of 12 percentage points in the relative pay level of the public sector. This was compounded by an informal but effective freeze of the basic pay of civil and public servants at the 2008-level. In 2012 the gradual pay increase of doctors and nurses was decided and in 2013 teachers' pay also increased, but these had not reversed the worsening trend by May 2013: public sector employees were paid 20% less than their counterparts – based on gender, age and education – in the private sector; just as in 1996, the second year of the “Bokros package”.

### On instability in the public sector

This section presents some of the characteristics of Hungarian regulation that are essential for understanding the public sector labour market. The first is the *extreme instability* of the public sector's relative pay level.

As has been shown the relative pay level of the public sector compared to the private sector fluctuated between the extremes of a more than 20-percentage-point pay disadvantage and a nearly 20-percentage-point wage premium since 1986. Such fluctuation of the pay gap was unprecedented in the European Union before the 2008 financial and economic crisis. (Even since then, only Romania experienced a loss of advantage comparable to Hungary, see *Vasile*, 2012.)

**Table 1.3: The range of pay gaps between the public and private sectors in selected countries between 1993 and 2000 (percentage points)**

Country	Minimum	Maximum	Difference
Austria	1.5	4.3	2.8
Finland	-1.3	0.0	1.3
France	-3.2	7.7	10.9
Germany	7.9	10.4	2.6
Greece	9.6	21.8	12.2
Holland	3.6	7.5	3.9
Ireland	16.3	21.9	5.6
Italy	10.3	12.1	1.8
Portugal	16.7	23.0	6.3
Spain	13.8	20.3	6.5
Hungary 1993–2000 <sup>a</sup>	-22.0	-3.8	18.2
Hungary 2001–2008 <sup>b</sup>	-11.6	17.7	29.3

<sup>a</sup> Compared to companies with more than 20 employees.

<sup>b</sup> Compared to companies with more than four employees.

Note: Positive (negative) values indicate the pay advantage (disadvantage) of the public sector. Control variable in the *Campos and Centeno* (2012) study: gender, age, square age, education, marital status, years in service. Control variables for the Hungarian data: gender, age, square age, education.

Source: European Community Household Panel (ECHP) data from Table 5.1 in *Campos and Centeno* (2012). Values for Hungary are the author's calculation based on data from the Wage Tariff Survey.

As data in *Table 1.3* (based on *Campos and Centeno*, 2012 and our own calculations) indicate, the difference between the minimum and maximum value of the pay gap nowhere exceed 6.5 percentage points between 1993 and 2000, apart from in Greece and France. Meanwhile in Hungary the difference was 18.2 percentage points in the same period and 29.5 percentage points in the following eight years. It should also be highlighted that in Greece the pay gap reached the 12.2 percentage points range as a result of a steady increase, and in France the pay gap ranged between  $-3$  and  $+8$  percentage points. Fluctuations similar to the Hungarian ones – as well as the large pay disadvantage at the nadirs – are rather exceptional in developed market economies.<sup>2</sup>

### The effect of pay rises and reductions on relative earnings

The second characteristic can be seen in the differences within the public sector: the highly paid benefitted more from the pay rises between 2000 and 2004; however the decrease during the “Bokros package” in 1994–1996, and particularly the decline since 2004 also affected them the most. This is illustrated in *Figure 1.3* with public servants who make up the largest group in the public sector. To create the figure, public servants were ranked into 100 groups based on their pay for each year. For each percentile the ratio of their average pay to the national average was calculated. The graphs of *Figure 1.3* illustrate the *changes* in these relative pay indicators. A value of 1.0 means that the rate of increase or decrease was the same as in the general economy.

The austerity measures of the “Bokros package” had a somewhat stronger effect on the high earners except for the highest paid two per cent (99<sup>th</sup> and 100<sup>th</sup> percentiles). In the “years of plenty” between 2000 and 2004, when the pay of public servants increased well above the national average, the pattern was more complex. There is a relatively large gain at the bottom of the distribution. There is a rapid increase in pay between the 10<sup>th</sup> and 70<sup>th</sup> percentiles, especially towards the higher ranks. In the top third of the distribution – where basic pay constitutes a smaller part of pay and thus the effect of an increase is also smaller – the rate of pay increase is smaller; however it is still about a third higher than the national average.

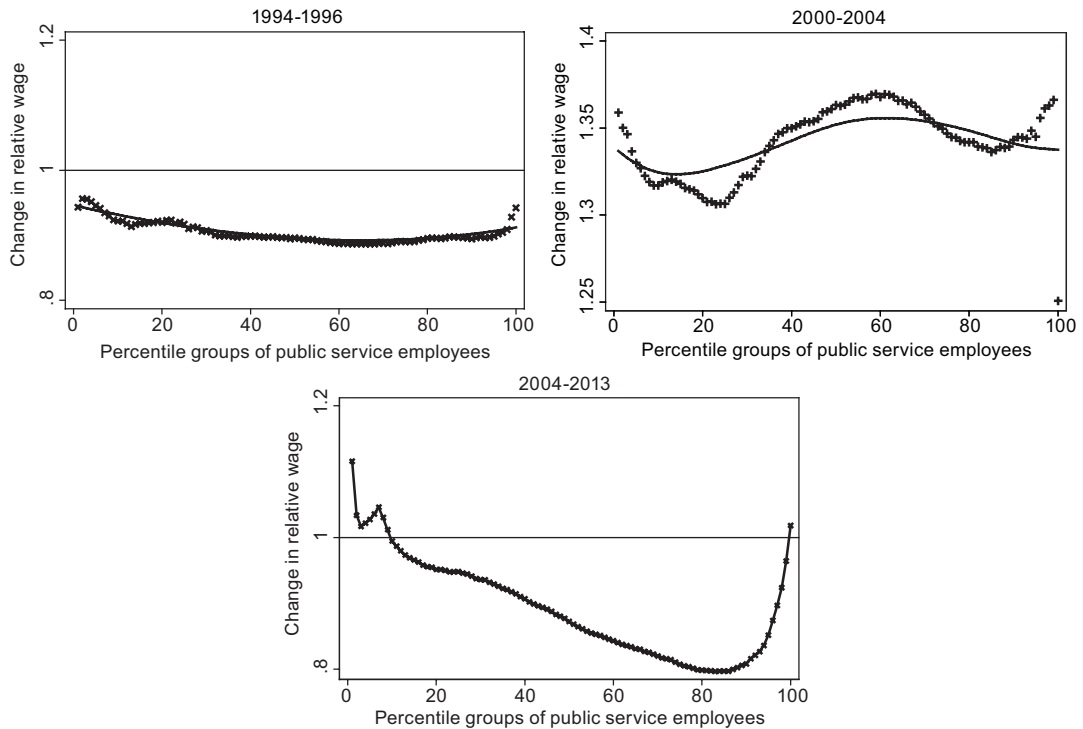
Pay changes showed a *U-shaped* curve between 2004 and 2013. The pay of the lowest paid workers kept up with the national average thanks to the minimum wage; however higher in the pay hierarchy there are increasing relative pay losses with the exception of the highest paid 10%, where towards the top

<sup>2</sup> However, *Gimpelson and Lukiyanova* (2009) find a very substantial pay disadvantage (26–28 percentage points according to their regression estimates) in the Russian public sector in the early 2000s.



the data show smaller relative losses. The top two per cent avoided the (relative) pay decrease affecting the majority of public sector workers altogether and they even had a modest increase.

**Figure 1.3: Changes in the pay of public servants in comparison to the national average by pay percentiles, between different time periods (ratio)**

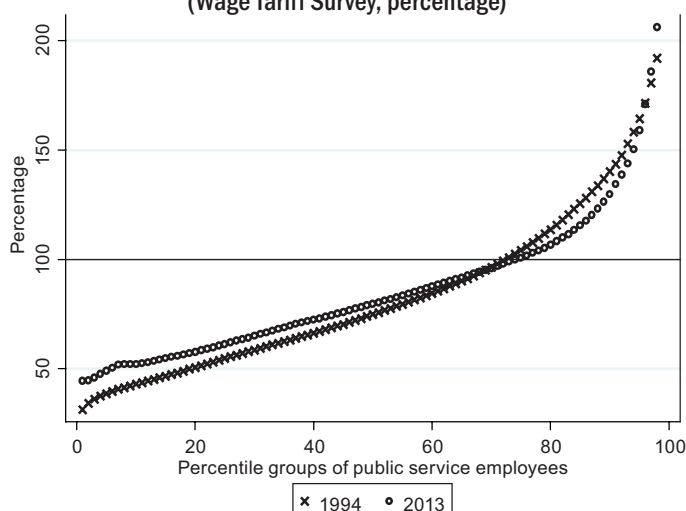


Source: *Wage Tariff Survey*.

As a result of austerity measures since 2004, public sector pay declined to the level of the last “peace year” before the Bokros package. *Figure 1.4* shows that the lowest paid public sector workers (percentiles 1–10, first decile) earned 30–40% of the national average in 1994, and 40–50% in 2013. In both years, approximately one in four public servants was paid more than the national average. At the same time, the distribution of earnings became more balanced: the gradient towards the lower end of the distribution was less steep in 2013 than in 1994.



Figure 1.4: Pay of public servants compared to the national average, 1994, 2013  
(Wage Tariff Survey, percentage)



Note: To calculate the national averages only data from companies with more than 20 employees was taken into account. The 200–300 percentage values for the 99<sup>th</sup> and 100<sup>th</sup> percentiles were not included to ensure clarity of the figure.

Source: *Wage Tariff Survey*, 1994, 2013.

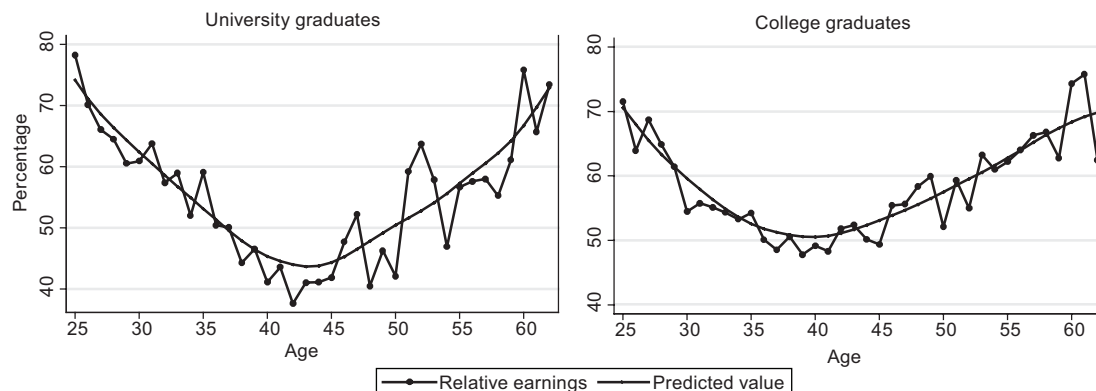
### The age-earnings profile of college/university graduates

The third characteristic is the distinctive age-earnings profile of *graduate* public and civil servants. Earlier studies (see for example Varga's 2008 paper on the teacher labour market) have already highlighted the *U-shaped* relative pay profile of graduate public servants: the pay disadvantage of the youngest and the oldest is considerable smaller than in the middle cohorts. This is because the regulations set a linear wage path for public servants and civil servants while in the private sector graduate – particularly university graduate – pay follows a strongly non-linear pattern: starting from a low level it increases rapidly then starts to decline towards the end of the career path.

Figure 1.5 shows that graduate school leavers earn 20–30 per cent less than their counterparts with a similar education and age in the private sector. Their disadvantage increases to 50–60 per cent around the age of 40. The disadvantage is smaller in the older cohort, it returns to the 25–30 per cent range. The pay disadvantage of college graduates is somewhat smaller, but the relative age-earnings curve shows a similar pattern.

The *U-shaped* curve, which essentially resulted from a legislative error in the early 1990s that has not been corrected since, has important implications. Firstly, young graduates entering public service face a continuous decline in relative pay in the first 15 years of their career and thus staying in public service means an increasing relative pay loss each year.

Figure 1.5: Graduate pay in the public sector compared to private sector employees of similar age and education, 2013 (percentage)



Source: *Wage Tariff Survey*, 2013.

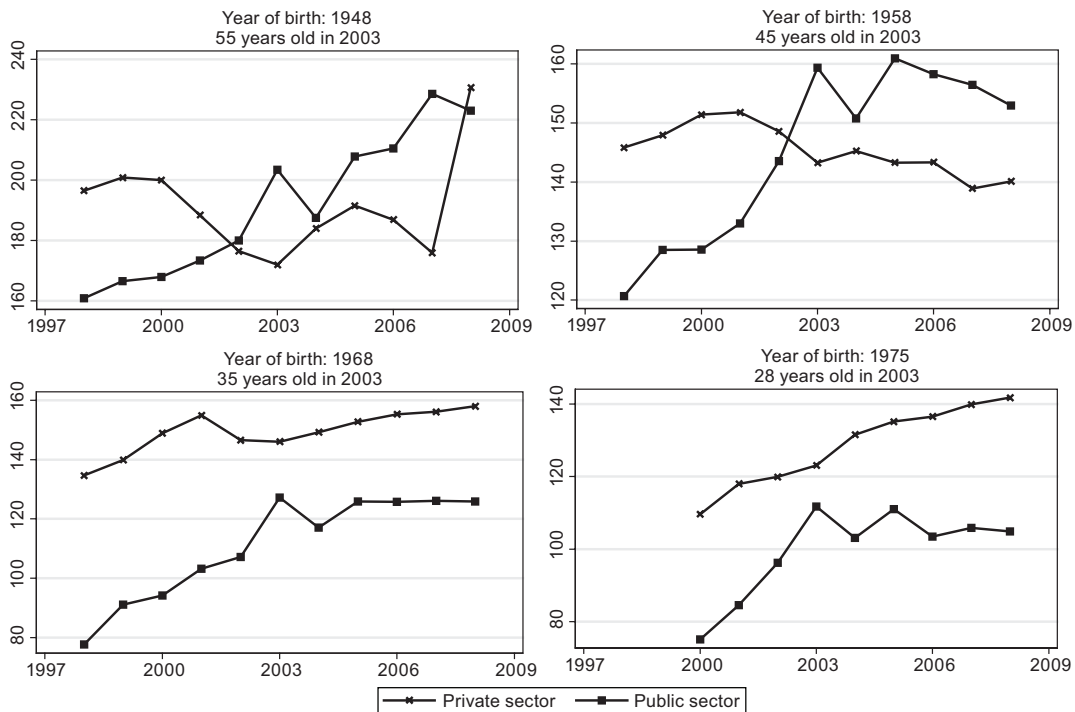
Secondly, in austere years, such as 2013, the disadvantage of middle cohorts can become extreme. Even if there are a number of non-pay rewards to set against the pay disadvantage (such as greater job security, longer holiday entitlement, feeling of usefulness, power in some areas, privileges, gratuities and income from corruption in others), according to international experience, a pay disadvantage of this extent – 50–60 per cent – is generally not permitted by legislation in developed market economies.

Thirdly, the *U-shaped* curve is so marked that it can influence the development of the relative pay of some *birth cohorts* in *calendar time*. If pay goes up in the public sector, its effect can be partly or fully offset by the fact that young people lose relative to their counterparts in the private sector each year until the age of 30–35 years. However, in older groups the effect of age adds to the effect of pay increase along the age-earnings profile: after the age of 35 years graduates in the public sector move closer to private sector employees even without a sectoral pay increase.

This is illustrated by *Figure 1.6* which follows the development of pay of four birth cohorts whose members were 55, 45, 35, or 28 years old in 2003. (People who were 25 in 2003, were still secondary school students at the beginning of the observations, therefore a slightly older cohort was selected.) The figures are based on information from the Electronic Register of the Central Administration of National Pension Insurance (in Hungarian: Országos Nyugdíjbiztosítási Főigazgatóság Központi Elektronikus Nyugdíj-nyilvántartási Rendszere; “Kelen” for short) that has enough observations to enable an analysis by birth cohorts. The curves show the effect of pay rises before and after the 2002 general election. The substantial disadvantage of the two older cohorts turned into a significant advantage, while in the case of the younger cohorts, the pay increases were enough only to stabilise their position – they

were still at a substantial disadvantage compared to their counterparts in the private sector even in the best years. This also implies that in years when pay is decreasing, younger cohorts are especially worse off.

Figure 1.6: Pay in graduate jobs in selected cohorts, 1998–2008 (percentage)



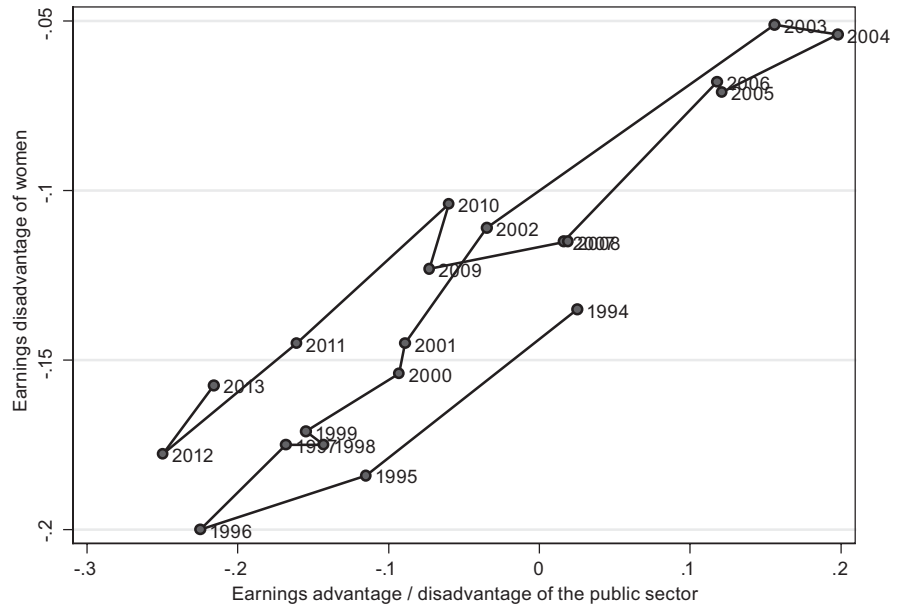
Indicator: employment status and daily pay calculated from the annual income of public servants/civil servants who had been in continuous employment during the year, expressed as a percentage of the average of the total sample.

Source: *Kelen*, 20 per cent sample.

### Public sector pay and the gender wage gap

The fourth characteristic that should be highlighted is the impact of pay fluctuations in the public sector on the situation of *women*. If the size of the two sectors, the proportion of women within the sectors and their pay disadvantages remains stable (the latter stabilised after 1993 in Hungary), then there will be a linear relationship between public sector pay and the gender pay gap. This is a rather trivial relationship, however its *strength* is noteworthy – this is highlighted by *Figure 1.7*. The horizontal axis of the graph indicates the regression-adjusted pay disadvantage (controlled for age and education) of the public sector. The vertical axis represents the gender pay gap in the *overall economy* using similar controls. The curve and the years indicate how the labour market moved within these coordinates in Hungary between 1994 and 2011.

Figure 1.7: Public sector and the gender pay gap, 1994–2013 (points on the logarithm)



Source: *Wage Tariff Survey*.

3 It emerges that the disadvantage of women is about five percentage points lower now – despite the fact that the overall wage disadvantage of the public sector is back at its mid-1990s level. This might be related to the narrowing of wage differentials in the public sector as depicted in Figure 1.4.

The points are essentially aligned on a straight line that has a gradient of 0.32. In other words, a 10-per-cent decline in the pay level of the public sector, increases the pay disadvantage of women by 3.2 per cent.<sup>3</sup> Considering the wide fluctuations of relative pay in the public sector, it seems justified to argue that the budgetary and political cycles of the past 20 years had the strongest effect on the labour market disadvantage of women.

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## 1.1 Number of employees and average wages in government and municipality owned businesses

LÁSZLÓ NEUMANN & KITTI VARADOVICS

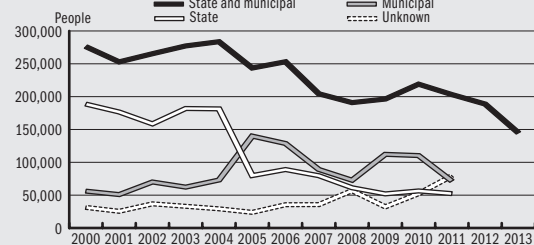
Given that the state-municipality owned business sector is, as a rule, classified as a part of the market sector – since the Labour Code is relevant also for employees of this sector –, this “hidden” public sector is virtually an unexplored area for statistical analysis. It is this shortfall that we have attempted to address by analysing data from the individual wage surveys conducted by the National Labour Office (Nemzeti Munkaügyi Hivatal, NMH) between 2000 and 2013. These data allow a breakdown of the market sector according to ownership structure into enterprises with a majority of state-local government ownership and to “genuine” private companies, where the state or the municipality has no, or only minority, ownership. Further fine-tuning of the analysis is possible if, within public assets, we separate state assets from municipal ones by relying on data from corporate tax returns, which are connected to the wage surveys of the KRTK data bank.

We are aware that for methodological reasons wage surveys are far from ideal for estimating the number of employees, nevertheless, for want of a better approach, we have to accept it as a first estimate. According to the data, the number of employees in the government and municipal business sector has decreased by 100,000 over the past decade, but still numbered 190,000 people in 2012 and 145,000 in 2013 (*Figure B1.1.1*). Taking this into consideration significantly enriches the well-known institutional statistical data on public sector employment (see Chapter 1).

Over the decade employment at companies owned by the central government decreased sharply and steadily, but grew at municipally owned enterprises. There was a radical change from 2004 to 2005, the explanation for which as yet remains unknown. On figure B1.1.1., up until 2011 (the last year when we were able to separate state and municipal ownership) we put “unknown” for the number of employees at companies where there was no

information on whether the owner was the government or a municipality. Such headcount figures differed each year (ranging between 11 and 39%) and the outstanding changes in 2008 and 2011 are, as it were, complements of municipal employment, therefore we can assume that the outlier data (more or less the part over 30,000) also represent municipal companies. With this correction it seems that since the 2006 austerity measures the employment level at municipality-owned companies has stabilized at around 100,000 employees. It can only be increasing because of expanding participation in the public works programme, although our estimate based on the wage survey suggests that until 2012 in this sector the increase of the full or part time workforce within the public works programme did not go beyond 5,000.

**Figure B1.1.1: Number of employees at state and municipally owned enterprises, 2000–2013**



Source: *Wage Tariff Survey* and the connected data on corporate tax returns from the *National Tax and Customs Administration of Hungary*.

The dynamics of earnings, non-adjusted for inflation, is almost unchanged in this sector, showing a steady increase (*Figure B1.1.2.a*). In the public sector (public servants and public service employees, without the public works programme) however, the increasing of wages ceased after 2008 and as a result of the crisis the dynamics of the genuine private sector was broken by 2010. Thus neither the government’s austerity measures, nor the impact of the crisis prevailed in the sector studied. The only marked change can be noted in connection with

the central state assets between 2006–2008, when the sector fell behind the municipal sector which was enjoying a steady increase in earnings, and also fell below the private sector. This disadvantage was overcome by an outstanding growth in 2009. (We do not know the exact reason behind the fluctuation but the assumption is that the Gyurcsány government had the state asset management organisations implement its austerity measures in the first two years, while the successor Bajnai government gave in to corporate efforts in this respect.)

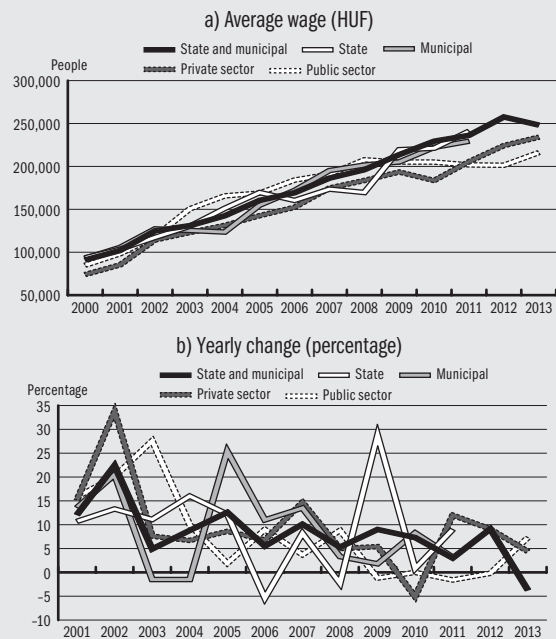
Differences between state- and municipality-owned companies are even more striking when we consider the fluctuation of yearly wage increases (*Figure B1.1.2.b*). The minimum wage hike in 2001–2002 can be perceived in every sector, as can also companies' reactions to it: pay increases were withheld in the following years. This was a particularly powerful process, causing an explicit decline in wages and lasting two years in the sector of municipal enterprises, despite the statistics showing that the proportion of low wage earners is no higher here than in the private sector or among public servants and public service employees. Another noteworthy phenomenon is the central government's "tightening-loosening" wage policy after 2006, which produced almost regular two-year cycles.

In order to define income disparity within sectors we used the inter-decile wage ratios of gross salaries (D9/D1, pertaining to the breakpoints of the first-second and ninth-tenth deciles) (*Figure B1.1.3*). As was expected, income disparities (the maximum being 5.1) are greatest in the real private sector, which decreased significantly in 2012 and remained low in the following year, probably due to the government's "wage compensation" measure that impelled the mandatory increase of low wages. The entire governmental-municipal sector is closest to the aggregated public sector (excluding public works programmes).

The minimum wage hike in 2001–2002 squeezed the pay scale in the private and the municipal sector but its impact was hardly visible at companies owned by the central government. In 2013 the smallest income disparity (3.0) was detected in the public sector, which can be explained by the squeezing

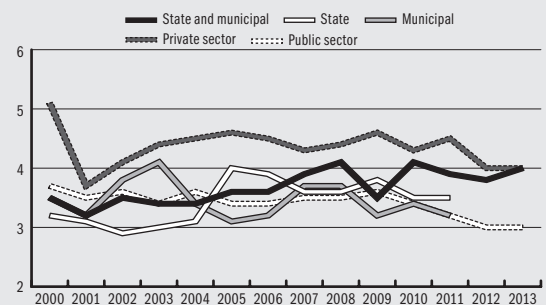
of the pay scale, which on this occasion was due to the minimum wage arriving at a level which exceeded frozen wages in pay scales. (See sub-chapter 3.2 of the present volume). Although the indicator of enterprises owned by municipalities and the central government has shown great swings over the decades – not independently from the annual wage increases –, it has nevertheless remained in the range between 3.0 and 4.0.

**Figure B1.1.2: Average wage and its yearly change at state- and municipally-owned companies, 2000–2013**



Source: See: Figure B1.1.1.

**Figure B1.1.3: Wage differentials (D9/D1) in different sectors**



Source: See: Figure B1.1.1.



## 1.2 The size and cost of public works employment

ÁGOTA SCHARLE

One of the characteristics of the public sector in Hungary is the large and expanding public works sector, which employed more workers than the textile industry or water management and almost as many as the public health care sector in 2010 (*Figure B1.2.1*). In Hungary on average 30–40 thousand people worked in some form of public works each year between 1996 and 2008. This number increased to 60–100 thousand after 2009 and in 2013 it surpassed 130 thousand. This means that on any given day of the year, on average 10–14 per cent (21% in 2013) of the registered unemployed were employed in public works programmes, and this was approximately equal to the total number of people in re-training, wage subsidy and other active labour market programmes.\* The total cost of the various public works programmes was around 0.1–0.2 per cent of the GDP before 2008, which increased to 0.2–0.5 per cent after the launch of the “Road to Work” programme.

**Figure B1.2.1: Share of public works employment within the public sector, 1992–2013**



Source: Number of people in public works programmes: IE CERS HAS Database and Annual Reports of the NLO, *Cseres-Gergely* (2014). Public sector workforce: CSO institutional labour statistics and János Köllő's estimate based on the NLO's Wage Tariff Survey.

\* More precisely, the number of people employed in public works programmes was compared to the sum of registered unemployed and public works participants.

According to OECD data from 2010, only Belgium had similarly high public spending on public works programmes (0.39% of the Hungarian and 0.36% of the Belgian GDP). Expenditure in Ireland, France and Slovenia was also high, but more modest than in Hungary, while other European countries spent below 0.1% of their GDP. The number of participants in public works programmes is also extremely high. In Hungary 2.4 per cent of the active population worked in some form of public works in 2010, in Belgium 3.2 per cent. The number of participants was also relatively high in Slovakia, Ireland and France (1.6, 1.1 and 1.0 per cent respectively), while in other countries it was below one per cent.

There have been public works programmes in Hungary since 1987. Similar public works programmes, although under different names and somewhat different conditions, were run by local councils from 1987, then by labour offices/centres from 1990, by the Public Works Council from 1996 as well as by municipal governments from 1997. However, their scope reached this spectacularly high level only after the launch of the Road to Work programme in 2009.

According to current regulation, people in public works programmes are employees in some respect: they pay pension and health care contributions, they are entitled to sick leave and annual leave, however their pay is somewhat under the statutory minimum wage.\*\* Municipal governments can organise public works programmes for activities that promote the “public good”, except for core municipal tasks. Therefore, for example health visitor, nursery worker and social welfare officer jobs cannot be filled with public works employees.

Public works provides cheap labour, but only that. Therefore it only represents good value for municipalities if it is used for tasks that do not re-

\*\* Another difference is that (unlike regular employees) if they refuse to take part in public works (or hand in their notice and leave) they cannot re-register as unemployed and claim benefits for 60 days.

quire substantial capital, highly specialised skills and expertise, or major organisation and management. On the one hand, this encourages local communities to use highly labour intensive technologies to carry out the tasks that are most useful to them. On the other hand, it also encourages them to choose projects that can be efficiently accomplished using mainly manual labour. In the first case, the municipality is contributing to the public good, however in a wasteful manner. In the second case, although they are using their resources efficiently, there is no guarantee that they are carrying out tasks that are most useful for the public. Whichever option municipalities follow, the sub-

stantial amount spent on public works fails to maximise the public good. \*\*\*

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\*\*\* Public works programmes are not inspected on a regular basis, which might create an opportunity for fraud; however this is not related to the size of the programmes or the number of participants, therefore it was not considered here.



## 2. WAGE LEVEL AND SELECTION IN THE PUBLIC SECTOR

### 2.1 Wage differential between the public and private sector in Hungary between 2002 and 2008

#### – the long term effect of wage increase

SZILVIA ALTWICKER-HÁMORI & ANNA LOVÁSZ

Contrary to experiences in Western European countries, in Hungary the average wage in the public sector is lower than in the private sector. The growing wage inequality between sectors in the 1990's resulted in social discontent and a decline in the demand for public sector jobs. To alleviate the situation the Government made pledges and introduced various measures: in line with their election campaign promises they increased the basic wage in the public sector on average by 50 per cent. In addition to improving fairness and appeasing public opinion, this also aimed to attract and retain highly qualified workers in the public sector. This chapter explores trends in the development of the wage gap between the public and the private sector in the context of wage reform between 2002 and 2008 using data from the National Employment Office's Wage Tariff Survey. It aims to answer the question of whether the wage increase helped the public sector to compete for a high quality workforce. The analysis is limited to public servants because they were affected by the 50% wage rise, and it concentrates on trends over time between sectors.

The analysis follows *Machado and Mata's* (2005) counterfactual decomposition method using quantile regression that enables us to identify different sources of wage differential: those that arise from the different characteristics of workers and employers, and the unexplained (residual) difference. The latter difference provides a better estimate of the real wage differential between public and private sector workers than the overall wage gap. The method of quantile regression also enables us to analyse the difference at various points of the wage distribution, rather than using the means.<sup>1</sup> Given that the shape of distribution is different in the private and public sector, it is difficult to assess the effect of wage rise for different groups using only the mean.

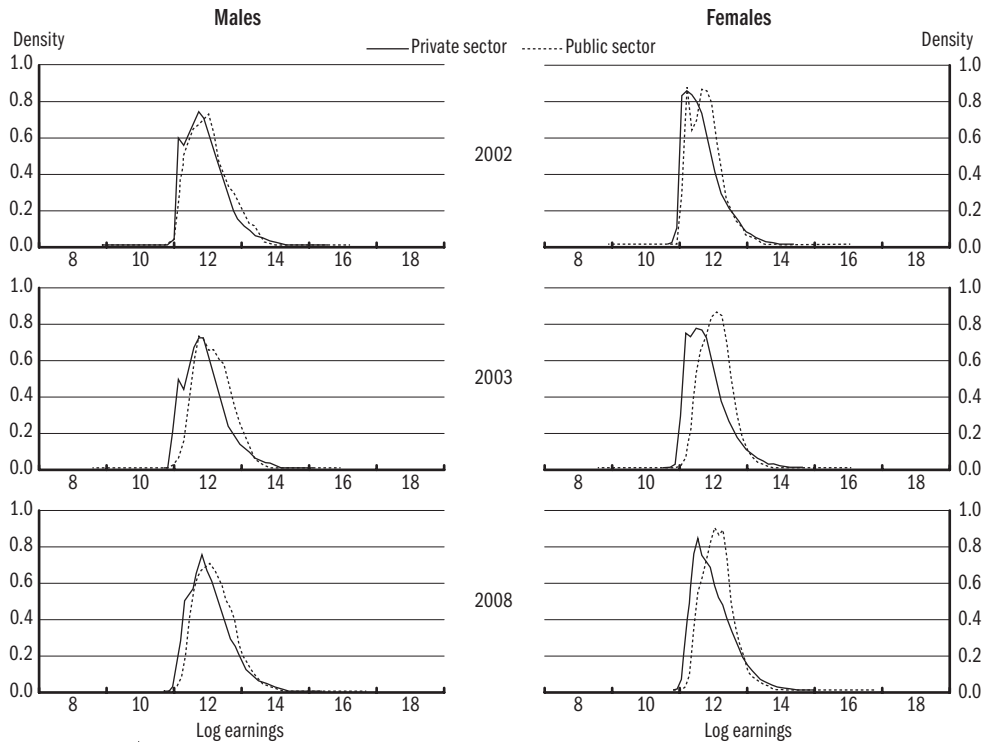
#### Wages in the public and private sector

Wage setting in Hungary is under political pressure – this is not unique – thus the wage scale is set in a way that ensures that workers in low-skilled jobs are not paid too little and highly skilled workers are not paid too much. Therefore, the spread of wages in the public sector is smaller than in the private sector where the primary aim is competition and wages are based on productivity. These differences can be observed on the density estimation of

<sup>1</sup> Difference between average wages was examined by *Telegdy* (2007). The average wage was 18 per cent higher in the public sector than in the private sector in 2004 as a result of the pay rise. Based on estimated unexplained wage differentials, public sector pay was higher than private sector pay in nearly all educational and occupational categories in 2004 (with the exception of graduates where the differential was under four per cent). This suggests that the government was successful in aligning and even increasing public sector wages.

wage distribution by sectors and gender (Figure 2.1.1). For the public sector (public servants) the distributions are more pointy (condensed), while in the private sector the tails of the distributions are flatter. The figures also illustrate the problem of fictitious minimum wages (under-reporting of wage) because there is a clear peak – particularly for men – at the level of minimum wage in the private sector.<sup>2</sup>

**Figure 2.1.1: Unconditional wage distribution in the public and private sector by gender, 2002, 2003, 2008**



<sup>2</sup> Various studies look at the prevalence and effect of under-reporting of wages, especially “fake minimum wage earners”; see for example *Elek et al.* (2012).

<sup>3</sup> The public service pay scale has fixed salary bands while the civil service pay scale sets out of minimum pay level for people in the same occupational group with the same level of education and experience. The pay scale is progressive both horizontally and vertically: wages increase according to 10 educational categories (A–J), within each educational category pay increases according to experience

*continued*

Note: Estimated Kernel-distribution of the logarithm of wage in the private and public sector, for women and men, 2002, 2003 and 2008. Public sector refers to public servants and the private sector is defined as workers employed by companies with at least 20 employees. Wage is real wages, deflated for 2008 prices using the consumer price index

Source: *Wage Tariff Survey* database.

The Government introduced differential wage increases for different groups of public sector workers (government officials, police, army and judiciary employees) between 2001 and 2003. The most significant wage reform was implemented in 2002 – an average of 50 per cent wage increase for public servants – that affected approximately 20 per cent of the total workforce in Hungary. The Government also modified the existing wage scale<sup>3</sup> after it had become squeezed as a result of the minimum wage increase and there-

fore it also changed relative wage. *Figure 2.1.1* shows the impact of changes on the distribution of wages in the two sectors during this period. In 2003, compared to 2002, wage distribution in the public sector moved right as a result of large wage increases; however, in 2008 the distributions became more similar again. The next section takes a closer look at the changes in the relative position of workers in the two sectors and the groups that were most affected by the reform.

## Data

The empirical analysis uses the database of the Wage Tariff Survey – this is an annual, representative, cross-sectional survey – that includes information on both private and public sector employees. *Public sector* institutions include public servants, civil servants, judges and prosecutors; however, this analysis focuses on public servants because the 50 per-cent wage increase affected only this group. Public servants make up approximately 85–89 per cent of all public sector employees. Judges and civil servants have separate wage scales. The Wage Tariff database includes a sample of all workers employed by public sector organisations. The *private sector* (business sector) refers to employees of businesses in Hungarian, international or public ownership in Hungary. The sample was limited to those aged between 25 and 55 years and people working part-time (less than 36 hours per week) were excluded.<sup>4</sup> Businesses with fewer than 20 employees were also excluded because under-reporting of wages is most common among small enterprises (*Elek et al.*, 2009, *Tonin*, 2007).

The database also includes the gross monthly wage of workers as well as the total income defined as the monthly average of gross wage and any regular or incidental benefits in the previous year. Values for the latter are presented here, although trends are very similar for gross wage as well. Income is on 2008 real value, deflated using the Consumer Price Index. In addition to wage and income, the analysis uses covariates related to the characteristics of employees (education, professional experience, years of service, job) and organisations (region, size of organisation). Finally, as a further covariate, variables related to the work environment (whether there is a lunch break, type of contract, difference between actual and official working hours) are also used, even though their scope is somewhat limited.

*Table 2.1.1* gives an overview of the mean values of the variables in the first and last period of the analysis. In 2002 average real wage for both men and women was higher in the private sector than in the public sector. In terms of education, the education level appears higher in the public sector:<sup>5</sup> in the public sector approximately 40–49 per cent of women and 42–45 per cent of men are graduates, while in the private sector the same number is 10–16 per cent and 13–16 per cent respectively. Professional experience is broadly similar in both sectors; however public sector employees have had a longer

in 14 grades. In the revised pay scale in the lowest educational category and grade (A1) pay equals the statutory minimum wage, and in the highest educational category with minimal experience (J1) it is 2.65 times the minimum wage. For graduates the lowest monthly wage was set at 100 thousand forints (in grade F1) which was twice the amount of the statutory minimum wage.

<sup>4</sup> Part-time employees in the private sector were not included in the data in 2002. The estimation was carried out on the full sample of employees between 2003 and 2008, which produced similar results. The samples from these years show that the proportion of part-time workers was really low, on average 3 per cent of all workers.

<sup>5</sup> This is also true for many other countries, such as the United States (*Poterba and Rueben*, 1994) and Western European economies (*Dustmann and van Soest*, 1997, *Lucifora and Meurs*, 2004, *Melly*, 2005).

tenure with their current employer. It is important to note for the analysis of trends over time, that there were no significant changes in the composition of the sample within the time frame of the analysis.

**Table 2.1.1: Covariate descriptive statistics, 2002 and 2008**

Variable	2002				2008			
	Men		Women		Men		Women	
	private	public	private	public	private	public	private	public
Average income <sup>a</sup> (forint, 2008 value)	189,472	155,990	233,020	207,681	188,004	176,512	155,125	132,546
<b>Education (percentage)</b>								
Primary school	16	14	13	10	18	13	25	19
Vocational school	45	22	43	20	24	9	25	10
Secondary education	26	21	28	21	41	33	40	32
Degree	13	42	16	49	16	45	10	40
Experience <sup>b</sup> (years)	22.2	22.9	22.1	22.5	22.6	23.6	23.7	23.4
Time at current employer (month)	104.6	113.7	94.3	115.2	85.9	133.6	106.0	131.4
<b>Region (percentage)</b>								
Central Hungary	31	36	36	39	41	32	36	28
Central Transdanubia	13	7	14	6	14	8	11	10
Western Transdanubia	13	8	11	7	11	8	13	9
Southern Transdanubia	9	10	7	11	7	11	8	10
Northern Hungary	11	11	10	9	9	11	9	14
Northern Great Plain	12	15	12	16	10	16	11	17
Southern Great Plain	12	13	10	13	9	14	11	13
Lunch break <sup>c</sup> (percentage)	46	92	50	96	43	98	40	98
Actual working hours (hours/week)	6.8	7.1	2.9	2.8	2.6	2.5	6.5	6.8
Permanent contract (percentage)	94	94	96	88	94	92	94	97
N	50,859	6,947	53,284	5,465	36,407	22,048	35,689	29,815

<sup>a</sup> *Income* is the sum of monthly gross wage and average monthly benefits, Hungarian forints, 2008 value, deflated with the annual consumer price index.

<sup>b</sup> *Experience* is potential professional experience: age of employee *minus* years spent in education *minus* six.

<sup>c</sup> The *Lunch break* variable indicates whether the work contract provides for a lunch break.

## Methods

<sup>6</sup> The method of quantile regression has been applied to the analysis of wage differential between the public and private sector among others by *Lucifora and Meurs* (2004), *Melly* (2005), *Mueller* (1998), *Nielsen and Rosholm* (2001) és *Poterba and Rueben* (1994). *Hátori* (2008) showed that similarly to international experiences the estimation of pay differential between the public and private sector is very sensitive to its position in the distribution.

For a closer examination of distributions, the method of quantile regression is used (*Koenker and Bassett*, 1978) that enables us to analyse the effect of covariates at different segments of the income distribution.<sup>6</sup> While in the OLS estimates, the effect of covariates on the dependent variable is measured at conditional means, here the extent of income differential between sectors is estimated at the 10<sup>th</sup>, 25<sup>th</sup>, 50<sup>th</sup>, 75<sup>th</sup> and 90<sup>th</sup> conditional percentiles. Therefore, we are not measuring average effect but allow for a different sector effect on the bottom, middle and top parts of the wage distribution. There is good reason to do this: more equal wage practise in the public sector might

mean that those on the bottom of the wage distribution are better off, while those at the top are worse off – this is also shown by the graphs. Quantile estimates provide a more accurate picture on how wage for a certain group of employees would differ in the private sector.

Total wage differential is decomposed using wage functions by quantile.<sup>7</sup> The Blinder–Oaxaca method (*Blinder, 1973, Oaxaca, 1973*) decomposes the difference between mean wages into a part explained by observable mean differences in characteristics and an unexplained, residual part. The method of quantile decomposition does not decompose wage differential only at the mean but at the quantiles as well. With *Machado and Mata's* (2005) method we are simulating what the income of public sector workers would be if they were working in the private sector (and would be paid the same for their characteristics), or differently we are looking at a counterfactual income distribution. Then this distribution will be compared to the actual distributions of private and public sector by separating the total income difference into a part that is explained by different characteristics and an unexplained part that is due to the fact that different characteristics are paid differently in the two sectors. Results are presented for total differences, differences explained by different characteristics and residual differences, for each year, by quantiles and gender.

## Results and conclusions

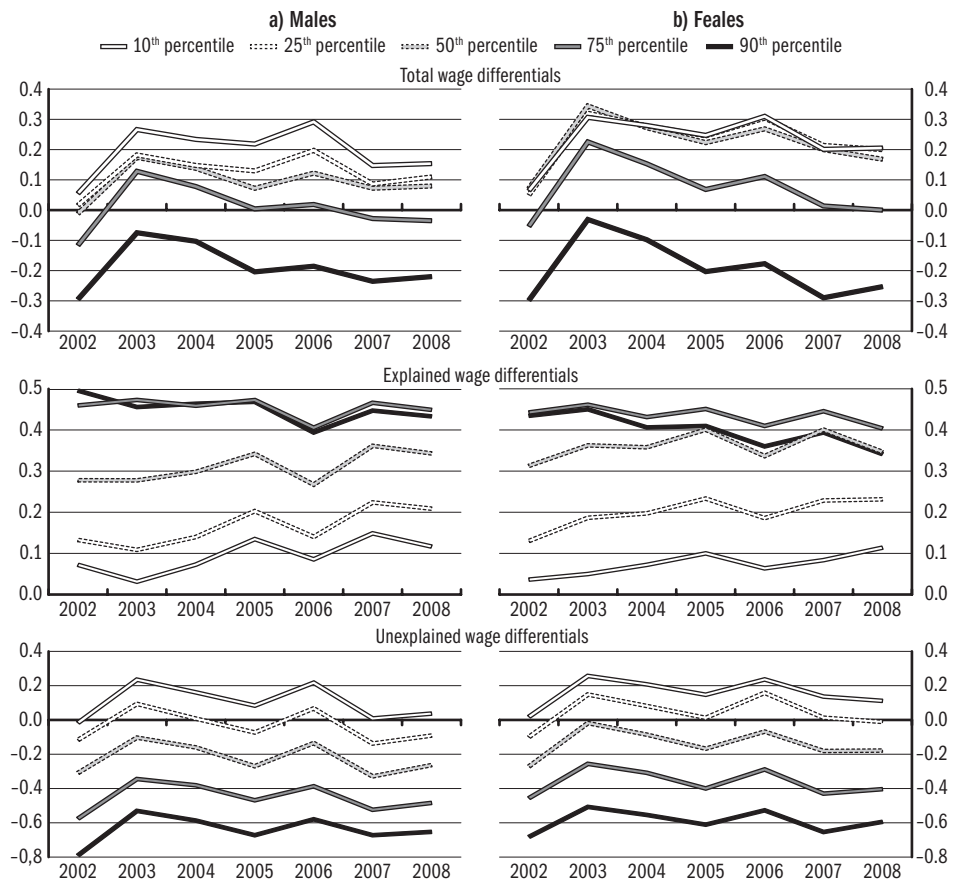
Part a) of *Figure 2.1.2* shows total, explained and unexplained differences between the private and public sector for men. The total difference at the median was 0.02 in 2002; in other words the median income of men (50<sup>th</sup> percentile) was two percentage points lower in the public sector than in the private sector, while in 2003 this difference was 0.17 in favour of the public sector. This advantage was diminishing between 2004 and 2008; however the advantage of the public sector remained. Looking at the quantiles, a different picture emerges due to the narrow wage structure of the public sector: those at the bottom of the distribution in the public sector and those at the top in the private sector have a wage advantage. Prior to the wage reform the public sector's disadvantage at the 90<sup>th</sup> percentile was –0.3. After the reform, in 2003, this dropped to –0.07, however it again increased to –0.22 by 2008. The public sector had more favourable employee and organisational indicators for each estimated quantile throughout the studied period, especially because of the higher education level of employees: the explained difference was positive for each quantile.

In terms of the unexplained difference, the private sector has a more substantial advantage than anticipated on the basis of the raw differences: apart from the 10<sup>th</sup> percentile, the difference is mostly negative. At the median the unexplained difference was –0.28 in 2002 that fell to –0.11 as a result of the

<sup>7</sup> Selection bias is an issue when estimating the differential between sectors. *Kézdi* (2002) argues that the working conditions are very different in the private and the public sector in Hungary: in the public sector the actual working time is shorter, benefits are more predictable and there is greater job security. We try to filter out this effect by including variables related to working conditions. These provide a weak measure of workplace characteristics; however there was little change over time (*Table 2.1.1*).

wage reform in 2003, then gradually returned to its pre-reform level at  $-0.27$  by 2008. Along the income distribution the unexplained difference, in absolute terms, is increasing towards higher incomes and it is very high around the top percentiles. The difference at the 90<sup>th</sup> percentile was  $-0.75$  in 2002 that decreased to  $-0.47$  in 2003 and – similarly to other percentiles – it returned close to its pre-reform level at  $-0.62$  in 2008. All in all, it can be argued that relative income in the public sector improved at each estimated percentile, however the unexplained difference at the median (and above) remained negative. By 2008 income differences returned close to their 2002 levels.

**Figure 2.1.2: Quantile decomposition, 2002–2008 (logarithms of income differences: total, explained by individual and organisational covariates, and unexplained)**



Note: The top part of figure a) and b) shows the unconditional income differences in the public sector in comparison to the private sector at different percentiles; negative values indicate public sector disadvantage. Graphs in the middle show explained differences, and graphs at the bottom depict unexplained income differences.



Part b) of *Figure 2.1.2* shows the comparison of income difference for women. Overall, the graphs show similar trends to men with some notable differences. Women's situation in the public sector is more favourable than men's: they enjoy a bigger advantage over the private sector between the 10<sup>th</sup> and 50<sup>th</sup> percentiles. However, at the top end of the distribution the total difference was also  $-0.3$  for women, and by 2008 it was larger than for men, at around  $-0.25$ . As far as the unexplained differences are concerned, after the initial effect of the wage reform these also return close to their original levels.

To put the estimates for Hungary into perspective it is worth highlighting that in Germany the estimated unexplained difference between the public and private sector for men (between 1984 and 2001) was consistently five per cent at the 10<sup>th</sup> percentile and  $-17$  per cent at the 90<sup>th</sup> percentile (*Melly, 2005*). The same estimate for Hungary was  $-10$  per cent  $-75$  per cent in 2002, and two per cent and  $-65$  per cent in 2008. This suggests that the public sector wage around the top end of the distribution is not only low in absolute terms compared to Germany – this alone would encourage “brain drain”, especially among health care professionals – but is also low in relative terms compared to the private sector. In order to retain highly skilled workers in the public sector, any future strategies should aim to improve the relative situation of highly skilled or high level employees. This cannot be achieved through a general wage rise for all public servants because its effect on relative wages vanishes in the long run; therefore a more targeted approach is needed.

This study has examined the long term impact of the large and rapid public sector wage rise implemented in 2003. From a researcher's perspective, this wage rise provided a quasi-experimental opportunity to examine the adaptation process following the rapid increase of relative wage. Data for the analysis was available until 2008, and it was clear that the effect of the 50-per-cent wage rise in 2003 had been eroded by then; the situation of public sector employees – especially the highly skilled – did not improve substantially compared to the private sector. There have been no similarly large or rapid increases in relative wage since 2008; however the measures introduced during the economic crisis that affected the public sector – the abolition of the 13<sup>th</sup> month wage, wage freeze – has probably had an adverse effect on the relative situation of public sector workers and intensified the exit of the highly skilled workforce from the sector.

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### 2.1.1 Do women have better opportunities in the public sector? An analysis of the gender pay gap and occupational segregation in the public and private sector

ANNA LOVÁSZ

In Hungary, similarly to many other countries, a large number of working women are employed in the public sector. There might be various reasons for this: women are more likely to choose traditional female occupations – teacher, nurse etc. – that are mainly in the public sector, or some features of public sector jobs (e.g. job security, working time and expectations, less stress) are more popular among women. Furthermore, women might prefer public sector jobs because they might think they are less likely to face discrimination thanks to stricter workplace policies (e.g. pay scales, promotion). However, the latter assertion is difficult to prove or quantify because pay (relative to men) and occupation depend on a number of other factors (individual or workplace characteristics previously highlighted) that are often unobservable.

International findings (*Barón and Cobb-Clark, 2010, Chatterji, Mumford and Smith, 2011, Melly 2005, Mora and Ruiz-Castillo, 2004*) suggest that there is less discrimination in the public sector. It

might be valuable to examine the extent of discrimination by sector; in the event that there is a difference, it might have a significant influence on women's decisions. Estimates for the extent of discrimination are compared in two ways: the pay gap and the probability of achieving a management position. The analysis uses data from the Wage Tariff Survey covering the period between 2002–2008; this is a representative sample of both sectors and enables us to take into account both worker and institutional characteristics. *Table B2.1.1.* compares the ratio of women and mean wages in the two sectors.

Labour market discrimination can be manifested in pay – if a woman with comparable characteristics (productivity) is paid less than a man. Mean wage difference is the most commonly used indicator of gender differences in the literature (*Altonji and Blank, 1999*), but unexplained wage differential is a better approximation of discrimination because it also eliminates the effect of covariates re-

**Table B2.1.1: The ratio of women and mean pay by occupation and sector, 2002–2008**

	Ratio of women		Mean pay (forint)	
	private sector	public sector	private sector	public sector
Managers: HSCO first digit = 1	0.312	0.653	384,400	370,320
Managers: using more precise definition	0.246	0.713	364,503	333,562
Tertiary independent	0.402	0.754	355,545	235,637
Tertiary and secondary	0.599	0.863	203,527	163,815
Clerical	0.905	0.951	148,094	135,503
Services	0.528	0.728	105,552	117,844
Agriculture	0.258	0.277	101,930	109,655
Manufacturing	0.198	0.118	128,995	126,334
Machine operators	0.232	0.017	137,642	137,324
Unskilled	0.466	0.803	90,956	99,721

Note: The public sector includes public service employees, civil servants, judges and prosecutors, while the private sector includes employees of businesses. In the first row managers were defined based on the first digit of the HSCO code, in the second row a more precise definition was used for each industry.

Mean pay was computed from individual pay based on total monthly gross income (mean of basic pay and incidental benefits in the previous year), in forints, at 2008 value deflated with the annual consumer price index.

Source: *Wage Tariff Survey*.

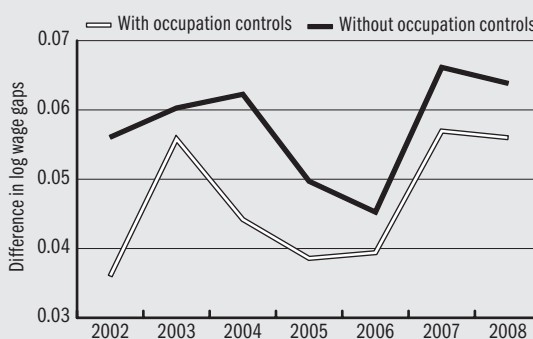
lated to worker and workplace characteristics. This study will estimate individual wage equations using observable worker and employer characteristics, gender and sector dummy variables, and their interaction as control variables. The estimated coefficient of the interaction is the measure of the unexplained pay differential between the two sectors.\* *Figure B2.1.1.* shows the development of this measure over time, while *Table B2.1.2.* summarises the main coefficients of wage equations estimated by quantile. In the public sector unexplained wage difference is on average 5–6 per cent lower. Nevertheless, there is a significant – around eight percentage points – unexplained difference between the mean wage of men and women. Looking at different points of pay distribution, it emerges that the disadvantage of women is greater at the higher end of the distribution, suggesting a glass ceiling effect (*Arulampalam, Booth and Bryan, 2007*);

\* It should be emphasised that the unexplained pay gap should be considered the upper range limit of discrimination because there are other, unobserved differences in employee characteristics that might skew upwards the estimated extent of discrimination. When comparing wage differentials between sectors, selection bias between sectors is an issue. This is not corrected here due to the lack of data but it might be argued that it can potentially lead to underestimating the relative advantage of the public sector (*Tansel, 2004, Greene and Hoffnar, 1996*).

however the increase of the difference is smaller in the public sector.

Another form of discrimination can be manifested in hiring and promotions – if employers are

**Figure B2.1.1: Difference in unexplained gender pay differential between sectors, 2002–2008**



Note: The figure represents the estimated interaction coefficient of the *public sector* and *women* dummy variables based on wage equations for each year between 2002 and 2008. The control variables are: employee characteristics (education, potential work experience and its square), institutional characteristics (size and region), and job characteristics (lunch break, type of work contract, difference between actual and official working time). For the estimations individual and institutional weightings were used. Occupation control variables are dummies generated from the first digit of HSCO codes.

Source: *Wage Tariff Survey*.

**Table B2.1.2: Unexplained pay differentials between the two sectors, percentiles**

	Percentiles				
	10 <sup>th</sup>	25 <sup>th</sup>	50 <sup>th</sup>	75 <sup>th</sup>	90 <sup>th</sup>
Women	-0.041 (0.001)	-0.078 (0.001)	-0.126 (0.001)	-0.185 (0.002)	-0.236 (0.002)
Public sector	0.246 (0.003)	0.153 (0.003)	0.002 (0.004)	-0.148 (0.006)	-0.255 (0.008)
Public sector × women	0.019 (0.003)	0.040 (0.003)	0.057 (0.004)	0.084 (0.005)	0.121 (0.007)
N	1,401,418				

Notes: Columns contain the coefficients of individual wage equations estimated by quantiles (standard error in brackets). The coefficients of *Women* dummy variable indicate the disadvantage of women compared to men in the private sector. The coefficients of *Public sector* dummy variable measure the advantage or disadvantage of the public sector in comparison to the private sector, for both genders.

Interaction coefficients of the two variables measure the disadvantage of women in the public sector compared to the private sector. For a description of the dependent and other control variables – such as experience – the definition of public sector and weighting see the note for Table 1 in *Lovász (2013)*. N is the number of individual observations.

Source: *Wage Tariff Survey, 2002–2008*.

less likely to hire women than men or promote them to higher positions (the “glass ceiling” effect). To grasp this phenomenon we will compare the likelihood of women and men with similar characteristics to get to management positions in the two sectors. The ratio of women in management positions is considerably higher in the public sector; however this might be due to their higher ratio within the public sector workforce. Therefore their ratio within occupations is also included among the control variables. The results of probit estimations (Table B2.1.3) suggest that the odds of women are no smaller in the public sector, while in the private sector they have an approximately two-percent disadvantage compared to men with similar characteristics.

These results suggest similar trends to wage differentials: the estimated extent of discrimination against women is smaller in the public sector than in the private sector. Although there are significant unexplained gender pay differences in the public sector, overall it seems that regulation limiting the employer’s scope for individual discretion can be successful in improving the opportunities of women in the labour market. It is unlikely that there have been major changes in unequal gender treatment since 2008 in the absence of substantial gender-related changes that would affect the regulation of the public sector. It is likely that data in 2013 would still show that limiting the possibilities of employers for individual discrimination improves

the labour market opportunities of women in the public sector in comparison to the private sector, although the difference is not too big.

**Table B2.1.3: Odds of management occupations, probit estimations, 2002–2008**

	Private sector		Public sector	
<b>Estimated coefficient</b>				
Women	-0.438	(0.011)	-0.080	(0.018)
Vocational school	0.426	(0.032)	0.447	(0.077)
Secondary education	1.295	(0.030)	0.960	(0.067)
Degree	2.143	(0.031)	1.929	(0.065)
Experience	0.025	(0.000)	0.028	(0.001)
<b>Marginal effect</b>				
Women	-0.021	(0.000)	-0.003	(0.001)
Vocational school	0.020	(0.001)	0.016	(0.003)
Secondary education	0.061	(0.001)	0.035	(0.003)
Degree	0.100	(0.001)	0.071	(0.002)
Experience	0.001	(0.000)	0.003	(0.000)
Observations	1,098,965		370,002	
Pseudo $R^2$	0.3006		0.1984	

Note: Standard errors in brackets. Probit estimations, the dependent variable is probability of getting to a management position. The control variables are: employee characteristics (education, work experience and its square), institutional characteristics (size and region), and the ratio of female employees in the organisation. Experience is potential work experience; it is obtained by subtracting the sum of years spent in education and the compulsory school age from the employee’s age. Public sector refers to public service employees. For the estimations individual and institutional weightings were used.

Source: *Wage Tariff Survey*.

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## 2.2 Wage spillovers between the public and corporate sectors

ÁLMOS TELEGDY

The aim of this section is to analyse the effect of public sector wages on corporate compensation. This indirect effect of the State's activity on labor markets has largely been neglected from research on wage spillovers over recent decades although the interaction of public and corporate wages is an important ingredient to wage setting policies.<sup>1</sup> If public and corporate workers compete on the same labor market, corporate employees may consider the public sector as an alternative to their current employment. If total compensation, including the net value of amenities and disamenities derived from various job attributes, is high in the public sector, private employers may face difficulties in the hiring process or have to cope with large quit rates among incumbent employees. To prevent such mechanisms taking place, they have to increase wages to keep a high-quality workforce and to prevent their current employees moving to the public sector.

May spillovers between public and corporate wages exist, their estimation is not straightforward, to say the least. Public and corporate labor markets are distinctly different in all countries. Public sector employees work fewer hours, enjoy longer paid vacations, have more secure jobs and the required effort, worker motivation and job satisfaction may also differ across the two sectors (*Delfgaauw and Dur*, 2008; *Heywood et al.*, 2002). Workers therefore self-select themselves into one or the other sector based not only on observable, but also on unobservable characteristics such as their innate ability, risk aversion, willingness to work hard in exchange for higher wages and faster promotions and so on (*Roy*, 1951). Another problem contaminating the measurement of wage differentials of private and public sector employees is that public sector workers typically cluster in a few industries – predominantly in state administration, health care and education – where the share of corporations is small or non-existent. This makes it impossible to control for industry wage effects, which may be sizable (*Krueger and Summers*, 1988). Any of the factors discussed above may create co-movements of the wage levels in the two sectors; to identify a causal relationship, an exogenous variation of public sector wages is necessary.

The Hungarian institutional context is particularly useful in analysing public wage spillovers as it provides the exogenous variation of public wages which permits overcoming many of the identification problems discussed above and the interaction of public and corporate wages can be measured more accurately than is usually possible. The Hungarian government executed a large wage increase in 2001 and 2002 and thus created the conditions to establish

1 A thorough search of the literature resulted in only a few papers analysing public wage spillovers: for example, *Jacobsen* (1992) studies this question in the United States and *Lacroix and Dussault* (1984) in Canada.

the effect of public wages on corporate compensation. The large and rapid increase of public sector wages provides a unique opportunity to identify wage spillovers as the exogenous wage increase breaks co-movements between public and private sector wages. The sector-specific differences discussed above, which may bias the estimation, do not present a problem here as it is unlikely that the composition of workers, job attributes or industrial wage differentials changed considerably in such a short period of time.<sup>2</sup>

### Data description

The dataset used in this study is the Hungarian Wage Tariff Survey Data, hosted by the National Employment Office. It provides yearly information on workers' year of birth, gender, highest level of education, occupation, earnings, tenure and type of contract (corporate and two types of public sector labor relation, as discussed below). These data are recorded for May of a given year. I use the years between 1998 and 2006 in this chapter as the public wage increase took place in the middle of this period.

I keep in the sample only full time employees between 18 and 60 years. The police, military, firemen and border guards are not included in the public sector data, and I excluded the legal professions as their employment relation is regulated by a special law and they were not subject to the wage increase. The final sample includes 379–487 thousand public sector employees and 106–153 thousand corporate workers. The comparison of the sample and the population data reveals that the sample of corporate and public sector employees is about 7–8 and 70 per cent, respectively.

### Composition of employment and the evolution of wages in the public and corporate sectors

*Composition of the public and corporate employment.* Public and corporate employment differs in a wide variety of dimensions. The public sector is present in health care, education and public administration while the share of corporations in these economic sectors is minuscule. As presented in *Table 2.2.1*, the demographic attributes of employees are very different in the two sectors. Three-quarters of public sector workers are female which is almost twice as large a share as in corporations. Corporate employees' potential labor market experience is shorter by two years.<sup>3</sup>

Given the peculiar industrial structure of the public sector, it is not surprising that the occupational structure of employees is very divergent across the two sectors. Professionals and associate professionals are the most typical occupations in the public sector and 60 per cent of all employees belong to these categories. This is in sharp contrast with such occupations' share of 20 per cent in corporations. As expected, skilled workers are the most typical workers in the corporate sector as 46 per cent of all occupations are in

<sup>2</sup> Employers may raise wages even if actual mobility does not take place between the two sectors due to threat effects. See *Borjas et al. (1997)* on threat effects in the context of international trade and *Farber (2005)* on wage effects resulting from the threat of unionization.

<sup>3</sup> Potential experience is computed as age – years of education – 6.

this category while such occupations' share is only 6 per cent in the public sphere. Managers are more prevalent in the corporate sector: their share is 9.5 per cent, 1.5 percentage points higher than this occupation in the public sector. Elementary occupations have a share of 14 per cent in the public sector, almost twice as high as in corporations.

**Table 2.2.1: Composition of the workforce in the public and private sectors**

	Public	Corporate
Gender (Female)	73.5	39.8
Labor market experience	23.8 (10.6)	22.0 (10.1)
Occupation		
Manager	8.0	9.5
Professional	30.6	4.9
Technician, associate professional	28.4	14.9
Clerk	6.4	6.7
Service	6.7	10.3
Skilled agricultural, craft industrial	6.0	45.7
Elementary	13.9	8.1
N	3,969,046	1,185,909

Notes: Pooled data. All variables are dummy variables, except average experience (in years, standard deviation in parentheses).

*Public sector wage policies.* The period between 1997 and 2006 is characterized by a steady growth of the Hungarian economy. Gross domestic product (GDP) grew each year between 3 and 5 per cent (Hungarian Statistical Office), and private wages followed this pattern, as we document below. Public sector wages, however, presented a more volatile behaviour which was probably rooted partly in the need to increase these relative to corporate wages and partly through political considerations.

Wages in the public sector are determined by a wage grid, which consists of a base wage and multipliers. Compensation may change either by raising the base wage (in this case the relative wages in the public sector are not affected) or the multipliers can be changed (which implies that relative wages within the public sector will vary).

During the period studied the multipliers concerning public servants' wages did not change so their relative wages were also stable, but the base wage was raised considerably. Most importantly, a large and universal wage increase raised each public servant's base wage (but it did not affect civil servants). While the base was increased steadily between 1998 and 2002 such that relative wages between the public and corporate sectors were stable, in 2002 it was suddenly increased by 50 per cent. The following year it did not change but in 2005 it was raised again by 14 per cent. This was, however, accompanied by a decrease in multipliers which further reduced the wage differentials



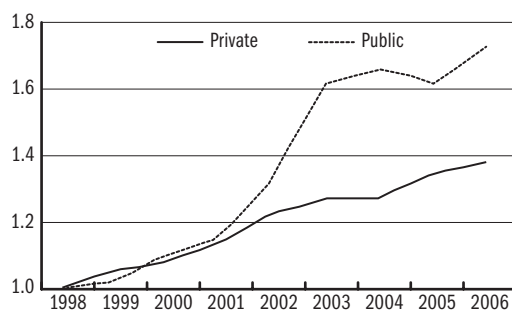
within the public sector. The last year in these data was election year and the base wage was raised again by 10 per cent.

Civil servants' wages were increased in 2001 (15 per cent of the sample are made up of these employees, who are typically highly skilled and work in public administration). Wage policy in their case was used to motivate civil servants to work in the public sector for their whole career. The base wage was almost constant, but the multipliers were changed such that it increased the relative wages of university graduates and those with long experience.

It is important to note that the wage grid serves only to set the minimum compensation for various categories of workers (defined by the level of education and experience). Total compensation may be larger due to allowances (such as a managerial allowance) and public sector organizations also have the right to pay higher wages if they have the funds for it. Public sector employees also received a 13<sup>th</sup> month's salary during the period studied.

During the first several years of the analysis public sector employees had indeed very low wages.<sup>4</sup> Despite the fact that the share of university graduates is much larger in the public sector than in corporations, average wages are about 11 per cent lower in this sector before 2002. *Figure 2.2.1* shows that public and corporate wages had experienced widely different growth patterns.

**Figure 2.2.1: Wage growth in the public and corporate sectors**  
(1998 = 100, N = 1,184,604)



While corporate real wages steadily increased by 3–6 per cent each year (except in 2004 when they did not change), wages in the public sector follow a distinctly different pattern. In the first three years of the analysis the overall growth rate is quite similar in the two sectors, but between 2001 and 2002 – the year when civil servants experienced a wage growth – public sector wages grew by 15 per cent. This is followed by an increase of 22 per cent in 2002, which is more than a 5 times larger wage growth than in corporations.<sup>5</sup> Our data therefore show that over a two-year time period, real wages in the public sector increased by 40 per cent while those in corporations by only 12 per cent. In the last years of the analysis the overall growth rates are quite similar (but the timing varies). During the whole period studied, therefore, cor-

<sup>4</sup> The wage measure used in this chapter is the monthly wage paid in May, and it includes the base wage, overtime pay, regular payments other than the base wage (such as language and managerial allowances), and 1/12<sup>th</sup> of the previous year's irregular payments (e.g., end-of-year bonuses and the 13<sup>th</sup> salary in the public sector).

<sup>5</sup> The policy was labeled as a 50 per cent increase, but it was not applied to civil servants and referred to the base nominal wages. We computed the growth of nominal base wages for public employees between 2002 and 2003 which is indeed very close to 50 per cent.

porate wages increased by 38 per cent while public sector wages increased by 72 per cent – the large difference between the two growth rates was built up in only two years.

### Identification strategy, results

The starting point in the measurement of the degree of interrelatedness of public and corporate wages is the classification of corporate workers by their “closeness” to the public sector: how similar they are to public employees. This is important to identify those workers who are likely to be affected by the wage increase. If, for example, a corporate worker has an occupation which does not exist in the public sector and his or her abilities are also very different from what is demanded, a switch to the public sector is almost impossible due to a lack of demand or is very costly for the worker as most of his human capital will be lost. Therefore, the employer of such workers does not need to take into account their earnings potential in the public sector, which can be seen as an outside option in wage bargaining.

The variable measuring public sector proximity of a corporate employee is the proportion of public sector workers in labor market segments defined by gender, occupation and work experience. More precisely, I segment the labor market by gender, potential labor market experience (5-year intervals making up 8 groups) and 7 occupational dummies (manager, professional, associate professional, clerk, service worker, skilled worker and elementary occupation). I call this variable *PSHARE*.<sup>6</sup>

I regress the log of corporate sector wages on *PSHARE*, which is interacted with two periods of time which represent the periods before and after the public wage increase (1998–2001 and 2002–2006, respectively). To control for average wages by worker type, I include fixed effects of the variables used in the construction of *PSHARE* ( $Z_{ijt}$ ) as well as year effects, 21 regional (county) effects and a full set of 2-digit industries to partial out any differences between local labor markets, consumer prices, and industrial wage differentials. As the level of public sector wages may also affect the strength of the spillover, I also control for the average public sector wage within labor market cells ( $WP_{ijt}$ ). The unemployment rate ( $UE_{ijt}$ ) at the cell level is included as well, as it can also affect spillovers: if there are many unemployed, the bargaining power of workers declines and they cannot ask for higher wages, regardless of the proximity of the public sector (*Blanchflower and Oswald, 1990*).<sup>7</sup> The estimation equation is the following ( $i$  indexes workers,  $j$  the labor market segment and  $t$  indexes time):

$$\begin{aligned} \log(w_{ijt}) = & \alpha_0 + \gamma_{before} PSHARE_{jt} BEFORE_t + \gamma_{after} PSHARE_{jt} AFTER_t + \\ & + \alpha_{wp} \log(WP_{jt}) + \alpha_{ue} \log(UE_{jt}) + \alpha x Z_{ijt} + \sum \alpha_{ind} INDUSTRY_k + \\ & + \sum \alpha_{reg} REGION_r + \sum \alpha_t YEAR_t + \varepsilon_{ijt} \end{aligned}$$

<sup>6</sup> The average value of *PSHARE* is between 22 and 27 per cent during the period studied, its median is 13–14 per cent. The standard deviation of the variable is large relative to the mean showing that the variable covers most of the interval on which it is defined.

<sup>7</sup> The unemployment rate is computed for each labor market segment defined by gender, experience and education, using the Hungarian Labor Force Survey.



The estimated spillover effect is the difference between  $\gamma_{after}$  and  $\gamma_{before}$ : this measures the change in the effect of the presence of the public sector on corporate wages.

The results suggest that private wages do not vary by the exposure of workers to the public sector before the public sector wage increase as the coefficient on the interaction of PSHARE and the period before the wage increase is only 0.001. In the period subsequent to the public sector wage increase, however, the level of corporate compensation increases in the sectors exposed to the public sector: the estimated coefficient of PSHARE after 2001 is equal to 0.143 (and is highly significant in statistical terms). Taking the difference between the coefficients associated with PSHARE before and after the wage increase as a measure of the wage spillover, this analysis finds that during a period of a 40-per cent increase in the public wage, a 10-per cent difference in public sector exposure induced a larger wage growth of 1.4 percentage points. Compared to the wage increase of about 12 per cent during this period, this result translates to a faster wage growth of over 10 per cent, which is quite sizable.

To gauge how the spillover effect evolves in time, we present the same regressions as before, but with a full set of interactions between years and PSHARE. These results are shown in Table 2.2.2. In the first three years of the analysis the coefficients of PSHARE are between  $-0.027$  and  $-0.017$  with no conceivable trend. In 2001, in the year of the civil servant wage increase, the effect of public sector exposure on corporate wages is 3.3 per cent and one year later it grows to 7.1 per cent (both coefficients are statistically significant). In 2003, after the large public employee wage increase affecting almost all public sector workers, the coefficient becomes 0.176 further increasing to 0.2 the following year. The difference between the coefficient in 2001 and 2004 is 0.167 which we take as the estimate of the wage spillover. As the public wage premium starts to stagnate, the coefficients decrease somewhat.<sup>8</sup>

Table 2.2.2: The yearly effect of public sector size on corporate wages

PSHARE × 1998	-0.027	(0.018)	PSHARE × 2003	0.176***	(0.014)
PSHARE × 1999	0.017	(0.017)	PSHARE × 2004	0.200***	(0.014)
PSHARE × 2000	-0.019	(0.017)	PSHARE × 2005	0.158***	(0.015)
PSHARE × 2001	0.033**	(0.015)	PSHARE × 2006	0.112***	(0.017)
PSHARE × 2002	0.071***	(0.013)			
R <sup>2</sup>		0.445			
N		1,184,604			

Notes: Each regression includes controls for gender, experience, education, year, industry, and region. Robust standard errors in parentheses.

\*\*\* Significant at the 1-per cent level; \*\* significant at the 5-per cent level.

Wage spillovers may also vary along the occupational structure of the corporate sector. Workers with occupations which are abundant in the public sector are likely to have a higher wage increase, as they can find a job more easily

<sup>8</sup> The last year of the analysis was election year which resulted in an increase of public sector wages. As the budget deficit was 10 per cent of the GDP, it was expected that the new government would cut back spending. As such interventions make the public sector less attractive to employees, this may be the reason for a declining spillover effect.

and will not lose their occupation-specific human capital if they move (e.g., *Kambourov and Manovskii*, 2009). To test this, I construct a dummy variable which categorizes each 3-digit occupation by its public sector share: the dummy equals 1 if this is larger than 40 per cent.<sup>9</sup> This variable enters the estimation equation in a three-way interaction between the time periods before-after the wage increase and PSHARE (and I also control for its level). The estimated coefficients, presented in *Table 2.2.3*, indeed demonstrate that the spillover effect is larger for such workers. The interactions term just described is associated with a coefficient of  $-0.18$  before the wage increase which shrinks to  $-0.115$  in the period subsequent to it. Therefore the wages of such workers increase faster if the worker is exposed to the public sector.

**Table 2.2.3: The effect of occupation on wage spillovers**

PSHARE – BEFORE	0.057***	(0.013)	PSHARE – OCCPREV – BEFORE	-0.179***	(0.016)
PSHARE – AFTER	0.173***	(0.012)	PSHARE – OCCPREV – AFTER	-0.115**	(0.017)
R <sup>2</sup>	0.446				
N	1,184,604				

Notes: Before = 1998–2001, After = 2002–2006. Occprev = 1 if occupation prevalent in public sector. Each regression includes controls for gender, experience, occupation, year, industry, region, and the Occprev interacted with “Before” and “After.” Robust standard errors in parentheses.

\*\*\* Significant at the 1-per cent level; \*\* significant at the 5-per cent level.

Another feature of the labor market which may alter wage spillovers is the proportion of new hires in the public sector. If there are no employment opportunities, corporate workers cannot switch sector. We compute the rate of new hires in the public sector relative to the number of workers in corporations within each labor market segment, and we add this variable to the regression.<sup>10</sup> The results (presented in *Table 2.2.4*) show that public sector hiring does not have an effect on corporate wages before the wage increase (the estimated coefficient is essentially zero), but after the public sector wage increase this coefficient becomes 0.12. Although the coefficient is not significant, its large magnitude provides partial evidence that more public vacancies induce a significantly faster wage increase in the corporate sector.

**Table 2.2.4: The effect of public sector vacancies on wage spillovers**

PSHARE – BEFORE	0.017	(0.017)	PROPORTION HIRED – BEFORE	-0.007	(0.125)
PSHARE – AFTER	0.152**	(0.014)	PROPORTION HIRED – AFTER	0.120	(0.078)
R <sup>2</sup>	0.444				
N	951,303				

Notes: Before = 1998 to 2001; After = 2002 to 2006. Each regression includes controls for gender, experience, occupation, year, industry, region, and proportion hired. Proportion hired is measured relative to the size of the corporate sector. Robust standard errors in parentheses.

\*\*\* Significant at the 1-per cent level; \*\* significant at the 5-per cent level.

<sup>9</sup> Out of 136 occupations, there are 42 which satisfy this condition, and they cover 10 per cent of corporate workers.

<sup>10</sup> This variable is not interacted with PSHARE because it is proportional to it by construction. The average public sector hiring rate (standard deviation) relative to private sector employment is 0.024 (0.065).

## Conclusions

This chapter analysed public wage spillovers, using for identification a fast and large wage rise which increased public sector wages by 40 per cent over a two year time period while corporate wages increased by only 12 per cent. Measuring public sector proximity by the share of public workers in labor market cells defined by gender, labor market experience and occupation, it finds that a 10 per cent higher share of public sector employment in the labor market cell caused a faster corporate wage increase by about 10 per cent.

The above analysis therefore suggests that public wages do have an effect on the wage policies of corporations: not only may average wages increase inducing therefore larger personnel costs, but wage differentials may also change as those workers, who are typical in the public sector, will be affected by spillovers to a larger extent than those who are not. It is also likely that such spillovers not only existed in Hungary in the early 2000s, but they occurred everywhere. This study used the periods before and after the public sector wage increase only to have a credible identification strategy – in the lack of an exogenous movement of public wages it is difficult to obtain an unbiased estimate of wage spillovers.

Using the results of the chapter, we can drive insights about the public sector wage spillovers in contemporary Hungary. Looking at the evolution of wages over the last decade or so, it is likely that their effect on corporate wages declined. As the information of the Hungarian Statistical Office suggests, between 2006 and 2013 public sector wages declined both in real and nominal terms and also relative to corporate wages. While the unconditional relative wage between the two sectors was 14–16 per cent in 2007 and 2008 (showing that public sector workers obtained a premium on average), during the following four years this was continuously falling resulting in a public wage penalty of 15 per cent in 2012 (despite the fact that the proportion of highly skilled workers is much larger in the public sector than in corporations). The current policy which increased the wages of several occupations in the public sector is not shown yet in the data, but it is likely that in the absence of a large wage increase, public sector wages will lag behind the compensation in corporations which decreases wage spillovers. This tendency, however, can be attenuated by longer job search in the corporate sector and less job security, which can make public sector jobs look more attractive to employees.

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## 2.3 Pay level and selection to the public sector

### JÁNOS KÖLLÖ

This chapter is based on a study by Köllő (2013) that examines changes in the *number* and *quality* – as measured by their residual earnings in the private sector – of graduates moving from private sector to public sector jobs as a result of the large pay increases implemented before and after the 2002 general elections.<sup>1</sup>

The analysis is based on a large administrative panel dataset covering a relatively long period (1998–2008) but limited in terms of the number of variables. It explores the development of mobility between the two sectors and then draws conclusions on the quality of inflows from the private to the public sector based on the *mean residual wages* of those shifting from the private to the public sector. (Residual wage is the difference between the actual wage and the expected wage on the basis of gender, age and education). The analysis concludes with a panel estimation that directly quantifies the relationship between the sectoral wage gap and private sector residual wages of workers moving to the public sector.

### Earlier literature and methodological considerations

Surprisingly few studies examined inter-sector mobility and the selection effects of public sector wages over recent decades. Some studies draw conclusions about selection effects from the between-sector earnings differentials – without actual data on mobility [see e.g. Foguel *et al.* (2012) on Brazil, Tansel (2005) on Turkey or Assad (1997) on Egypt]. Other studies (Bellante and Link, 1981, Blank, 1985) analyse selection directly, without data on wages. Obviously, even “lopsided” studies like these can have valid conclusions on the relationship between wages and selection if they can reliably estimate how much public sector employees would be earning in the private sector and vice versa. For example Stelcner, van der Gaag and Vijverberg (1989), Heitmueller (2006) or Gimpelson and Lukiyanova (2009) use this approach (*switching regression*) to address this problem.

Nickell and Quintini (2002) draw conclusions from comparing time series of the wage gap and various quality indicators. Quality is measured as test results in early teenage years and they show the deterioration of these results alongside the weakening in the wage position of the public sector in Britain. Katz and Krueger (1993) find a strong positive relationship between relative wages in the public sector and changes in educational attainment *within* public service occupations in the United States.

Borjas (2002) captures the quality of people moving to the public sector using *the residual wage they achieved in the private sector*, assuming that to some

<sup>1</sup> In the absence of data on education, “graduate professionals” are defined as employees who worked in occupations that require higher education or in a managerial position for any length of time in the observed period between 1997 and 2008.

extent this reflects their productivity. In this study Borjas basically provides an adaptation of the Roy-model (Roy, 1951, Borjas, 1987) to the issue of selection between the private and public sector. Thus, its main focus is the relationship between the quality of entrants and wage *dispersion* within sectors. If both sectors value more or less the same skills and the dispersion of wages is much smaller in the public sector, more productive workers will select themselves to the private sector, even if mean wages in the two sectors are equal – this is one of the key conclusions of Borjas' version of the Roy-model. The study presented here also follows this approach in measuring quality, however it does not aim to adopt Borjas's (2002) model mechanically because dispersions within sectors did not change at all in Hungary in the period observed; however mean wage differentials between the two sectors fluctuated within a very wide range. Therefore, it is worth concentrating on the effects of the latter and keeping the measurement method of the Borjas study.

The use of residual wage as an indicator of quality needs a qualifying note here. The actual wage of people moving from one sector to the other can differ from the wage that would be expected on the basis of their gender, age and educational attainment due to a variety of unobserved factors. Residual wages that are controlled for only these factors might reflect characteristics associated with quality, such as management position, diligence or talent, but they will also contain items that compensate for non-wage advantages or disadvantages, industry rents, trade union premiums, bonding schemes and other factors that divert the actual wage from actual marginal productivity. Of course, it cannot be posited that in the comparison of two individuals higher residual wage indicates higher productivity.

However *changes over time* in *mean residual wages* of people who move between sectors – especially if these changes are not trend-like – can indicate increases or decreases in mean productivity, particularly if there are no changes or no trend-like changes in the composition of the private sector in terms of sub-sectors, company size, ownership or trade union membership. A large sudden increase or decrease in residual wages among those who move between sectors, in otherwise stable circumstances, is likely to indicate a positive or negative selection effect, which is the focus of this analysis.

Further questions can be raised. First, are there any factors, in addition to the pay gap, that might cause sudden changes in the composition of people considering a sector change? Moving to a job in the public sector can be motivated by a variety of considerations. These can include changes in risk tolerance or preferences to do with age and family status. (On the role of risk tolerance in selection between sectors see for example Bellante and Link 1981, Pfeifer, 2008, Buurman et al., 2009.) It is also possible that some people who are made redundant accept a job in the private sector, but later, when the opportunity arises they reconsider this decision and move to a more preferred

job in the public sector. And vice versa: somebody who is at risk of unemployment in the private sector, might decide to accept a job in the public sector immediately rather than risk unemployment, even if their preferred option would be a private sector job at the given wage. However, the influence of these factors is unlikely to fluctuate if the age distribution of the work force is stable (or changing steadily) and the labour market is near equilibrium. On the contrary, an abrupt increase in the relative pay position of the public sector makes it suddenly profitable for higher paid, more productive workers to move to a public sector job as well.

Secondly, it is arguable whether changes in *intentions* to move to another sector can be captured through time series on actual mobility. The supply effect can only be demonstrated from data on actual moves if public institutions are intending to select the best applicants at the given pay level. This seems like a reasonable assumption for most jobs; apart from those positions that are filled according to explicitly political criteria.

Based on these considerations this study uses the following methods: we observe, over a long period of time (1997–2007), all cases when a graduate employed in the private sector in year  $t$  moves to the public sector in year  $t + 1$  without any unemployment or other interruptions in between. After this, changes in the residual wage of people who changed sectors are examined. Finally, we estimate how the between-sector pay differential affects the residual wage of switchers. The procedure is presented in Annexe 2.3.

## Data and variables

The Central Administration of National Pension Insurance (CANPI) has a centralised electronic register that holds records of contribution payments (“Kelen”) starting from 1997. This chapter uses a 20-per cent random sample of individuals who were registered in Kelen between 1997 and 2008; it includes a total of 15,464,904 annual records for 1,288,742 individuals. In the database there were 738 thousand individuals employed in “graduate occupations” in 1997 and 852 thousand in 2008.<sup>2</sup> For further information on the sample and the key concepts see the original paper (Köllő, 2013). Here we only summarise how coding in the “Kelen” data base affects the definition of public and private sector employees and switchers.

*Private sector employees* are defined as employees whose income came exclusively from one or several private sector jobs in a given year. Switchers are those who worked as public service employees or civil servants for any length of time in the following year, without any time spent in unemployment, on parental leave, or as self-employed or independent contractors.

For *public sector employees* the only certainty is that they worked in the public sector *for any length of time* in the given year, thus their income might also include earnings from the private sector. Furthermore, direct mobility

<sup>2</sup> The CSO Labour Force Survey found 773 thousand and 900 thousand college or university graduates in these years. Obviously some of those who are considered “graduates” on the basis of their work history do not have a degree, while some graduates would probably not meet the above criteria based on their work history. Nevertheless the figures are reassuringly similar.



from the public to the private sector is only observed if the individual was employed in the private sector for the whole of the following year and had no other earnings. Also, particularly at the beginning of the period, it was common that public sector workers moved to the private sector without a change of jobs through outsourcing or privatisation. On the extent of this and job moves from the public to the private sector see Chapter 2.4 of this *In Focus* and for more detail *Elek and Szabó's* paper (2013). Thus, shifts from the public to the private sector are not examined in this chapter. We focus on direct moves from the private to the public sector.

The *earnings data* relate to total annual earnings subject to social insurance contributions while the number of qualifying days is also known. The wage level is measured as *earnings per day* and is expressed as a percentage of the total sample's mean.<sup>3</sup>

### Development of wages in the private and public sector

*Figure 2.3.1* shows the development of the wage differential between the two sectors, controlled for gender, age and educational attainment, based on data from the Wage Tariff Survey and Kelen. In the latter case, the wages of those who worked for the whole year were taken into account. Based on administrative data the wage level of the public sector seems higher, but this is not unexpected as, unlike the Wage Tariff Survey, the Kelen data base includes the low-paid workers of companies with fewer than five employees. However, the development of the wage gap over time is similar, apart from 2004. This might be explained by the differences in recording earnings data: the Wage Tariff Survey of May 2004 recorded regular earnings in May plus 1/12 of the bonuses and premiums received in 2003, while Kelen records earnings in the year they are actually paid.<sup>4</sup>

### Mobility

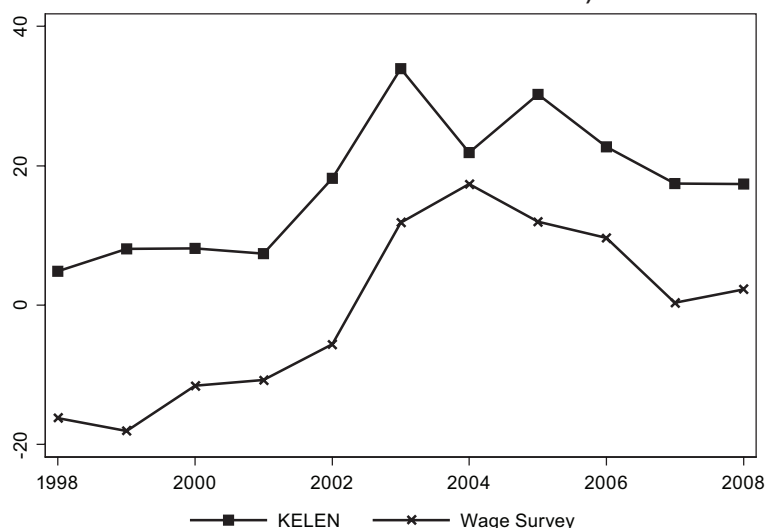
Public institutions can use their increased resources in a variety of ways that has implications for our expectations about the development of job mobility. Pay rises can – even without any additional action – slow down the exodus of high-quality workforce and thus reduce entry mobility. At the same time public institutions could also take advantage of higher wages and recruit more and better workers from the private sector. (They could have done this all the more as the number of public sector workers – including employees in graduate occupations – was rising until 2005.) This latter strategy increases the rate of entry to the public sector and may also increase the exit rate if the number of jobs is held constant.

The data clearly show that wage rises during the Medgyessy and Orbán governments increased the number of direct moves from private to public sector jobs only in 2003 (*Table 2.3.1*). (Note that the rows indicate the last year

<sup>3</sup> Information on wages for 1997 had considerable amounts of missing data and seemed unreliable – the mean and dispersion are much smaller than in subsequent years – therefore wage data for only 1998–2008 was used. The time-scale of employment statistics is 1997–2008, for mobility it is 1997–2007, and the analysis of the relationship between wages and mobility is for the period between 1998 and 2007.

<sup>4</sup> The Wage Survey records regular earnings for the month of May minus irregular bonuses in May plus the monthly average of irregular bonuses from the previous year.

Figure 2.3.1: The earnings advantage/disadvantage of public sector employees, 1998–2008 (percentage points, private sector employees with similar observable characteristics = 0)



Note: The curve represents  $e^{\beta}$  values calculated from  $\beta$  parameters. For public sector employees some of the qualifying days might be from the private sector.

*Wage Tariff Survey.* Wage: Gross wage in May excluding irregular bonuses but including 1/12 part of the total bonuses in the previous year. Sample: employees of companies with five or more (in 1998–1999 10 or more) employees, and public service employees and civil servants in the public sector. Dependent variable: the logarithm of wage. Control variables: gender, age, age square, educational attainment, number of paid working hours.

*Kelen.* Wage: monthly breakdown of annual earnings from employment or public service/civil service status. Sample: everyone who paid contributions on labour income for the whole year. Dependent variable: the logarithm of wage. Control variables: gender, dummies for single years of age, proxy for educational attainment (see main text).

spent in the private sector, therefore moves that happened in 2003 are shown in the row of 2002!) The block on the left side of the table displays the unadjusted transfer rates for everyone and also separately for people aged under and over 40 years. The block on the right shows year fixed effects from probit models that estimate the probability of transition between sectors controlled for gender and single years of age. Both the raw data and the estimates suggest that the transfer rate was slowly declining in 1998–2002, slightly increased in 2003, and then dropped sharply to well below any previous levels and remained there, fluctuating within narrow ranges.<sup>5</sup>

It might be argued that the transfer *rate* could have decreased without a decline in the absolute number of job movers as a result of the steady increase in

<sup>5</sup> The statistical tests also confirm that the transfer rate fell significantly both in the older and younger group in 2003. In earlier or later periods fluctuations were not statistically significant.

the number of graduates employed in the private rather than the public sector. The data disprove this: the fall in the transfer rate was sudden and much greater than would have been justified by a steady decline in the relative weight of the public sector (that was even interrupted by a slight increase in 2002–2003). The question might also be raised of whether the remarkable decline in flows from the private sector was caused by an (implicit) hiring freeze introduced alongside the wage increases. This is clearly not the case because the number of graduates working in the public sector steadily increased from 290 thousand in 2001 to 306 thousand in 2004 and only started to decrease as a result of austerity measures taken in 2006.

**Table 2.3.1: Job moves from the private to the public sector – transfer rates and year fixed effects, 1997–2007 (probability that a private sector worker moves to a public sector job in the subsequent year)**

Last year in the private sector	Unadjusted transfer rates <sup>a</sup>			Year fixed effects controlled for gender and age		
	All	25–40 years	41–61 years	All	25–40 years	41–61 years
1997	1.95	2.14	1.68	2.24	2.13	2.13
1998	2.08	2.21	1.89	2.40	2.19	2.45
1999	1.69	1.92	1.35	1.75	1.73	1.58
2000	1.83	2.07	1.48	1.95	1.90	1.80
2001	1.79	2.12	1.28	1.85	2.00	1.48
2002	1.97	2.35	1.41	2.13	2.34	1.69
2003	1.43	1.72	0.99	1.30	1.46	0.99
2004	1.48	1.72	1.10	1.39	1.50	1.19
2005	1.41	1.69	0.96	1.28	1.47	0.94
2006	1.34	1.57	0.97	1.18	1.32	0.96
2007	1.25	1.45	0.93		reference	

<sup>a</sup> Transfers to public sector as a percentage of private sector workers.

<sup>b</sup> Probit marginal effects at the sample mean, percentage.

Dependent variable: worked in the public sector for any length of time in the subsequent year.

Independent variables: gender, age, age square, dummies for single years of age. All year effects are significant at 0.01 level.

*Table 2.3.2* presents time series data on mobility from the public to the private sector in a similar structure to *Table 2.3.1*; however it must be emphasised that these data differ from data on moves in the opposite direction. The slump in 2002 is clearly noticeable in the total sample as well as in the older and younger groups. Job moves from the public to the private sector – and any vacancies as a result – decreased considerably: in the four years when the public sector paid high wages, moves to the private sector were over 30 per cent lower than either before or after. The increase later, in 2006–2007 could already be related to the redundancies that had begun to commence in the public sector.

**Table 2.3.2: Job mobility from the public to the private sector, 1997–2007**  
 (the probability that somebody who [also] worked in the public sector  
 in year  $t$  would have earnings only from the private sector in year  $t + 1$ )

Last year in the public sector	Unadjusted transfer rates (percentage)			Year fixed effects controlling for gender and age <sup>a</sup>		
	All	25–40 years	41–61 years	All	25–40 years	41–61 years
1997	4.63	5.90	3.05	3.29	4.34	2.31
1998	3.92	5.38	2.19	2.45	3.62	1.32
1999	3.96	5.35	2.42	2.59	3.57	1.64
2000	4.17	5.81	2.41	2.90	4.18	1.68
2001	3.59	5.05	2.10	2.24	3.20	1.33
2002	2.64	3.83	1.46	1.04	1.57	0.51
2003	3.00	4.40	1.62	1.54	2.36	0.80
2004	3.03	4.32	1.79	1.64	2.30	1.06
2005	2.90	4.21	1.66	1.50	2.22	0.88
2006	3.55	5.12	2.08	2.41	3.52	1.46
2007	3.39	4.85	2.05	benchmark year		

<sup>a</sup> Probit marginal effects at the sample mean, percentage.

Dependent variable: only has earnings from the private sector in the subsequent year.  
 Independent variables: gender, age, age squared, dummies for single year of age. All  
 year effects are significant at the level of 0.01.

### Wages of job movers in the public sector

The wages of job movers are first examined using repeated cross-sectional regressions. *Table 2.3.3* indicates that the daily wage of graduate job movers controlled for gender, age and working time (“residual” hereafter) was 2.5–8 per cent lower, than the daily wage of stayers in 1998–2001, and the difference was significant at 0.05 in three out of the four years.<sup>6</sup>

The number of observations increased at a steady rate over time: ranging from 91,439 to 116,682 in the full sample, from 49,480 to 69,944 in the younger group and between 44,756 and 50,139 in the older group.

In the years of large pay rises (2002–2004) the wage of movers – as expected – exceeded the wage of stayers by 4.4–5.6 per cent. However, alongside the decline in the relative wage level of the public sector this advantage first disappeared and then in 2007 turned into a significant and rather large 6.6 per cent disadvantage. It would be difficult to attribute the sudden changes to anything else than the temporarily high public sector pay, which made it profitable for high earner private sector employees to move to the public sector. Public institutions used positive selection and chose applicants that appeared to be more productive.

The development of residual wages over time in the younger and the older age groups was similar, however according to estimations by age group the selection patterns were different. Earnings of young movers (aged 25–40) were below the earnings of stayers in each year. Their disadvantage was statistically significant and substantial (10–16 per cent) in 1998–2001. During

<sup>6</sup> The coefficients show the wage advantage or disadvantage of employees moving between sectors in logarithm points. For example, the value in the upper left corner indicates that the wage of people moving between sectors is 0.0512 logarithm points – or approximately 5.1 per cent – higher than the wage of stayers all other things being equal.

the pay rises of the Orbán and Medgyessy governments, this gap disappeared and the group of movers was comprised of average earners. However, the gap re-appeared with the decline in public sector pay in 2005–2007 and movers – increasingly – came from the lower tail of the wage distribution.

**Table 2.3.3: Wage premium/disadvantage of graduate job movers from the private to the public sector compared to stayers in the private sector, controlled for gender, age and number of years worked (logarithmic point, linear regression coefficients estimated with the method of ordinary least squares)**

Last year in the private sector	Full sample		Younger people (25–40 years)		Older people (41 years and over)	
1998	-0.0512**	(2.33)	-0.1082***	(3.65)	0.0233	(0.74)
1999	-0.0824***	(3.36)	-0.1609***	(5.10)	0.0478	(1.28)
2000	-0.0239	(1.04)	-0.1095***	(3.70)	0.1149***	(3.22)
2001	-0.0696***	(3.30)	-0.1427***	(5.65)	0.0811**	(2.31)
2002	0.0448**	(2.35)	-0.0360	(1.55)	0.2066***	(6.48)
2003	0.0442*	(1.94)	-0.0119	(0.43)	0.1685***	(4.32)
2004	0.0550***	(2.49)	-0.0159	(0.59)	0.2016***	(5.35)
2005	-0.0104	(0.46)	-0.0782***	(2.93)	0.1580***	(3.93)
2006	-0.0285	(1.27)	-0.1058***	(3.90)	0.1427***	(3.74)
2007	-0.0655***	(2.95)	-0.1334***	(4.93)	0.0757*	(1.99)

Note: *t*-values in parentheses.

Dependent variable: the logarithm of daily earnings.

Independent variables: male, dummies for single year of age variables, days in work during the year, dummy for movers set to 1 if the individual worked in the public sector in the subsequent year and 0 otherwise).

\*\*\*  $p < 0.01$ , \*\*  $p < 0.05$ , \*  $p < 0.1$ .

In the older group, movers' earnings *exceeded* that of stayers in each year, although the difference was not yet significant in 1998–1999. During the time of large pay rises the average residual wage of older switchers jumped to 20 per cent. It then started to fall and drop below 8 per cent in 2007.

So far the argument that fluctuations in the residual wage of movers were related to variations in the sectoral pay gap was based on *the similarity in their time series*. The following sections will attempt to show – using the panel equation presented in *Annexe 2.3* (A2.3.1) – that there is a direct relationship between them. First, we form  $K = 640$  groups of private sector workers on the basis of their gender, single year of age and calendar years. Second, we regress the wages of private sector workers on a set of controls, a *MOVER* dummy and its interaction with the deviation of the  $k^{\text{th}}$  group's annual average public sector pay ( $w_{kt}$ ) from its intertemporal average ( $w_k$ ). The coefficient of the *MOVER* dummy measures the average difference between movers and stayers. The coefficient for the interaction term [*MOVER* \* ( $w_{kt} - w_k$ )] measures how fluctuations in the public sector pay of a given group affect the residual wages of movers (relative to stayers) in that group.

The estimated wage equation is controlled for gender, age, age square, the number of days in work during the year and calendar year fixed effects – the coefficients of these variables are not presented here. Younger and older age groups are distinguished on the basis of their year of birth rather than their age – to make sure that categories are stable. The two age groups are: people younger than 40 years in 2003 and anyone older than this.<sup>7</sup>

As for the results presented in *Table 2.3.4*: according to estimations for the full sample, the difference between the wages of movers and stayers *entirely* depended on variations in earnings potential in the public sector. The wage of stayers is only 0.85 per cent higher if the level of public sector pay is at its intertemporal mean. By contrast, if the public sector wage is 10 per cent higher in a group than its intertemporal mean, the residual wage of movers is increased by approximately 6 per cent compared to stayers.

**Table 2.3.4: The effect of public sector pay level on the wages of people moving from the private to the public sector, 1998–2007 (panel estimation assuming individual random effects and using the method of least squares)**

	Full sample	Younger people <sup>a</sup>	Older people <sup>b</sup>
$\beta_1$ : <i>MOVER</i>	0.0085** (2.00)	-0.0213*** (3.76)	0.0364*** (5.86)
$\beta_2$ : <i>MOVER</i> $\times$ $(\ln w_{kt}^k - \ln \bar{w}_k^k)^c$	0.5780*** (8.14)	0.6280*** (7.55)	0.3975*** (2.71)
Internal $R^2$	0.0422	0.0613	0.0052
External $R^2$	0.0727	0.0611	0.0452
Total $R^2$	0.0622	0.0663	0.0292
Mean number of years observed	6.7	6.5	7.0
Number of observations	1,313,629	783,390	530,239
Number of individuals	207,597	126,222	81,375

Dependent variable: logarithm of relative wage.

Sample: private sector employees.

<sup>a</sup> Born before 1963.

<sup>b</sup> Born after 1963.

<sup>c</sup> :  $(w_{kt}^k - \bar{w}_k^k)$  deviation of the mean wage in group  $k$  (based on gender and age) in year  $t$  from the intertemporal (between 1998 and 2007) mean wage in the public sector.

$Z$  values in parentheses.

\*\*\*  $p < 0.01$ , \*\*  $p < 0.05$ , \*  $p < 0.1$ .

The effect of public sector wages is much stronger in the group of younger people born after 1963 than in the older group: elasticity is above 0.6 in the first group while it is below 0.4 in the second. This is most probably related to the fact that people who move to a public sector job at an older age are more likely to be at a senior level. Some of the moves might be part of politically motivated reshuffles of senior government officials or people might move to the public sector as elected officials.

<sup>7</sup> The estimation was carried out using GLS panel regression assuming random effects for the reasons presented in the discussion of equation (A2.3.1). Due to the presence of predicted variables in the equation, standard errors were estimated with a 500-step *bootstrap* method also taking into account that there are multiple, possibly correlated observations for each individual. Therefore we adjust the standard errors for “clustering by individuals”.

## Conclusions

The substantial increase of public sector pay – first for civil servants, then for public service workers – in 2002–2003 made the sector more attractive even for higher paid private sector workers. At the same time thanks to the large pay rises, which were not accompanied by redundancies, the number of employees leaving the public sector for a job in the private sector fell and so did the number of vacancies. Public institutions could hire fewer people from a pool of better quality applicants and this led to an improvement in the quality – as measured by the residual wage – of new entrants.

With the erosion of the wage advantage from 2002 and the “slimming down” of the public sector that started in 2006, the number of people coming from the private sector continued to decline as well as their overall quality. The large pay rise temporarily – for three years strongly and for a further two years moderately – improved the *composition* of workers moving to the public sector, however any positive effect on the public sector workforce was limited by a large fall in the entry rate – to two thirds of its previous level. The public sector could have benefited more from the higher wage level if at the same time it would have “sifted through” its existing workforce.

Measures introduced during the economic crisis – especially the abolition of the additional 13<sup>th</sup> month salary and an unofficial but effective pay freeze – pushed the relative pay level of the public sector into a low not seen since the early 1990s. Considering Hungary’s current growth and fiscal prospects it is unlikely that this will change in the foreseeable future. At the time of writing this chapter, in 2013, the wage level of the public sector was 20 per cent below the private sector for people of the same gender, age and educational attainment – this has been unprecedented since 1996, the second year of the Bokros package.

Based on the estimations presented in this study it is expected that the public sector will become even less attractive for workers, and it is likely that much of this deterioration has already happened. (Of course there is no way to verify this prediction until micro data covering 2013 is available.) At the same time it is unclear whether a general pay rise similar to 2002 would lead to the desired outcome: improvement in the quality of the public sector workforce. In addition to pay rises, this also requires selection based on performance and skills.

## Annexe 2.3

The effect of the fluctuation of public sector wage on the residual wage of movers was estimated with the following panel regression:

$$\ln w_{ikt}^M = \alpha X_{ikt} + \beta_1 MOVER_{ikt} + \beta_2 MOVER_{ikt} \times (\ln \bar{w}_{kt}^K - \ln \bar{w}_k^K) + \gamma t + u_{ikt} \quad (A2.3.1)$$



The left side of the equation represents the annual income from year  $t$  for  $t^{\text{th}}$  private sector worker in group  $k$ ,  $X_{ikt}$  includes the indicators of gender, age and working time, and  $t$  is a set of dummy variables for calendar years. The upper case  $K$  (public sector) and  $M$  (private sector) indicate the two sectors. We distinguish those who are known to have worked in the public sector in year  $t + 1$  (*MOVER*). The expression  $w_{kt} - w_k$  measures to what extent the mean public sector wage of a given group differs from its own intertemporal mean. For the estimation we calculate mean public sector pay for 640 age years  $\times$  gender  $\times$  year interactions. Separate estimations are carried out for younger and older workers.

The estimation was carried out using the method of generalised least squares (GLS), assuming *random effects*. A fixed effects model would not answer the question that we are interested in – are higher paid people selected if public sector wages are temporarily high – but would answer the question of whether the wage of movers increases in the year of move compared to their own personal average if the pay advantage (disadvantage) of the public sector is growing (falling) compared to its mean advantage (disadvantage). In other words: our aim is not to filter out but to measure the selection bias arising from the non-random selection of movers.

The reason why the wage component in the interactive term is defined in the way it has been is that we only want to capture the variance of group-level average wages over time. (In an equation that uses the *public sector pay* variable without removing the mean, parameter  $\beta_2$  would simply measure that the wage of movers is likely to be higher in groups where wages are high in both sectors. In the equation (A2.3.1)  $\beta_1$  measures the mean residual wage of movers, while  $\beta_2$  measures the effect of fluctuations in public sector pay on the selection of movers.

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## 2.4 Labour outflow from the public sector in Hungary

PÉTER ELEK & PÉTER ANDRÁS SZABÓ

This chapter concentrates on the outflow from the public sector in Hungary in the period between 1998 and 2010; a more detailed analysis can be found in *Elek and Szabó's* (2013) paper. First, the rate of job mobility and outflow into unemployment or inactivity from the public sector will be compared to the same rates from the private sector and we will consider whether the public sector is more stable in any of these aspects. It will be shown that the likelihood of moving into unemployment or another job from the public sector was approximately half of that from the private sector between 1998 and 2010.

Secondly – as a possible implication of the public sector's higher stability – it will be examined whether people who leave the public sector end up in a significantly worse position than similar workers leaving the private sector. This will be assessed by examining the re-employment probabilities of those made redundant and overqualification rates of those who left to move to another job. The results will show that – with the exception of the low-skilled – workers coming from the public sector are not at a disadvantage in terms of finding a new job and they are not at increased risk of ending up in a “worse” job position compared to people from the private sector.

An important contribution of this study is that it uses two large micro-level panel data sets [the Labour Force Survey (LFS) of the Hungarian Central Statistical Office (CSO) and the 200,000-strong sample from the register of the Central Administration of National Pension Insurance (CANPI)] to examine these questions.

### Data and definitions

*CSO Labour Force Survey.* The CSO's Labour Force Survey (LFS) is a quarterly survey on a representative sample of 70,000 individuals. It provides information on self-reported labour market status and other characteristics. From the perspective of the present study, an important feature of the survey is that it asks about the reason for terminating previous employment (dismissal, redundancy, leaving the job etc.) and thus it is possible to distinguish between people who left the public sector voluntarily and people who were forced to leave. The survey follows participants for six quarters and thus consecutive quarters can be linked to create a panel dataset.

This study adopts a relatively narrow definition of the public sector when using CSO Labour Force Survey data: an employee is part of the public sector if they work in, public administration and defence, education, health and

social care or research and development branches<sup>1</sup> and their employer is not fully privately owned. Thus, the definition excludes people who work in privately owned hospitals or schools, as well as people who work in state-owned businesses in manufacturing or services (for example the Hungarian National Rail). We also exclude people who are employed in public works programmes because they are significantly different from the rest of public sector employees.<sup>2</sup>

*CANPI pension insurance database.* The other data set comes from the Central Administration of National Pension Insurance, and contains an anonymised administrative panel data of 200,000 people between 2000 and 2006. It records social security insurance status (for example work contract, public service employee or civil servant status, self-employed etc.) and corresponding income as well as transfers (sick leave, family benefits, pensions) received by the individuals in the sample for each month. In addition the data set includes some demographic and personal information (age, gender, post code), and the occupation (SCO) code for most social security statuses (except for self-employed statuses and alike). Thus the CANPI database makes it possible to follow the (official) labour market and transfer status of individuals on a large sample over a longer period than the LFS.<sup>3</sup>

Since the CANPI administrative database has no direct information on branch, public sector was identified jointly on the basis of social security status and the SCO code. An employee is considered to be part of the public sector if they are employed in public service, public administration, judiciary, law enforcement, armed forces or “premium years” status (the latter is designed for the employment of public employees just before the pension age limit), *or* if their SCO code indicates an occupation that is highly likely to be in the public sector (doctor, nurse, teacher etc.). Thus, the CANPI dataset (unlike the CSO Labour Force Survey) includes doctors and teachers in private hospitals, schools etc. among the public sector workers.<sup>4</sup> In the analysis private sector means employees outside the public sector; the self-employed and entrepreneurs are excluded. The CANPI database does not have information on educational attainment, but this is approximated on the basis of occupation by assigning the typical (median) educational attainment of employees with the same SCO code in the Labour Force Survey to the SCO code of the individual in the administrative data.

### The characteristics of people leaving the public sector

According to *Figure 2.4.1* the public sector comprised approximately 800,000 people between 1998 and 2002. Then, this number started to increase rapidly and reached its peak at around 850,000 by 2003–2004. By 2008, it dropped to 790,000, which was again followed by a rapid rise but only due to the rising number of participants in public works programmes.

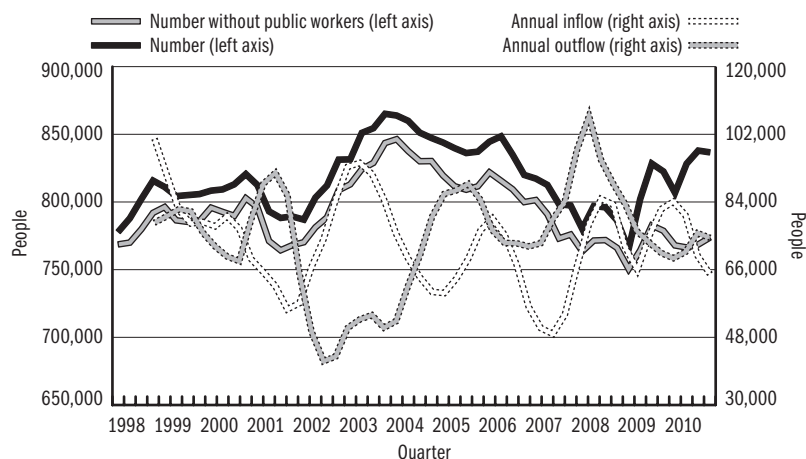
1 This includes Hungarian NACE–2003 codes 73, 75, 80 and 85, that correspond to codes 72, 75, 84–88 in NACE–2008 (the latter has been used in the definition since 2009).

2 For details of the narrower definition of the public sector see *Elek and Szabó* (2013).

3 For a detailed description of the database see *Elek et al.* (2009a).

4 The exact definitions can be found in Table F2 in the Annex of the more detailed version of this study (*Elek and Szabó*, 2013).

**Figure 2.4.1: Number of public sector workers and the estimated annual in- and outflow to/from the public sector**



Note: The number of people entering or leaving the public sector are presented after iterative proportional fitting and (symmetrical) moving average smoothing over four quarters.

Source: Own calculations based on CSO Labour Force Survey data between 1998–2010, public sector without public works participants.

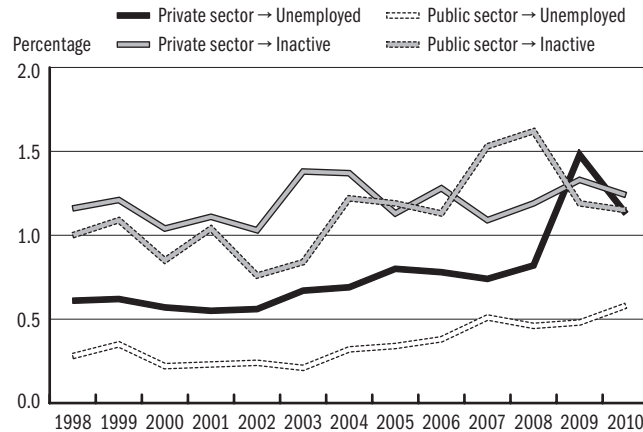
Figure 2.4.1. shows the estimated outflow from, and inflow to, the public sector (without public works participants) in this period.<sup>5</sup> The probability of entry to, or exit from, the public sector was around nine per cent on average annually, and changes in the number of people entering or leaving the public sector all had a clear role both in the rapid rise between 2002 and 2004 and the decline later. In the following the first component, the outflow, will be examined. (On inflow see Chapter 2.3 by János Köllő in this *In Focus*.)

Figure 2.4.2. and Figure 2.4.3. show quarterly outflow rates from the public sector – without public workers – into inactivity, unemployment or other jobs in another sector compared to the corresponding rates from the private sector between 1998 and 2010.<sup>6</sup> A large part of the outflow from the public sector was comprised of people who become inactive (retire, claim child care benefits or enter another inactive status). The quarterly probability of outflow to inactivity was on average 1.1 per cent and showed an increasing trend, although it was not substantially different from the same rate in the private sector. The probability of becoming unemployed and of job mobility were considerably lower in the public sector, on average around 0.3–0.4 per cent each, well below the same transition probabilities of private sector workers. It is noticeable that while the risk of unemployment increased considerably in the private sector after the 2009 crisis, it did not grow at all in the public sector until 2010. Hungary was still characterised – as shown by Boeri and Flinn (1997) in their earlier study on three transition countries (Poland, Hungary and Slovakia) – by lower mobility in the public sector compared to the private sector.

<sup>5</sup> In the calculations we did not use unadjusted transition probabilities that were computed directly from Labour Force Survey panel data, but we adjusted these using *iterative proportional fitting* to ensure the consistency between stock and flow figures.

<sup>6</sup> In addition to the above transitions, outflow from the public sector formally includes outsourcing as well. See the more detailed version of this study (Elek and Szabó, 2013) on the number of people affected by this.

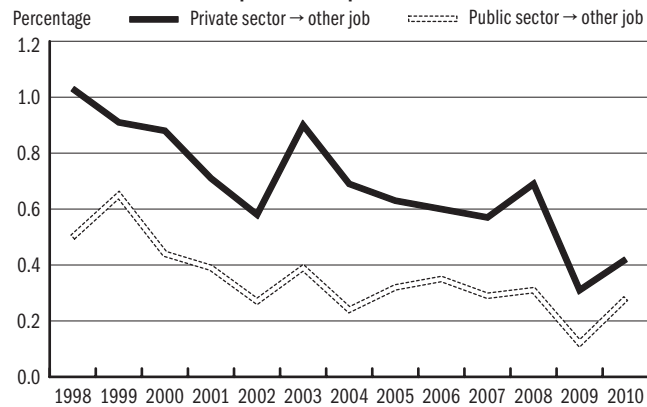
**Figure 2.4.2: Quarterly transition probabilities from the public and the private sector into unemployment and inactivity**



Note: The figure depicts the quarterly probabilities of outflow into inactivity and unemployment from the public sector (without public workers) and from the private sector.

Source: Own calculations based on CSO Labour Force Survey data between 1998–2010

**Figure 2.4.3: Quarterly probabilities of job mobility from the public and private sector**



Note: The figure depicts the quarterly probabilities of job mobility into other occupation and industry from the public sector (without public workers) and from the private sector.

Source: Own calculations based on CSO Labour Force Survey data between 1998–2010

<sup>7</sup> On outflow into retirement see for example *Cseres-Gergely* (2008), on family benefits see *Scharle* (2008). On the “crowding-out” dynamics between younger and older employees in the public sector see *Cseres-Gergely* (2013).

In the following we will focus on two out of the three important transitions: outflow into unemployment and another job. As has been shown the probability of the third type of transition (into inactivity) is not substantially different in the two sectors, thus the mechanisms at work are likely to be broadly similar as well, and the general patterns of retirement have already been examined by various studies.<sup>7</sup>



## Transitions into unemployment from the public sector

The raw data in *Figure 2.4.2* hide large variations in outflow in terms of educational attainment and other factors. A more detailed analysis of the risk of becoming unemployed shows that its probability in the public sector is approximately half of that in the private sector at each educational level.<sup>8</sup> If a logit regression model is used to control for factors known to influence the probability of unemployment (for example gender, age, type of settlement), then the results show that people with higher educational attainment (at least general secondary education) in the public sector are in an even better position than those with lower education; the relative risk of unemployment (compared to the private sector) among the highly educated is 20–30 per cent better than the corresponding relative risk among low-skilled workers.<sup>9</sup>

*Probability of re-employment.* Using LFS and CANPI data the widespread belief that public sector workers who are made redundant remain unemployed for longer (i.e. are less likely to be re-employed) than similar workers in the private sector can be examined. The labour market status of redundant workers was observed quarterly for up to four quarters in the LFS; and monthly even for years – depending on the date of redundancy – in the CANPI data. We use *Prentice and Gloeckler's* (1978) proportional hazards discrete-time duration model that is often referred to as the *Jenkins* model in the literature based on *Jenkins* (1995). Similarly to continuous-time duration models, this expresses the hazard function  $\lambda(t)$  of unemployment's duration  $T$  (or the “intensity” of re-employment) as the product of baseline re-employment intensity  $\lambda_0(t)$ ,<sup>10</sup> and a factor depending on individual characteristics:

$$\lambda(t) = \lambda_0(t) \times \exp(X\beta),$$

where  $\beta$  is the parameter vector to be estimated and  $X$  indicates the individual variables. Thus, individual characteristics have the same multiplicative effect on re-employment intensity in each period. If, for instance,  $\beta = 0.1$ , then the given variable increases the intensity of re-employment by about 10 per cent at each time point. (So if the probability of re-employment is five per cent in the sixth month of unemployment, then the given variable increases this to  $1.1 \times 5$  per cent = 5.5 per cent.)

For the analysis of re-employment probabilities two approaches are used on both LFS and CANPI data to define people who flow out of employment. The first, narrower definition includes people who probably were made redundant.<sup>11</sup> The other definition is broader and includes all employees who become inactive or unemployed (the “total” columns on *Figure 2.4.4*).<sup>12</sup> The sample has been constrained to include only people aged between 25 and 54 years and not in a public works programme.

8 Obviously people with at least a general secondary education are a lot – by about a third – less likely, in both sectors, to become unemployed than those with at most a vocational education.

9 For the estimation results see the more detailed study (*Elek and Szabó, 2013*).

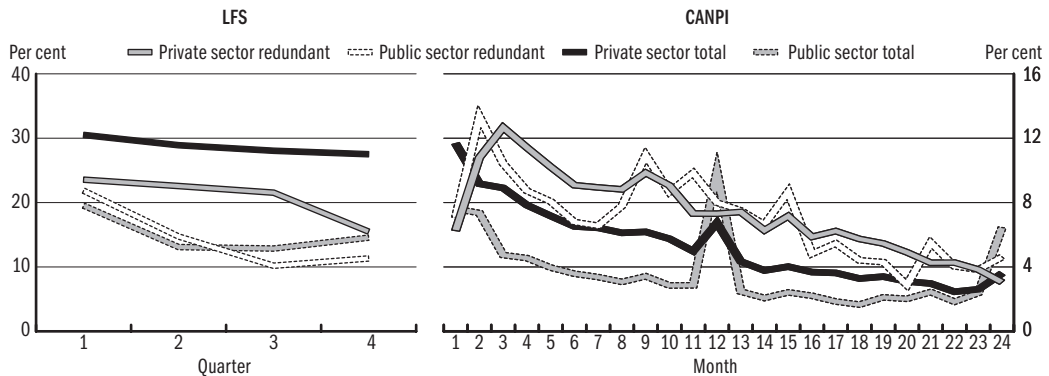
10 This is specified as non-parametric on LFS data and as a modified Weibull-distribution for the CANPI data (see the more detailed *Elek and Szabó, 2013* study).

11 In the LFS-based analysis these are people who were in employment at observation  $-1$  and were out of work at observation  $0$  and reported that they had lost their job (or their temporary contract had come to an end). In the CANPI database people are considered “displaced” (“made redundant”) if they received unemployment benefit for any length of time within two months from the termination of their employee status. Thus, this is an even smaller group than the LFS definition because not all displaced workers are entitled to unemployment benefits.

12 In the LFS this includes people who became unemployed or inactive in a given quarter, while in the CANPI it includes people who are out of work due to the termination of a previous employment status or to long-term leave (because of illness or parental leave etc.).



**Figure 2.4.4: Re-employment probabilities of people leaving the public and the private sector by length of time out of work, based on LFS and CANPI data (percentage)**



Note: Re-employment intensity of employees aged 25–54 years after leaving a job, excluding public workers.

Source: Own calculations based on quarterly CSO LFS 1998–2010 and monthly CANPI 2000–2006 data.

Figure 2.4.4 shows that raw re-employment probabilities are consistently smaller for people who leave the public sector compared to employees from the private sector; however the difference is smaller among those who “lost” their job than among the broader groups. The results of the discrete-time duration models, presented in Table 2.4.1, also support this. (The detailed model specifications can be found in *Elek and Szabó’s* 2013 paper.) Results for people who are made redundant (groups of columns 1 and 3) indicate that the raw re-employment intensity after public sector work history was 25 per cent (LFS) or five per cent (CANPI) lower in each period compared to private sector work history. (However, only the LFS-based difference in re-employment rates is significant.) The difference essentially remains the same even after controlling for demographic (educational attainment, gender) and other variables (job tenure, transfer status): in the LFS model it is highly significant (at around 25 per cent) and in the CANPI model it is still not significant.

It is worth considering whether there is any difference in the re-employment probabilities of employees made redundant in the public and the private sector by educational attainment. In the bottom section of Table 2.4.1 the interaction variable of public sector and educational attainment is also shown in addition to the control variables of the previous model. The results reveal that former public-sector employees with low educational attainment (primary education or vocational training school) are 20–40 per cent less likely to be re-employed according to LFS data and 10–20 per cent less likely according to CANPI than similar workers made redundant in the private sector. There is no such difference between graduates and in the CANPI specification between people with general secondary education. Overall the moder-

ately lower re-employment probabilities (25 per cent lower according to LFS and no significant difference according to CANPI)<sup>13</sup> are entirely caused by the worse prospects of lower skilled employees, and this conclusion seems robust regardless the available datasets (LFS and CANPI).

**Table 2.4.1: Re-employment intensity of the non-employed leaving the public sector (compared to the private sector) based on LFS and CANPI data**

	LFS		CANPI (re-employment within 12 months)	
	"Redundant"	"Total"	"Redundant"	"Total"
<b>Baseline models (raw difference between the two sectors)</b>				
Public vs. private sector	0.762*** (0.056)	0.510*** (0.023)	0.945 (0.032)	0.635*** (0.012)
<b>Models with control variables</b>				
Public vs. private sector	0.766*** (0.061)	0.581*** (0.029)	0.962 (0.035)	0.794*** (0.019)
<b>Models with interactions and control variables, benchmark = public sector × primary education</b>				
Public sector	0.606*** (0.091)	0.634*** (0.073)	0.790*** (0.059)	0.811*** (0.043)
Public sector × vocational training school	1.260 (0.266)	1.003 (0.154)	1.109 (0.118)	0.838** (0.063)
Public sector × general secondary education	1.195 (0.276)	0.844 (0.123)	1.381*** (0.133)	1.023 (0.067)
Public sector × higher education	2.141*** (0.521)	0.887 (0.132)	1.552*** (0.194)	1.018 (0.074)

Note: Calculations are presented for the age group 25–54 years (former employees only, excluding public works participants). The pension variable in the CANPI data was available for 2000–2004 only, therefore models including the transfer status were estimated for this period. In the CANPI models education is approximated as the median educational attainment for a given occupation (SCO code).

Discrete-time hazard models, where the table displays relative risks [ $\exp(\beta)$ ], and standard errors are reported in parentheses. Hence there is no effect if the parameter estimate equals one.

Models with control variables: education, gender, age and other factors that affect re-employment are included. The full list of control variables and their estimated parameters are reported in *Elek and Szabó (2013)*.

\*\*\* $p < 0.01$ . \*\* $p < 0.05$ . \* $p < 0.1$ .

Source: Own calculations based on *CSO LFS 1998–2010* and *CANPI 2000–2006* data.

Finally, groups of columns 2 and 4 in *Table 2.4.1* show the difference between the re-employment rates of people who leave their job for whatever reason by their sector of origin (public/private). Results based on both LFS and CANPI suggest that the raw intensity of re-employment is about 35–50 per cent lower for people leaving the public sector, which drops to 20–40 per cent in models with control variables. This means that although there is no significant difference between the re-employment probabilities of those who become redundant, inactivity is more likely to be a permanent exit from the labour market in the case of public sector workers compared to private sector employees. The main reason is that people who retire from the public sector or leave it due to “other reasons” (according to the LFS) are a lot less likely to return to work than those who leave the private sector for the same

13 The difference between the LFS and CANPI results is due to differences in the databases and the definition of the public sector.

reasons. In contrast to those who are made redundant, in these models there is no significant difference in the relative re-employment rate of public sector workers by educational attainment.

### **Job mobility from the public sector**

As has been shown above, the public sector was not only more stable in terms of outflow into unemployment but also in terms of job mobility compared to the private sector between 1998 and 2010: in both cases the appropriate transition probabilities were around half of those observed in the private sector (*Figures 2.4.2 and 2.4.3*). However, raw data in *Figure 2.4.3* conceal which public sector groups – in terms of education, age or branch – are more likely to move to the private sector. Using a logit regression model, it emerges that people who are disadvantaged on the labour market (low skilled, living in rural areas) moved to the private sector with a greater probability in the last 12 years. There are also substantial differences in the raw probabilities of exit to other jobs from the three main branches of the public sector. However, these get much smaller after the inclusion of control variables, when only health care appears to still have a lower exit rate by about 25–30 per cent compared to the other two branches, public administration and education. (For details see *Elek and Szabó's* (2013 paper).]

### **Overqualification in the new job**

It is a widespread belief that people who leave the public sector are likely to accept jobs for which they are overqualified (for example a teacher becomes an administrator). Transition from the public to the private sector provides an opportunity to examine this: if it can be shown that people who move from the public sector are more likely to be overqualified for their new job, then this might indicate the lower quality of the public sector workforce – compared to the private sector.

To address this question on the LFS database we assign to each occupation group (four-digit SCO code) the median educational attainment (MEA) of workers within that occupation group. Overqualification occurs when an employee has a higher educational attainment than the MEA corresponding to their occupation. Therefore being overqualified is not only an individual characteristic but also a characteristic of the occupation group. For example – at the level of detail of the current SCO classification – overqualification is much less common among people with general secondary education in the public sector than in the private sector. Overall, 14 per cent of public sector workers and 25 per cent of private sector workers are “overqualified”.

Therefore, it is not surprising that people who leave the public sector for another occupation in the private sector have a higher probability – around

37–39 per cent – of being overqualified in their new job than the 14 per cent average in the public sector. This raw ratio is also significantly higher than the ratio observed among movers to a different occupation and branch within the private sector (30 per cent). However, after controlling for other factors that are important for overqualification (especially education) the difference basically disappears. The logit regression models of *Table 2.4.2* show this.

**Table 2.4.2: Probability of overqualification among people moving to a new job in the private sector by the sector of origin (public or private) (logit models)**

	Odds ratio	
<b>Raw odds ratio</b>		
Public vs. private sector	1.664***	(0.147)
<b>Model with control variables</b>		
Public vs. private sector	1.040	(0.108)
Educational attainment (benchmark = vocational training school)		
General secondary education	7.313***	(0.349)
Higher education	13.627***	(0.987)
Sample size	14,063	
LR $\chi^2$	2237.1	
Pseudo $R^2$	0.1726	

Dependent variable: Is the individual overqualified? Unweighted logit estimation. Sample: people moving to another occupation and branch (in the private sector), without public workers.

Note: The table shows the odds ratios, standard errors in parentheses. Raw odds ratio: odds ratio of being overqualified for people moving from the public sector *versus* people changing jobs within the private sector.

In the model with control variables: education, gender, age, age squared, and the dummy of at least two years' tenure in previous job are included. For the estimated parameters of control variables see *Elek and Szabó's* (2013) study. Control variables do not include primary education because people with primary education cannot be overqualified by definition.

\*\*\*  $p < 0.01$ , \*\*  $p < 0.05$ , \*  $p < 0.1$ .

Source: Own calculations based on *LFS* 1998–2010 data.

The raw odds ratio of being overqualified for people leaving the public sector compared to people moving within the private sector is 1.66 (highly significant). After controlling for education and other parameters this drops to 1.05 and is no longer significant. So if people with similar educational attainment are compared then the widespread belief that people who come from the public sector are more likely to end up in “worse” jobs than those moving within the private sector can be refuted. This view might have developed because graduates are overrepresented in the public sector and they – naturally – are more likely to be overqualified in a new job compared to people with lower educational attainment.

## Conclusions

This chapter has concluded that the public sector was considerably more stable both in terms of outflow into unemployment and into other jobs than the private sector between 1998 and 2010. The question of whether greater stability was related to adverse selection – “poorer” quality of public sector workers – was examined by looking at the re-employment rates of people who became unemployed and at the flow of workers from the public to the private sector.

The results have shown that the re-employment probability of workers made redundant in the public sector is moderately (by 5–25 per cent) lower than the same rate in the private sector; however the difference disappears in groups with higher educational attainment. Similarly the overqualification rate of movers to another job is no greater than in the private sector after controlling for educational attainment and other factors. Thus, these estimates do not support the widespread belief that people who leave the public sector face greater difficulties in finding a job and are more likely to accept jobs below their qualification level. The findings are especially interesting given the fact that our estimation strategy is more likely to overestimate rather than underestimate the quality differences due to a possible selection bias – people are much less likely to be made redundant in the public sector. However, related to its greater stability, people who leave the public sector for whatever reason are significantly less likely to be re-employed (the intensity of re-employment is 20–40 per cent lower even after controlling for other factors), mainly because pensioners who have retired from the public sector are significantly less likely to return to work.

The number of public sector workers increased between 2010 and 2013, although a large share of this increase was due to the expansion of public works programmes. It will be interesting to examine in the future how the re-employment prospects of people made redundant in the public sector have changed since 2010, when the Hungarian economy started to expand following the period of stagnation and recession after 2007. To answer this question the panel database of the Labour Force Survey as well as the database on individual social security contributions will have to be extended until 2013.

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## 2.5 Why do people choose to work in the public sector?

### The role of subjective factors

GYÖRGY MOLNÁR & ZSUZSA KAPITÁNY

Selection between public and private sector jobs is influenced by a variety of factors in addition to potential pay. An important objective factor is the relatively higher demand for highly educated employees in the public sector. The main subjective factor is greater security in the public sector in a number of ways: greater job security, more regulated working conditions, and more predictable promotion opportunities. Those who value these are more likely to choose to work in the public sector even if it means lower pay. Another important subjective difference is that people are often motivated by a stronger sense of mission or social responsibility when choosing to work in the public sector.

The decision can also be influenced by family circumstances. This study will identify a number of life scenarios that support this hypothesis. The effect of motivations related to social responsibility will be examined through participation in voluntary work and attitudes towards income redistribution.

The study will address three related questions: 1) What are the family factors which influence public sector employment? 2) Are public sector employees more likely to be involved in voluntary work? 3) Are there any special characteristics of public sector workers in terms of their attitude to centralised income redistribution?<sup>1</sup>

### Background

It was *Bellante and Link* (1981) who first suggested that risk averse people are more likely to choose to work in the public sector than in the private sector. Their study was mainly based on *Bloch and Smith's* (1977) finding that public sector employees – *ceteris paribus* – are less likely to become unemployed than private sector workers. *Gregory and Borland* (1999) highlighted a potential issue with the interpretation of results: *Bellante and Link's* (1981) findings only show that public sector employees are more likely to be risk averse than those in the private sectors. It is possible, however, that the effect mechanism works in the opposite direction and that the public sector prefers risk averse employees. Furthermore, there is a possible third explanation: public sector employees become risk averse as a result of the job requirements. *Hartog et al.* (2002) examined factors associated with risk aversion: public sector employees are more, while entrepreneurs are less, risk averse, private sector employees are in the middle.

In addition to security, the feeling of social usefulness can also play a role in choosing to work in the public sector. Various studies showed that the motive of doing socially useful work is stronger among public sector employees (see

<sup>1</sup> This chapter is a shorter and simplified version of the paper by *Molnár-Kapitány* (2013), which includes a more in-depth literature review and descriptive statistics.



for example *Dixit*, 2002). Dixit concludes that this motive is much stronger in the early stages of the establishment of institutions than later on, and is more characteristic of employees who work directly with people than managers.

Most studies examined the relationship between social responsibility and public or private sector employment using questions about social responsibility. However there is a risk of social desirability bias here; the responses of public sector employees might be influenced by social expectations towards them. In a behavioural experiment *Buurman et al.* (2009) showed that the motivation to help others is stronger than average among people in the early stages of their public sector career.

Perception of the extent and dynamics of income inequalities can strongly influence preferences for income redistribution (see for example *Meltzer and Richard*, 1981), and that might be an indicator of social responsibility. This is often assessed using the following question: “Do you agree that the Government should reduce income differences?” The answer to this question is influenced by a number of additional factors: absolute and relative financial and wealth situation, mobility, expectations towards the future, personal history, education, family structure, and so on. *Alesina and Giuliano* (2010) provide an in-depth review of the literature on preferences for redistribution, while *Molnár and Kapitány* (2006) analyse the issue on Hungarian data. Different factors might be important in different countries, nevertheless support for redistribution generally decreases with the increase of income and more positive expectations towards the future.

There are few studies that look at working in the public sector in the context of attitudes towards redistribution. *Jaime-Castillo* (2008) found a positive but not significant relationship between working in the public sector and preference for income redistribution in Spain. *Finseraas and Ringdal* (2012) using data from 23 European countries including Hungary found a very strong relationship. According to their analysis, employees who work in the public sector – *ceteris paribus* – are more likely to support the welfare state than others. In international comparison the Hungarian data suggests a paradox situation. Hungary is among the countries with a strong preference for a range of welfare state activities. However, when asked to indicate the desirable extent of taxes and welfare provisions on a scale between 0 and 10, Hungary produces the lowest value. One of the possible reasons for this contradiction is the low level of tax awareness in Hungary and undervaluing the tax cost of public services (see *Csontos et al.* 1998, *Gábor et al.*, 2007 and *Tóth*, 2009). Very low trust in public institutions in international comparison might also contribute to this phenomenon (*Tóth*, 2009). Therefore people think that it would be possible to provide more welfare services from the taxes they pay.

*Linder* (2010) examined the situation of civil servants in Hungary. In her dissertation she used the findings of a 2003 survey that asked public service

employees about the most attractive aspects of their job as a civil servant. Most respondents (75%) mentioned benefits for the community and security (70%), and any financial aspects only came after these. However, the author also raised the question of whether the frequent mentioning of community aspects might reflect social desirability (*Linder, 2010, pp. 203–204.*). At the same time, frequent reorganisations, large scale redundancies, and the weakening of the principle of irremovability raise the question of whether greater public sector job security is still the case in Hungary.

### About the data

The analysis uses Hungarian data for the two-year EU–SILC (*European Union Statistics on Income and Living Conditions*) household panel survey collected by the Central Statistical Office in 2005–2006. The sample includes around 5,000 households and 13,300 individuals, out of which 12,800 people took part in both years. The selection of these years is justified by the inclusion of questions on life satisfaction and attitude towards income redistribution in the 2006 survey. The 2006 questionnaire also includes a question on voluntary work and there is information on the ownership of the workplace for both years. In the analysis the public sector includes civil servants, public service employees and employees of state or local government owned businesses. Household income was computed using the “OECD1” equivalence scale because this is the most appropriate within the Hungarian context (see also *Cseres-Gergely and Molnár, 2008*).

### Why do people choose to work in the public sector? The role of family factors

In life situations when job security and predictability of working conditions is very important, the decision to work in the public sector might be an advantage. Such life situations might include *raising children*, the *health status* or *long term condition – not work-related* – of the individual or other family members, and factors related to other family circumstances. In terms of health status, people with a long-term condition – who are able to work – are more likely to work in the public sector. In addition to their own illness, the presence of long term conditions in the family and any caring commitments might also influence decisions about jobs.

The rate of people who had been unemployed previously is considerably lower in the public sector than in the private sector (28 and 42 per cent respectively). In addition to different education levels, this might be due to higher job security in the public sector or the fact that the public sector is less likely to recruit unemployed people for jobs. A two-year panel survey is very short for making any general conclusions, however it is indicative that only 2.6 per cent of public sector employees had been unemployed in the previous year

compared to 5.9 per cent of employees in the private sector. Therefore, in terms of the preference for job security, earlier unemployment in the family might be a relevant factor.

The sample has been limited to employees, excluding entrepreneurs and casual workers in the private sector. In the data set approximately 35 per cent of employees worked in the public sector. A logistic model was used to estimate what factors influenced the likelihood of working in the public or private sector and to what extent. The results of the estimation are summarised in *Table 2.5.1*; this presents not the coefficients but the estimated marginal effects. (For continuous variables the marginal effect shows the average effect of a one-unit increase in the explanatory variable. Categorical variables with multiple values were compared to reference groups, so for example a difference of 46.5 percentage points shows the difference in the probability – expressed as a percentage – of a female university graduate to work in the public sector compared to a male with a vocational school education. For dichotomous variables the marginal effect shows how much their occurrence increases or decreases probability.)

Each life year – taking all other explanatory factors as constant – increases the likelihood of working in the public sector on average by 0.5 per cent. Women with a vocational school or vocational secondary education or lower are 8–9 percentage points more likely to work in the public sector than men with the same level of education. Men whose highest education is general secondary education are as likely as women with the same education to work in the public sector and there is no significant difference between the two values. This means that the public sector provides better opportunities for men with a general secondary education and no vocational qualification than the private sector. There is no difference between men with a general secondary education and men with a college degree in this respect.

In terms of gender differences, it is greatest among graduates, particularly college graduates. Women with a college degree are 15 percentage points more likely to work in the public sector than men with a similar education, while among university graduates the gap is somewhat smaller: 12 percentage points. The likelihood of working in the public sector increases with education.

There are no differences in terms of the number of children; however there are two types of households that stand out. Single parents are more likely to work in the public sector than people in other types of households. This effect no longer prevails if there is another adult (for example a lineal relative) in the household. The result suggests that the public sector provides better opportunities for single parents to manage their child care responsibilities and therefore they are more likely to work here rather than in the private sector.

In cohabiting households the likelihood of working in the public sector is smaller than in other households. A possible explanation is that people

who value formalised security less are also less likely to get married or have a more secure job.

**Table 2.5.1: Factors influencing selection between the public and private sector among employees, 2006 (logit estimate, dependent variable: selection of public sector job, N = 4,200)**

Variable	Marginal effect (percentage)
Age	0.5***
Vocational training school or lower, male	reference group
Vocational training school or lower, female	8.3***
Vocational secondary school, post-secondary vocational qual., male	8.9***
Vocational secondary school, post-secondary vocational qual., female	17.6***
General secondary education, male	21.2***
General secondary education, female	24.1***
College, male	24.2***
College, female	40.9***
University or higher, male	34.2***
University or higher, female	46.5***
Single	-0.1
Married couple without children	-3.3
Married couple with child(ren)	1.5
Single parent with child(ren)	7.7**
Single parent with child(ren) + another adult	0.9
Cohabiting partners	-6.3**
Other type of household	reference group
Spouse or partner worked in the public sector in the previous year	11.5***
Long-term condition	6.4***
Spouse/partner or child in the household has long-term condition	7.3***
Husband had been unemployed before 40 <sup>th</sup> birthday of wife	7.3**
Wife had been unemployed before 40 <sup>th</sup> birthday of husband	3.7
Logarithm of regional unemployment rate	10.9***
Pseudo R <sup>2</sup>	0.127

Note: We used robust estimation clustered for households. The estimated odds ratios and standard errors are available in Table 1, *Molnár and Kapitány* (2013).

\*\*\* Significant at 1% level, \*\* significant at 5% level.

People who have a self-reported long term condition are significantly more likely to work in the public sector than those who do not have a long-term condition. One of the possible reasons is that the public sector provides better employment opportunities for people with long term conditions, or the public sector makes more of an effort to employ people who are disadvantaged due to a long term condition. This effect does not only prevail for their own illness; people whose spouse/partner or child has a long term condition are also more likely to work in the public sector.

Women whose husband had been unemployed before they (wife) turned 40 (or any time in the case of those aged under 40) are more likely to work in the public sector than others. There is no similar significant effect in the case of cohabiting couples or men (whether their wife had been unemployed).

Finally, in terms of regional effects, contrary to international experience, in Hungary people who live in the capital are less likely to work in the public sector than others. (More precisely this is only true for public sector employees, not for civil servants.) The phenomenon is related to the regional distribution of unemployment. The higher the unemployment in a region, the more likely it is that people in employment are working in the public sector. There are numerous small regions in the country where only the public sector provides any employment opportunities.

In summary, it might be concluded that attributing the decision to work in the public sector to individual risk aversion is overly simplistic; it is often the result of family rather than individual strategies. Nevertheless, these strategies will only remain valid in the long run if the public sector does provide greater security in these life situations. There have been some opposite trends in recent years: the economic and financial crisis might have increased the advantage of the public sector in terms of job security over the private sector; however frequent reorganisations and the further weakening of the principle of irremovability might have worked in the opposite direction.

### Voluntary work

Voluntary work is considered a possible proxy variable for social responsibility. The number of people involved in voluntary work is rather low and less than half of them undertake it at least once a month. The frequency of voluntary work in the total adult population is just under 15 per cent, and 18 per cent among the economically active.

Estimates for factors associated with participation in voluntary work are presented in *Table 2.5.2*. The model was estimated for the *total* adult population rather than employees only. It is assumed that involvement in voluntary activities is cumulative within the family. To examine this, a variable was created that indicates the ratio of adults involved in voluntary work in the household. The augmented model that includes this variable is shown in the second column of the table.

People employed in public education, research and culture are around 10 percentage points more likely to be involved in voluntary work than people who are private sector workers. For people who work in health care or social care the difference is approximately six percentage points. Somewhat surprisingly, there is no significant difference between public administration and private sector workers in terms of involvement in voluntary work; *there is no evidence* of a greater than average social responsibility among people who work in public administration. This finding supports *Linder's* (2010) argument above that civil servants tend to respond according to social expectations in surveys. The indirect measurement, based on voluntary work most probably provides a more realistic picture.

**Table 2.5.2: Factors influencing voluntary work in the adult population (logit estimation, dependent variable: does any voluntary work, N = 10,664)**

Dependent variable: does any voluntary work	Marginal effect (percentage)	
	Model 1	Model 2
Employed in the private sector	reference group	
Employed in public administration	1.3	0.7
Public education, R & D, culture	10.7***	9.5***
Health and social care	6.3***	5.9***
Other public sector	1.4	2.0
Entrepreneur	1.9	0.6
Casual worker, public worker	6.8**	6.8***
Retired	0.6	0.6
Student	14.8***	11.0***
Other unemployed and inactive <sup>a</sup>	-1.4	-1.0
Logarithm of household income	1.7	0.7
19–29 years, not in education <sup>b</sup>	reference group	
30–39 years	6.6***	5.7***
40–49 years	8.2***	5.2***
50–59 years	9.3***	7.8***
60–69 years	8.9***	7.7***
70 years or older	6.8***	6.4***
Poor health	-6.2***	-5.3***
Female	-0.9	-0.7
Primary education or lower	reference group	
Vocational training school	6.0***	4.6***
Vocational secondary school	11.0***	8.8***
General secondary education	9.9***	7.8***
College	18.3***	14.7***
University	17.8***	13.3***
No children under 15 in the household	reference group	
1 child	5.1***	2.5***
2 children	6.7***	3.2***
3 children	10.2***	5.6***
4 or more children	8.1	4.5
Rate of adults involved in voluntary work within the same household <sup>c</sup>	-	21.0***
Budapest	reference group	
City with county rights	4.3***	3.4***
Town	2.6*	2.3**
Village	9.1***	6.8***
Pseudo R <sup>2</sup>	0.098	0.189

Note: See comments for *Table 2.5.1*.

<sup>a</sup> Includes: unemployed not in public works, full-time parents, homemakers, other non-working.

<sup>b</sup> 99% of students age over 18 are between 19–29 years, therefore – as students are in a different variable – the reference group is comprised of 19–29 year olds not in education.

<sup>c</sup> The indicator was obtained by dividing the number of adults who do voluntary work by the total number of adults in the household. The observed individual was not included in the numerator nor in the denominator. If there were no other adults in the household the value of the variable is zero.

\*\*\* Significant at 1% level, \*\* 5% level, \*10% level.

For public service employees another question is whether voluntary work is truly altruistic and genuine or if it is forced upon the individual by the employer. This was examined by comparing old and new public service employees in the paper by *Molnár and Kapitány* (2013) mentioned earlier. The detailed findings of this study are not presented here, nevertheless they seem to suggest that even if there are expectations from employers, the people who work in human services have a higher level of social commitment than others.

It is worth considering what other factors influence involvement in voluntary work based on *Table 2.5.2*. Among students (mainly students in higher education) participation in voluntary work is very high, then it declines and again it slightly increases with age. As the level of education goes up involvement in voluntary work also goes up, and this is especially true for graduates. Voluntary work is partly related to children. The probability of voluntary work is higher in villages than in towns and especially Budapest. The financial situation does not play a role but family factors have a very strong effect.

More recent developments, radical re-organisations and increasing centralisation weaken the sense of mission. To test this hypothesis it would be important to include questions on voluntary work and other factors suitable for measuring social commitment in household surveys on a more regular basis.

### Attitudes towards income redistribution and the public sector

In relation to income redistribution respondents answered two questions: “Do you agree that the Government should limit the income of the rich?” and “Do you agree that the Government should provide higher income to the poor?” There was a similar survey in 2002 as well, see *Molnár and Kapitány* (2006b). In the four-year period between 2002 and 2006 the rate of respondents who *strongly agreed* increased considerably by about 10 percentage points against those who *somewhat agreed* in both categories (*Table 2.5.3*). The share of those who strongly or somewhat agreed reached 91 and 80 per cent respectively in 2006.

**Table 2.5.3: Attitudes towards income redistribution, 2002 and 2006 (percentage)**

	Higher income for the poor		Limiting the income of the rich	
	2002	2006	2002	2006
Strongly disagree	4	3	6	9
Somewhat disagree	7	6	14	11
Somewhat agree	29	21	30	21
Strongly agree	60	70	50	59
Total	100	100	100	100

The starting hypothesis was that public sector employees are more likely to support income redistribution than others. There might be various reasons for this: the desire to reduce inequalities related to social responsibility; soli-



darity with the poor; funding of the public sector, including their own job comes from income redistribution; envy of the rich.

Attitudes towards the two directions of income redistribution were first examined using an ordered logit model; detailed calculations are presented in *Molnár and Kapitány* (2013). A simpler analysis was also carried out by merging the three categories other than *strongly agree*. There are no fundamental differences between the two results; however the second version – presented in *Table 2.5.4* – allows an easier presentation and interpretation of marginal effects.

**Table 2.5.4: Factors influencing attitude towards income redistribution in the adult population (logit estimation, dependent variable: dichotomous variable of attitude towards income redistribution, N = 10,219)**

Variable	Marginal effect (percentage)	
	Higher income for the poor	Limiting the income of the rich
Employed in the private sector	reference group	
Employed in public administration	1.1	-1.7
Public education, R & D, culture	-0.4	2.3
Health and social care	5.6*	8.4**
Other public sector	3.7	3.0
Entrepreneur	-3.5	-8.0***
Casual worker, public worker	0.0	1.4
Retired	0.9	2.6
Student	-8.4***	-8.1***
Other unemployed and inactive	1.6	5.5***
Logarithm of household income	-7.8***	-10.2***
Age	-0.1	0.1
Poor health	4.9***	5.1***
Female	1.4*	1.0
Primary school education or lower	reference group	
Vocational training school	-1.4	2.8*
Vocational secondary school	-6.4***	-5.1***
General secondary education	-7.9***	-3.5*
College	-13.0***	-14.7***
University	-13.5***	-21.5***
No children under 15 in the household	reference group	
1 child	0.5	-3.9*
2 children	-9.0***	-9.7***
3 children	0.2	-7.6*
4 or more children	-13.8	-3.3
Budapest	reference group	
City with county rights	7.0***	8.6***
Town	9.0***	11.3***
Village	9.0***	13.7***
Pseudo R <sup>2</sup>	0.044	0.069

Notes: See comments for *Table 2.5.1*. The categories of the dichotomous variable for attitudes to income redistribution are “strongly agree” and all other categories combined.

\*\*\* Significant at 1% level, \*\* 5% level, \*10% level.

Contrary to our initial assumption, in the public sector only people who work in health care or social care support are more likely to support income redistribution than workers in the private sector. They are also more likely to agree with limiting the income of the rich. The question as to why there is a difference between health and social care, and education, science and culture in this issue might be raised. The review of literature has highlighted that attitude towards income redistribution can be related to the perception and attitudes to inequalities. The results suggest that these are different in the two areas of human services.

Entrepreneurs are less supportive of limiting the income of the rich than others. However, students are the least likely to agree with income redistribution in both categories. This is probably associated with their student status and positive expectations towards the future. Interestingly, “other inactives” (including the unemployed) are in favour of limiting the income of the rich, however there is no significant effect for supporting the poor.

As income increases, there is a noticeable decrease in the preference to income redistribution in both areas. Poor health increases preference for income redistribution; here self-interest is probably a motivating factor as people with a long term condition benefit from income redistribution. There is a negative relationship between educational attainment and preference for income redistribution. People with children are more likely to support limiting the income of the rich. There is a negative relationship between the size of settlement and preference for redistribution.

In conclusion, characteristics associated with preference for redistribution and voluntary work often work in the opposite direction, although not always. The correlation between the two factors is near zero, they are independent of each other. Therefore, attitude towards redistribution is not always a suitable indicator to measure social responsibility.

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### 2.5.1 The satisfaction of public sector workers

GYÖRGY MOLNÁR & ZSUZSA KAPITÁNY

*Luechinger at al.* (2007, 2010) examined selection between public and private sector alongside satisfaction. Their starting assumption is that people allocate themselves into the public or private sector based on their individual characteristics; they choose – if they have the possibility – between sectors based on their life situation and preferences, and this results in additional satisfaction. They argue that the public sector is chosen primarily by people who are more risk averse or committed to social issues, while people who aspire to work in the private sector value more highly the opportunity of a dynamic career. Thus, the sectors might offer different sources of additional job satisfaction to different workers. By comparing actual allocation and satisfaction with a hypothetical random allocation and related satisfaction they show that self-selection produces a non-trivial amount of additional satisfaction.

When looking at job selection, the question might be raised of whether there are hidden advantages in the public sector that are not possible to measure directly due to their nature. The analysis of life satisfaction (in a different terminology – subjective well-being) might provide answers to such questions. *Luechinger at al.* (2008) examined whether there was a difference between the subjective well-being of public and private sector workers based on data from the European Social Survey and the Latinobarometer. If public sector workers are more satisfied with their life than workers in the private sector that indicates the existence of hidden rents other than higher wages, and it also suggests that entry into the public sector does not depend only on education and skills but also connections. In their international comparison they found a greater than five per cent difference in satisfaction between the public

and private sector in four countries (Czech Republic, Greece, Poland and Paraguay). Unfortunately Hungary was not included in the international comparison because there were no questions on the ownership status of the employer in the period they looked at.

Therefore subjective well-being in Hungary was examined. In an earlier paper (*Molnár and Kapitány, 2006*) we concluded that the sharp increase in household real income between 2000 and 2002 increased subjective well-being less than expected, especially among private sector employees. The reason was that people were uncertain about the sustainability of growth and prospects for the future. At the same time there was no significant difference in the subjective well-being of public and private sector workers.

Using the database from 2005–2006 the question was examined again using the same methods. We found no significant difference between the subjective well being of public sector employees, and also more closely civil servants, compared to those who

are employed in the private sector. This suggests that working in the public sector does not have systematic hidden benefits in Hungary. The 2013 wave of EU-SILC again had questions on subjective well-being. As soon as the dataset becomes available it will be possible to examine whether there have been any changes over the past few years.

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### **3. THE INSTITUTIONAL ENVIRONMENT OF THE PUBLIC SECTOR LABOUR MARKET**

#### **3.1 Trends in labour law – the dismantling of job security in the public sector**

**BEÁTA NACSA**

This section offers an overview of the regulation process leading to the dismantling of public sector job security, exploring the issue through the lens of broad-based labour law. First, we will look into the factors – that continue to be valid – that justify designing guarantees of job security and that argue in favour of sustaining legal protections. We will discuss the need for legal protections for a legally employed person and on the relationship between the guarantee of job security and the neutrality and professionalism of public service. Then, we will summarize the reasons behind the introduction of dismissal without stating cause and of the Constitutional Court and European Court of Human Rights overruling of that law. We will look at new regulations that replaced the overturned laws, which formally comply with the court rulings but which continue to contradict them in substance. Finally, we will briefly explore other flows in Hungarian labour law regulation that have eroded job security. In the beginning, we will underline the legal concept of civil servant (a term which has been changed repeatedly over time), but will also look at the public servant, albeit to a lesser extent.

#### **Reasons in support of establishing and maintaining guaranteed job security**

Traditionally, the legal status of the civil servant as used in the current sense was not considered a private law contract between equal parties but a status-based relationship regulated by public law derived from the principle of state sovereignty. The reasoning that sums up this approach is: “The state and the servant working for it cannot be set one against the other as contracting parties of equal rank ... The servant is not merely the executor of the will of the state but is also the implement by which the state fulfils its calling.” (*Mártonffy* unknown date, p. 667) The state bureaucracy assured the civil servant of life-long protection and a stable legal status.

The principle of state sovereignty was significantly reduced over the course of the 20th century insofar as interpretation of the various legal relationships of the state was concerned. Distinctions between the “external” and “internal” legal relationships of the body exerting public power became increasingly accepted. In fact, it was recognized that in external legal relationships the state

might appear not only as the entity exercising public power but also as a private entity, for instance when signing a lease or a purchase or sales contract.<sup>1</sup> By the start of the latter half of the 20th century it became clear that the principle of sovereignty did not cover the essence of the “internal” legal relationship between the state and the civil servant. Therefore, professional articles emanating from the west began exempting the civil servant from labour law arguments. Starting with the 1960s a new approach began taking over in which the body of public administration, as employer, was not exercising state power but was employing natural entities to meet specific functions, just like any other employer. State officials are no longer considered representatives of the state in the legal relationship surrounding employment. Instead, they are employees who work for the state and who – in this capacity – are far more conscious of their employee status than their status as a representative of a sovereign power (*Ozaki, 1990*).

The legal conditions of employment in the private and public sectors are identical in that the employee is subordinate to the employer and that the employee performs the tasks assigned by the employer, following employer instructions on any and all components of the job, doing so regularly and continuously, in return for remuneration. It is clear from the content of this work relationship (in the broad sense of the term) that the civil servant is economically and personally dependent on their employer, which is the outcome of the economic and organizational supremacy of power. At the same time, there are specifics to employment by the state that justify maintaining some unique features in the regulation of the legal relationship governing employment (*Horváth, 2008*). The lowest, fundamental feature of the civil servant fits within the broader concept of legal employment, and the secondary characteristics stemming from the civil service nature of the relationship form a superstructure.

The regulation of job security is essential to both layers, albeit the dogmatic arguments for them differ. It follows from the concept of legal employment in the broader sense that a tenet of principle to protect the weaker entity, as is typical of all legal employment, is needed here, too (*Morris and Fredman, 1993*). The civil service character – as a secondary characteristic – also justifies the regulation of job security guarantees as has been pointed out by experts in labour law and public administration law alike, since this is how to provide professionalism, reliability, and an absence of prejudice in public administration. In this context it is worth exploring how Hungarian professional literature has described the guiding principles of public administration law. István György underlined the principles of political neutrality, lawfulness, subordination, career and professionalism, and heightened responsibility.

*Political neutrality* is the outcome of the separation of civil service and politics. “...the personnel involved in public service need to be separated from

<sup>1</sup> If the state (body) appears as a private law entity within a legal relationship, then the rules of private law – with possible but not necessary modifications – are the ones to be followed. Privity is based on contract and not on a unilateral act of the state.



the venues of political infighting, and must be rendered independent of party politics.” (György, 2007. p. 47) The political neutrality requirement is the defining principle of public administration from which numerous other principles of modern public administration are derived. The principle of political neutrality includes the requirement of loyalty between the civil servant and whichever authority is in power. The civil servant is mandated to accept the legitimately elected power and execute every lawful instruction coming from it (Gajduschek, 2006).

The *requirement of loyalty* gives rise to the promise that a change in government will not result in large scale replacements among staff and that political neutrality is, in the final analysis, the ultimate factor securing the evolvement and operation of professional public servants.

In public administration the *principle of lawfulness* is slightly different from its primary definition in the private sector. In the private sector, everything is legal unless prohibited by law. In the public sector, the civil servant may only do what the law explicitly permits or prescribes. At the same time, the law places a more powerful responsibility on the civil servant than would be the case otherwise, since it requires not only that the civil servant obey the law, but also that they compel others to do so.

The *principle of subsidiarity* on the one hand set public administration as subordinate to the elected bodies and on the other, it establishes a strict hierarchy within the official apparatus, which includes the ensuing right to give orders.<sup>2</sup> Morris and Fredman (1993) added that the strict hierarchy of superior and subordinate in an office ensures a clear chain of command that goes up to the minister’s responsibility to parliament on the one hand, and on the other, makes sure that the official staff exercises its public function vis-à-vis the citizens in a transparent, fair and unbiased way. Lőrinc and Takács (2001) have summed up the basic principles of public administration as manifest in the democracy and effectiveness of public administration. In this context they view the principle of democracy as the restriction on public administration. All of these principles will directly or indirectly reinforce the requirement derived from the specifics of employment, that a civil servant may only lose their job if, for some reason, the purpose for which they were employed no longer exists.

Regarding the other basic form of public sector employment, the public servant, a unique approach in Hungarian laws has existed regarding this form of employment since it was established in 1992. The public servant fits in somewhere between the general employment condition and the civil service. In this case the employer performs a public service<sup>3</sup> that does not require the exercise of some form of public power or state prerogative. The public servant employment status was established by Act XXXIII of 1992 on public service employment (hereinafter: Kjt.). The basic feature of this employment

2 The right to give orders, which is generally typical of work as an employee, becomes reinforced because of the principle of subsidiarity.

3 Therefore, the regulation of the public servant is exceedingly diverse, since any number of sectoral laws (on public education, higher education, health care, etc.) and ministerial decrees regulate the specifics of people employed under this title.



status is that it was established to meet topical political and – even more so – budget circumstances. In other words, it is the product solely of pragmatic considerations and not legal dogma (*Horváth, 2008*).

**The dismantling of job security in labour law in general and in the public sector (among civil servants and public servants) in particular**

The labour law of 1992 regulated public sector employment separately, separating it from private sector employment, and also separating the civil services, the public services, and the professional members of the armed services (the latter includes law enforcement and firefighting) within the public sector. The 1992 regulations introduced a set system of terminating employment in the public sector. The text of the law included an exhaustive list of the factors, which, should they occur, would allow or require the employer to unilaterally terminate employment. The guiding principle of Act XXIII of 1992 on the legal stature of civil servants (hereinafter: Ktv.) regarding job security was that the people employed were career civil servants who did their work professionally, and in exchange the state would guarantee them job security and regular opportunities for advancement.<sup>4</sup>

In contrast, the private sector worked under the principle of the semi-restricted job termination system as set down in sequential Labour Codes. In other words, it listed the specific types of causes for which dismissal became possible, which were concretized over a lengthy timeframe by day-to-day practices and court interpretations of the law (Act I of 2012, Paragraph 66, Section 2). This regulation faithfully reflected public thinking in terms of labour law in the 1990s, which also coincided with the above reasoning. In other words, labour law accepted job security as the goal and requirement of the regulation.

In the meantime Hungarian labour law underwent significant changes. Labour law protections were reduced drastically and it seems reasonable to assume that current Hungarian regulations offer one of the lowest levels of work protection in all of Europe and North America.

Although arguments in favour of reducing job protections can be heard often by a wide range of analysts, convincing dogmatic arguments are sorely absent from this position. They cite the dismantling of labour protections as a way to expand employment and improve competitiveness without demonstrating exactly how the reduction in protections will do this, or through what mechanisms, albeit their goals are valid and necessary. The literature covering labour law lacks systematic investigation into how the past two decades of labour law, which deregulated employment, has impacted job creation and competitiveness. Has it improved them and if not then why do we believe that future deregulation will do the job? To my knowledge related sciences have also failed to prove a cause/effect relationship. Actually, they seem to dem-

<sup>4</sup> These regulations are the most important guarantees of the principle of closed public administration discussed above.

onstrate the opposite. Labour economy research (domestic and international alike) have verified that the dismantling of labour law protections has not influenced employment levels. At most it has had a statistically insignificant impact on the composition of the workforce. (*Esping-Andersen and Regini*, 2000, *Cazes and Nesporova*, 2007, p. 36–39) Among the goals thought to be attainable with deregulation is increasing employment (something which can be quantified and monitored) and the much less palpable goal of improving competitiveness. However, generally such analyses fail to offer concrete information on the content of competitiveness or the desired goal. This makes it harder to explore and monitor cause/effect relationships.

In the public sector, reducing job security was intended to, in part, meet other goals. Partly it was a move to cut budget outlay and partly – as of 2010 – it was to adjust public sector staff to meet political preferences. The eroding of job security among public sector employees started in about 2000. After facing the legal consequences of unlawful dismissals – which the Constitutional Court reversed in Decision 4/1998 (III. 1.), the job of eliminating the legal consequences of unlawful dismissal got underway by amending the law.

An amendment to Kjt. on 1 September 2007 essentially redrew the set of legal consequences for the unlawful dismissal of civil servants (Kjt. Paragraph 34.) The amendment started by discarding the principle of *restitutio in integrum*, under which the violator of the law was mandated to return the unlawfully dismissed employee to their original job. Under the new rule the civil servant only could request being returned to their original job if the employer's decision violated the principle of equal treatment, if the person was under special protection prohibiting or restricting dismissal, or if the move violated special workplace protections afforded to elected union officials (a member or chair of a civil service council or a public employee representative) or a labour safety official. (Kjt, Paragraph 34, Section 1., Subsections a and b). Among the factors requiring the return of someone to their original job, the changed legislation – effective 1 January 2010 (Subsection c) – cited dismissal without legal cause or disciplinary dismissal that was found to be a disproportionately severe sanction.

All other violations of the law – in fact every single violation usually committed – were cited among the violations regulated by Section 4., where the legal consequence was limited to a payment obligation on the part of the employer, the amount of which was determined by the court. Therefore, if the employer gave no cause for dismissal or if the cause was a falsehood (which occurs quite often), the civil servant could not request a return to their former job. In fact, under decrees that took effect in 2007 and are still in effect, albeit in changed form, these regulations, which were full of fault legally, were considered valid, and the job was classified as legally terminated at the time specified in the notice of termination. In other words, an employer could

deliberately flaunt the law and dismiss a civil servant without risking the consequence of having to return the civil servant to the job, since the risk of having to return the person to the job was non-existent except in the specific cases listed in the law.

The driving force of this 2007 amendment was an attempt to save central budget monies. Ending the need to return someone to a job also prevented a returned employee from demanding back pay and, should the employee again be dismissed, severance pay. Limiting the amount of back pay a person was owed saved the budget from having to pay out multiple years' worth of salary that the civil servant had not worked for when court proceedings were lengthy. While the regulation did save money it was dogmatically inconsistent, since limiting the chance to return to the job to a very limited circle broke with the fundamental legal principle which declared that an action which seriously violated the law was null and void and could have no legal consequence.<sup>5</sup> At the same time, the lengthy court proceedings and consequentially, the employer's growing payment obligation occurred for circumstances unrelated to the civil servant since the lengthy proceedings generally could not be blamed on the malevolent efforts of the civil servant trying to drag out the proceedings.<sup>6</sup> In fact, the drawing out of the court proceedings was disadvantageous to the plaintiff civil servant since the outcome remained in limbo, requiring them to secure a living through other means while remaining uncertain of receiving any compensation (sometimes for years on end) even if there were solid grounds for the lawsuit. It would have been in the interests of both sides for the government to have taken measures to get the courts to move faster in labour disputes and had this been done legislative amendments running counter to labour law dogmatics could have been averted.

Another amendment to the detriment of civil servants limited their right to back pay. A provision declaring that an income covered through another source did not have to be paid out by the employer who had violated the law was already in effect. In other words, if the civil servant had found another job in the interim and received a salary, or had been receiving unemployment benefits, the amounts received were to be subtracted from the amount the employer had to pay. The 2007 amendment added the twist that a civil servant who did not display proper diligence in seeking another source of income was not entitled to back pay either. Failure to display proper diligence particularly meant that the person did not cooperate with state employment agencies in looking for a job, did not conclude a job-seeking agreement with them, or that the employee had rejected what the employment agency qualified as a satisfactory job offer – in keeping with the conditions in the law on job seeking – and was not actively seeking employment otherwise (Kjt. Paragraph 34, Section 5.) If the court found an absence of proper diligence it could investigate all circumstances surrounding the case before setting back pay, if any.

<sup>5</sup> Act I of 2012 on the new labour code cited this logic *expressis verbis* as an exception to the principle of said action being null and void.

<sup>6</sup> Cases got dragged out far more often by unrealistically long (sometimes six-month) interruptions between two court proceedings, delayed evidence submitted by the employer (the employer did have some obligations) and lengthy expert evidentiary proceedings.

Shortly after the new labour code was adopted the legal consequences of unlawful dismissal underwent further erosion in the sphere of public service. As of 1 July 2012, the abovementioned regulations on the legal consequences of unlawfully dismissing a civil servant as specified in Kjt. were declared null and void and replaced by regulations in the new labour code containing even weaker sanctions.

As regards public service employment regulations, public service itself was essentially redesigned between 2010 and 2012. Parliament adopted Act LVIII of 2010 (Hereinafter: Kjt.) on the legal status of government officials.<sup>7</sup> The new legal status of government officials brought two essentially new approaches into the regulation of public sector employment conditions. 1) It introduced dismissal without cause, drastically reduced notice time, and separated the duration of notice time from the length of time the person had spent on the job. (Kjt. Paragraphs 8 and 9).<sup>8</sup> 2) Instead of overtime pay for overtime work government officials became entitled only to time off, on an hour-for-hour basis (Kjt. Paragraph 15). These regulations were later incorporated into the rules governing civil servants.<sup>9</sup> The reasoning in the law on the legal status of government officials stated that the amendment was necessary to establish balance among the subjects covered by the law, i.e. employer and employee. Therefore, the obligation to provide cause in the unilateral termination of employment had to be identical for both as did the period of notice.<sup>10</sup> This regulation was extended to civil servants as of 1 January 2011. Under the new regulation there was no need to offer cause for dismissal – much the same as when termination was initiated by the employee – and notice time, previously adjusted to years on the job, was reduced to two months for termination by either employer or employee.

The reasoning behind this law contradicted the basic principle governing labour law. The argument, which set a body of public power on the same footing as a private individual not only broke with the principle of sovereignty but also rejected the existence of the difference in economic and organizational power as it exists in employment situations, and treated the legal status of the government official and the civil servant as equals under civil law. Consequently, it rejected the protective function of labour law based on the principle of proportionate interest, which is the principle that labour law regulation had to protect the weaker party, the one performing the work, at the points where they were vulnerable, and to offer sufficient protection through legal regulation to counterbalance that vulnerability (*Hepple*, 1996–1997). Under the generally accepted principle of labour law dogmatics, in all regulated systems (including the labour law of the United States which is considered the most liberal) the employer is more restricted in job termination than the employee. The economic justification for the regulation significantly favouring the employee is the excessive economic power of the employer, while the

7 This new legal status of government officials replaced the old one as part of the legal status of employment in bodies of public administration.

8 For an early albeit well-developed critique of the law see: *Kocsis* (2011).

9 Ktv. Paragraph 18, Ktv. Paragraph 71, Section 2, Subsection a) stated that the regulations in the labour code calling for cause to be given for dismissal was no longer to be applied to civil servants as of 1 January 2011.

10 This is the portion of the reasoning quoted by the Constitutional Court in its decision to overturn the law discussed below.

legal justification is the right to work (*Collins*, 1991). The demand for protection of the employee when employed by the state is even stronger, since the state is an employer whose excessive power is vastly heightened. In addition, the requirement for job security is derived from the guiding principles of public administration (particularly those of neutrality and efficiency), as was discussed in greater detail earlier in this analysis.

In 2011 both of these laws were struck down by the Constitutional Court as unconstitutional. The Constitutional Court struck down the decree on the status of the government official in Decision 1068/B/2010. It began its justification with the general characteristics of public service regulation and the specifics of a closed public administration system. Then it focused on the issue on the basis of the right to work and the constitutional regulations on the right to bear public office, and on past Constitutional Court interpretations of these rights. Finally, it drew the conclusion that Ktjt. Paragraph 8, Section 1, Subsection b) allowing the termination of government official employment without cause was unconstitutional because it violated the principle of the rule of law regulated in Paragraph 2, Section 1 of the Constitution, the right to work regulated in Paragraph 70/B, Section 1, the right to bear public office regulated in Paragraph 70, Section 6, the right to seek redress from the courts in Paragraph 57, Section 1, and the right to human dignity in Paragraph 54, Section 1. The date given for overturning the law on government officials was – surprisingly – 31 May 2011, which allowed nearly another six months to continue the dismissals without cause although it was based on regulations declared unconstitutional for multiple reasons. The Constitutional Court gave its reason for the nullification date as the fact that parliament had to enact a new law for which it needed several months to prepare.

In a separate decision the Constitutional Court overturned the same provision allowing dismissal without cause in Ktv. § 17., offering a reasoning that essentially coincided with the above, based on constitutional principles.<sup>11</sup> The termination of the regulations governing public official legal status was retroactive although, since the effect of the earlier regulations was restored with the overturning of the new ones the given decree was overturned with *ex nunc* validity.

The legislation that followed the Constitutional Court decision was CX-CIX of 2011 on public service. While less obvious, it retained the right to terminate employment without legally relevant cause despite a 2011 government document called the Magyar Program that declared itself to be establishing the basics of “good governance” and “good public administration.” On the surface the dismissal system returned to the former one but the reasons the employer was required to give were as abstract as “becoming unworthy of the position” and even “loss of confidence in the person by the manager.”<sup>12</sup>

One can cite objective considerations within the rubric of becoming unworthy of a position. Therefore at least in principle it is possible to offer a concrete

11 Constitutional Court Decision 29/2011 (IV. 7.)

12 Act CX-CIX of 2011 on public service officials, Paragraph 63, Section 2, Subsections a) and e)



reason, and which limits challenges in the courts. While it is possible that losing the confidence of the manager can be the result of objective circumstances, in cases when rational and consistent reasoning could describe how confidence was lost, the wording itself suggests that subjective considerations could play a much bigger role than objective ones when coming forward with that argument. In other words, the dismissal could be the outcome of a completely subjective factor, such as that the manager personally disliked the civil servant and did not want to work with them. This extreme interpretation makes possible not only politically motivated discrimination but discrimination by gender, age, family status, or disability, which conflicts with European Union *acquis* and international legal norms.<sup>13</sup> The concepts of “unworthy” and “loss of manager confidence”, though the former is the less serious of the two, are hardly different from the legislation thrown out by the Constitutional Court, unless judicial practice can restrict their use.<sup>14</sup>

### Summary

The new labour law has almost completely eliminated job security with labour regulations covering civil servant employment conditions. The first moves towards this end were in the mid-2000s, when regulations governing job termination that no longer rested in dogmatic principle were first introduced, exclusively to reduce budget expenditure. The regulations that diminished basic labour laws tended to “go around and come around.” In other words, if a regulation withstood Constitutional Court scrutiny it was included into additional laws and thus reduced labour law protections for all categories of public sector workers. The process peaked in 2010 when dismissal without cause was introduced. At this time political factors appeared to have been more important than budget considerations, given that a new political party moved into office. The excuse, however, was to establish true equality among partners (i.e. employer and employee). The inconsistency of the argument and the absence of a foundation of principle were underlined by the fact that in addition to the reference to the equality (non-existent) of state and civil servant, – the law also argued for state sovereignty, i.e. its overwhelming authority – while calling for the termination of other rights. Taken separately, neither argument holds water. Applying them together is self-contradictory and spotlights the absolute superficiality of the reasoning given for the laws.

The regulation allowing dismissal without cause was overturned by both the Constitutional Court and the European Court of Human Rights,<sup>15</sup> in part for overlapping reasons. In its decision the Constitutional Court underlined the right to work and the right to bear public office while the European Court of Human Rights found the right to fair procedure to have been violated by the *de facto* impossibility of court control.

13 Lawsuits continue to remain possible despite the new regulation, but given that the highest level of this strange regulation is that of employer subjectivity, it is possible that anti-discrimination regulations would also be violated in Hungarian practice. Balancing out the two norms will require very circumspect interpretation of the laws.

14 For more on the uncertainties related to the new regulations, see *Mrs. Nagy* (2012) and *Ferencz* (2012).

15 European Court of Human Rights, Section Two. *K.M.C vs. Hungary, case* (submission 19554/11) Strasbourg. 10 July 2012. Final. 19 November 2012.

The new legal regulation formally complied with court conditions but the new reasons which allowed termination of employment, in particular, the loss of confidence on the part of the manager, retained the opportunity to terminate employment for purely subjective reasons. This has opened the door to all manner of discriminative and unlawful employer practices.

In addition to rewriting the causes for which an employer or the employee could give notice, sanctions for unlawful dismissal were reduced. Reducing sanctions to a minimum along the entire spectrum of labour law leads to a situation in which employees will not protest even flagrant violations of the law in workplace practices. Formally, this will lead to an improvement in statistics on labour-related lawsuits but in practice will lead to deteriorating working and living conditions.

At the same time the regulations are dysfunctional from the aspects of organization development and human resource management because they reinforce servility and stifle opportunities for independent thinking and action. Thus, they could lead to the deteriorating performance of businesses, government administration, and the institutions that service them, possibly within the very near future.

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### 3.2 The specifics of setting salaries and interest reconciliation in the public sector

ERZSÉBET BERKI

The portions of the Hungarian legal system covering public sector employees that evolved between 1992 and 1996 divided up the public servant sector which until then had been nearly a single entity. The divisions were partly along the lines of branches of service and were partly linked to the role of their employers. Three major public servant groups were established within the government power structure: armed services (including law enforcement and the military), public servants, and public service employees. Without offering details on the specifics of these legal relationships, we do need to say that the first two are related to public administration and power functions while the employers of public service employees provide residential services. Therefore, employment specifics related to armed forces and public servants tended to make up “closed systems”, while the regulation of the public service employees was less restricted and more like that of the business sector.

#### Wage systems for public sector employees

The differences appear in the pay scales even though all three operated with set remuneration systems based on education level and years of service that determined both rank and wages. There was one significant difference regarding public service employees, in that while the minimum was set, anything higher could be negotiated. The regulation of labour relations was set in accordance with that difference. Among public service employees wage agreements and collective agreements were possible, while both were out of the question for the other two categories.

The pay scale for the armed service and for public servants had little room for employer decisions and there was no such thing as collective bargaining, albeit the system did contain a smidgeon of flexibility. The law governing public servants allowed local governments to set their own “base salary”<sup>1</sup> for pay scales. As far as civil servant salaries were concerned, over time the law allowed deviation from the pay scale, initially by  $\pm 20$  per cent and then over a range of from minus 20 per cent to plus 30 per cent. In addition, it introduced a configuration called “personal remuneration” which was completely divorced from the pay scales. As of 1996 there were two separate pay scales for armed forces personnel. One was a remuneration scale linked to position and the other linked to rank. Remuneration under the first system differed from the pay scale in that it operated along a 100–120 per cent scale. Promotion dates were set into zones, which meant that when time for a mandatory promotion arrived (this was the lowermost section of the waiting time zone) the remuneration also increased.

<sup>1</sup> The “base salary” (*illetmény-alap*) is a basic point of the pay scales, regularly set by the law. Mandatory basic salaries in all brackets of the pay scale are defined by tariff multipliers combined with the “base salary”. While salary increase can be given for everyone by establishing a higher “base salary”, the wage proportions across different brackets remain unchanged. (Editor’s note: there is a similar technique in the French public sector pay scale, the common English translation for the French counterpart of “base salary” is “index point”.)

For all three categories, a broad range of bonuses topped on the basic salary. For public servants the remuneration was made up of the salary set by the pay scale plus a remuneration supplement, while for armed forces remuneration for rank was added to this.

Although all three remuneration systems were based on nearly identical principles and centrally set wages were the rule, actually salaries were quite different from one another. This was because of differences in the pay scale (more specifically, the structure of the pay scale and the various multipliers) as well as the fact that the “base salary” for public servants and civil servants (the latter’s “base salary” has to be applied for armed forces) was quite different. We have summarized mandatory pay for the three categories under the rules valid for 1994 in *Table 3.2.1*.

**Table 3.2.1: Extreme values of mandatory pay for employees with the same education level in 1994 (HUF, minimum wage at the time: HUF 10,500)**

	Soldier <sup>a</sup>	Civil Servant	Public Service Employee
“Base salary”	18,000	18,000	8,000
Minimum	30,096	9,900	8,000
Maximum	122,760	63,360	44,000
Maximum/minimum	4.08	6.40	5.50
By education level, with 10 years of service			
Eight grades primary school	–	21,780	10,500
Secondary school completed	32,640	31,680	16,800
College/university	75,240	46,530	27,200

<sup>a</sup> Given that Act XVIII that regulated armed services was only adopted in 1996, the calculations here are based on Defence Minister 50/1987 and 8/1994 Ministry of Defence Commands, which are limited to soldiers.

Source: *Berki* (1994a) p. 16.

In 1994 – after the civil servant pay scale was introduced but before the public service one came out<sup>2</sup> – the average monthly income of civil servants according to a survey in May was HUF 43,342 while the average for public service employees was HUF 41,052.<sup>3</sup> In other words, there was hardly any difference at this time, but by the end of the decade they were quite different. According to a report published annually by the ministry responsible for labour, in 1998 comparative earnings<sup>4</sup> took the shape seen in *Table 3.2.2*.

**Table 3.2.2: Comparative earnings in the public sector, 1998**

Sector/sub-sector	Comparative earnings ratio compared to the private sector (per cent)	Actual amount, monthly	As compared to the average for the public sector (per cent)
Public sector total	64.2	64,158	100.0
Civil servants <sup>a</sup>	90.3	98,519	153.6
Public service employees	59.3	54,934	85.6

<sup>a</sup> No data available for armed forces.

Source: *KSH Informative database* – Gross average earnings of civil servants and public service employees in public institutions.

<sup>2</sup> It took effect on 1 January 1995.

<sup>3</sup> See: Briefing on the income evolution over the first half of 1994 and valid collective agreements. Ministry of Labour, September 1994 (quoted by *Berki*, 1994b, p. 12).

<sup>4</sup> When comparing earnings, standardized data for education level and length of service were used.

In other words, some of the differences in income were built into the pay scale and others were the outcome of the lower “basic salary” of public service employees, when legislators built a huge gap into the pay system even though the difference in the social status of the three groups at the time of the regime change did not justify it.

### The forums for interest reconciliation and the main issues

When the interest reconciliation system took shape (*Table 3.2.3*) there were regular negotiations between the government and the public sector unions, which reached and signed onto agreements. Until the 2000s, the most important venue for bargaining was the Interest Reconciliation Council for State-financed Institutions (KIÉT),<sup>5</sup> and later the salary issue became the central theme of the National Labour Council for Public Service Employees (KOMT).<sup>6</sup> Dialogue was essentially between the government and the unions with the positions of local government associations determined by central government budget resources. The complete set of vertical and horizontal forums for public service interest coordination was ready by 2002. Every trade union federation and confederation organizing public servants within the government’s power structure participated in the coordination on nationwide, sectoral, sub-sectoral, settlement and workplace level alike.

**Table 3.2.3: Peak interest reconciliation forums in the public services**

Time of operation	Forum
September 1991 to October 2001	Interest Reconciliation Council for State-financed Institutions (KIÉT)
July 1993 to July 2001	Interest Reconciliation Forum for Civil Servants (KÉF).
October 2001 onward	Labour Council for Public Service Employees (KOMT)
July 2001 to March 2012	Interest Reconciliation Council of Civil Servants (KÉT), National Local Government Civil Servants’ Interest Reconciliation Council (OÖKÉT)
November 2002 to October 2006	Intergovernmental Interest Reconciliation Forum of Law Enforcement Bodies (RSZTÉF)
December 2002 onward	National Public Service Interest Reconciliation Council (OKÉT)
October 2006 to July 2012	Interest Reconciliation Forum of Armed Forces Members (SZÉF)
March 2012 onwards	Interest Reconciliation Council of Public Servants (KÉT)

<sup>5</sup> This was a four-party forum operating from 1991 to 2001. The members were the government, the federations of public sector unions, the federations of local governments and several organizations of institutional employers, the latter without voting rights.

<sup>6</sup> The governments were generally careful to keep salary levels satisfactory in central government public administration, while regulations also made it possible for local governments to do the same.

Given the significant differences in systems of remuneration and in earnings levels, the unions involved in the various interest reconciliation forums were focused on reducing the income gap that, as already mentioned, had been built into the system. The players in the system were also pushed towards bargaining upon the “base salary” by the knowledge that if the “base salary” were increased pay for the entire circle of employees under their authority would increase quasi automatically. As following the central bargaining the “base salary” is legally set finally, its value determines what the outcome of bargaining will be during the sectoral or local phases.

In the late 1990s and primarily on trade union initiative a spontaneous effort was made to decentralize wage bargaining,<sup>7</sup> which resulted in separate wage multiplier systems used for the various public service employee groups. The profession/sectoral wage multiplier was intended to provide a measure of extra earnings, in addition to the public service employees' pay scale, to the employees in the various sectors. The rationale was 1) to be able to raise pay in selected sectors without changing the pay scale but while keeping in step with the differentiation in it, and 2) to deny the increase to other sectors employing public service employees. The size of the multiplier was strongly differentiated, depending primarily on which sector had a stronger influence on government decisions.

The outcome was a higher education and R + D pay scale that is still in effect, that adjusted the mandatory (guaranteed) salaries<sup>8</sup> of teachers and researchers to the system of professional promotions. At this time KIÉT still existed formally but was no longer in operation. Given the decentralized bargaining mechanism it might have appeared to no longer be necessary.<sup>9</sup>

However, it soon became clear that decentralized bargaining had numerous disadvantages. The government conceded to the demands of some groups of public service employees while other groups (sectors and professions) fell behind wage-wise while no one was really controlling labour market impacts. Another argument against decentralized bargaining was that the unions – for the most part, the ones in the Trade Unions' Cooperation Forum (SZEF) – soon realized that they were unable to influence the distribution of central budget resources between ministries or sectors, which could easily be played one against the other. So, to prevent internal conflict, they tried once again to negotiate within the KIÉT framework. This saved the ministries supervising the sectors and acting as executors from tough wage negotiations, by enabling them to turn the talks over to the one minister responsible for labour affairs and the finance minister.<sup>10</sup>

The government that took office in 2002 opted for a consistent interest reconciliation system and a reduction in the wage gap discriminating against public service employees. The result was two important measures, the establishment of the National Public Service Interest Reconciliation Council (OKÉT), and a “50 per cent” wage hike for public service employees. The result of the latter was a substantial decline in the wage gap. In 2003 the public service employees got 92.97 per cent of the average earnings for the public sector while civil servants got 133.93 per cent. In 2002 the difference was nearly double that amount.<sup>11</sup>

From 2002 to 2006 there was comparative calm in interest reconciliation forum operations and in public sector wage flows. Interest reconciliation became centred on the mass layoffs that began in 2003 and the human resource policy measures announced by the government to update public service. As

7 The agreements reached through interest reconciliation lacked the power of the collective agreements. The only way adherence could be guaranteed was through legislation that included the content of the agreements or by an administrative entity involved in the process issuing a decree to that effect. Therefore, most authors refer to bargaining negotiations occurring here as quasi (wage) bargaining.

8 For instance, as of September 2001 the professional multiplier was 1.43 in public education. As of January the multiplier in health and social care was 1.2. As of September the multiplier for college/university graduates in social care was 1.26, while as of September the multiplier was 1.2 for institutes of general culture and public collections. For more details see *Berki* (2000).

9 Seven plenary meetings were convened in 1998 and none in 1999. In 2000 there were three plenary meetings – but from 1998 on, not a single agreement was reached (*Berki and Dura*, 2012).

10 Though momentary interests appeared to coincide, the real underlying problem was that no one dared to touch the issue of establishing a direct ranking of public service employees by salary since there was no foundation of principle to establish that the work of a doctor was more valuable – and therefore should be paid more – than a teacher, or vice versa.

11 Own calculations based on KSH data.

far as public servants were concerned it introduced a performance-evaluation-based system – something it was said to be considering for the other sectors, too. It transformed the target-based bonus system and reshaped the rules under which public service employees could bargain collectively, and so on. But, these efforts bore very little result. In the autumn of 2006, the Gyurcsány administration announced – as an austerity measure – that it wanted to discontinue payment of certain income components, which is why no wage agreement had been reached for 2007 within OKÉT. Negotiations with the united public service strike committee established in the wake of the announcement did end with an agreement but in the autumn of 2008 the government declared that it did not have the means to honour that agreement (*Berki*, 2008). The strike committee, suspended earlier, was reactivated and negotiations continued until 15 October 2009. The agreement signed then however left the pay scale unchanged, discontinued the 13th month salary, introduced the super-gross income, allowing the portion of incomes deducted *ab ovo* for social insurance to also be taxed, and introduced a single compensatory factor, an earnings supplement of HUF 98,000 gross, for incomes lower than HUF 340,000 (*SZMM*, 2009). The series of negotiations in themselves demonstrated that as long as negotiations remained balanced they had a place in the interest reconciliation system, but when a collective dispute occurred the interest reconciliation system did not have the ability to handle it.

### Interest coordination after 2010

“The interest reconciliation system was fundamentally changed after the new government took office in 2010, since the position of the new government was to govern employers and employees as though they were one and the same and to focus on the interests of both when governing.” (*Berki and Dura*, 2012, p. 89.) The National Interest Reconciliation Council ceased to function after a few meetings, and after a bit of a delay, it was taken over by a tripartite forum operating far from the public eye and devoid of legal authorities.<sup>12</sup> As far as the reconciliation of public sector interests was concerned, the government believed that persons affected by changes in public service had to be notified of said changes so it retained that mode of communication while otherwise changing part of the system.

The National Public Service Interest Reconciliation Council is still in operation. The employee side was significantly changed twice since 2010. Currently there are five trade union confederations in it, but FRDÉSZ<sup>13</sup> (the Armed Services and Law Enforcement Interest Protection Federation) is not among them. OKÉT held talks on altering the legal profile of public service on more than one occasion. It also negotiated regarding public sector wages but no agreement was reached on substantive issues. In the autumn of 2013 OKÉT’s union side called for 20 per cent salary increases. The National Labour Coun-

12 The Private Sector and the Government Standing Consultative Forum (VKF) was established by a tripartite agreement in February 2012, which included three employer organization and three trade union confederations that had been members of the defunct National Interest Reconciliation Council.

13 The Armed Services and Law Enforcement Interest Protection Federation, which quit the Liga Trade Union Confederation and lost some of its member organizations in disputes among trade union associations.



cil of Civil Servants (KOMT) is also in operation but limits itself to peripheral issues. It has not discussed the transformations undergone in the various branches or the changes in the remuneration system of civil service employees (health care, education) to any substantive extent.<sup>14</sup> At the same time legislative regulation has altered the area for which KOMT was responsible. Under Subsection a) of Section 1, Paragraph 6 of the Act on Public Sector Employees on labour relation issues and matters impacting the legal status within the entire public service employee sector, the minister in charge of the sector may negotiate with the union representative of the branch within KOMT or with the sectoral interest reconciliation forum, but must include the national local government interest advocates, too. This rule has overwritten the old one, namely, while issues affecting all public sector employees should be negotiated at KOMT, sectoral issues should be on the agenda of sectoral forums only.

KÉT and ÖÖKÉT were replaced by a revived Public Service Interest Reconciliation Forum while the law divided the civil servants into government civil servants and other civil servants. In 2011 Act CXCI on public servants put them in the same service employment relationship, although it was a civilian service relationship. The forum raised every single issue affecting the public services under the law, so when the government civil servant legal category was introduced, the issues of job termination without specifying a reason and the 98 per cent excise tax on severance pay were debated at the forum but the unions failed to get their points across. For that reason they chose a variety of possible remedies which they proposed to their members. The situation is similar today with restrictions on voicing opinions, the legal issues surrounding loss of confidence (see sub-chapter 3.1 in this volume), and other legal questions.

The Interest Reconciliation Forum of Armed Forces Members (SZÉF) was terminated. It was replaced in part by the Internal Affairs Interest Reconciliation Council since in the meantime, all law enforcement bodies excepting the tax and customs tariff services, were placed under the authority of the Ministry of the Interior. The Hungarian Law Enforcement Faculty/Body (MRK),<sup>15</sup> established in 2011, was granted an interest protection function under the law so it took over the role of the trade unions in sectoral interest reconciliation, which were otherwise significantly weakened by amendments to Hszt.<sup>16</sup> and the Labour Code (hereinafter Mt.).<sup>17</sup> The Armed Services Interest Reconciliation Council, which in recent years has faced problems similar to those of the unions and law enforcement workers, continues to operate. However, these forums were unable to substantively influence the transformation of the armed service pension system (see in sub-chapter 4.4) or to prevent the deterioration of their own operation conditions.

There have also been problems with sectoral interest reconciliation, which used to be ministerial level issues. These forums – particularly the ones covering public education, higher education, culture, and health care – had once

14 Today nearly half of the brackets in the pay scale is “unmarked” since the guaranteed salary included in it is higher than the minimum wage and the guaranteed minimum wage for skilled workers – more about this later.

15 The Hungarian Public Administration Faculty/Body, whose members are government officials, did not receive such clear-cut union rights.

16 Act XLIII of 1993 on the service conditions of armed forces professionals (hereinafter: Hszt.)

17 Hszt. amended the provision on deducting trade union dues and actually terminated the mandatory dues deduction – without giving the unions time to prepare. The outcome was that the unions lost a significant portion of their members. The position of the unions was also weakened by the establishment of the MRK – the Hungarian Law Enforcement Body/Faculty, which fostered the illusion among many members of the armed forces that it was an interest advocacy group that didn’t charge dues.

operated in part as information disseminating and consultative channels that substituted for sector-level collective bargaining. Today, the structure of the bodies serving to maintain these areas is being transformed (the public schools and some health care facilities are being shifted out of local government control and placed directly into the hands of the central government), and this – in accordance with the government’s human resource policy outlook – has led to the introduction of lifelong career models and the transformation of civil servant remuneration. The second of the sectoral interest reconciliation forums has been the public education,<sup>18</sup> health care and armed services sector interest reconciliation forum, and an agreement on the renewal of the forum in the social care sector was reached in September 2013.

The failure of the transformation of public education and of the lifelong career model of teachers led to the establishment of a strike committee in which every single union organized in public education originally participated. Despite the fact that the government reached agreement with the members of the strike committee – with the exception of one union, the Democratic Teachers’ Union – innumerable disputed issues remained. The circle of participants in health care reconciliation talks has been haphazard, with professional and interest advocacy organizations participating jointly. The main issue here has been the sector’s human resource strategy, which is seeking a resolution to the problem of people leaving the professions and the labour shortage. The forum is an opportunity for the invited participants to directly notify the state secretariat of the issues where quick intervention would be desired (such as the home paediatric practitioners employed by local governments whose salaries had fallen well behind), but there were no institutional guarantees that there actually would be any government decisions to remedy the problems raised here.

### **Effective wage systems for public services**

At this point, we would like to explore the main components of the remuneration system, including starting salaries and highest attainable salaries under the various legal formations. In the professions where introduction of lifelong career models is currently under negotiation (health care, public education) separate pay scales have been devised. Therefore, a number of ranking systems will be established (although the original public service employee and the higher education pay scales will be retained) and the uniform remuneration system for public service employees will be terminated. Introduction of the lifelong career model will trigger a significant rise in earnings,<sup>19</sup> albeit over a lengthy timeframe, so people for whom the old public service employee pay scale remains in effect can expect their incomes to drop back (as happened with the social care sector, for which the unions set up demonstration committees in August 2013).<sup>20</sup> In parallel, under the rules, collective agreements<sup>21</sup>

18 Act CXXIX of 2013 amending several laws regulating education did establish a National Teachers’ Body/Faculty. Its functions, however, were not enumerated in the law so we cannot say anything about its connection to interest advocacy.

19 For instance, teachers in public education are to be categorized in accordance with the new system by 2017.

20 The main demand of the unions is increasing salaries but updating the interest reconciliation system and even concluding a new sectoral collective agreement were also included among their demands.

21 For business entities that became budget-sponsored institutions, Act CIII of 2013 amended the National Budget Act. “Collective agreements in effect in these entities lose their validity at the time the government takes over the responsibilities of these entities” (Paragraph 11/F, Section 12). “Any works council in operation at the company shall be terminated at the time the government takes over the responsibilities of these entities” (Paragraph 11/F, Section 13).



are being terminated in business entities that the government has taken over, which will lead to employees here losing the benefits listed in those agreements.

In *public education* the future of the collective bargaining agreements is unclear. The benefits that local governments had funded were not provided by the central government in 2013. In the other variations, according to the regulations governing wages that have been made known<sup>22</sup> the “base salary” for remuneration is not uniform. For people with a secondary education it is 120 per cent of the minimum wage, for people with a higher education at bachelor level it is 180 per cent of the minimum wage, and for people with Masters degrees, it is 200 per cent. In 2013 the minimum wage was HUF 98,000, and civil servants starting their careers were entitled to 100 per cent of that amount. The pay scale contains five remuneration classifications, with 15 levels of payment. The highest multiplier is 265 per cent, which means that HUF 519,400 could be paid as a basic salary. For people employed in non-teaching jobs, the old public sector employees’ promotion system is to be applied.

In *health care*, two pay scales,<sup>23</sup> introduced in 2012 and operative since 1 January 2013, have been in effect. Under them, attempts were made to cover any salary increases due but left unpaid through differentiated lump sums in compensation. For doctors the pay scale set up three pay grades (*H, I, and J*) and 15 levels within that (for years of service from zero to 45). The base remuneration is HUF 108,000 and the lowest multiplier is 1.809. The highest is 3.415. For professional health care workers the pay scale retained the 11 classifications of public service employees and also includes 15 levels. Salaries range from HUF 103,000 to HUF 330,725. The starting level of Category *D* is HUF 118,000, higher than the 2013 guaranteed mandatory wage minimum for skilled staff.

The *higher education* remuneration system was retained (with, however, the chance to differentiate to a greater degree than the original system made possible), in which the university professor occupation is the “base salary” on the pay scale, and 40 to 106 per cent is a guaranteed salary. The guaranteed remuneration for university professor No. 1, was HUF 437,300 as of 1 January 2013. Forty per cent of that is HUF 174,920 and 106 per cent is HUF 463,538.

The public service employees not cited here separately continue to be paid according to the public service employee pay scale. Since the minimum wage is regularly increased and the “base salary” has not been changed, about half of the pay scale is now “empty” (61 of the 140 cells appearing in *Table 3.2.4* are in gray) since the minimum wage or the mandatory guaranteed minimum for skilled workers is now higher than the guaranteed pay in the pay scale. (Every group of public service employees has the right to conclude a local collective agreement but the wage agreements within it can only regulate the amount of the add-ons and salary extras that the law explicitly assigns to collective bargaining to regulate. This latter only may be paid out at the ex-

22 See the version of the Public Education Act valid as of 1 September 2013.

23 See the appendices to Act LXXXIV of 2003 on certain issues within the realm of health care activity.

pense of the institution's own (market) income, which means that additions of the type controlled by collective agreements are very rare.

**Table 3.2.4: Remuneration set as mandatory under the public service employee pay scale for the different wage categories and payment levels**

	A	B	C	D	E	F	G	H	I	J
1	69,000.0	77,000.0	78,000	79,000.0	89,000.0	122,000	127,000.0	129,500.0	142,000	154,500.00
2	70,207.5	783,47.5	79,560	80,975.0	91,447.5	126,270	131,445.0	135,975.0	148,390	163,770.00
3	71,415.0	79,695.0	81,120	82,950.0	93,895.0	130,845	136,207.5	142,450.0	156,555	175,357.50
4	72,622.5	81,042.5	83,070	84,925.0	97,010.0	135,420	140,970.0	148,925.0	165,785	186,945.00
5	73,830.0	82,390.0	85,020	86,900.0	100,125.0	139,995	145,732.5	155,400.0	176,435	198,532.50
6	75,037.5	83,737.5	86,775	88,875.0	103,240.0	144,570	150,495.0	163,170.0	187,085	210,120.00
7	76,417.5	85,277.5	88,725	91,047.5	106,577.5	149,145	155,257.5	172,882.5	197,735	219,390.00
8	77,797.5	87,780.0	90,675	93,812.5	109,915.0	154,330	161,607.5	182,595.0	208,385	229,046.25
9	79,350.0	90,282.5	93,210	96,775.0	113,252.5	159,515	169,227.5	192,307.5	216,905	238,702.50
10	80,902.5	92,977.5	95,940	99,737.5	116,590.0	166,835	177,165.0	202,020.0	225,425	248,358.75
11	82,455.0	95,672.5	98,865	102,700.0	119,927.5	174,155	185,102.5	210,437.5	233,945	258,015.00
12	84,007.5	98,367.5	101,790	105,662.5	122,597.5	181,475	193,040.0	218,855.0	242,465	267,671.25
13	85,560.0	101,062.5	104,715	108,625.0	125,267.5	188,795	200,977.5	227,272.5	252,405	278,486.25
14	87,112.5	103,950.0	107,640	111,587.5	128,382.5	196,115	208,915.0	235,690.0	262,345	289,301.25

Act LVIII on the legal status of government civil servants, no longer in effect, was adopted in 2010. It did nothing to change the essence of government civil servant salaries but certain incomes were significantly reduced because of it.<sup>24</sup> Act CXIX of 2011 on *public servants* regulates the legal status of civil servants and government civil servants. The law retained the basic features of the earlier pay scale. For government civil servants the remuneration range ran from –20 per cent to +50 on a performance basis (in the ministries and the prime minister's office, the maximum is +30 per cent. The salaries of office workers with lower qualifications are set by the office chief and must be as high as the guaranteed wage minimum for skilled staff but may not exceed six times the "base salary". The other considerations for setting the basic salary must be set down in the public service regulations of the given administrative unit. The wage of a public service employee can be set between the minimum wage and ten times the average national economy-wide gross monthly wage for the previous year. For priority government bodies salary supplements for people with a university or college education is 50 per cent and for people with secondary education it is 15 per cent. For bodies on the lower level of the hierarchy it is 10 per cent for people with a university or a college education. The salaries of the top managers can be set by their superior body without fitting it into a category, in which case the manager is not entitled to any salary supplement. Depending on the organization, remuneration may range from 28 times to 17 times the "base salary" level. For offices not part of the central

<sup>24</sup> The institutions subordinated to the county public administration bureaus established in the reorganization of public administration of 2010–2011 were dropped down a level in the public administration hierarchy. The outcome was that salary supplements were also dropped down by one level, which meant a loss of earnings for the government officials. [According to the tariff chart the salary supplement is to be determined as a percentage of the (job category) salary, for instance, if the worker has a college or university degree and works in a parliamentary office the multiplier is 80 per cent, if in a ministry it is 50 per cent, if in a public administration body it is 30 per cent and if in a body subordinated to it, it is 10 per cent].

government, and those in local government, there are two important differences in the remuneration systems. Add-ons to remuneration and leader remunerations differ. The law does not limit the civil servant salary insofar as how much it can deviate from the remuneration set for a person's given rank, and a personal remuneration can be set without limits.

Under currently valid regulations, employers and the representative bodies of local governments have far greater scope in setting salaries than earlier.

For persons in the *armed services* the "base salary" is the same as in public administration, but the pay scale is unique. Despite amendments to Act XLIII of 1996 on the service relations of professional members of the armed forces the basic remuneration system was retained. The remuneration system was made up of a position salary, rank salary, salary supplement, service time supplement and other supplements. The position salary and rank salary combined made up the basic salary. The system contains two pay scales (categories), for officers, high ranking officers and generals (requires college or university degree) in Category I, non-commissioned officers and second lieutenant equivalent (with a secondary education), in Category II. Both pay scales are projected onto the public servant "base salary". The service time bonus functions as a partial salary booster with the starting amount at 12.5 per cent and the highest amount at 25 per cent. (The wages of defence employees working under the Labour Code (Mt.) cannot be higher than 10 times the national economy-wide average income.)

The remuneration for soldiers is governed by Act CCV of 2012 on the legal status of armed forces personnel and is of a similar structure (except that it uses a "defence" multiplier instead of a rank-based salary.) The salary is made up of a position salary, a defence bonus, a salary supplement, a service time supplement, a salary add-on, and at times, an additional salary component. The position salary and the defence bonus together make up the basic salary. Officers must be in Category I while rank-and-file personnel and non-commissioned officers are in Category II<sup>25</sup> with each category made up of a ten-point scale. The defence bonus is equal to the multiple of the "base salary" and the defence multiplier.<sup>26</sup> A minister's decree can allow the commander exercising the rights of employer to raise the salaries of subordinates by 30 per cent for a timeframe extending to 31 December of the given year. For persons with a university or college education the salary supplement is to be 20–50 per cent of the position salary depending on the place where the service is performed. For persons without college or university degrees it is 10–15 per cent of the position salary. The service time bonus ranges from 5 to 35 years and is 10–22.5 per cent of the "base salary".

The public sector salaries (if we ignore possibilities to deviate because of performance or qualifications and calculate maximums with the highest salary supplements) are summed up in *Table 3.2.5*.<sup>27</sup>

25 Since there is a shortage of soldiers who contract for a number of years, non-commissioned soldiers and service personnel with lower commissions are also granted other benefits not detailed here.

26 Please note that in the Defence Forces the tables of service personnel state that positions and ranks are subordinated to one another as specified by law, and therefore specific ranks are required to hold the various positions. If someone is mandated to advance to a higher rank for which the given position is no longer suitable, the position must also be re-shuffled to a higher level. Considering that there are not a sufficient number of higher positions to cover the people with higher ranks, the law contains an interim solution that acts as an incentive for people to remain in their previous positions.

27 Please note that the law for teachers was amended at the end of August 2013, and on the one hand it extended the scope of regulation to teachers working outside of the public education, while on the other, it reduced the starting salary. The system called for a 3.5 year interim to transit to the new pay scale, so for the moment the sections of the law referring to them are fiction.

**Table 3.2.5: Internal differentiation of the public service pay scales and the extreme values compared to the 2013 minimum wage**

Categories of public sector employees	Mandatory maximum salary at the end of a career compared to starting minimum	Starting mandatory minimum compared to minimum wage	Mandatory maximum at the end of a career compared to the minimum wage
Salary set by the Act on Public Service Employee	4.19	0.70*	2.95
Teachers (with college/university degrees)	2.94	1.80	5.30
<b>Health care</b>			
Doctors	1.89	1.99	3.76
Skilled health care workers	3.21	1.05	3.37
Higher education, researchers	2.65	1.78	4.73
<b>Public servants</b>			
University/college graduates	2.90	1.22	3.55
Secondary school graduates	2.83	0.71*	2.00
Office workers	2.03	1.16	2.37
<b>Law enforcement</b>			
University/college graduates	3.34	1.22	4.08
Secondary school graduates	3.73	0.63*	2.36
<b>Defence</b>			
University/college graduates	5.00	1.18	5.92
Secondary school graduates	2.81	0.79*	2.22

\* The minimum wage must be paid in the public sector too, so in practice the multiplier = 1.

The calculation does not include the special bonuses available in some occupations that are not available to all, or non-wage benefits that can be chosen from among alternatives, which amounted to HUF 200,000 among civilians whose salaries are paid by the central budget. When discussing these pay scale configurations we particularly wanted to show the internal ratios, so when conducting our calculations we also sidestepped the items that go below the HUF 98,000 minimum wage and HUF 114,000 guaranteed wage minimum of 2013.

### Summary

*Table 3.2.5* and the history of interest reconciliation over past years allow us to draw the following conclusions.

- The salaries of people working in the public sector are far from uniform. Today there are even significant differences among public service employees. There are a total of 14 different pay scales in the public sector if we ignore the public institutions' employees operating under the labour code.
- The differentiation of pay scales was not the outcome of different interests and negotiations at public sector interest reconciliation forums – it was primarily the result of government intentions influenced by pressures from

some professions, but the latter was random and the bargaining was decentralized to professions rather than sectors.

- Chances of advancing in the various careers are quite different. Within the services, the best chances of income growth were among military officers while the new system of advancement for doctors does not even see to it that their incomes will double during their careers. The only ones whose initial earnings can go up by threefold are law enforcement personnel and skilled health care workers.
- For persons with a secondary education and no specific profession, the wage scale is below the minimum wage everywhere except in public education. For government office workers it is equal to the guaranteed wage minimum – which is quite low.
- The difference between maximum earnings and the minimum wage is much smaller than the difference in the private sector. People with a secondary education will barely earn more than double the minimum wage even at the end of their careers.
- The new pay scales replacing the old ones create new disparities which cannot be justified or explained on a theoretical basis.

While the Act on Public Service Employees formally allows collective wage bargaining there is no scope for them in practice, and in the other sectors even the formal possibility of collective agreements has been denied. The multitude of pay scales prevents any centralized wage agreements based on higher level interest reconciliation from taking place. There is little likelihood that bargaining, should it occur within sectors or even professions if allowed by law would lead to proportionate outcomes keeping the labour market balanced. The failure of the decentralized bargaining taking place in the late 1990s should serve as a warning to today's negotiators.

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### 3.2.1 Collective bargaining in businesses owned by central and local governments

ERZSÉBET BERKI

In 2011 there were 13,991 businesses in Hungary employing over 20 people each.\* These are businesses in which it was realistic to establish collective agreements. Trade unions can conclude collective agreements, and unions are more likely to exist in public sector companies than elsewhere.\*\*

The Information System of Labour Relations (MKIR), which rests on the mandatory requirement to report collective bargaining agreements, has a registry of 964 valid collective agreements at employers in the business sector (of which labour relations are regulated by the Labour Code.) (Table B3.2.1) This amounts to 6.9 per cent of the businesses employing more than 20 people.\*\*\* look at all collective agreements in existence shows us that 355 of them (26.4 per cent) are in the public sector (owned by central or local government).

In September 2013 there were a total of 65 multi-employer collective agreements, and the scope of two of them included public sector employers. Of the 18 sector-level collective agreements (concluded by employers' associations), the scope of three included public sector employers and one was an extended agreement (valid for all employers in the given sub-sector) which covered public ones as well.

\* Source: KSH.

\*\* According to research conducted within the TÁMOP 2.5.2 programme there are trade unions operating at about 15 per cent of employer premises, and within that, at 58 per cent of facilities owned by the government. Similarly, the public sector businesses stand out regarding the union density level, with average unionization at 22 per cent and public sector unionization at 43 per cent (see: *Neumann and Simonovits*, 2010, p. 53–55).

\*\*\* Please note that the real number of collective agreements is likely to be less than this, on the one hand because as of 1 January 2013 the agreements concluded with unions at lower unionization levels than 10 per cent were declared invalid, while on the other, the parties involved do not always comply with the obligation to register that their agreements had been terminated.

**Table B3.2.1: Number of valid single-employer collective agreements in the business sector and breakdown by the owner of the business<sup>a</sup>**

Majority owner	Number of collective agreements	Breakdown (%)
Central government	135	14,0
Local governments	120	12,4
Private	709	73,5
Total	964	100,0

<sup>a</sup> As of 8 September 2013.

Source: *Labour Relations Information System* (Munkaügyi Kapcsolatok Információs Rendszere).

This tells us that collective agreements are far more common in the public enterprises (central or local government owned ones) than in the business sector as a whole. However, the Labour Code (Act I., of 2012) that came into effect on 1 July 2012 limited opportunities to conclude collective bargaining agreements with public sector employers. The new law contains two sections with restrictions (Paragraphs 205 and 206), stating that collective bargaining agreements cannot deviate from the law with regard to

- the duration of notice period,
- the regulations governing the conditions for granting severance pay and the amount of said pay,
- the regulation of time that does not qualify as working hours, and in this regard daily working time amounting to less than a full working day (eight hours) cannot generally be accepted as a full working day,
- the regulations governing the works council, or
- the regulations governing trade unions.

These restrictions lead to a weakening in the positions of the traditionally strong workplace unions in the state/local government owned businesses. Additionally, the unions stand to lose a portion of their incomes and may not come up with any other form of support, and thus their financial opportunities (for instance for training courses or to con-



sult with experts) are reduced. This leads to the deterioration in the quality of collective bargaining.

The above bans remove issues that are typically regulated in collective agreements. Thus, they expressly damage the positions of the employees, who, for instance, lose the extra notice time, the higher severance pay and the shorter working hours set under the former collective agreement (*Nacsa and Neumann*, 2013). One consequence of the deterioration in worker positions could be a further decline in trade union density.

Prohibitions on the organization of working time can also create significant problems for employers, too, primarily because in many places a break in the midst of working hours was a part of the working day, as well as because they are no longer allowed to operate with special reduced-hour working days. Several major state-owned firms were forced to redesign their working time schedules to more or less comply with the law.

In the longer term, the prohibitions, stating that collective bargaining agreements cannot deviate from the law on labour relations, works councils, and trade unions, can damage the quality of labour relations. With this move the public sector employers as well as their unions and works councils are deprived of the possibility to jointly conclude innovative solutions. According to some interpretations of the law the collective bargaining agreement may not even regulate an issue on these matters not covered by the law because that too would be a deviation from the law.

When the collective bargaining agreements cover only one employer it is easy to formally adhere to

these prohibitions since any agreement conflicting with the law is automatically void and therefore, does not have to be applied. However, when the collective bargaining agreements are sectoral and when the employer organisation involves a combination of central government, local government, and private sector businesses the parties involved have no idea regarding when they are in compliance with the law, since the same provision that is unlawful for the government employer can be lawful for the private sector employer. Another question concerns whether the collective bargaining agreement under which the ruling was agreed can discriminate against some of the employees under its auspices, depending on the form of ownership of their employers. On the whole, these prohibitions on public sector labour relations lead to the deterioration of the quality of labour relations, a decline in the number of collective bargaining agreements, a reduction in their regulatory power and, in the final analysis, they could result in a competitive disadvantage that could hurt employers.

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### **3.3 Crises and waves – changes in the system of public employment in Europe**

**LÁSZLÓ VÁRADI**

The recent decades of public employment have passed in a continuous wave between the maintenance of the Weberian “bureaucratic ideal” (*Weber*, 1978, pp. 220–221) and the new trend of the seventies, the 3Es (*economy, effectiveness, efficiency*). The essence of the “fight” can be summarised in the way how, and by how much, individual countries deviate from the ideal of the public servant independent of the daily fluctuations of politics towards the direction of a public employment that operates cheaply, effectively and efficiently (*OECD*, 1999, pp. 8–14).

Different countries have built up distinct public employment systems depending on their actual economic situation, social conditions and traditions and, even today, they also react differently to the challenges. As far as the systems of public employment are concerned literature applies numerous types or categories (*Linder*, 2010, *Gajduschek*, 2005), but the substance of them is the same in an employment aspect, where the individual public employment systems are situated at some point on an imaginary Weberian – open employment scale.

#### **New Public Management**

The conditions of public employment that used to operate in a Weberian framework had changed at the end of the seventies: the pressure of the socialist world order disappeared, taxes were reduced in order to increase competitiveness, the middle class extended, and the new toolkit of management became available (summarized by *Hajnal*, 2004, p. 34, and about the reasons: *Pollitt and Bouckaert*, 2000, pp. 25–27). And the answer is: the *New Public Management* (NPM), which intends to integrate the system of public management into the economy as a whole.

As *Christopher Pollitt* summarizes:

- “... I will here assume that the NPM is a two level phenomenon: at the higher level it is a general theory or doctrine that the public sector can be improved by the importation of business concepts, techniques and values, while at the more mundane level it is a bundle of specific concepts and practices, including:
- Greater emphasis on ‘performance’, especially through the measurement of outputs.
  - A preference for lean, flat, small, specialized (disaggregated) organizational forms over large, multi-functional forms.
  - A widespread substitution of contracts for hierarchical relations as the principal coordinating device.

- A widespread injection of market-type mechanisms (MTMs) including competitive tendering, public sector league tables and performance-related pay.
- An emphasis on treating service users as ‘customers’ and on the application of generic quality improvement techniques such as TQM.” (*Pollitt*, 2007, p. 1.)

*New Public Management* has completely changed principles in employment that were believed previously untouchable. The system of “jobs until retirement”, life-long employment that used to be considered as a basic condition has been suppressed, although not radically.

- “This suggests that the principle of life-long employment seems to belong – as opposed to promotion criteria or pay systems – to those traditional elements of the civil service that have been subject to the least modification during the reform processes in the EU Member States and particularly in career systems. While the principles of recruitment and pay are increasingly being influenced by current practices in the private sector, this does not seem to be the case for life tenure.” (*Bossaert*, 2005, p. 18.)

Nevertheless, significant changes have occurred in its content. Dismissal of public servants has become easier. As the most important element of change is that performance is taken into consideration, though we cannot speak about its widespread expansion.<sup>1</sup> Even so public servants remained safe from “rationalisation” type dismissals in most countries. If it has occurred then the conditions of the dismissal for them are more favourable than in the market.

Although measures to increase flexibility had poor results in this area, financial difficulties and the constraints and spread of the *New Public Management* also brought another solution: the fixed term contract. Of course, it has nothing to do with lifelong employment, i. e. it is far from the principles of Weberian public management. At the same time, in systems where employees are hired for concrete tasks this also fits logically. Many countries have increased the rate of fixed term contracts in order to bridge the headcount and generate cost reductions due to the economic changes (as in Germany where the volume of public servants is definite).

Occasionally, these measures created situations where employees of different status may be used in the same workplace or even in the same job. However the basic question for these clerks having a differing status but working at the same time or even together is the following: if a non public servant can perform the task why do we need clerks with a specific status? Although, from many aspects we would expect the expansion of this more flexible employment in Europe – whilst the picture is very colourful – this tendency cannot be clearly observed.

Probably, the largest impact on the traditional employment was effected by the performance measurement systems. Earlier, individual public servants

<sup>1</sup> We should note that the new EU member states mostly chose less stringent solutions just in this field (*Bossaert*, 2005, p. 23).

were remunerated according to the competences demanded by their jobs or the time spent in service. When the remuneration of the personnel is bound to performance, numerous problems have to be faced and the predictability of a public servants' existence, the unidirectional nature of the path are generally questioned. In order to let the whole system completely "come into play" in the public servant's life, not only does the traditional order of remuneration have to be broken but the model of promotion, the strict order of hierarchy changed, traditional values questioned, and public servants easily fired. Depending on an individual countries' determination to break with tradition, varying systems were introduced. This is true as to the system itself (its size, elements, etc.) as well as the way of the introduction, the methods used, the range of stakeholders, the person of the appraiser, etc. The experiences of the EU member states concerning the introduction are listed by *Cardona* (2006) based on a report from May 2002:

- Performance-related pay systems are costly and time-consuming to implement.
- In many cases such systems are only applicable at senior levels.
- Discretion of managers is confined to issues such as measurement of performance and distribution of the small pool of money available for performance-related pay.
- Some systems have been introduced as pilot projects with a view to wider application at a later date, but in absence of rigorous analyses of the effects of the pilot projects it is not clear how wider application could be introduced.
- Almost none of the current schemes addresses the issue of underperformance (no punishment for failure to deliver).
- Measurement of performance, particularly in areas where there are no obvious quantifiable outputs, is a very difficult issue.
- No evidence has been found that performance-related pay schemes have contributed to an improvement in performance, in human resource management or in the quality of the service delivered.
- Additional remuneration was not a significant motivator for the employees concerned.
- The regular, annual or more frequent, formalised discussions between managers and employees on performance, targets and progress achieved have positive effects on motivation (recognition of the contribution of an individual to the organisational performance) (*Cardona*, 2006, pp. 3–4).

The author of the report draws our attention to two aspects. One of them is the complexity of the system. "Performance management needs to be based on strategic management according to which goals and results are established in a consistent way during the political, policy-making and managerial processes." (*Cardona*, 2006, pp. 4–5) That is, while the higher level political and institu-

tional objectives and consequences are not yet unambiguous, and are not obviously defined, it is also very difficult to establish a consequent performance management system at a managerial – even more at an individual – level.

The key of the other aspect is that objectives and results are different for the political institutions and for the individual institutions and their managers. It is a very rare “state of grace” in the development of public institutions when subsequent governments are able to modify the operation of the public management along similar lines with similar aims, although the introduction of such large systems concerns more than only the government actually in power.

It does, however, seem evident that the system of performance management can contribute not only to the introduction of the performance based remuneration. The system can be specifically useful – even economical and efficient – if the other, hidden opportunities of the performance management system receive more emphasis, such as having goals focused on development and improvement, to enforce the relationship between leader and follower, and the development of human resource management. The aspect not really favoured by many people is also important, that performance appraisal supports measurability of the differences between the public sector and the market, increases permeability, and thus makes the internal and external assessment of the public management more realistic.

The aim of the reforms as mentioned earlier is to make employees of the public sector work more economically, efficiently and effectively. To this end, the next step would be to motivate employees by giving them some tools to do this. It has already been widely determined that the most important motivation tool is money, a higher income, and this supports experiments connected to performance based remuneration.

Of course, contemporary motivation theory doesn’t support this one-sided approach to a great extent. As different research works proved public employees’ wages significantly surpassed market wages on average in pre-crisis Europe – this is partly explained by the higher average age, and the higher rate of those with higher education and in managerial positions (concerning these see the 2.5 sub-chapter of this actual *In Focus*) –, while the working hours of public employees are less everywhere (at least according to the legal regulation) than of those employed in similar jobs in the private sector. These considerations would imply that the conditions of public employees do not justify their motivation through higher salaries. Numerous research papers concerning the motivators of public work testify (see e.g. *Steen*, 2006, *Cerese and Farinella*, 2006, *Forest*, 2006), that higher income doesn’t appear as the primary factor among the motivators for public employees. Well regulated work, activity for the public good, or political neutrality are much more important for them (*ILM*, 2010. p. 6). (Although, only very few analytic works have been prepared in this field based on facts, we can probably state that in the poorer

European countries where the public servants' incomes are more moderate the wages play a significantly more important role. Here, public opinion is fairly steadfast that salaries are good tools to reach long term performance improvement. About this topic see also the 2.5 sub-chapter of this In Focus.)

Analysing the impacts of the New Public Management we can establish in general that it has generated significant but not radical changes in public administration. In countries more open to change – in Scandinavia, in the United Kingdom, etc. – not only has the structure of public administration essentially altered but also its model of operation. Numerous activities have been outsourced thus radically reducing the number of public employees and management of the institutions has been decentralised, both of which has basically modified the operation of these institutions. Less open countries also took steps in this direction – Germany, France, etc. – but we cannot speak about a real breakthrough in this respect in their cases. Between the two extremes we can find several countries (Mediterranean countries, etc.) which are radical in the transformation of the public administration only in their political slogans.

“What was an option ten years ago is not an option anymore today. I would say that in PA [public administration – *ed.*]

- in 1995, it was still possible to believe in NPM, although there were the first strong and substantial critiques
- in 2000, NPM was on the defensive, as empirical findings spoke clearly against it as well
- in 2005, NPM is not a viable concept anymore.

Yet, in many areas, both of scholarship and of the world, as well as in policy, NPM is very alive and very much kicking. It is, therefore, necessary to look both at the concept itself and at the reasons for its success.” (*Drechsler*, 2005, p. 17)

### **Search for equilibrium – Neo-Weberian approach**

In the light of experience both theoretical and practical approaches tended towards some mixture of the Weberian and the market elements. The essence of the thus born Neo-Weberian concept is that the principals of public service with a distinct status, culture and conditions should remain in employment associated with “A professionalization of the public service, so that the ‘bureaucrat’ becomes not simply an expert in the law relevant to his or her sphere of activity, but also a professional manager, oriented to meeting the needs of his or her citizens/users.” (*Lynn*, 2008, p. 11)

Lesser or greater changes have taken place in the public administration of each country, and practically in all the countries which have had to face the fact that – as quoted – the traditional instruments are already not necessarily effective, while the new market oriented tools also haven't brought about the

impact demanded. It has meant a specific difficulty for the decision makers of the EU because, in the enlarging organisation, diversity – not only in general but very concretely in public administration and in public employment – has further increased. In addition, one of the main objections against the New Public Management was that it couldn't operate as a generally accepted best practice, as it didn't take into consideration the traditions, the situation and the specifics of the individual countries. Therefore, the EU could only suggest an initiation that is sufficiently flexible, and, at the same time, presents a certain direction for the member states.

In reaction to the above mentioned problems the European Union created and announced the principle of flexible security (*flexicurity*) in 2006–2007 (*EC*, 2007). The concept was intended to provide a solution framework essentially to the market problems, however, the same two directions also had to be harmonised in the case of public employment. Through the announcement, as we said, they wanted to combine the flexibility created by the incorporation of the market models with the elements of traditional employment security. This comprehensive approach was also embraced by the public administrations themselves. Multiple trends are outlined again in the implementation 1) countries with systems based on a secure public service (*career-based*) (Austria, Belgium, France, Germany, Greece, Ireland, Romania, Spain, etc.); 2) more flexible but secure systems based on given tasks (*position-based*) (Denmark, Finland, Netherland, Sweden and the United States) and 3) neither flexible, nor secure systems (Bulgaria, Czech Republic, Estonia, Hungary, Slovakia and Slovenia, etc.) (*Kuperus and Rode*, 2010, p. 21).

### **Decomposition – effects of the crisis**

However, the crisis in 2008 interfered in the debate concerning how to proceed. The majority of countries introduced austerity measures in the employment of public employees either sooner or later. They made a choice from the possible methods or we might say the different options of escape, basically according to their budget situation (*Glassner*, 2010, p. 32).

As Christopher Pollitt states, the solution of the situation of the European public administration can be centralised around three key areas: 1) reduction, liquidation of waste, 2) renovation of processes, innovation, and 3) co-operation of the different social actors to find the common solutions. In an optimal case, measures in all the three areas, should work in synergy together strengthening each other in the long run, or in a better scenario even in the short one (*Pollitt*, 2011).

Although, these intentions sound good, there is only a vague chance for their implementation in reality. Most countries introduced radical constraints in the field of employment: froze or rather decreased wages, cut allowances, benefits, ordered a recruitment shut down, or even fired large numbers, and en-



gaged in short term, occasionally “special” employment contracts.<sup>2</sup> The results of these measures were growing workloads, deteriorating quality and consequently evaluation, risk evasion due to fear, decisions being pushed to higher levels, centralisation, and thus overwhelming bureaucracy, as well as growing costs. Under these circumstances, fear of the employees in public administration from privatisation is increasing, as well as their resistance towards cooperation with the private sphere. Accordingly, the chance to renovate the systems, to find the multilaterally useful and successful solutions is very limited.

Of course, in the countries where they were not forced to introduce widespread and long run constraints we can observe excellent examples of systematic reform measures. In many countries the number of public employees remained stable, and the tool of dismissing people was not used or only used to a limited extent. The numbers of personnel in industries that they considered strategic (education, health care) were increased, or women’s share in the numbers of employees was improved thus implementing a highly anti-cyclical economic model.

Nevertheless, measures have had their impacts along the same lines in most countries.

- Fairness of the system deteriorates, *ad hoc* measures smash the hierarchy, disrupt responsibility relationships.
- Different employment or contract relations tilt the balance within the public administration (between sectors, age groups, social cohorts, etc.).
- Decreasing financing, growing workload, increasing internal and external expectations, remuneration changes and deteriorating workplace atmosphere – as we mentioned above – degrade working conditions.
- Social dialogue transforms. The weight of the trade unions that are generally very strong in the public administration declines, employees’ vulnerability increases.
- Development in general is suppressed due to the austerity measures, consequently there is less process development and thus less training and other personal development. The quality of public administration worsens and therefore, its authority and attraction reduce.
- Promotion of the employees slows down and may even be blocked for a period. Career programs are often frozen, most talented young people can only with difficulty be kept in public administration.
- If there is an option, migration reaches a high level from public employment (policemen, firemen, doctors, teachers, IT professionals, etc.), and international migration can also increase in some jobs.
- Earlier reforms may become partially or totally meaningless. The performance based remuneration becomes a nonsense by the freezing of wages, just like fixed term contracts by the constraints on benefits, and the appraisal system by the blockage of promotions.

2 Here we don’t speak about the public works programme just designed to eliminate the effects of the crisis. Professional literature assesses its impacts as doubtfully positive even for the individuals in the long run, and evidently negative for the market (EC, 2010, p. 86).



Certainly, there could be procedures to improve the situation, even though they could hardly significantly change the essence of it. Nevertheless, it would be important that governments a) fix the timely and the economic limits of the constraints, b) negotiate with the stakeholders (even if they fail to agree), c) choose solutions that cause less damage in the long run, d) support strengthening social solidarity with their decisions, endeavour to draft a widely acceptable public employee career path. With these measures they can improve the chances for the acceptance of the crisis measures and also of their implementation.

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### 3.4 Crisis driven changes in wage setting systems in the EU

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Data from 2010 shows that slightly more than 50 million employees worked in the public sectors of the EU member states which accounts for a quarter of all persons employed in Europe (EC, 2012).<sup>1</sup> Naturally, the share of the public sector varied greatly among member states, exhibiting more than an 18% difference between the higher Scandinavian data (between 2008 and 2011 in Denmark and Sweden it was 32% on average) and a lower share in South Eastern Europe (during the same time period the public sector employed 18% in Bulgaria and only 14% in Romania) (EC, 2013, p. 94). Though it goes beyond the scope of this sub-chapter we must draw attention to the fact that one of the main obstacles in comparing European public sectors is the lack of adequate statistical information.<sup>2</sup>

Data from 2010 is important given that this was exactly the time when the mortgage and credit crises that hit the United States in 2008, and which reached Europe, at least in the sense of the labour market as a production and economic crisis, transformed into a fiscal one. This was mainly the result of three factors: the state founded bail-outs of the troubled bank sector, falling tax revenues and the extra pressure on social and welfare benefits due to the shrinking labour market. As a consequence of this process the retraction of the labour market, felt thus far only in the private sector spilled over to the public sector (Anxo *et al.*, 2013). Our aim in the present sub-chapter is to show the impact of the crisis on the public sector of European Union member states paying special attention to its effects on the wage setting mechanisms.

The first part of the sub-chapter maps the legal statutes of employment which govern the public sectors of EU member states with a special emphasis on the wage determination systems. The second part reviews European wage setting mechanisms including the state's role in that process. The third shows the direct impact of the crisis on the situational positions of the public sector employees of EU member states highlighting wage cuts and workforce reductions. Finally, the fourth part analyses the indirect effects of the crisis concerning mainly the changes in the structure and the role of collective bargaining. Our inquiry here is primarily directed towards that part of the public sector at central government level including those institutions directly dependent on the central government. A deeper analysis of the local government sector can be found in sub-chapter 3.5. Notwithstanding, this distinction often proves to be extremely cumbersome especially in times when the responsibility of many service provisions are shifting between governance levels as a part of the reforms and of crisis responses.

1 This data was elaborated using NACE codes so it contains data on private employees working in health and in education.

2 On related methodological problems please refer to the study of János Köllő, the first chapter of this present volume; and also EC (2013) p. 26 and 36. The demand for better quality statistical data was clearly formulated by the President of the European Commission Herman Van Rompuy in a conference dedicated exclusively to address this issue (Rompuy, 2013)

### Traditional public sector models in Europe

The historical development of the modern state's administration gave birth to two traditional types of legal models of employment relationship in Europe: the Prussian-Napoleonic model and the Anglo-Saxon model based on the civil law tradition.

The main features of the *Prussian-Napoleonic model* are the following: young employees enter into the system following completion of appropriate studies and remain a part of it throughout their careers until retirement. Entry requirements may also include the successful completion of a competitive public exam. Expulsion from the system may only occur in the event of serious legal wrongdoing. The legal regulations that govern employment relations in the public sector are separated from those governing the rest of the labour market and expressly emphasize seniority based promotion. (For this reason the literature refers to it on numerous occasions as a career-based or “closed” public sector model). Wages are usually set according to the pay-scales codified by law and mostly dependent on service period and education level. These pay-scales may be indexed for instance by the level of inflation. Contrary to this, in the public sector model based on the *Anglo-Saxon civil law tradition*, employees are subject to the same legal regime as those in the private sector. Accordingly, employees in the public sector do not enjoy a “preferential status” and additionally restrictions on entry and leaving (including being dismissed) are relaxed. All vacancies (including senior positions) are offered in public announcements and filled through public competition open to all so consequently, neither the concept of the career nor the notion of seniority play a major role within the system. Wages are mainly dependent on the position occupied and its development is regulated by individual and collective agreements instead of mandatory pay-scales. (This model is also known as position based or “open” public sector model). (EC, 2013, p. 104)

Two classical examples of the *Prussian-Napoleonic model* are worth mentioning as an illustration. For the German *Beamter* (civil servant) the state guarantees the means for an adequate lifestyle through a suitable economic recompense, based on a legally established pay scale (Bosch et al., 2012). Civil servants employed by the French *fonction publique* are in a similar situation as far as their income is concerned. According to the text of the legislation instead of a salary (*salaire*) they receive a stipend (*traitement*) dependent on various factors, such as the corps they belong to, the education level, the post and the seniority (*ancienneté*) of the employee. This “stipend” depends on the pay scale of the public sector (*grille*), which establishes a multiplier (between 308 and 1501 in 2012) that can be applied to the “index point” (EUR 55.56 since 2010) to arrive at the annual income of any given employee (Audier et al., 2012, p. 8). The reform of 1982 cancelled the previous inflation based automatic indexation of the “index point” (Audier et al., 2012, p. 11). Even

though the German and the French public sector model are different in many ways, neither the *Beamter* nor the *fonction publique* status is restricted to public administration officials, so the majority of those who would be considered in Hungary a public service employee, (i.e. the majority of teachers and physicians) belong to their ranks.

It is interesting to note that while the European Union through its politics indirectly yet efficiently, encourages the reform of its member states' public sectors its own bureaucracy corresponds to the Prussian-Napoleonic model. Applicants to the "EU bureaucrat" positions can gain entrance through public contest to its two bodies – *administrators* and *assistants*. While the former group is made up of 12 rank levels (AD05-AD16) the latter has only 11 (AST01-AST11). Thus wage categories are divided into 16 levels and each level has 5 seniority steps (with the exception of the 16th level which has only 3). Monthly base wages (from 1st of July 2010) are between EUR 2,654.17 (first level, first seniority step) and EUR 18,370.84 (16th level, third seniority step).

Three examples are worth reviewing to illustrate the *Anglo-Saxon civil law based model*. The UK is the first example given that its public sector is unique in many ways. First of all, only 9% of those employed in the public sector are civil servants, working mainly for the ministries and for state agencies and employed directly by the Crown. The remaining 91% are public services employees and their employment contracts are regulated by the "regular" private sector labour legislation (*Administration*, 2008). Also, until recently the legal standing of civil servants was governed by custom and not by law.

The second characteristic example is Sweden. Here labour regulations are the same for both public and private sector employees. Even though those who work for the state have no separately legislated labour status they do enjoy advantages of some particular legal conditions only applicable to them. The previous, seniority based system was reformed and replaced by the new position based "open" public sector model in the 1990's. However, employees of the diplomatic corps, of the army and of the police are subject of specific norms and regulations (*Public...*, 2010).

The last example is Estonia, which established a position based public sector in 1995 while the vast majority of the new Eastern European Member States have a public sector that could be described as a Prussian-Napoleonic one. Dissimilar from the other countries that use a position based public sector, in Estonia a separate legislation regulates the sector and further special legislation applies in those positions with the highest relevance for the state (diplomatic corps, police, army and judges). At the same time those employed in health care and education are under the private sectors' labour law (*Public...*, 2010).

These examples clearly indicate that there are no pure and model-like cases. Although member states could be classified by their dominant public sector model, this would only blur the characteristic differences of how each of them

mixes the two models to be able to take advantage of both. A pure position based model is difficult to implement in certain areas, such as the army or police, where special emphasis is put on hierarchical subordination and on a predictable promotion system. And inversely, more and more member states exclude from the secure public sector positions not only auxiliary jobs (such as cleaning and catering) but also complete areas of health and education, reorganizing them as contracted services either from market based actors or from state/municipality owned enterprises. (Outsourcing and in-sourcing is an issue treated in detail in sub-chapter 3.5). In summary, it can be indicated that member states blend the two pure (ideal-type) models into a country specific mixture, that, generally speaking, are similar in their internal segmentation despite the palpable differences.

### **Wage setting mechanisms**

In wage determination there are also two opposite poles, corresponding to the two ideal types of legal models of employment.

*Unilateral wage setting* can be directly related to the Prussian *Rechstaat* model. According to this the employer of the public sector (for the sake of simplicity: the state) unilaterally, within its own limits of power, decides on the public employee's income thus ensuring their independence both economically and politically (EC, 2013, p. 104). Given that idealistically "wage" is not subject of an agreement, an incidental wage dispute may require litigation. Thus the court is to decide on whether a "salary reduction" impedes the adequate way of life guaranteed by law for the German public servant.

*Collective bargaining* as a wage setting mechanism is mainly used in the case of those employees who have a (fixed-term or open-ended) work contract regulated by labour law. The two sides participating in the collective bargaining are the representatives of the employees and the state or municipality (and their agencies and enterprises). A particularity of the situation is that the state is as much a negotiator as the actor laying down the rules for the same negotiation. This obviously results in an advantageous negotiating position. In Sweden to counterbalance the possibility of direct state interference a specialized state agency is accredited to carry out the negotiations (Berki et al., 2007). Also, in the UK during the 1970s, Pay Preview Bodies were established in the 6 areas of the public sector to address the same problem, replacing collective bargaining with annual proposals for wage development based on hearings with the participation of three groups – employees' representatives, those representing the employers and also independent scientific experts (Grimshaw, Rubery and Mariano, 2012a).

Besides these two main systems some EU member states use a hybrid structure to determine wages in the public sectors (or in some of its areas). This means that wage setting is *de facto* carried out through negotiations between



the state and the trade unions; however the deals forged in these negotiations *de jure* are enacted through legislation or promulgated through the declaration of the pertinent executive body. This form of wage setting is relatively common in Eastern European member states and a similar system is used in both Italy and Spain (Glassner, 2010). Naturally, in this system the negotiating position of the state is stronger without even taking into consideration the fact that agreements forged in these negotiations may fail to enter into force.<sup>3</sup>

The review of the European wage determination systems also shows that there are member states that use more than one system simultaneously to set wages in the public sector. First and foremost, it is possible that those working in the central state administration and those working in offices of the municipalities are subject to unilateral wage setting, while the rest of the sector is governed by collective agreements or by a hybrid wage setting mechanism. The situation can, however, be even more complex: in some member states, for instance in Italy and in Spain, “salaries” of central administration employees also depend on the type of contract used and also on the level of administration at which the employee is employed (Glassner, 2010). This may lead to the situation where two persons, employed in the same position, are subject to different wage setting mechanisms.

The two wage determination models in the public sector correspond to two types of state role: the state (or the municipality) can be a *sovereign employer* (which makes unilateral decisions) or it can be *role-model employer*. In this latter case, characteristic of the Anglo-Saxon civil law based model, the state, by those agreements forged in the public sector, sets a model for the private sector. In these agreements the state guarantees employees job security, income security (sick money, pensions, etc.), equal opportunities, fair processes and that the employees’ representations are taken into account through adequate channels. Last but not least the state guarantees a “fair payment” based on just comparisons (Grimshaw, Mariano and Rubery, 2012b, p. 32). Naturally, these are not rigid and mutually exclusive roles given that the state as a sovereign employer can set models for the private sector while, though this is a paradox, the role of the state as a model employer is not exempt from elements of guarantee, particular within the career based systems. Furthermore, even in those EU members where the state acts as a model employer there are sub-sectors and areas (the army could be a suitable example here) where the state can only act as a sovereign employer.

3 This can occur for formal reasons: the entity with due authority – e.g. the Parliament – refuses to accept the negotiated results and thus declines to promulgate it, or – especially in times of crisis – the wage increase can become mired down in the governmental hierarchy due to the lack of funding.

### **The impact of the crisis on the public sectors of EU member states.**

Prior to the crisis employment in the public sector had been increasing modestly. For instance, the headcount of public administration grew by 2% between 2004 and 2008, though the speed of growth was on the decline. Employment of the sector remained more or less intact by the first phase of the

crisis (that is to say between 2008 and 2010). During this period dismissals took place predominantly in the private sector, and as a consequence, the share of the public sector in the total employment figures even rose in a number of member states, at least statistically (*Anxo et al.*, 2013). Since 2010, however, packages of fiscal restraints impacted on the public sector directly.

Due to the external pressure exercised by foreign investors, various European member states applied for help to the “troika” (made up of the International Monetary Fund, the European Central Bank and the European Commission).<sup>4</sup> In exchange for the financial bail-outs governments offered severe austerity packages in order to curb the expenses of the central budget. Given that a really important part of this derives from the public sector’s employment costs (salary and other), it was not surprising that the primary and immediate effects of these measures were wage freezes, wage cuts and layoffs in the sector. Additionally, these fiscal restriction packages in some cases contained dispositions designed exclusively to limit the scope and influence of the social dialogue (*Ghellab and Papadakis*, 2011, p. 85).

At the same time, this “wave of restrictions” had a negative impact on the public sector (as far as its employment, salaries and the role in the social dialogue are concerned) even in those member states such as Poland where the effects of the crisis had less of an impact compared to other member states which required external help. The spread of austerity measures was stimulated by two factors: on the one hand, in recent years low state spending on the public sector became the main benchmark of the “fitness and healthiness” of the state (*Anxo et al.*, 2013). On the other hand, in 2011 the stability and growth pact was replaced by the Euro Plus Pact that contains much stricter regulations. Only four member states opted out of the new agreement: Sweden, the UK, Hungary and the Czech Republic (*Bach and Stroleny*, 2013).<sup>5</sup>

Before turning our attention to the crisis reactions it is worth highlighting the fact that traditionally trade unions are stronger in the public sector than in other sectors of the economy though union density has fallen remarkably since the beginning of the crisis. While *Glassner* (2010) using data from 2003 found that trade union density was not higher in the public sector than in other sectors only in 2 member states, a more recent report of the European Commission (using different data sets from between 2009 and 2012) indicated 6 member states where union density is equal in the public sector and in other sectors of the economy and 3 where it was actually lower (*EC*, 2013, p. 44, chart 1.11).<sup>6</sup>

The easiest way to reduce wage expenses of the public sector is by *reducing its workforce*. Naturally, there are many different ways to complete this task. One of the most widespread procedures is by not filling vacancies. This was used for instance in France where only one vacancy was made available for each two persons leaving the public sector. A much more drastic “exchange

4 In 2008 Hungary, Romania and Latvia, in 2009 Greece, Portugal and Ireland, in 2010 Spain and finally in 2011 Cyprus.

5 It might be mentioned that the wave of austerity reached the administration of the EU with a surprising delay only in 2012. Also this happened only thanks to the sustained personal pressure of the English Prime Minister David Cameron. As a result a 10% restriction on the EU bureaucracy was agreed to be implemented during the fiscal period of 2014–2020. Naturally, employees contested with strikes.

6 The countries of the Glassner study are Belgium and the Czech Republic. And those of the EC report are: Latvia, Lithuania, Hungary, the Slovak Republic, Slovenia and Belgium in the former category and the Czech Republic, Poland and Estonia in the latter.



rate” was offered in Greece where first a 1 to 5 rate was agreed, later modified to 1 to 10. Incidentally this latter exchange rate also applies to many areas of the Spanish public sector (EC, 2013, p. 142).

Another way is to allocate “surplus” labour into a “reserve force” as a first action. Besides being a direct income reduction for the employee concerned, this also means that if a new workplace cannot be found for the individual within a limited time period their eventual dismissal becomes possible. Such a solution was planned in Greece affecting some 15,000 employees, though in the end the measure was never implemented (EC, 2013, p. 142).

Thirdly, headcount reduction can be completed through outsourcing and privatization. “Internal externalization” is a special instance of this. Such a process happens when a public sector employee, holding a protected employment status (which implies a higher degree of job security and correspondingly a more advantageous position), is replaced by an employee having a private sector contract (for instance, instead of a public servant an employee is hired according to private sector labour regulations). In the French public service, even before the crisis, it had become common to hire employees using various contracts under the private sector law rather than employing them in accordance with status based legal dispositions of the *fonction publique*. In other words the private sector’s labour conditions had been “smuggled” through this process behind the safety barriers of the public sector (Audier et al., 2012). Instead of a replacement it is also possible that the legal position of the given employee is transformed though this has much higher transactional costs.

Finally, work force reduction could also mean effective dismissals that, no doubt, also entail high expenses, whether we speak about severance payments accompanying dismissals or early retirement (Public..., 2010).<sup>7</sup> It must be emphasized that layoffs in the public sector affected mainly those working in administration and in management. Also in various countries the most affected were those with a fixed-term contract due to the possibility of refusing renewal (EC, 2013).

*Freezing wages* has a great potential in political communication: it sends the message to voters that the otherwise privileged public sector employees also share the burdens of the crisis. A wage freeze, however, does not necessarily mean a real worsening of the public sector employees’ wage position. This may be the result of the fact that only freezing the pay scales does not exclude the effective wage increase of a given employee. Firstly, because the employee can advance on the job ladder, and secondly, because seniority related wage development can also take place. So it is not so surprising that many member states opted to implement this measure.

A more drastic expense cutting measure is to *cut wages*. This generally triggers wide-scale refusal by trade unions who usually argue that public employees are not to be blamed for either the unfolding of the crisis or for its delayed

<sup>7</sup> This can impact heavily on the pensions systems. In 2010 in Portugal so many people requested pre-retirement that the government had to suspend the whole pre-retirement program.

effects (EC, 2013 p. 150). These wage cuts mainly targeted those extra benefits that are unusual in the private sector (such as the 13th and 14th month salary and other social and fringe benefits). At the same time, in some member states the lowest earners were excluded from the negative effects of a wage decrease (EC, 2013). Such positive discrimination was implemented in Ireland, Italy and in the UK. It is interesting that on many occasions decisions on dismissals and wage freezes/cuts entered into force with considerable delay, there was even a case where an austerity package was implemented according to the original plan only following the national elections.

### **Reforms of the wage setting systems**

Prior to the crisis, in various member states the ongoing reforms were driving the given state's wage determination systems closer to the model dominated by collective bargaining. This process originally started in the 1970s when Finland changed its unilateral wage setting system and established one based on collective agreements (EC, 2013, p. 39). A move in the same direction can be observed in the Spanish reforms of 1984, in the reforms of 1993 in Italy, and also in the one in 1998 in Portugal (Anxo *et al.*, 2013). The appreciation of negotiations could also be observed in the expansion of the European level sectoral social dialogue with the inclusion of 4 areas of the public sector: local and regional public administration (in 2004) hospitals and healthcare (in 2006), education (in 2010) and central public administration (also in 2010). These committees, formed after lengthy negotiations between 2004 and 2011, permit trade unions and employer representation organizations of the different sectors to engage in direct negotiations. Additionally, immediately before the crisis these forums were looking for ways to extend and thus upgrade even further the traditionally bilateral relation in this sector via the inclusion of other stakeholders, such as users for instance (EC, 2013, p. 144).

The majority of EU member states' governments acted in a prompt and determined manner to counterbalance the impacts of the crisis. One of the side effects of the immediate reactions was that governments ignored the traditional channels of social dialogue (Anxo *et al.*, 2013). Therefore, the role of the government in wage setting and thus unilateralism has increased, while social dialogue began to decline. Glassner (2010) already lists 10 member states where crisis reactions made governments take unilateral decisions on salaries in the public sector. Also, this approach to set wages unilaterally as a response to the crisis reached beyond the original group of countries that had used hybrid wage setting systems, for instance and now also includes the UK, which had previously used, almost exclusively, collective agreements to set wages.

Despite this in some of those countries hardest hit by the crisis agreements were forged within the framework of social dialogue. However at least in the Lithuanian and Hungarian cases analysts cast doubts on how meaningful and

real these negotiations were (Glassner, 2010). Only Ireland was an exception to this tendency. There, within the framework of a nationwide accord called the Cork Park Agreement parties agreed on a 4 year framework for action. Thanks to the agreement actual dismissals were avoided through a strict “no replacement” measure that ruled out the possibility of opening new vacancies, while wages were frozen too (EC, 2013, p. 145). It must be highlighted though that the above mentioned is only a pale imitation of those social pacts that were characteristic of Ireland in the 1980s and 1990s – the scope of the Cork Park Agreement was obviously limited to the public sector. The strength of the agreement was also put into question by the *Irish Federation of University Teachers* when it refused to sign it. Another warning sign was seen when, in 2009, the biggest employer association, *IBEC (Irish Business and Employer Confederation)*, left the national wage negotiations and suggested its members carry on with consultations at local level. By the middle of 2013 even its last supporter, the government, backed out of the Cork Park Agreement and started to sign bilateral agreements with a series of trade unions of the public sector within the new framework of the public sector stability agreement (2013–2016) better known as the Haddington Road Agreement. The government opted for this solution once negotiations of a Croke Park II Agreement became stranded thus making it impossible to come up with sector wide accord. Nonetheless only three trade unions, working in the area of education, declined to sign one of these bilateral agreements (Sheehan, 2013).

Unfortunately, European level social dialogue in the public sector failed to play any prominent role in managing crisis driven conflicts of interests. From the four sectoral social dialogue committees, only two: the one on municipalities and the other on central government were able to come up with something and this was only a joint statement on the crisis (EC, 2013, pp. 109–110).

Three main crisis related tendencies can be observed in the field of social dialogue (Bach and Stroleny, 2013). Firstly, many governments responded with *restriction*, primarily in member states where social dialogue had no deep historical roots. In some EU member states this restriction included the suspension of nationwide social dialogue. This led in some cases to protests and demonstrations and also to the decentralisation of social dialogue from the blocked governmental level to local and sectoral levels. This process can be observed clearly in the case of the Netherlands and also in Italy, though in these cases government interference was less drastic than in others.

The second tendency was a move in the direction of *flexibility*. This process produced some positive outcomes predominantly in member states where legal dispositions require joint consultation. It was this requirement that opened the channel that social partners could use to debate issues that traditionally were addressed at the central (higher) negotiation level. Although this was a positive consequence it must be mentioned that the results mostly served

the interests of the employers, as issues like outsourcing, flexibility and rising service quality, were overrepresented in the final outcome.

Finally, governments could also try to *reform the system of the social dialogue* as such. One of these reforms was implemented successfully in Denmark. Here the municipality level of the social dialogue was reinforced with a permanent forum that works with the participation of the elected chief negotiators even between the collective negotiation rounds. Another example is the Bercy agreement in France (which entered into force in 2011 with the exception of local governments where it applies only from 2014). The agreement, which imported solutions from the private sector's labour relations, tied representativeness of the trade unions directly to workplace level elections and extended the scope of the collective negotiations (to include issues of working conditions, career and training among other new topics). At the same time however, collective agreements in the public sector did not become legally enforceable so those parts of the unilateral system that benefited the state remained intact (Tissandier, 2010).

In Italy the Brunetta-reforms (2009–2011) must be mentioned, which had the specific aim of raising the efficiency of the Italian state bureaucracy. Named after the Minister of Public Service and Innovation, Mr Brunetta, the reform package changed the system of the wages (from one which was seniority based to one production based) and made it possible to dismiss workers from the public sector. The implementation of the reform was completely unilateral; the opinion of the trade unions was ignored as much during the preparatory phase as during the implementation of the reform itself. As a consequence of the changes it became possible to make wage decisions related to the state bureaucracy without any involvement of the trade unions. In addition the agency (*Agenzia per la Rappresentanza Negoziabile delle Pubbliche Amministrazioni, ARAN*) representing the state as the employer in wage negotiations was reorganized. All these actions resulted in strong resistance from the trade unions. In the end, mainly as a result of the impossibility of creating a unified workplace level trade union structure (which the reform also aimed at) and also because of the political changes at national level, it became inevitable to initiate negotiations with the trade unions (Rinolfi and Paparella, 2008, DellaTorre, 2008). In May 2012, the agreement, signed with the participation of the municipalities, modified in various aspects the original Brunetta-reforms, which was a clear success for the trade unions (Sanz, 2011).

Along with differences in member state specific responses to the crisis, there were clearly observable topic related differences too. Strict restrictions were common in “hard” questions (such as wages and salaries) while on “softer” issues a posture closer to flexibility was permitted to govern. As a conclusion, however, it must be stated that in numerous member states changes were contrary to the dynamics that had prevailed in the labour relations of their

public sectors before the crisis. (Furthermore, as the Italian example shows, the opposite of the contrary to the previous direction might even materialise as the winning resolution.) As far as the transformation of the social dialogue is concerned both decentralization and centralization can be observed as growing in importance. As indicated above the “negotiation avoiding” behaviour of the central government greatly helped the decentralization, upgrading the regional and municipality level social dialogue. Notwithstanding, it is a fact too that public sector dismissals first affected those employed in a flexible contractual way, and as a result the share of the workforce with a better job security has risen. This of course, permits a higher centralization in wage negotiations.

### Conclusions

The public sectors of EU member states can be located in between the two fundamental end points of some dimensions of a continuum. The opposing poles are usually described in Prussian-Napoleonic vs. Anglo-Saxon civil law tradition terms as far as the legal model of employment relationship is concerned; unilateral vs. collective bargaining in terms of wage setting and finally in dimension of the role the state plays as the employer: sovereign vs. role-model employer. At the same time each member state’s public sector is a particular. It is a country specific mixture of these approaches whereas employees employed according to different models work together, sometimes directly in the same workplace. Yet, these country specific resolutions of the member states are really similar in many ways.

This duality, similarity and divergence, was characteristic of the crisis driven transformations in all segments of the public sector. There was a great similarity among the various state’s responses, moreover the harder the economic pressure on a country resulted in a higher similarity in the austerity measures implemented. Meanwhile the possibility and viability to execute the proposed measures, again, varied greatly among the member states. There were member states where a unilateral state position was possible and others where it produced such resistance (in the form of strikes and protests) that it could not be implemented successfully. Furthermore there were examples (as in the case of Germany and Austria) where, even though unilateralism is the legally codified way of procedure, it did not become necessary to ignore and exclude the opinion of the social partners in addressing the crisis. Moreover, the dominance of the unilateral state approach was independent of the established legal model of employment, of the traditional form of wage setting and also of the role the state usually plays as an employer. Apparently, an early statement of Marsden (1994, p. 17, cited by Grimshaw *et al.*, 2012b) still applies. According to this, unilateral wage setting may help states to reach the desired fiscal objectives effectively. However a process of the wage setting mechanism

involving employers and trade unions is a “much more flexible tool for legitimating changes”. In other words the risk of immediate fiscal control is the conflict between employers and employees. Also, the sustainability of wage reforms presupposes employees’ approval too.

In any event, it is thought-provoking to consider how the European Union and also the majority of its member states, so proud of their institutes of social dialogue, could ignore in a such a uniform manner all those resources which have been invested in the building up of the institutional structure of the social dialogue. Furthermore, they did so, just at the moment when these institutions could have demonstrated their efficiency in these critical times.

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### 3.5 Privatisation of municipal services, outsourcing and in-sourcing efforts and their employment impacts in the European Union countries and Hungary\*

LÁSZLÓ NEUMANN & MÁRK EDELÉNYI

In December 2012 some unusual news appeared in daily newspapers regarding a “strike” at the public transportation company of a Hungarian town. At dawn on a Monday morning one third of the bus drivers refused to start work, therefore many bus lines were not operating during the morning peak hours. The director of the company alluded to a coup attempt, suggesting that although bus drivers were citing the technical condition of buses, their refusing to work was in fact due to their wage claims. The trade union leader’s statement, of course, immediately rebutted this assumption. By the end of January 2013, the news reported that the trade union leader, who had long been protesting because of the condition of the buses, was laid off, the company justifying it through a loss of trust. The trade union took legal action against the unlawful dismissal. A report in mid-February 2013 revealed that a police investigation was underway for “disturbing the operation of works of public interest”. In his statement the town’s mayor promised full support to the company director who had gone to the police, calling it unacceptable that the town’s life should be paralyzed by a wildcat strike that no one could prepare for.<sup>1</sup>

The case gained nationwide publicity and exposes, to some extent, a field of industrial relations which has so far received little attention in studies: the specificities of the municipality-owned enterprises sector. Coincidentally, half a year before the above-mentioned case we had actually conducted interviews at the company in question in the framework of an international research project<sup>2</sup> and could not detect any signs of the coming conflict. Therefore we will return to the case at the end of the present sub-chapter and attempt to give an explanation as to the developments that ensued in the meantime.

The original field research, conducted in the framework of an international research project, took place in two country towns that provide a wide range of public services, involving the private sector and church institutions in different ways (*Berki et al.*, 2012). The two towns, differing in size, were indebted to different degrees and party politics appeared differently in their lives. In both towns we conducted interviews with the heads of the municipality and its institutions/companies, as well as interest representation organisations – wherever they existed. In both places we focused on five service areas: public transportation, geriatric care, provision of school meals, cleaning and waste management. Hereby we would like to thank our interviewees for their cooperation.

\* The authors would like to thank Erika Steiner (National Federation of Local Governments, TÖOSZ) for her help with the research.

1 The news reports appeared in the local media, national newspapers and at the Hungarian News Agency. Unfortunately we have to omit the exact references and verbatim quotations for the sake of anonymity which we must ensure for every interviewee who participated in the research.

2 The research project “Public sector pay and social dialogue during the fiscal crisis” covered five countries (France, Germany, Hungary, Sweden and the United Kingdom) and was funded by the European Commission (VS/2011/0141), Research coordinator: Damian Grimshaw, Manchester Business School (*Grimshaw, Rubery and Mariano*, 2012). This chapter builds greatly on the results of the research gained both in Hungary and internationally.

In line with the practice of New Public Management (NPM), described in Chapter 3.3 of the current volume, an increasing part of municipal public services are provided – in various structures – by private or non-profit organisations, and the disintegration of sharp divisions between sectors can be seen. The first part of the sub-chapter provides a brief overview of the motives behind outsourcing and in-sourcing, (public) procurement, its prevalence and regulation, as well as its impact on the labour market in some of the EU member states. The second part attempts to map the relevant Hungarian experience – the starting point being the specificities of management, service provision and interest reconciliation in the Hungarian municipal system –, giving a description of interests and counter-interests that are behind organisational changes. Finally, we will take two case studies to illustrate the employment impact of outsourcing and re-municipalisation, as well as the involvement of the church in service provision. Our article focuses mainly on labour market segmentation and the transition between various employment statuses, so many other parts of the topic will have to be covered in outline only.

### **Municipalities' crisis reactions and outsourcing in some EU member states**

a) *The impact of austerity measures at the level of municipalities.* An ILO study (Vaughan-Whitehead, 2012) exploring European crisis reactions, and more closely the adjustment of the public sector, between 2008–2010, distinguishes between quantitative measures (redundancies, wage freeze and wage cuts) and structural reforms. Differences among countries in this respect are significant: while in Greece or Portugal it was necessary to significantly reduce the size of the public sector, other countries – such as the UK or the Netherlands – chose a combination of two adjustment approaches: in the case of some public services the responsibility of provision was decentralized and delegated to the municipalities. In many countries the direction of structural changes was privatisation, outsourcing, purchasing services from the private sector – that is processes that began with the New Public Management (NPM) (see sub-chapter 3.3) have been bolstered. According to OECD data, calculated on the basis of the national accounts, the total volume of buying services from the private sector between 2007 and 2010 increased on average from 12% of the GDP to 13%. In Holland, Finland and Canada particularly significant increases were registered. Hungarian figures are close to the average but show an approximately 1% decrease (OECD, 2013).

Research on the reactions to the crisis focused initially on national responses (see sub-chapter 3.4) and only the most recent studies have come to study the level of municipalities. This is despite the fact that a considerable element of public services are provided in the framework of municipalities, therefore budgetary constraints introduced after the onset of the crisis appeared most-

ly at this level. Our topic requires that we address the economic autonomy of municipalities and local systems of wage agreements and interest reconciliation channels (*Leisink et al.*, 2013). While the wide range of municipal services is very similar in different countries, there are significant differences as to the division of labour among governmental levels and the financial approaches applied; therefore there are considerable differences with respect to the financial autonomy of local governments. OECD data show that the proportion of transfers from the central budget (subsidies, shared taxes, etc.) is high in the United Kingdom (70%) and in Hungary (59%); it is smaller in France (29%), in Germany (18% in the constituent states and 35% at the level of municipalities) and Sweden (24%).<sup>3</sup> The order of course is reversed when looking at the proportion of local taxes and other revenues.

Depending on their fiscal autonomy, local governments can decide about how to react to the austerity measures introduced by the central government. They may choose to reform the local tax system, shrink the range of services they provide, or – under some circumstances – it can be the opposite: they may be prompted to experiment with a “countercyclical policy”, to ameliorate the impacts of the economic crisis by increasing wages or concluding outsourcing contracts on better terms, etc. – thus endangering the implementation of the central government’s budgetary goals. In the absence of autonomy, however, municipalities may be instructed or impelled – by changing political and economic conditions – to curb their services, investments, employment level and, if possible, increase taxes. Such reforms may be followed by what is called the vision of the “Big Society” (UK), which encourages citizens’ self-reliance, volunteer activities and the involvement of not-for-profit organisations (*Bach*, 2012). In welfare states settlements with a greater proportion of low-paid or unemployed inhabitants are more affected by subsidy cuts, as they are more dependent on targeted subsidies for the disadvantaged sections of the population. In the United Kingdom these include a large part of centrally provided subsidies, which the current administration decreased by 25% on average, while in the poorest locations central support dropped by 72% (*Grimshaw, Rubery and Mariano*, 2012). If the central government cuts support for local governments, while also delegating to them the responsibility for service provision, there will be strong pressure at the local level to organise services more efficiently.

All this must have an impact on the employment of those providing public services locally. In their paper *Leisink et al.* (2013) sum up the conclusions of another international research project, where case studies were conducted in three countries (Italy, the Netherlands, United Kingdom), describing two municipalities in each country, exploring industrial relations at municipal level in the wake of the crisis and examining if they are similar or different in the case of the municipalities studied. When austerity measures reach the level of mu-

<sup>3</sup> 2011 data, source: [OECD Fiscal Decentralization Database](#), Table 17.

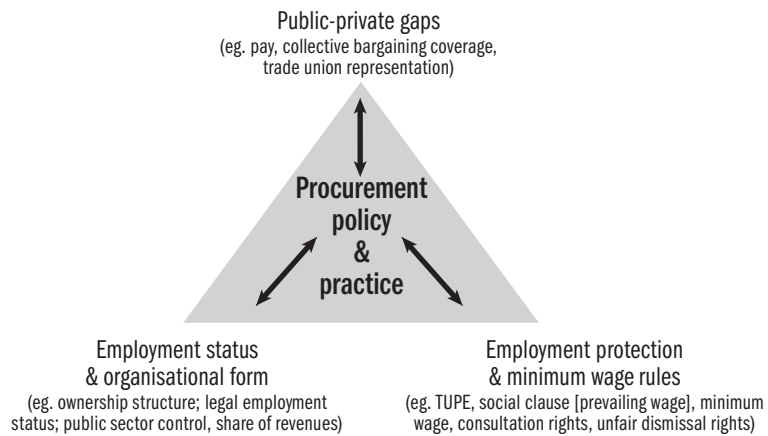
municipalities then interest reconciliation channels prove to be an important factor: whether there is a sectoral or local forum of social dialogue, whether trade unions are strong or not, and the level of institutionalization, all play a role.

From this point of view institutions in Italy and the Netherlands are strong, whereas in the UK they do not really have a place in the liberal economic model. Despite the traditional dual-level collective bargaining, municipalities in Italy, for instance overrode the central government's unilateral decision on a wage freeze, while in the Netherlands interest representation bodies of local governments drew on a 1994 law to retain their entitlement to conclude collective agreements in the face of pressure from the central government to implement a wage freeze. In the United Kingdom, however, municipalities were able to exempt themselves from the scope of national wage bargaining – in the few areas, that is, where they had such a role. Thus in the Netherlands and the UK municipalities and trade unions had a legitimate scope of action against the central will, while in Italy the unilateral government decision on wages allowed no such opportunity. In the latter case, however, municipalities' financial potentials were decisive and the fairly wealthy local governments negotiated employment terms without formal authorization as well. So despite the fact that fiscal constraints in the three countries prompted municipalities to act, the implementation of restrictions at the local level was determined by national intermediary institutions and the structure of the local government – thanks in main to their autonomy *vis-à-vis* the central government and the institutions of social dialogue. Thus local governments and employee representation bodies had some freedom in deciding how to react to the central austerity measures. There were, however, significant differences within the countries, and therefore the differences despite a similar institutional set-up suggest that the strategies and decisions of local actors also had an impact.

b) *Decisions on outsourcing, labour market regulation and the role of interest representation.* The extensive body of literature on privatisation and outsourcing decisions generally emphasizes two main labour market factors: the public sector's wage advantage over the private sector and the different influence in interest representation (works council entitlements or the trade unions' bargaining power). The latter is usually weaker in the private sector, which is evidenced by the rough indicator of trade union density. The wage advantage of the public sector is typically considerable in the Anglo-Saxon countries, therefore in these countries there is a possibility to decrease costs by restraining wages; no wonder this approach was mostly emphasized in the Anglo-Saxon studies. Large wage gaps provide a strong impetus for outsourcing low-wage jobs, especially in times of austerity. Obviously, wherever wage differences are smaller or of the opposite direction, then it can hardly be the main motivating factor.

*Grimshaw, Rubery and Mariano* (2012) suggest that beside wage differences and the strength of interest representation, a third factor also plays an important role the different levels of legal protection of employees in the two sectors, whether it concerns the status of civil servants or other public sector employment statuses (non-civil servant). The difference in employees' legal protection within the public sector manifests itself in labour market segmentation as well: in differences concerning employees' remuneration, access to promotions and job security. These three factors of course carry different weight from country to country when it comes to decisions about outsourcing (see: *Figure 3.5.1*).

**Figure 3.5.1: Procurement policy and the labour market**



Source: *Grimshaw, Rubery and Mariano* (2012).

Decision-making is further complicated by two additional factors. On the one hand service provision often does not take place in pure community or private frameworks but in a varied combination of ownership structures: there may be countless variations for this from 100% privately owned, profit-oriented companies to 100% publicly owned, not-for-profit enterprises.<sup>4</sup>

On the other hand, beside the consequential external and internal labour market segregations, other aspects are taken into account when considering outsourcing. These may include regulations about the transition, most prominently the regulations concerning transfer of undertakings and wages following the outsourcing (for more details see later). These regulations differ from country to country and if they prove effective, then they make the transition to outsourcing a smoother process and alleviate the impact of the consequential labour market segmentation. Decisions about outsourcing seek to be sensitive to the specificities of the service concerned, while reacting sensitively to financial constraints and the legal regulations related to (public) procurement. The choice of organisational form is influenced by the

<sup>4</sup> In an extreme case, for instance, the municipality contracts the self-employed, keeping its *de facto* control over service providers. It is a typical decision in many countries to use an enterprise with the municipality having majority ownership, thus retaining control over the operation, which may also be a source of income and may provide the opportunity to circumvent the headcount limitation in the public sector, while applying employment regulations valid for the private sector.

VAT regulations as well. In Germany, for example, VAT is applicable where the local government is participating in service provision, which is a way to encourage decisions towards favouring the private sector. At the same time acquiring investment sources is another important incentive for outsourcing, while the establishment of municipal enterprises is justified by the revenues generated by the sale of shares, which is a way to decrease debts.

In France there is some pressure to in-source, which is, in all likelihood, due to the disappointment at the obscure, uncontrollably complicated organisational structure and the great costs and low quality of previously outsourced services. The decision to outsource/contract a private provider thus – according to the literature – is the result of decisions made on the basis of various viewpoints, and not only a reaction to price signals.

Outsourcing decisions are by no means exempt from ideological aspects – political motives play a role too. In the United Kingdom it is essentially up to the municipalities to decide how they cope with the cuts in subsidies from the central budget, while they have to retain the responsibility of service provision. In connection with geriatric care, for instance, they often had to cut the fees of outsourced services, laid down in the contracts, meaning they had no choice but to economize at the cost of service quality. On top of that, the current government is encouraging outsourcing by financial means as well, as local governments may apply for funding if they involve the private sector. Therefore every new school is built in such a setting without any real supervision of municipalities. Joint financial structures of the public and private sectors are encouraged in the entire municipal sector, not least for the purpose of decreasing the amount of recorded debts within local governments and the employment level in the public sector.

c) *Interaction between regulation and outsourcing practices.* The appearance of private sector actors in the provision of public services raises the question of interaction between different labour market regimes, including the nature of labour market segmentation and the possibility of a regulation to prevent the emergence of considerable differences between the two sectors. A general presumption is that employees working in jobs outsourced to the private sector receive lower wages, their promotions lack predictability, and they are more exposed to changes in market demand, therefore additionally making their jobs more at risk. This logically follows from the fact that the goal of outsourcing is to ensure more efficient work for lower pay and/or more flexible working conditions. Experience shows, however, that this is not always the case. Our first counter-example is not about outsourcing to the private sector, it is only about organisational decentralization. During the reforms of the 2000's in France, as many as 128,000 employees (mainly primary school teachers) were transferred to the municipalities. Most of them accepted this move voluntar-



ily in the hope of better payment conditions, as the municipalities' scope for action was greater despite the fact that salaries – as determined by the civil servants' pay scale – were lower than those set in the central pay scales.

It is also an experience in France that in-sourced employees usually lose their benefits in-kind that they are entitled to in the private sector, such as the supplementary health insurance, and those other benefits that the works council at the private enterprise have achieved. Having returned to the public sector, they constantly suffer disadvantages compared to those employees with long-term employment in public service. Although their salaries are unchanged following their transfer later on they are excluded from seniority-based pay rises because their years spent in the private sectors are only partially taken into consideration. All this explain why employees and their trade unions are reluctant to support in-sourcing. An in-depth study revealed that interest representation bodies always consider the conditions of the concrete transition and its expected outcome when deciding whether to support or oppose the proposed changes (*Audier et al.*, 2012).

The study conducted by *Grimshaw et al.* found that of the four Western European countries there are only two where the outsourced private sector offers lower wages: Germany and the United Kingdom. In Germany, however, this difference is decreasing following the introduction of a new lower tariff category (see later) in the public sector and the minimum wage in certain services, while in the UK the collective agreement concluded with the local governments may improve the situation. In France the situation is similar, although the private sector allows longer working hours and greater work intensity, while in Sweden the collective agreement is applicable in each sector. Trade union reactions to outsourcing correspond to wage considerations. There is no resistance in France and Sweden, but there is general opposition from the trade unions in Germany (because of worse working conditions and because there are no guarantees warranting the application of the collective agreement) and in the United Kingdom (due to less favourable working conditions and the loss of pension entitlement).

The transition is tempered by the regulation of the relevant public service act, insofar as it may maintain status change over time, for instance by applying the more flexible conditions of the private sector to the new employees only. This is what happened in Germany, where in the 1990s the transfer of employees with a civil servant status led to complicated legal problems because they sought to both keep their special legal position and also facilitate the application of the wage setting mechanisms and working conditions of the private sector. Similarly, in France, when state-owned companies were privatized – e.g. in telecommunications and the electricity industry – employees who had already been employed were able to keep their status based on a separate law and the conditions pertaining to the private sector only applied to newcomers.

Transition between the two sectors, and competition among labour regimes may be moderated by more general regulations as well: a relatively high minimum wage, the rules concerning the transfer of undertakings, the law on the prevailing wage, the extension of collective agreements and social clauses added to the outsourcing contract – the practices differ from country to country (*Schulten and Brandt, 2012*). A high national minimum wage may imply a lower limit in the wage competition (especially in those countries and sectors, where the proportion of low-paid employees is relatively high). The connection between the minimum wage and the wage regulations in the public sector is also interesting, especially when the minimum wage catches up with the lower wage categories of the public sector pay scale as a result of the faster rise of the former.

Of course the reforms of the public sector may result in a decreasing difference between the two sectors if pay and employment are made more flexible. There are reforms with the opposite intentions as well, such as the overhauling of the tariff agreements in the public sector in Germany in 2005, when a new, lower wage category was introduced for “extremely simple activities” (*einfachste Tätigkeiten*) that in Hungary would be called unskilled labour requiring no qualifications. The new tariff was introduced explicitly to ensure that wage differences do not necessarily lead to outsourcing. Its reception was quite controversial even in trade union circles (as the goal of job protection clashed with the principle of fair wages) and there is no convincing evidence that it successfully prevented outsourcing (*Bosch et al., 2012*). Examples of more successful interest representation are connected mainly to consultations preceding concrete decisions of outsourcing or in-sourcing. In France it was trade unions, while in Germany the works council, that were able to intervene proactively, partly using formal channels (e.g. at local governments’ committee meetings preparing economic decisions, where they are regularly heard) or through informal ones (that is, through their political channels) (*Grimshaw, Rubery and Mariano, 2012*).

Transfer of Undertakings (Protection of Employment) – “a change in the person of the employer”, as the new Hungarian Labour Code terms it – have been regulated by EU’s TUPE directives since 1977; however, there are great differences between countries as to their interpretation and the protection they ensure. For instance some countries allow employees to “refuse” “automatic” continuation of the employment relationship at the new company, in which case the rules that apply are those related to the termination by the employer. In the United Kingdom, for instance, the application of the directive ensures only a relatively small degree of protection. Although the government has included in the regulation the right “to refuse” it did so in a way that there would be practically no legal consequences if those rights were to be infringed (*Hartzen et al., 2008*, citation by *Grimshaw, Rubery and*

*Mariano*, 2012, p. 70). Refusal practically entails resignation but it does not entitle employees to any kind of compensation, there is no protection against an unlawful procedure. (The Hungarian regulations in the market sector are basically on these lines.) In these countries there is no guarantee for the long-term maintenance of employment, while elsewhere the successor (transferee) employer is obliged to maintain employment for a certain period of time: for 15 months in France and 12 months in Germany and Sweden.

The application of social (employment) clauses stipulating equal treatment in the context of outsourcing contracts was introduced by a 1949 ILO convention.<sup>5</sup> The ruling of the European Court of Justice on the *Rüffert case* in 2008 concluded that the employment clauses in contracts with private enterprises restrict competition, which practically determines the European Commission's stand as well.

The practice of the extension of collective agreements including wage tariffs also differs from country to country. Nowadays they are widely applied in the German constituent states. In North Rhine-Westphalia – where case studies for the research were conducted – the first law regulating wages in the course of outsourcing was passed in 2002 (*Schulten et al.*, 2012).<sup>6</sup> They were later abolished after the governmental change in 2006 – when the red-green alliance was replaced by the CDU/FDP. The new government argued that they did not fulfil their goals effectively enough. In 2008, a law in Lower Saxony, similar to the above-mentioned Rüffert decision, led to the reappraisal of contractual clauses on wages. However, in 2010–2011 a new wave of legislation on “prevailing” wages (*Tariftreugesetz*) swept through the constituent states, which complied with the requirements of the European Court of Justice. Their essence is that during outsourcing entrepreneurs in the private sector should comply with wage tariffs included in collective agreements, provided the agreement has been extended to the entire sector.

In the United Kingdom, however, there are examples of the voluntarily application of the standards common in the public sector, when – at the initiative of local governments and trade unions – certain employers apply the wages common in the public sector without any legal or contractual pressure. An example for such an initiative is the so-called living wage in London, which tracks living costs that are far above the average, its main supporter being the city's mayor (*Grimshaw, Rubery and Mariano*, 2012).

5 Convention No. 94 – Hungary did not ratify this convention.

6 At this point about half of the German constituent states applied similar laws, mainly for construction works and in public transportation, but their scope was extended to other services as well.

### **Outsourcing and in-sourcing of municipal services in Hungary**

a) *Local governments' system and economic management.* In the West European countries rather different local government systems have been evolved, depending on the size of the country, the local traditions and the level of economic development. Despite recent convergence in the level of economic development and of cohesion efforts of the EU, there have remained sub-

stantial differences in terms of the number of local governments, autonomy of municipalities and the division of tasks between various governance levels. We cannot enter into a detailed discussion due to limited space, and the following presentation of features of the Hungarian local government system will also necessarily remain sketchy. The principle “one settlement–one local administration” became established in Hungary in the 1990s. The Local Government Act assigns the responsibility of provision of a wide spectrum of mandatory services (public education, health care and social welfare services, maintenance of the local infrastructure, environmental protection, social housing, fire services, public safety, etc.) to local governments – regardless of their largely varying size in terms of population and economic power. At the same time they are given a free hand to determine the organizational framework of service provision and how to spend their own revenue. The “Hungarian model” resembles the Mediterranean one with respect to its fragmented nature, and is similar to the Scandinavian system in terms of the wide range of local government functions (*Vigvári*, 2011).

Despite the existing legal framework providing for strong decentralization, centralization occurred from the early 1990s, mainly as a result of fiscal incentives. Local administrations’ own revenues are generally modest, primarily based on revenues from property sales, local business tax and top-down income tax distributions, a system which has generated considerable financial disparity among local administrations. This has led to the state periodically intervening to provide uniform per capita support for mandatory services, development subsidies and by reorganizing the tax system. In order to guarantee their continuing functioning, local administrations that are “in a disadvantaged situation through no fault of their own” – are entitled to supplementary state support. According to OECD statistics, government transfers accounted for a relatively high share, 59 per cent, of local government expenditure in Hungary in 2011. Due to the decrease in state subsidies, EU tenders emerged as the sole source of funds to finance development works.<sup>7</sup>

State subventions for local government functions have been continuously decreasing since 1995. On joining the EU, the state undertook the obligation of observing budgetary discipline, based on the Maastricht criteria. Thus the 2006 convergence programme brought about a new phase in budget cuts in the local government system. The brunt of stabilization costs was borne by local government. Direct cutbacks in the municipal subventions are estimated to have improved the balance by 0.7% of the GDP (*Vigvári*, 2011). In addition, cutbacks in the healthcare and other sectors affected local governments’ ability to maintain their institutions, from hospitals to fire brigades. (Then local government expenses made up 11% of the GDP.) Cuts in subsidies provided from the central budget for mandatory functions did not necessarily take the form of limiting the wage bill paid to local government employ-

<sup>7</sup> The importance of EU grants is indicated by the fact that their winning prompts an opportunistic approach; as one interviewee, a mayor, put it, before they sought grant opportunities for what the community needed, today they would apply to any open call for proposals, like for building a football pitch, as is the case now: “if the prime minister is mad about football, ... then we will build a football pitch next to the pool, we will join the crowd. What we build stays here and adds to the town’s assets.”

ees. Unfortunately, no statistics are available concerning the extent of budget cuts for an unchanged, comparable set of mandatory services. According to a study conducted by the State Audit Office, between 2007–2010 in the cities of county status, cuts varied in different services (1% in child welfare, 6% in primary schools, 16% in school dormitories). In this period the lack of resources which emerged was compensated for by institutions' own revenues and increasing local government support (*ÁSZ*, 2011).

Municipalities reacted to government austerity measures by raising considerable external funds, predominantly by issuing bonds denominated in foreign currencies. Even the credit limit stipulated in the Local Government Act was not enough to close the loopholes that used various “financial innovations”. The financial crisis triggered a major increase in interest payments, accompanied by dwindling local tax income and increasing claims for social assistance due to the economic crises. There were substantial differences among municipalities as to the level of their indebtedness, and in some towns bankruptcy was an everyday threat by 2012. With the decrease in revenues, local governments had to adopt a new approach towards private enterprises – in some settlements this meant a withdrawal of benefits (for instance, tax-exempt status) provided for them earlier. Others opted for a strategy of not only maintaining the level of levies imposed on enterprises but also made efforts to retain their presence by easing their situation, hoping that they would expand their operation after the crisis and that tolerance on the part of the local government would pay off later in employment creation and the increase in local business tax.)

With the majority of mayors affiliated to the governing party, local government indebtedness became a political issue. In October 2012 the Prime Minister announced a fiscal consolidation programme for municipalities, under which the state budget would take over the debts of small municipalities (under 5000 inhabitants, i.e. a total of 1700 villages), and on average 40 per cent of the debts of larger ones. However, in practice the government negotiated conditions town by town in 2013, with the process lacking in transparency and strongly influenced by party politics.

Although the law defines the minimum standards of services, the government itself sought to narrow the extent of certain service provisions in response to the crisis. The Law on Social Care assigns the duty of providing care for the elderly to local government. Paradoxically, however, municipalities can freely decide as to the scope of beneficiaries, as well as on the quality of services provided and also regarding the extent of co-payment. In 2009, however, a ministerial decree ordered that entry to residential care facilities, run by the state (local government), ought to be subject to a doctor verifying the need for care of a minimum of four hours per day in the case of each person. Although the number of beneficiaries did not decrease in residential care

facilities (KSH, 2011). According to our case studies however, it resulted in a dramatic increase in the proportion of in-patients with dementia, whose care implies a far greater workload and is subject to specific standards.

The government in power has taken a number of steps promoting the centralization of public administration and institutions providing public services. As of 2013, local governments' public administration functions have been transferred to government agencies, either at central government level or at district (micro-regional) level. This process began in the health care sector, affecting hospitals belonging to small municipalities. From January 2013 a large share of public education was transferred to state management, meaning that all teachers are now employed by a single government agency. School facility management has however mostly remained with the local administrations. Parallel to centralization the current government is facilitating the transfer of certain services (education, health care and social care) to church-based institutions by providing these with higher per capita subsidies compared to those run by municipalities. The current wave of public service centralization and their transfer to church-based institutions is motivated more by ideological and political considerations than based on evidence or on negotiations with key stakeholders.

b) *Interest reconciliation and employment policy in local government.* Either directly or indirectly (through their institutions and business companies) the municipalities employ about half of the public sector employees in Hungary. Despite local governments' budgetary autonomy, the base salary of public sector employees and civil servants is defined according to the pay scales specified in the relevant laws. As we have shown in sub-chapter 3.2, in national level interest reconciliation related to legislation and government policies local government alliances also take part, in their capacity as employers, besides trade union confederations. (Pluralism prevails here as well, as there are three such organisations.)

Employees of municipal companies are subject to the Labour Code (which applies to the genuine private sector, too) and the mandatory minimum wage that implies there is no tariff system to apply to their wages. Sectoral level interest reconciliation takes place at the Subsectoral Social Dialogue Committee on Communal Services. The Committee has no direct influence over wages; its members did not conclude a sectoral collective agreement. As to the typical remuneration practice of local government organisations, a recently conducted survey found that although a large proportion, 84%, of local government organisations carry out performance evaluation, only at 17% of them did the results influence annual pay (Bordás, 2012).

In the local government sector collective agreements are concluded only at company level. On the employer side, the agreement is signed by the com-



pany's management. Although the lack of management autonomy is a common barrier to collective wage bargaining in the entire public sector, this is particularly the case in certain municipal companies. According to the head of the sectoral trade union, local governments, as owners, are not represented at the bargaining table, and the management does not have the necessary authorization. Moreover, the management is often unable to meet its legal obligation to provide information because the local government as owner disallows it. As a consequence, there is no consultation on important or strategic decisions of the owner. The competence of the local company's management to enter into negotiation is further curbed by the practice that larger towns set up a holding-organisation over their municipal companies, which determines company managers' scope for action and centralizes resources.

As a result, trade unions in the municipalities do their best to negotiate directly with the owner, i.e. the local administration. In larger towns there is an interest reconciliation forum where trade unions can have direct negotiations with the local administration's chief officials. For instance, the Budapest Public Service Consultative Forum has been in existence since 1993, with the vice-mayor consulting with trade unions on such topics as restructuring. Although, legally speaking, this is not collective bargaining, each year they develop guidelines acting as recommendations for local wage agreements. It seems that a prerequisite to operating such a forum is to have a large number of institutions and companies, as well as well-organized trade unions. One of our case studies also shows that in a small town, however, there was no evidence of any collective bargaining, and wages in the public service companies were low, corresponding to conditions on the local labour market. According to our interview data, everyone is paid "on the minimum wage". This means that employees receive the lowest level of remuneration allowed by the law. Two organisations had previously had collective agreements (in a vocational secondary school and at the local hospital). However, subsequently, both organisations were integrated with a third that is non-union and as a result their collective agreements will become void 12 months after the merger. In any event, the collective agreement at the hospital included no provisions on wages and benefits. Because employees of local government organisations and local government-owned companies practically have no interest representation whatsoever, there is an absence of collective wage bargaining that could influence employment conditions and remuneration practices. (*Berki et al.*, 2012.) All in all, municipal-level social dialogue remains immature in Hungary.

c) *Local government policies of outsourcing and re-municipalisation.* The Local Government Act and other sectoral laws specify the services that local governments, depending on the settlement's population size, are obliged to provide. Additionally, the municipalities may undertake other services on a voluntary

basis. As we have seen, local governments are free to decide how service provision will be organised. A traditional arrangement is for local governments to maintain institutions with public service employees providing services. In such institutions the administration of finances is carried out in line with the – rather rigid – protocol, customary in budgetary institutions. According to this arrangement, the maintainer (i.e. the local government) may determine, beyond the institutions' budget, the number of employees and also the wage costs. The other arrangement implies that the local government outsources some public services, which might take the following forms:

- The municipality establishes and operates a business company. It does not necessarily need to maintain 100 per cent ownership, and may sell some of its shares or involve an external investor. This was the most common form of the privatization of public utilities in the 1990s.
- The municipality runs a public procurement procedure to select an enterprise for providing the service or offering it a concession.
- The municipality concludes an agreement, generally with civil organizations or churches, for providing the mandatory tasks.
- It forms a consortium with other local administrations to provide the public service using any of the above three approaches.

In each of the above-mentioned outsourcing forms, the municipality signs an agreement with the selected enterprise/non-profit organisation. Nevertheless, the local government bears a secondary liability for ensuring the uninterrupted delivery of public services; if the contracted enterprise is unable to provide an adequate level of service, then the municipality has to take back the responsibility of provision. Depending on the contract and the legal provisions, for services the local government continues to have the competence to determine service fees (e.g. water bill, public transportation fees) (*Dicső, 2010, Horváth et al, 2002*).

According to a survey conducted in 2011, 55% of local governments have shares in business associations and in 28% of such associations local governments have controlling stakes (*Bordás, 2012*). Privatisation of local government operated corporations, and involving external investors, became a major trend in the mid-1990s. The reasons behind privatisation of local government businesses were the same as that of state enterprises: intention to modernize financially weak corporations that had partially lost their markets, with the involvement of foreign technology and expertise in marketing and management. On the other hand, the budget revenue generated by privatisation was equally important for an indebted municipality. However, municipality level privatisation was even less transparent than that of state corporations; instead of the central State Property Agency, decisions were made by the elected general assemblies. A great deal of publicity was given to contracts that had been scandalous in being greatly disadvantageous for the local community.<sup>8</sup>

<sup>8</sup> A study, prepared on the basis of a research by the State Audit Office on corruption, also uses the conditional tenses when discussing this issue: "Ownership in a business association is, among others, a risk factor from the point of view corruption because the motivation behind owners' decisions is not necessarily to serve public interest, and there are no legislative or other kind of controls. In the case of privatisation, it would require an extensive study on efficiency and cost-effectiveness to decide whether an enterprise, selected to run a public utility service, is any better at it – or put otherwise, if privatisation serves the public interest or not –, and to answer the question whether they were undersold." (*Bordás, 2011*.)

Outsourcing certain auxiliary activities (cleaning, security and maintenance services, etc.) has for decades been a common practice at state and local government institutions. As of 2004, however, service providers, or the beneficiary of a concession, have to be selected through a procurement process. The motives behind local governments' outsourcing decisions are not sufficiently well known, however, and public statements rely on the same rhetoric as in the privatisation (increasing efficiency, bringing in special tools and knowledge, etc.). It is probable that the attempt to evade regulations on headcount may have been a more important factor here than in the private sector, although this is more likely to hold true for centrally managed institutions than for local governments which have more flexible financial administration. According to the above-referred survey from 2011, 31.7% of local governments outsource services; 25.1% of the outsourced services pertain to mandatory services of municipalities, 9.6% to specialized tasks, while 65% are linked to voluntarily undertaken functions of municipalities. As much as 37.9% of local governments have long-term cooperation agreements with civil organisations, although it is unknown what proportion of these covers the outsourcing of public services (Bordás, 2011).

The present government – referring in part to some well-known examples of privatization debacles – has been pursuing a policy of re-nationalization. Local politicians are also keen to regain full control over service providers and follow a re-municipalisation policy. Service-providing enterprises and beneficiaries of concessions constitute a different story: the government's approach in these cases is to renegotiate the contracts, i.e. not necessarily to nationalize them but instead starting a new procurement process and possibly replacing former providers. The emphasis here is on providing opportunities for Hungarian rather than foreign companies. Such attempts have however engendered scandals, such as when the new beneficiary turned out to be an entrepreneur from the clientele of the party in power, or a family member or friend of a well-known politician of the ruling party. Our case studies confirmed that such “political advantages” are prevalent among the motives of local decision-makers and similarly influence outsourcing or the redistribution of profitable businesses in line with a partisan-clientele rationale.

d) *Impact of outsourcing and in-sourcing on employment and wages.* Probably our most interesting research question was connected to transitions (privatisation, outsourcing, in-sourcing) between various service providers. We tried to reveal the motives of related decision making as well as the consequences, namely their influences on employment and wages.

Whether it is a private company, a church or other non-profit organisation that takes over service provision from the local government, employees' legal status will change regardless of the new provider: instead of the Act on the

Legal Status of Public Service Employees, they will be subject to the Labour Code following the transfer.<sup>9</sup> In the event that public sector employees refuse to accept a position offered to them, they receive a lower amount of severance pay than they would otherwise be entitled to.<sup>10</sup> Given that Hungarian law is in compliance with the TUPE Directive, dismissals cannot be effected at the moment of transition. However, as in many other EU member states there is a possibility to do that before and after. In our case studies we have come across restructuring, implying lay-offs of moderate scale, and the narrowing of the scope of services. In the case of institutional transferrals to church institutions, looking to the higher per capita subsidy for which they are eligible, there is no point in narrowing the scope of service, at least as long as the relevant law is in effect, although the issue of rationalizing operations is raised because of efforts at cutting costs. In the same manner, management is more rationalized in the case of services provided by the private sector than by state institutions. All in all, however, our case-study data suggest that the stability of employment has been retained despite the transfer. Moreover, in some cases some improvement in employment security has been noted, compared to the precarious situation which existed before.

In general – and particularly after the relevant changes in legislation effected in 2012 – the Labour Code implies far less constraints for the employer than the Act regulating the employment of public service employees, especially when it comes to pay: instead of applying mandatory wage tariffs, only the two-level statutory national minimum wage system must be observed.

With respect to wage levels and wage bargaining after outsourcing, the case studies allow only limited conclusions. Outsourcing and the subsequent remunicipalisation of public utility services in the bigger town in our scrutiny, where trade unions have a strong bargaining position, had practically no impact on the advantageous position of employees. Interestingly enough, in this town the geriatric care organization acquired by the church made no changes to pay conditions. As the new provider, the church was in a position to do so without any risk in the short term, since the majority of employees were paid the minimum wage anyhow and a large state subsidy covered additional costs. It is telling, however, that the new collective agreement for this particular organization does not set base wages or benefits. Therefore it is possible that in the longer run it will be easier to deviate from the wage scale. Moreover it also indicates that the employer does not foresee any wage bargaining taking place.

In the other small town investigated, wages in the local government sector are low, irrespective of whether the service is run by the municipality or a private company. Although drivers working at the bus company, operated by a private entrepreneur, earn somewhat more than the minimum wage their salaries are precisely half of that which bus drivers in the other bigger town receive, not to mention the difference in fringe benefits. (a strikingly higher

9 Both laws refer to the question of transition, more or less in compliance with the Transfer of Enterprises Protection of Employees (TUPE) Directive.

10 This is an exceptional ruling in Hungarian labour law, as in other cases employees do not have the right to refuse a transfer and are automatically taken over by the new employer.

difference than the usual 20–30 per cent disparity between regional averages). Wage differentials between different local labour markets are thus boosted in the case of services outsourced by the local administration, while the public service employees' pay scale – though very depressed – has had a levelling effect.

The law prescribes the obligation to provide information when public service employees become subject to the Labour Code, which may ideally facilitate collective bargaining. The case studies of the two towns indicate that such bargaining takes place only if the trade union has engaged in robust interest representation beforehand. Similarly, even in the towns where municipal-level information and consultation forums formally exist they hardly ever allow employee representatives to have a say in restructuring, outsourcing and re-municipalisation decision-making.

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However, as the excerpts cited in the introduction suggest, the industrial relations climate has radically changed at the bus company since the field-work in 2012. As was promised at the beginning of the sub-chapter, we now return to the case highlighted in the introduction – and presented in Box 3.5.1 – in order to shed light on the background to the events which have unfolded at the public transport company since December 2012. Though related labour court cases are still pending at the time of writing, one can pose the question as to what has changed over a half year period. What are the new circumstances which strengthened the employer position so much that it has become able to challenge the union's long-established bargaining power? It is very likely that the position of the city's right-wing dominated leadership has been consolidated since the general election of 2010. In addition to direct political support – and by no means independent thereof – the town's economic situation has been improving. The timing is noteworthy: negotiations with the government had just ended in a 70 per cent bailout – much higher than could have been expected from the initial announcement of the prime minister – and now the city is considering purchasing buses. If the city were able to upgrade its run-down fleet, this would mean less demand for experienced drivers and there would be no grounds for the drivers' work-to-rule actions.

In addition, legislation also contributed to the strengthened management position. The sectoral law on essential services established a level of service provision so high that it practically ruled out any lawful strike at the company. The new Labour Code erodes the position of local unions, especially that of maintaining the position of full-time president. The law also imposes specific limits on the scope of collective bargaining in the state and municipality-owned company. Sanctioning of unfair dismissal has also been weakened drastically. Moreover, a new ground for dismissal is an employee's inappropri-

ate behaviour. This includes violating the obligation to “behave in accordance with the necessary trust relationship related to the given job”.<sup>11</sup> It worth noting that the CEO went further in terms of legal tools by criminalising workers engaging in a wildcat strike. In his report to the police the employer accused the trade union leader with “disturbing the operation of works of public interest” (*Közérdekű üzem működésének megzavarása*), a statutory definition in the Hungarian Penal (Criminal) Code, which threatens the perpetrator of the offense with a two to eight year period of imprisonment.

### Final thoughts

While studying the local governments’ response to the crisis, trends of privatisation and outsourcing, the researcher may find a lot of similarities between Hungary and Western European countries. Nonetheless, it is difficult to draw far-reaching conclusions owing to the striking differences in local government systems, traditions of local autonomy and division of labour between various levels of governance. Constraining the conclusions to the core issue of our investigation, the privatisation and outsourcing efforts, one can witness diverging trends in Western countries. While in a part of the countries the ongoing process of building New Public Management (NPM) was reinforced (most characteristically in the UK), elsewhere numerous examples of in-sourcing or “re-municipalisation” emerged, partly as a result of the autonomous deeds of local actors, partly due to the regulatory efforts of the central governments or Lands in federal states. In the long run, however, in western countries these changes seem to occur in an *ad hoc* manner. Recent changes in Hungary, however look very strange by international comparison, and neither follow the model of UK moving to NPM, nor that of the other countries which pursue parallel outsourcing and in-sourcing policies. The Hungarian processes, namely the systematic re-nationalisation, “re-municipalisation” or centralisation of control over public services, as well as government incentives to reverse secularisation cannot be matched to any Western mainstream crisis responses and seem to be rather unique developments.

Relatively few foreign research projects have dealt with the impact of adverse economic conditions on social dialogue at the local level. In their theory focused on developed market economies, *Marchington and Kynighou* (2012) sketched various alternative scenarios concerning changes in employee involvement and participation. One of the extreme poles is the expected marginalisation of participative institutions, for employers/decision makers are becoming less interested in the meaningful operation of employee participation. At the other pole, a more intense operation of institutions can be imagined, for employers/decision makers are well aware that they can utilize the institutions with a view to legitimizing their measures and thus they can rely on employees’ participative support. According to the authors, the actual fate

<sup>11</sup> Article 52(5) of the Labour Code contains this obligation of employees. Legislators basically incorporated previous court jurisprudence into the new Code. (For the latter explanation, special thanks to *István Horváth*.) On the other hand, such justification of the dismissal may be attributable to the similar option recently introduced in the public servants’ employment relationship (see sub-chapter 3.1).



of employee involvement and participation depends both on the actors' strategic choice and on the institutional context. Stated differently the first means whether the representatives of the employers/decision makers and those of the employees are willing to cooperate in order to promote changes or not. The well-known theory of "Varieties of Capitalism" (*Hall and Soskice*, 2001) embraces one set of important factors of institutional context – whether the given country can be classified as a liberal or as a coordinated market economy. Another important factor is the established trust relationship between employers and employees. Although Hungary can hardly be classified as one of the main models of "Varieties of Capitalism", an evaluation of the above mentioned preconditions would be highly topical.

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### 3.5.1 Case studies on municipalities' service provision

LÁSZLÓ NEUMANN & MÁRK EDELÉNYI

#### *Reorganisation of geriatric care in a big town*

In the past two years, the indebted town has transferred the provision of the majority of social services as well as three public educational institutions to churches. In both areas, outsourcing was justified by financial gains: churches being immediately entitled to higher per capita funding than local governments. The difference between per capita amounts is calculated every year on the basis of the financial resources provided by the municipalities to supplement state funds for service provision.

Prior to the transfer, the system of social service provision had been reorganized twice for cost reasons. In the 2007 reorganization, services were centralized and bringing back in-house the delivery of cleaning services previously outsourced. From 2009, in the second reorganization further streamlining occurred, with just three organizations retained in-house: day care services, care for people with disabilities and geriatric care. In the latter case, the number of residents decreased, with residential geriatric care being transferred to a church organization in 2011. Four workplaces and 343 employees were taken over by the Hungarian Baptist Aid. Two of the remaining three sites were closed, with the third taken over by the Jewish Community.

Having outsourced these activities, the town is no longer obliged to subsidize elderly care, and saved 0.5 billion HUF (EUR 1.8 million) per year (1.25% of the entire town budget); moreover, it proved to be advantageous despite the fact that the municipality undertook the responsibility of renovating some of the buildings after the transfer. The

outsourcing contracts include a clause stipulating that the municipality is obliged to “re-municipalize” geriatric care homes should there be any changes in financing. This would be relatively easy to put into practice, as the outsourcing is restricted to the operation of the organization and does not cover its assets and property. At the same time, the contract contains no guarantees as to the quality and price of services beyond that laid down in the relevant law. In 2012 the new provider was thus allowed to increase fees significantly. Not only did the local administration not interfere with this action but it also appreciated the advantages of not having to take such an unpopular measure itself.

In the residential care home taken over by the Hungarian Baptist Aid, a church organization, the largest employee group is made up of nurses and mental health professionals. As services are not outsourced, cleaners, laundry and kitchen personnel and drivers are also employed. Given the nature of the work, the majority of the workforce are women. Prior to the takeover, employees experienced a great deal of uncertainty, not only because of the previous lay-offs, but also because – aware of the municipality’s serious financial problems – they were very much concerned that their wages would not be paid. Such concerns were not unfounded, given that the local administration had previously revoked certain fringe benefits (the so-called cafeteria package and other benefits). On the other hand, they were afraid that the new provider would bring in its own people to replace existing personnel.

The local trade union has a 60–65 per cent unionization rate, although this has been in decline. Before the transfer, two trade unions had local or-

ganizations operating here as well, but they have since merged. In the spirit of union renewal, young people were taken on as shop stewards. Since the new provider was not going to take over more employees than the minimum prescribed in the Law on Social Services, the transfer was preceded by a collective redundancy of 49 people. Those who were laid off in this way included mainly two groups of employees: those who were eligible for retirement, since they did not have to be paid severance pay; and those whose work the new provider was planning to dispense with. Contrary to the general practice in Hungary, the consultations with the trade union and the works council also included the selection of the jobs to be eliminated and persons to be dismissed. Among those selected for transfer to the church employer, an estimated 20–30 people refused to accept the particular job they were offered. Some were planning to find employment abroad, others had hoped to get, in addition to the severance pay, a notice period together with the respective salary. The local government, however, refused to pay the latter, referring to the transfer of undertaking regulations according to which it was not due.

In the negotiations preceding the transfer, the church's representative promised to take over employees under the same terms and to retain the system of base salaries, defined according to the public sector employees' pay scale, and additionally bonuses as set out in the collective agreement. Following the takeover, the collective agreement was renegotiated but only minor changes were made, with the scale of bonuses and other benefits retained. The weakness of the new agreement, however, is that it is completely lacking a pay scale. This could also be explained by continuity, given that its predecessor also omitted it. However there is a crucial difference in the conditions: previously, under the scope of the public sector law, it was not necessary given the mandatory pay scale. In 2012 there were works council elections at the organisation, in compliance with the legislation for employees covered by the Labour Code.

With regard to pay, the new employer maintained salaries in line with the public sector pay scale, although the national minimum wage for skilled workers applied to the majority of employees. In addition, the employer re-launched the cafeteria package and resumed paying premiums that had been abolished by the local government. In essence, HR management practices remained the same. The only novel element concerns employees with a higher education degree, being given the possibility to attend a theology college free of charge.

\*

Since the case study was completed a dispute has unfolded between the management and the trade union because the employer intended to terminate the collective agreement without providing the trade union with any justification. In the meantime many employees have quit voluntarily, partly because of an announced collective dismissal, partly due to the weakening protection of employees. It is likely that the 2012-3 measures to increase wages in the health care sector (see sub-chapter 4.3) also motivated quitting and moving to the public health care, as it did not apply to nurses in the social care sector. Given these worsening working conditions, the local trade union asked the local government to consider the possibilities of "re-municipalisation".

#### *Outsourcing and in-sourcing of a big town's public transport*

The local administration has been the sole owner of the former state-owned public transport company since 2002. In the hope of replacing old vehicles with modern ones, partial privatization took place in 2008. A private investor acquired a minority shareholding (32 per cent) and received exclusive management rights. According to the original stratagem the new investor, together with the town's transport company, started off by establishing a new company with only minimum initial capital. This was followed by a business transaction, in the course of which the municipal transport company sold the old buses to the newly established entity

for HUF 2bn (EUR 7.2m), only for the former to lease back the vehicles at a high fee for the following 10 years. In exchange for this the new company agreed to upgrade vehicles.

A couple of months later the opposition party, FIDESZ, came to power in the municipal elections, and decided that the contract concluded by the previous town administration was disadvantageous for the community. At this point the story becomes extremely complicated, tainted by contract abrogation, pressing charges, tax authority investigations and court cases. A bitter dispute ensued, at the end of which the municipality decided to take public transportation into its own hands. The local administration set up a new 100 per cent-owned company and signed a contract with it for providing public transportation. Buses were returned to the original transportation company and now the latest company is leasing buses from the old one.

There seem to be two fundamental reasons behind “re-municipalisation”. On the one hand, the local administration was unable to fulfil the long-term leasing contract for purchasing new vehicles due to its financial difficulties. On the other hand, it may well be that the politicians leading the new city administration had no intention to do so, given the perception that the private investor’s profit was too high.

Although change in the ownership implied changes in the company management, it did not affect employment relations, as it still remained subject to the Labour Code. Similarly, there was no change with respect to payment conditions or other acquired rights of employees neither as a result of the company’s partial privatisation, nor their return to the new company fully-owned by the municipality. Trade unions had no role whatsoever in the transformations, although information provision always took place as required by law.

As a result of the unsuccessful privatization, the number of buses suitable for transportation has decreased since 2008, having a major impact on the

number of employees. In addition, the municipality’s budgetary problems prompted a 7 per cent cut in the number of services. The new municipal enterprise employs 460 people, while four years ago the number was over 500.

A trade union with considerable bargaining power exists at the company. It has a 100 per cent organization rate among drivers, and 87 per cent overall. Although there has not been a strike there since a two-hour warning strike in 1995, the trade union is adept at using other forms of pressure (which they are forced to do, given the tightening of strike laws). Their most common action is a work-to-rule. For instance, when the municipality attempted to cancel fringe benefits (i.e. the so-called cafeteria package), as it was able to do in the case of public service employees, the bus drivers’ trade union organized action ostensibly related to road safety. Bus drivers refused to drive buses other than those in perfect working order.

There is a collective agreement at the company which is renewed every year. The agreement includes a seniority-based pay system for drivers (which the trade union considers its greatest achievement), proportional (per cent) benefit rates, the extent of overtime and details of working time arrangements. As a rule, annual wage increases rarely exceed the forecast inflation rate but the trade union is sometimes able to achieve higher wage increases for certain groups. More recently, the company started introducing performance-based pay. In addition to their base wage, drivers receive shift bonuses, commission dependent on the number of tickets sold, an annual bonus and a cafeteria package (amounting to HUF 200,000 per year (EUR 722)). An important source of income is the overtime bonus, especially as the company makes full use of the 300-hour quota allotted to each employee. Nevertheless, salaries are high only by local standards. At present the average monthly income of blue-collar workers is HUF 211,000 (EUR 762).

## 4. OCCUPATIONAL LABOUR MARKETS

### 4.1 Teacher salaries, teachers' selection and turnover

JÚLIA VARGA

Becoming a teacher is not a result of a single decision, but of a series of subsequent ones. Prospective teachers first have to choose teacher training as a field specialization in their higher education studies, and then, after graduating (or later) they have to decide on entering the teaching profession and continuing therein. The composition of teachers is the result of this series of self-selection processes.

How do wages affect a teacher's decision to enter and remain in the teaching role? Can teacher attrition be reduced by means of wage increases? How does an overall wage increase affect teacher attrition for different groups of teachers? The answer to these questions is of central policy importance. As teachers constitute a large proportion of public servants and as the salary costs of teachers, and other school employees make up around 80 per cent of current educational expenditures a wage increase for teachers also has importance from a budgetary respect. This chapter investigates how teachers' salaries affect the composition of teachers, more specifically, how the 2002 year public servants' wage increase effected attrition of the different groups of teachers.

Earlier research has found that teacher salaries have an effect on who chooses the teaching profession (*Dolton, 1990, Chevalier et al., 2002, Wolter and Denzler, 2003*). For Hungary *Varga (2007)* found that the decisive factor in the choice of the teaching profession is the difference of attainable earnings between non-teaching and teaching jobs. The same study also found that there are self-selection processes at every point in the process of becoming a teacher – applying for teacher training, finding employment as a teacher after finishing higher education, and continuing teaching in the fifth and sixth years after qualifying. Those who apply for college-level teacher training have less advanced abilities than those who apply for other specialisations. The less talented graduates are more likely to take teaching jobs, and they are more likely to be found among those in their fifth or sixth year of a teaching career.

Nevertheless concerning the role of the attractiveness of higher-paying alternative occupations in teacher attrition research findings are mixed. A part of the studies found that there is a connection between teacher attrition and teachers' relative wages. *Murnane and Olsen (1989)* show that higher wages have an important influence on how long teachers stay in teaching. Similar results were presented by *Podgursky et al. (2004); Imazeki (2005); Krieg (2006); Ondrich et al. (2008); Dolton and van der Klaauw (1995), (1999);* and



*Chevalier et al.* (2002). Other studies found that very few teachers who leave teaching take jobs that pay more than their prior salaries as teachers. *Scafidi et al.* (2006); *Frijters et al.* (2004); and *Vandenberghe* (2000) found that a large share of teachers who leave teaching relinquish employment entirely or earn less pay in other occupations within the public sector. Other studies show that working conditions are as important in teachers' leaving decisions as relative salaries (*Hanushek et al.* (2001). *Stinebrickner* (1998) found that the role of family circumstances, such as maternity and marriage is decisive in teachers' leaving decisions. *Gilpin* (2011) found that the wage differential between a teaching and a non-teaching occupation matters only for inexperienced teachers – teachers with less than six years of teaching experience – while the work environment affects the leaving decisions of both experienced and inexperienced teachers.

This chapter is based on a study which investigated the role of wages in teacher attrition in Hungary; the differences in the effect of wages between differently aged teachers and the effect of the 2002 year salary increase on teacher attrition (*Varga*, 2013).

## Data

The base data-set used in the study was a merged dataset collecting information from the Pension Directorate (ONYF), the Health Insurance Fund (OEP), the Treasury (MÁK) and the Public Employment Service (ÁFSZ). The sample was created by a fifty per cent random draw from the Hungarian population aged 5–74 in January 2002. Each individual in the sample is followed from January 2002 until December 2008 or exit from the social security system (for reasons of death or permanent emigration). Out of the base dataset a “teacher” subsample was created. All individuals who were in a teaching job for at least one month between January 2002 and December 2008 were included in the teacher subsample. We have data for 57,546 individuals. The unit of observation is the monthly status of individuals and the maximum number of observations for an individual is 84 months.

Our data contains information on demographics (age, gender), educational attainment (for those with at least one unemployment spell), employment status, occupation code, wages for the occupation codes, and transfer receipt.

## Methods

For analysing, the effect of the 2002 wage increase on teacher decision to leave the profession duration models were used. Duration models estimate the conditional probability that a teacher leaves the profession given that she/he has not left it prior to the month of investigation.

First, we used *binary choice Cox proportional hazard models* (leaving the teaching profession or not), then *competing risk models*<sup>1</sup> that distinguish exits

<sup>1</sup> In the Cox model the base hazard is non-parametric, no form is pre-specified for the baseline hazard, the hazards are proportional to each other, and do not depend on time, but time-dependent covariates also can be incorporated to the analysis. Censored data are handled in the Cox model: both left truncated data, that for those who work as teachers in the first observation there is no information as to how long have they worked as a teacher and the model also handles the right censored data, that we only know that the event of interest had not happened for an individual during the time that was the subject of the study, but we do not have information if it happened later.



to another occupation and exits to a non-working state. In the Cox-model, the risk given covariates are the product of the baseline hazard and a relative risk:

$$\lambda[t, x(t)] = \lambda_0(t)e^{x(t)B(t)},$$

Where  $\lambda_0$  stands for the base hazard;  $t$  for time;  $x$  for the observable characteristics of the individual. The Cox-model can allow for time-varying covariates  $x(t)$ . The model also handles time-dependent effects, where the coefficients are a parametric function of time  $\beta(t)$ , so the effects of covariates are not proportional.

A number of those who leave teaching do not go on to another job, but intentionally or non-intentionally arrive at a non-employment state: become inactive, go on to child-care pension, retire, become unemployed, etc. As the determinants of these decisions might be different from the determinants of going to a non-teaching job teacher attrition was also analysed with the help of a competing risk model (*Fine and Gray, 1999*) which distinguishes exits to a non-teaching job (*NT*), and exits out of active status (*NF*). Competing risks are present when those who are working as teachers are at risk of more than one mutually exclusive event, and the occurrence of one of these will prevent any other event from happening. In our case the individual either goes on to a non-teaching job or becomes inactive or unemployed. Competing risk models define a separate hazard function for each event: going to a non-teaching job  $\lambda_{NT(t)}$  and becoming inactive or unemployed  $\lambda_{NF(t)}$ . The total hazard of leaving teaching is the sum of the sub-hazards.

The effect of the single, high level wage increase of public servants was analysed with the help of models where the independent variables contained dummy variables which indicated the year of the observation using 2002, on the one hand, as the reference category. On the other hand as the Cox-model makes it possible to split the data by episodes and check whether the effect of the covariates differs by episodes this method was used as well. The effect of the wage increase was also investigated using episode splitting. The public servants' wage increase came into force in September 2002. The data from January to August 2002 describe the state before the wage increase and the data from September 2002 the state after the wage increase. Thus, the data were split into two episodes and checked to determine if the effect of given covariates differed before and after September 2002.

Independent variables in the analysis were: gender, age-group dummies in the models that used the whole sample, and region of residence. Regional effect may reflect different effects: the differences in local labour markets, differences in the work environment, and differences in the quality of education caused by, for instance, differences in pupils' composition or other factors. Further independent variables in the models were if the individual had worked as a teacher in primary or secondary education. The effect of wages was measured

by the (log) wages of the individual at January 2002 constant prices.<sup>2</sup> In addition, the monthly unemployment rate of the region of the individual's residence was also included. Finally, a dummy variable indicated if the month was September. School years begin in September and prior to that there is a long summer holiday, so it might be worthwhile to delay an exit from teaching until September and use the full the summer holiday.

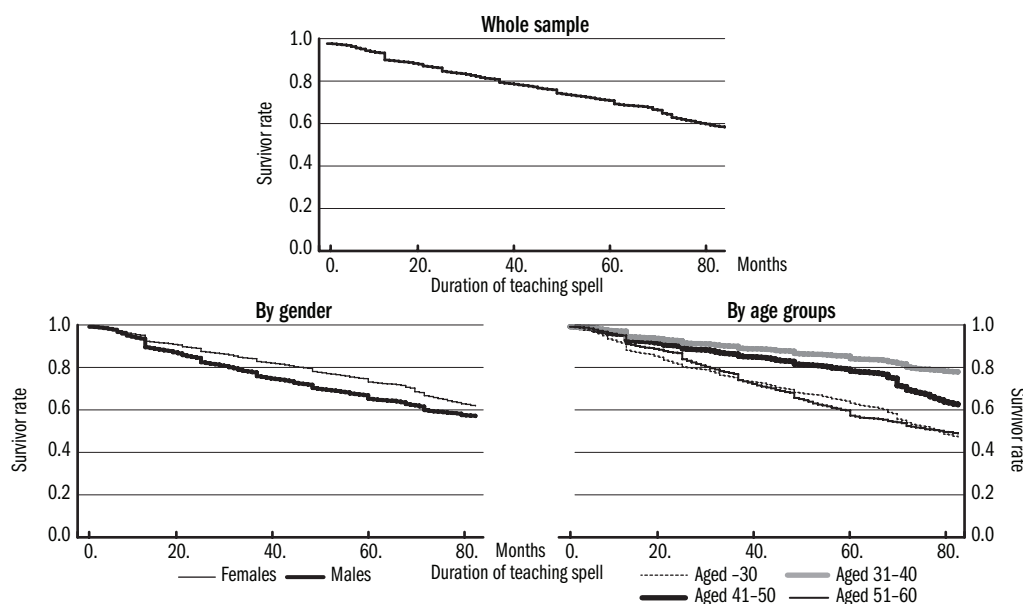
### Teacher attrition

Figure 4.1.1 shows the empirical Kaplan and Meier survival functions by gender and age-group.<sup>3</sup> The figure shows in the months observed the proportion of teachers who are still working as teachers. The figure for the whole sample shows that for those teachers who began teaching between January 2002 and December 2008 the unconditional exit rate was quite steady between 2002 and 2008. Exit rates of men and women were similar between January 2002 and September 2002, but thereafter the exit rates of men were higher than the exit rates of women.

<sup>2</sup> We estimated also three further specifications using different measures for teachers' relative wages. The detailed estimations results are reported in Varga (2013).

<sup>3</sup> Censored cases are not regarded as exits.

Figure 4.1.1: Kaplan–Meier empirical survival (remaining in the teaching profession) functions by gender and age-groups



There are marked differences after September 2002. Only half of the teachers who were younger than 30 years of age and older than 51–60 remained in teaching by December 2008. Survival was the greatest among teachers who were 41–51 years of age. Exit rates of the younger and older teachers were slightly higher by January 2008 than for middle-aged teachers, but thereafter

exit rates of the younger and older teachers accelerated. The smallest survival can be observed among young teachers.

### How much do teachers earn after leaving the profession?

Table 4.1.1 shows average monthly earnings of current and former teachers one month after former teachers had left teaching at constant prices. Average earnings of former teachers are smaller one month after leaving teaching than the average earnings of those who remain in teaching posts because a large proportion of former teachers become inactive, go on to childcare pension or retire. Average earnings of former teachers who remain active and are working in a non-teaching job is higher than earnings of current teachers

**Table 4.1.1: Average monthly earnings of current and former teachers  
(in constant prices – 2002 January, HUF)**

	All	-30 years old	31-40 years old	41-50 years old	51-60 years old	61- years old
Current teachers	149,818	106,531	130,229	169,783	192,820	159,807
All former teachers	123,480	84,294	104,286	151,043	172,909	107,529
Former teachers who remain working	152,031	113,220	138,516	170,804	181,320	104,384
Former teachers who are on child-care pension	47,348	47,030	46,858	37,013	-	-
Former teachers who are non-employed for other reasons	48,977	49,931	46,900	39,003	39,4712	43,890

There are differences *by age groups*. Inexperienced, young, former teachers, those who are younger than 30 and those who are 31–40 years of age earn more on average than those who remain in teaching. Average earning gain of former teachers is not too high at 6–7 per cent. Older teachers do not achieve any earnings gain from attrition. There is no difference between the earnings of former and current teachers for those who are 41–50 years of age. Earnings of former teachers who are older than 50 are even lower than the earnings of their counterparts who remain in teaching.

### The effect of salaries and the effect of the public servants' wage increase

In September 2002 the base salary of public servants was increased uniformly by 50 per cent and, as a consequence, average real salaries of teachers increased by 20.5 per cent. Nevertheless in the subsequent years the wage increase of teachers slowed down, and then stopped, and the relative earnings of teachers began to deteriorate. (See “Teacher salaries in the public sector”; in Box 4.1.1).

Table 4.1.2 reports the results of the binary choice Cox-model split for two episodes. The table shows the sub-hazard rates. The first part of the table reports the results of the base model. The second part of the table shows the

results of the estimations where the variables in the equation were split into two episodes (months 0–9 and months 10–84), to check if there was a difference in the probability of attrition before and after the public servants' wage increase. That is, it was checked to see if the probability of attrition differed during the first eight months of the observations and during the subsequent months for teachers with certain characteristics (belonging to different age-groups; teachers teaching in secondary education as compared to teachers teaching in primary schools; male teachers as compared to female teachers). A hazard ratio greater than one implies an increased probability of attrition while a ratio less than one implies a decreased probability.<sup>4</sup>

**Table 4.1.2: Binary choice Cox proportional hazard models  
(leaving teaching profession or not) split to episodes**

	Hazard rate
<b>Base model</b>	
Gender (Male)	1.142***
Teaching in secondary school	1.043*
Monthly unemployment rate in the region	0.926***
(log) real salary	0.693***
September	0.096***
-30 years old	2.282***
31–40 years old	1.599***
51–60 years old	3.373***
Older than 60 years	12.438***
<b>tvc (variables in tv equation interacted with <math>t &lt; 9</math>)</b>	
Gender (Male)	1.219**
Teaching in secondary school	1.219**
-30 years old	1.255***
31–40 years old	n. s.
51–60 years old	0.433***

\*\*\* Significant at the 1 per cent level. \*\* Significant at the 5 per cent level. \* Significant at the 10 per cent level. n.s. not significant.

Other controls: Regions Reference category: Female, teaching in primary or lower secondary education, region Southern Transdanubia, another month than September, 41–50 years old.

Results of the base model show that the lower the salary of the teacher the higher the probability of attrition. Teachers who are younger than 30 leave the profession with more than twice the probability as that of teachers who are 41–50 years of age. Teachers who are 41–50 years of age remain in teaching with the highest probability compared to the other age groups. The high probability of attrition for the 51–60 years of age group and teachers who are older than 60 is due to retirement.

The results of the interactions with duration show that the effect of gender is different in months 0–9 and 10–84. The estimate shows a 21.9 per cent

4 For instance in the base model the hazard ratio of men is 1.142 indicating that the probability of leaving for men is 14.2 per cent higher than for women. Similarly a one percentage point increase in the regional unemployment rate will decrease attrition by 7.4 per cent (the hazard rate is 0.926).

larger effect in the second, post wage increase period for men and a 21.9 per cent larger effect for teachers teaching in secondary schools. There is no evidence that the effect is different for the 31–40 year old teachers in the two periods. Young, inexperienced teachers left teaching with 25.5 per cent larger probability after September 2002 than before compared to teachers belonging to the reference group – those in the 41–50 years of age group. The probability of attrition of older, 51–60 years of age teachers decreased by 56 per cent after the wage increase.

Table 4.1.3 summarizes the results of the separate competing risk models for age-groups that analysed the effect of the 2002 year wage increase with the help of dummy variables which indicated in which year was the month under observation. The reference year was 2002. The competing risk models which consider the effect of wages on multiple causes of attrition were going to a non-teaching job and becoming inactive or unemployed.

**Table 4.1.3: The effect of wage increase – Competing risk models (subhazard rates).  
Risks: Working in a non-teaching job/ Inactive or unemployed**

	–30 years old		31–40 years old		41–50 years old		51–60 years old	
	Working in non-teaching job	Inactive or unemployed	Working in non-teaching job	Inactive or unemployed	Working in non-teaching job	Inactive or unemployed	Working in non-teaching job	Inactive or unemployed
Gender (Male)	1.511***	0.700***	2.031***	0.397***	1.707***	n. s.	1.241***	0.734***
Log real salaries	0.745***	0.670***	0.847***	0.660***	0.597***	0.464***	0.773***	0.788***
2003	0.777**	n. s.	0.760**	n. s.	0.561***	1.674***	0.920	0.864
2004	n. s.	2.355***	n. s.	n. s.	0.594***	1.769***	0.711***	0.682***
2005	n. s.	3.739***	n. s.	1.736***	0.591***	2.171***	0.676***	0.595***
2006	n. s.	3.581***	n. s.	1.884***	0.728**	2.256***	0.681***	0.234***
2007	1.667***	7.157***	1.518***	6.791***	n. s.	5.271***	n. s.	0.182***
2008	1.392***	8.258***		10.060***	n. s.	4.532***	n. s.	0.229***

\*\*\* Significant at the 1 per cent level. \*\* Significant at the 5 per cent level. \* Significant at the 10 per cent level. n.s. Not significant.

Other control variables in the model: teaching in secondary school, monthly unemployment rate in the region, September.

Reference category: female, teaching in primary school, region Southern Transdanubia, another month than September, year 2002.

Low salaries increase the probability of moving to another job or becoming inactive. As for the effect of the public servants' wage increase: in 2003 young teachers (younger than 30), and those teachers in the 31–40 years of age group left teaching for a non-teaching job with a lower probability than in 2002. The results show no difference in the probability of attrition after 2004, compared to 2002. After 2007 young teachers left teaching with a greater probability than in 2002. The probability of becoming inactive increased after 2004 both for teachers under 30 and teachers between 31–40 years of age. Teachers who are younger than 30 became, with twice as much prob-

ability, inactive or unemployed in 2004 than in 2002, and with an eightfold larger probability in 2008. For the 31–40-year-old teachers, the probability of becoming unemployed is tenfold greater in 2008 than in 2002.

The effect of the wage increase lasted longer for older teachers and was stronger than for the young. The probability of going to a non-teaching job decreased for older teachers after the wage increase. Both the 41–50 year old teachers and the 51–60 year old teachers exited teaching for another job with lower probability from 2003 to 2006 than in 2002. The effect was the strongest for the 41–50 year old teachers. They exited teaching with a 40–45 per cent smaller probability than in 2002. The probability of becoming inactive had been decreasing for the 41–50 year old teachers from 2003. The older, 51–60 year old teachers had become inactive with a much lower probability after 2002 than in 2002.

The public sector wage increase had reduced the probability of going to a non-teaching job for young teachers only for one year. The effect lasted longer for older teachers. After the wage increase young teachers for some years went to another job and became inactive with larger probability than before the wage increase. On the contrary, older, 51–60 year old teachers had not only gone to another job with smaller probability, but they had also become inactive with a smaller probability after the wage increase. Older teachers were the group of teachers that were retained in teaching by the wage increase.

### **Where do teachers work after having left the profession?**

To get a fuller picture of the determinants of teachers attrition it is worthwhile to summarize where teachers work after having left teaching. According to the results of earlier research (*Gilpin*, 2011) a large part of the teachers who leave teaching stay in the education sector in an administrative or non-teaching job. Our data contains information on the occupation codes of former teachers, and it is also possible from the data to identify the sector of employment of former teachers. *Table 4.1.4* shows by age-group if former teachers are working in the education sector or outside the education sector. *Table 4.1.5* shows the distribution of former teachers who are working outside the education sector by occupation group.

The majority of teachers who leave teaching remain in the education sector in Hungary too, but there are large differences between age-groups. More than 70 per cent of former teachers who are younger than 30 years of age leave the education sector and more than half of the 31–40 year old group who exit teaching go to work outside the education sector. On the contrary more than 60 per cent of older teachers remain in the education sector in non-teaching jobs. That is older teachers leave teaching for other possibilities within the education sector – administrative or management jobs. Only one-third of former teachers who are older than 41 find a job outside the education sector.



**Table 4.1.4: Distribution of former teachers  
by sector of employment after attrition (per cent)**

	Whole sample	-30 years old	31-40 years old	41-50 years old	51-60 years old
Working outside the education sector in non-teaching job	51.77	70.57	51.24	37.52	39.89
Working in the education sector in non-teaching job	48.23	29.43	48.76	62.48	60.11
All	100.00	100.00	100.00	100.00	100.00

**Table 4.1.5: Distribution of former teachers who left education sector  
by occupation group (per cent)**

	Whole sample	-30 years old	31-40 years old	41-50 years old	51-60 years old
Managers	33.1	11.6	32.0	50.6	47.9
Other professionals	29.7	31.9	32.3	25.5	28.6
Clerical support workers	29.9	43.9	25.4	15.8	17.1
Service and sales workers	3.9	7.9	5.5	3.7	1.1
Elementary occupations	3.4	4.7	4.8	4.4	5.3
All	100.0	100.0	100.0	100.0	100.0

The table indicates that inexperienced former teachers who exited the education sector work not only in other professional jobs, but they also go to other employment for higher earnings. 44 per cent of former teachers who are younger than 30 years of age work as office or administrative support and about 8 per cent as service and sales workers. The majority of 31–40 year old former teachers work as managers or professionals, a quarter of them become clerical support workers, and 5 per cent of them go to service and sales jobs. More than half of the former teachers who are older than 41 become managers, a quarter of them go to other professional jobs, and 16–17 per cent of them obtain employment as clerical support. About 5 per cent of former teachers work in elementary occupations in all age groups of former teachers.

## Conclusions

This chapter investigated the effect of salaries on teachers attrition. Results show that earnings matter. The lower the salary of a teacher the larger is the probability that the teacher will go to another job or becomes inactive in all age-groups of teachers, but the effect is stronger for young teachers. The majority of exiting young teachers leave the education sector and find a job outside the education sector. Teachers aged 41–50 remain in teaching with the highest probability, all other age groups find another job or become inactive with a larger probability. The public sector wage increase in 2002 did reduce attrition rates of young teachers' temporarily, but the effect disappeared as the relative earnings of young teachers began to deteriorate again thereafter.

Attrition rates of young teachers who are younger than 30 or the 31–40 year old group returned to the level where it had been before the salary increase or even worsened. Attrition rates of older teachers decreased after September 2002. In 2013, the so-called “teacher career model” was introduced in Hungary, and the base salary of teachers was increased in certain parts of the pay scale. At the same time, a number of earlier bonuses and supplements were abolished. So, we do not know yet if the total salary of teachers or certain groups of teachers has increased or decreased and how relative salaries of teachers have changed. Further analysis will be needed, when micro-level data on teacher salaries for 2013 and for the subsequent years will be available, to evaluate how the new conditioning of teacher salaries has affected the relative wages of teachers and the attractiveness of the teaching profession.

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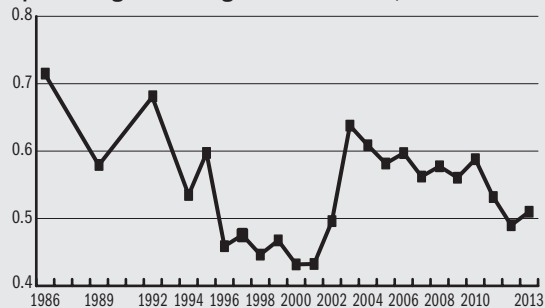
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#### 4.1.1 Teacher salaries in the public sector (1986–2013)

JÚLIA VARGA

Before the transition teachers earned about 70 per cent of other graduate salaries. After 1989, there was a dramatic decrease in the relative wages of teachers that was temporarily tempered by wage increases in some years: in 1992 and 1995. At the lowest point, in 1999–2000, the relative wages of teachers slightly exceeded 40 per cent of average graduate salaries. After the 2001 and 2002 year wage increase for public servants the wage lag of teachers ameliorated to a 1989 year level, but following that point the lag worsened once again from year to year. The increase in salary levels had lost its value within a few years. In 2012 the average teacher earned 49 per cent of average graduate salaries and, in 2013, 51 per cent (*Figure B4.1.1*).

**Figure B4.1.1: Average teacher salaries as a percentage of other graduate salaries, 1986–2013**

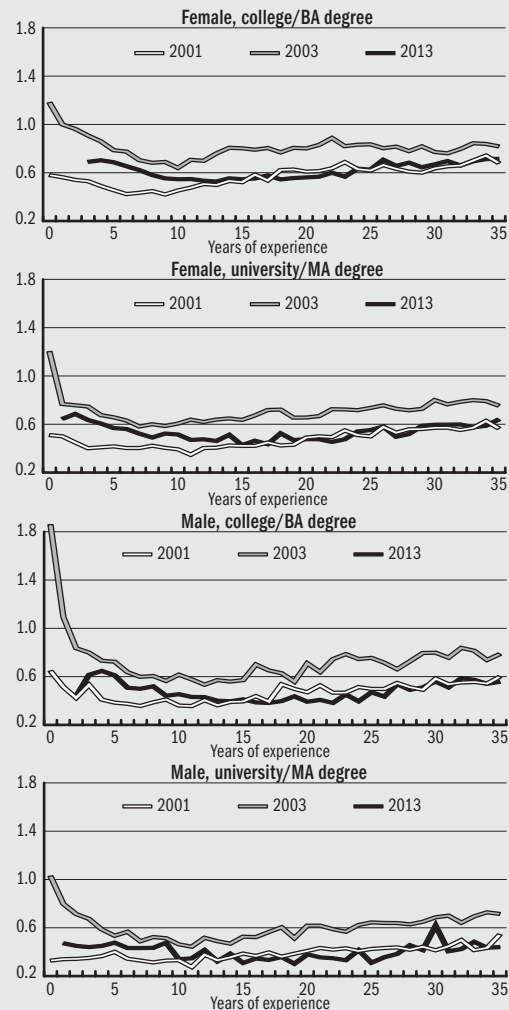


Source: Based on data of Wage Tariff Surveys of the National Employment Service.

There are marked differences in the relative position of teachers by educational level, years of experience and gender (*Figure B4.1.2*). The lag is larger for men than for women, larger for those teachers who have a master's degree than for those who have a bachelor degree. By years of experience, the relative wage profile of teachers takes a U-shaped line. The relative wage lag for the youngest and oldest teachers is much smaller than for those who have 10–15 years of experience. In the first 10–15 years of experience, there are widening differentials. The reason for this is that the salary schedule of teachers is quite different from the structure of

compensation in the non-teaching labour market – the teachers' pay scale rewards only degree level and experience.

**Figure B4.1.2: Teachers' relative salaries by years of experience and level of educational attainment 2001, 2003, 2011**



Source: Based on data of Wage Tariff Surveys of the National Employment Service.

The wage increase was uniform for all teachers. The base salary was increased by 50 per cent. The sal-

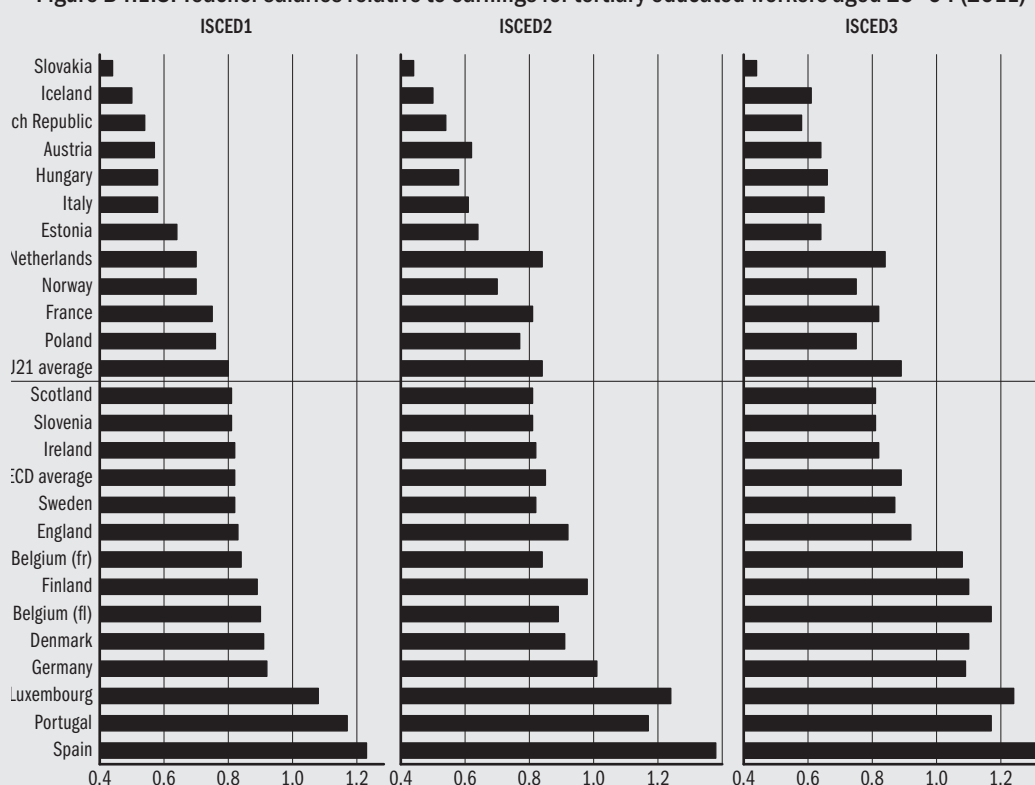
ary increase only lessened the widening lag behind other graduates' salaries during the first ten years of experience but did not correct it. (See the study of János Köllő János, in *In Focus*). In 2013 the relative wage lag was increasing by years of experience to a smaller extent than it was in 2003, but it still holds true that young teachers during the first 10–15 years of their career find themselves in a worse and worse relative position from year to year compared to other graduates.

Hungarian teachers' relative salaries compared to other graduates earnings are low by international comparison. Teachers' statutory salaries for those with 15 years of experience were much lower in 2011 at all educational levels compared to earnings for tertiary educated workers as the EU or OECD average shows (*Figure B4.1.3*).

International comparable statistics on teacher

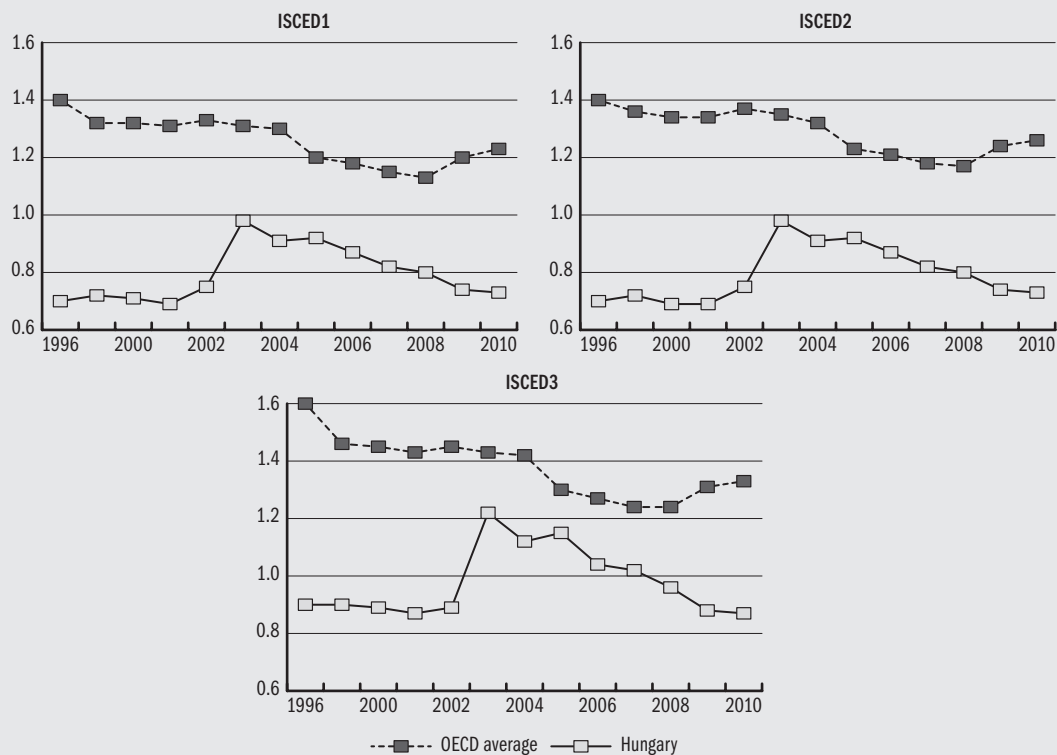
salaries relative to earnings for tertiary educated workers are available only for recent years so long-run changes cannot be tracked in this respect. Data are available for longer periods on teacher salaries relative to per capita GDP (*Figure B4.1.4*). Between 1996 and 2010 teacher salaries relative to per capita GDP were lower at all educational levels than the OECD average. In consequence of the public servants wage increase in 2002 the difference had decreased between Hungarian teacher salaries relative to per capita GDP and the OECD average, but thereafter the difference began to increase again. Between 2008 and 2010 the increase in the difference was due to the fact that between 2008 and 2010 in a part of the OECD countries teacher salaries increased relative to per capita GDP, in spite of the economic crises, while in Hungary teacher salaries decreased during the same period.

**Figure B4.1.3: Teacher salaries relative to earnings for tertiary educated workers aged 25–64 (2011)\***



\* Teachers with 15 years of experience. ■ Source: Based on data of OECD *Education at a Glance 2013*. Table D.3.2.

Figure B4.1.4: Statutory salaries of teachers\* compared to per capita GDP, 1996–2010



\* Teachers with 15 years of experience. ■ Source: Based on data of OECD *Education at a Glance* 2013. D.3.4.

## 4.2. Labour mobility and employee bargaining power in healthcare – Regional overview

IMRE GERGELY SZABÓ

In Hungary, the wages of government workers were frozen and in some cases reduced between 2008 and 2012. Within this very diverse set of employees, resident physicians were the only group capable of taking successful collective action and achieving wage increases that were extended to the entire healthcare sector. However, the 2011 mass resignation campaign organized by the Hungarian Association of Resident Physicians was not unique in the Visegrád region.<sup>1</sup> Similar protest events took place in Poland, Slovakia and the Czech Republic. Most importantly, in all these cases (including Hungary) the protest organizers took advantage of the issue of medical emigration and the resulting labour shortages. After the 2004 EU-enlargement, the westward migration of healthcare professionals from these countries intensified, causing further deterioration in health service coverage and quality. On the other hand, large-scale emigration increased the bargaining power of employees who remained in their home countries. Trade unions and professional associations used the issue of emigration to justify their wage demands and claimed that the only way to stop the exodus of professionals was to raise salaries at home. Furthermore, knowing how easy it is to find a job abroad, trade unions and professional associations of doctors launched mass resignation campaigns to back up their claims. Results were similar across the region: in all four countries, significant wage increases were achieved for all healthcare workers, but above all for doctors. Besides, in all cases, contentious action – most importantly in the form of resignation campaigns – proved to be more effective than collective bargaining. Protesters addressed their claims not to employer associations but directly to the central government. Similarly, in most instances the results were underwritten by statutory laws or government orders rather than by collective agreements. This was the case even in Slovakia and the Czech Republic where industry-level collective bargaining is stronger than in Hungary. Nevertheless, there were serious cross-country differences with regard to the timing of the events, the main actors involved and their relationship. The most pronounced conflicts between the government and trade unions and amongst trade unions could be observed in Slovakia, while disputes in Hungary were resolved in a relatively peaceful manner.

Within the region, *Poland* experienced the first major wave of emigration-related healthcare protest in 2007. The bargaining dispute lasted for almost a year and revolved around doctors' call for a starting monthly salary of 5000 zlotys (approximately 1300 euros at 2007 ECB reference exchange rate) for resident physicians and 7500 zlotys (2000 euros) for specialists. Doctors also

<sup>1</sup> This overview relies on the following news sources: English-language news sites *Spectator* on Slovakia and *Prague Post* on the Czech Republic, Hungarian-language sites *rezidens.hu*, *eduline.hu* and *uj szo.com* on Slovakia and Hungary.



demanding that these sums should be included in an industry-level collective agreement. Similarly to Hungary, industry-level collective bargaining traditionally plays a minor role in Poland. After failed negotiations at the hospital level, the trade union of doctors turned directly to the Ministry of Healthcare. Having deemed the ministry's offer unsatisfactory, the union launched a strike that affected almost 200 of the country's 700 hospitals (*Czarzasty, 2007*). In some hospitals, doctors collectively handed in their notice, paralyzing entire departments. Eventually, the 2007 crisis was solved by local level agreements, but the government later on gradually increased wages at the industry level as well, which may have contributed to the slowing down of medical emigration from the country (*Kautsch and Czabanowska, 2011*).

While emigration is a less severe issue in the Czech Republic, the Czech doctors' union was the first to organize a structured resignations campaign. While Polish doctors walked out spontaneously from hospitals, their Czech colleagues did this as part of a pre-planned action. The main trade union of physicians (*Lékařský odborový klub, LOK*) launched its "Thank you, we are leaving" campaign in March 2010, encouraging medical doctors employed in hospitals to resign prior to December 31 of the same year. Setting the wages of doctors between 1.5 and 3 times the national average featured prominently within the 13-point demands list issued by the union. As of 20 December 2010, 3,513 out of the 18,000 physicians employed in Czech hospitals handed in their notice, taking effect from 1 March 2011 (*Veverková, 2011*).

This move triggered a crisis that lasted until February 2011 and ended with the government granting an immediate wage increase of between 5 and 8 thousand korunas for doctors (the average wage in 2010 ranged between 45–50 thousand korunas, equalling 1800–2000 euros at 2010 ECB reference exchange rate). The government also committed itself to a long-term settlement under which doctors' salaries would reach 1.5 times the national average by 2013. The rest of the hospital workforce was not covered by the agreement, but right after the doctors' protest, the nurses' pay scale was upgraded and they were also promised a 10 per cent wage increase from January 2012. Further debates erupted on how to secure the resources for these undertakings. Doctors' pay increase was supposed to be financed by cutting the number of acute care beds and by restructuring the hospital procurement system. Those hospitals that were not run by the health ministry – but typically by the regions – did not receive any extra funds to cover the increases, neither from the central government nor from health insurance companies.

Emigration is not a new topic of bargaining disputes in Slovak healthcare, but until 2011 these debates were mostly contained within the existing industry-level bargaining forums (*Kaminska and Kahancová, 2011, 199*). This changed in autumn 2011, when following the Czech example, the Slovak Trade Union of Doctors (*Lekárske Odborové Združenie, LOZ*) called for

mass resignation. Responding to the call, around 2,500 doctors handed in their notice, mostly anaesthetists, whose work is crucial for most hospital departments. LOZ addressed the Radicova government with three major demands: doctors salaries should be raised to a level of between 1.5 and 3 times the national average, the hospital financing system should be restructured and hospital corporatization should be stopped.<sup>2</sup>

Compared to the other cases, Slovak protests caused the most serious disruption in the healthcare system. After their notice period ended on 1 December 2011, 1,200 doctors indeed refused to take up work. In response, the government declared a state of emergency extending to 15 hospitals and asked neighbouring countries (including Hungary) to provide substitute medical staff. The conflict was resolved by an agreement between the government and LOZ in late December 2011 that guaranteed the termination of corporatization and a three-stage wage increase. The first two stages were executed prior to June 2012, increasing resident salaries to 1.2 times and specialist salaries to 1.9 times the national average wage. The final step is still to be completed, but it will result in 1.25 times the national average for resident doctors and 2.3 times for specialists (*Czírta*, 2012a).

In the wake of the 2011 autumn doctors' resignation campaign, internal conflicts ensued both on the employer and on the employee side of Slovak healthcare. Employers were divided on the issue of how to split up the costs among the central budget, the health insurance companies and the hospitals. On the employee side open hostilities broke out between LOZ and the nurses' unions. Shortly after the agreement was reached between the doctors and the government, the Slovak parliament also raised the statutory wages of nurses – to a range of 640 to 928 euros per month depending on qualifications and years in service. Nevertheless, the medical chamber – being closely associated with the doctors' trade union – attacked the law at the constitutional court, claiming that due to the lack of allocated fiscal resources, it endangers the functioning of hospitals (*Czírta*, 2012b). It seems that this time, doctors overrepresented in hospital management acted as employers not as employees. In 2013, the court ruled in favour of the Medical Chamber and annulled the wage increase for nurses.

Despite the fact that on purchasing power parity, Hungarian physicians' wages are the lowest in the Visegrád region, (*Reginato and Grosso*, 2011, p. 4) Hungary was the last to be reached by the wave of protests. One of the reasons might have to do with the fact that medical emigration from the country accelerated only after 2007.<sup>3</sup> Besides, the resignation campaign was not organized by traditional trade unions but by the Hungarian Association of Resident Physicians, a relatively new formation. Nevertheless, once protests started, the Medical Association (MOK) and its trade union branch (MOSZ) expressed support. Due to the nature of the main organ-

2 Corporatization denotes the process during which public sector institutions change legal status and become corporations. In Slovakia, between 2003 and 2006, municipality-run hospitals were turned into corporations while public ownership remained intact. The aim of the reform was to introduce stricter rules of financial management for hospitals. In 2011, the Radicova government was going to extend corporatization to university hospitals as well.

3 According to the Office of Health Authorisation and Administrative Procedures, after a slight decrease between 2005 and 2007, the number of physicians applying for overseas recognition of their medical qualification increased from 695 to 1108 from 2007 to 2012.

izer, demands focused on the improvement of wages and working conditions for young doctors, but more general claims were also formulated, including the long-term goal of increasing practising physicians' wages three times above the national average. As of December 2011, the Association of Resident Physicians collected 2,500 resignation letters, which would have been handed in to employers in January 2012 and would have taken effect in March the same year. Direct confrontation was avoided however, as in the final days of 2011, the government offered a deal that the resident doctors found suitable as a basis for negotiations. According to the agreement that was finalized in March 2012, doctors earning below a monthly gross of 350,000 Forints (1150 Euros, without on call duty), were entitled to an increase of 66,000 Forints. Above this level, the increase was gradually capped, deducting 5,000 Forints from the increase after every 10,000 Forints of higher original wages. Moreover, the government launched new, or expanded already existing, scholarships for resident physicians (*Girasek and Szél, 2014*). The wage increases extended to qualified nurses as well: 32% of them could expect a wage increase of 20,000 Forints per month while another 47% 15 thousand per month. A new round of wage increases followed suit in 2013. It would be too early to assess how these recent wage increases affected emigration trends. In 2013, 955 physicians applied for a certificate of good standing necessary for taking up employment abroad, a drop in numbers compared to the years 2010–2012, but still higher than in the pre-crisis years (*Girasek and Szél, 2014*). Besides, the leaders of the Association of Resident Physicians gained countrywide recognition in the wake of the events, which they also want to exploit in a bid to influence policies of the Medical Chamber. It remains to be seen whether they succeed, but the “Residents” are getting involved in much broader issues of health politics. For instance in 2013 they launched an awareness campaign to fight against the widespread practice of informal payments.

The protest wave in the medical sector that spread through the region between 2007 and 2012 has several features that highlight the contradictions of collective bargaining within the public sector. First of all, despite decentralization and public management reforms, the ultimate responsibility for public sector employment relations is still born by the central government. Even in countries where the autonomy of hospitals is stronger than in Hungary, healthcare employees addressed their claims directly to the central government. Besides, it seems that within the public sector only healthcare employees have a generally favourable labour market position as a result of the migration opportunities they enjoy (*Kaminska and Kabancová, 2011*). Other public sector professions such as teachers or members of the armed forces have much less demand for their services and much less job opportunities abroad, which decreases their bargaining power.

The weaker bargaining position of teachers became evident during recent events in Slovakia and Hungary. In autumn 2012, one year after the doctors' resignation campaign, the Slovak teachers' union OZPŠaV started collective action in a bid to achieve a 10% wage increase, which was modest compared to that which the doctors received (Czírja, 2013). Reacting to a short warning strike in October 2012, the government offered 5 per cent but ruled out a more generous offer, referring to the difficult fiscal situation. The union rejected this and launched an open-ended strike, affecting three quarters of the country's schools. Demonstrating a willingness to yield, the government proposed 7.5%, but a portion of this increase should have been covered by municipalities. The leadership of OZPŠaV accepted the offer despite several school-level strike committees expressing dissatisfaction with it. Problems with the implementation of the deal and the government's lack of commitment to a long-term solution triggered a renewed strike threat from OZPŠaV in 2013, but no actual steps were taken. In Hungary, starting from 2012, and after four years of a wage freeze, the government carried out a wage settlement in education from above, in parallel with the re-centralization of schools and with the establishment of the National Board of Teachers, a corporative professional organization with compulsory membership. The two main trade unions in education (PSZ and PDSZ) fiercely criticized the centralization of the school system. They claimed that the new wage system was unfair and also that the new representative body was just a puppet of the government. Nevertheless, they were not able to influence government decisions to a significant degree.

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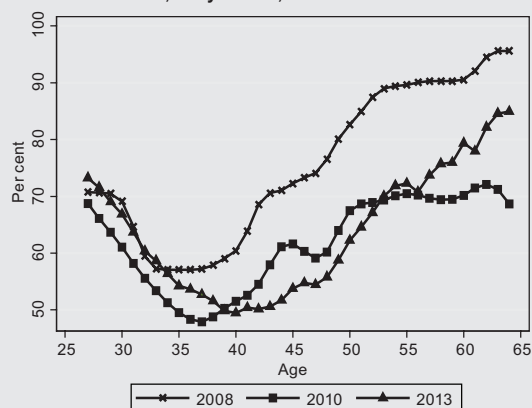
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### 4.2.1 Doctors' pay and gratuities

JÁNOS KÖLLŐ

*Official pay* in the health sector is low by any standards and it even declined substantially during the crisis. As it is shown by *Figure B4.2.1* graduate professionals in the sector – predominantly doctors – were earning significantly less already in 2008, than graduates with similar education and age employed in the private sector. Similarly to other graduates in the public sector, the gap was widest at the age of 35–40 years for doctors as well – on average 43%. As a result of the abolition of the 13<sup>th</sup> month pay and other measures, the gap increased to 51 per cent in this cohort by May 2010. At the same time the (official) relative pay of the most highly paid doctors – those aged over 55 – dropped even more drastically: from 90 per cent to 70 per cent.

**Figure B4.2.1: Monthly gross pay of graduates in the health care sector expressed as a percentage of monthly gross pay of graduates in the private sector, May 2008, 2010 and 2013**



Source: *Wage Tariff Survey*, 2008, 2010 and 2013.  
Moving means by three years.

Between May 2010 and 2013 the pay of doctors aged under 40 years increased by around seven or eight percentage points, however the pay of older doctors declined even further with the exception of those near retirement. The selection bias resulting from the increased exit of low-paid older employees might have also played a role in this. Even now, doc-

tors aged 40 earn no more than half of what their counterparts in the private sector are paid.

A distinctive feature of the struggle of doctors and nurses for higher pay in Hungary has been its initial link to the fight against *gratuities*. Although patients across Eastern Europe and in some Southern European countries routinely pay gratuities for health care (see e.g. the paper by *Chawla, Berman and Kawiorska*, 1998 on Poland, *Delcheva, Balabanova and McKee's* 1997 on Bulgaria, *Sabirianova and Zelenska's* 2011 study on Russia, *Burak and Vian's* 2007 research on Albania and *Liaropoulos et al.* 2008 report on Greece), but as far as we know, only in the Hungarian "pay movement" the idea of replacing gratuities with higher pay was put forward in the past years. The Hungarian Resident Association started the "green cross" movement at the end of 2010. Doctors supporting the movement would have given up gratuities for a 100 per cent pay rise (they would have expressed their support to the movement by wearing a green cross badge). However, the proposal was against the interest of older doctors benefitting from gratuities and therefore, with pressure from professional bodies (Hungarian Medical Council, Hungarian Medical Association, Association of Hospitals), it was rapidly taken off the agenda of pay negotiations.

There are various obstacles to tackling gratuities. Firstly, the opposition of senior doctors should be expected because it is unlikely that official pay would be brought into line with actual pay that includes gratuities, which widely vary with age, rank and field of practice.

Secondly, replacing gratuities with pay would also have major budgetary implications: *Bognár, Gál and Kornai* (1999) estimated annual gratuity payments at 33 billion forints in the early 1990s, *Szinapszis Ltd* at 45 billion forints in 2008, and *Patika Health Fund* at 73 billion in 2009.\*

\* The last figure was considered exaggerated by experts of *Szinapszis Ltd*, see *Kiss* (2009).



Last but not least, the reluctance of tax payers should also be considered: although they would happily get rid of the burden of gratuity payments and they overwhelmingly support a major pay rise for doctors,<sup>22</sup> at the same time over 80 per cent of voters rejected co-payment (a small fee for medical consultations and a daily fee for hospital stays) on top of social insurance contributions to create additional funding for health care – among others, to combat gratuity payment – at a referendum in 2008. Since Fidesz – who initiated the referendum – came to government, the introduction of any general co-payment scheme is very unlikely. In the current context, demand and supply of gratuities can be reduced by additional government spending and the introduction of new taxes (such as the “hamburger tax”), or by supplementary insurance and additional fee-paying services. Obviously, the last two can only provide a solution for the better-off upper- and middle classes for whom the “obligation” of gratuity payment is a lesser burden anyway (Szende and Culyer, 2006). Pay agreements that set out a gradual increase of wages signed in 2012–2013 created a necessary but insufficient condition to tackle the issue of gratuity: competitive and fair pay, and a health care sector free from gratuity payment are no longer as interconnected as in the original programme of the Hungarian Resident Association.

<sup>22</sup> According to a survey by Szinapszis Ltd 88 per cent of the population would support the pay increase of health care workers. One third of the population would consider a 50 per cent rise fair, and 11 per cent would double pay (Nógrádi Tóth, 2010).

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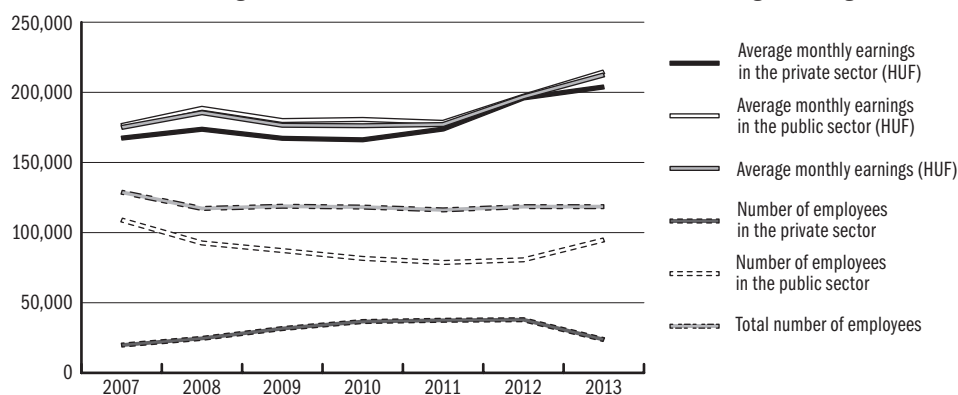
### 4.3 Nurses and other health care professionals

ERZSÉBET BERKI, ÉVA CZETHOFFER & ENDRE SZABÓ

The wage demands of health care professionals have been very much in the public eye in recent years. The Association of Hungarian Residents has organized a number of actions, and regular media reports on the emigration of health care workers have spotlighted working conditions in the health care sector (for details see sub-chapter 4.2 of this issue of *In Focus*). This article explores the status and movement of health care professionals on the labour market.

Both the public (central and local governments) and the private sectors have been equally involved in health care for many years. The outcome has been a patchwork of conditions set by various employers. Some people work as public service staff while others are straightforward employees, while overtime work and a variety of special contracts including ones that legally transform health care workers into private entrepreneurs try to fill in the gaps generated by a shortage of labour. The entanglement of the private as well as central and local government sectors in this area even muddles up the statistics, but overall trends can be unearthed by using a variety of databases (*Figure 4.3.1*)

Figure 4.3.1: Number of health care workers and average earnings



Source: Central Statistics Office Statistical Database (KSH STADAT) Annual time-lines (labour market, Tables 2.1.33., 2.1.35, and 2.1.38 and 2.1.43) and own calculations.

KSH data covering employment from 2007 to 2012 very clearly shows that employment in the public (central government) health care sector has been declining steadily while in the private sector – which includes businesses in which the government is a minority or majority owner – it has been on the rise. Overall however, the numbers have gone neither up nor down since 2008. There was one break in this picture, in 2013, when what till then had been private business entities were turned into central-budget-run institutions. That

year private sector employment went down by roughly 14,000 persons, while the number of people working in the public sector increased.

At this same time, mean earnings in the private sector were slightly below the average for the public sector (the biggest difference was in 2010, when it amounted to HUF 14,000/month). For all intents and purposes, earnings stood still between 2008 and 2011, and then began to rise in 2012–2013. Data for 2013 reflects a more significant rise in average earnings in the public sector than in the private one (these numbers also reflect the earnings levels of the staff that had been moved from the private to the public sector). By that time the earnings difference between the two sectors amounted to over HUF 11,000/month to the benefit of the public sector.

### **Public (central and local government) health care professionals and their career paths from 2002 to 2008**

There are a number of factors within the overall trend cited above that surface when exploring the career paths of health care professionals working in the public (central and local government) sector. We used data available in the databank of the Hungarian Academy of Sciences Centre for Economic and Regional Studies (MTA KRTK) to investigate this. In 2002, the sample covered half of the population between ages 15 and 74, of whom 114,089 people spent at least one month of the timeframe under investigation working in health care. This sample was made up of workers in the health care professions,<sup>1</sup> who constituted 4 per cent of total employees, a number that was slowly declining. During the period of the study (2002–2008) 32,809 members of the sample worked exclusively for private employers, and were therefore excluded from the sample on which the study focused. Some 81,283 people worked as public service employees or civil servants for at least a portion of the period, and were therefore included in this study. Together, they were employed for 88.5 per cent of the timeline under observation, were unemployed for 2 per cent, and were inactive for 0.65 per cent.<sup>2</sup> Some 8.77 per cent of the sample was not in any of the above groups. They were recipients of some sort of social transfer for 70 per cent of the months observed. Thirty-four per cent received old-age pensions, 12 per cent disability pensions or disability pensions following workplace accidents, and 16 per cent received benefits linked to small children (child-care aid/assistance/job substitution pay/support/maternity-confinement aid). The remaining 38 per cent received some other social transfer (e.g. a pension transferred through a different configuration, a family-member benefit, an allowance, or a fee for nursing a family member).

Our investigation revealed that 39,331 people or nearly half (48 per cent) of the 81,283 people in the sample quit the sector<sup>3</sup> during the period under exploration. A growing number of people left the public sector each year between 2002 and 2006. In 2002 the number of people from the sample who quit was

1 The selection was based on ISCO codes. 23 occupations listed with ISCO codes were included. Doctors obviously were not. Therefore, the data in the sample cannot be compared with the sectoral data of the NACE employer codes. At the same time it is obvious that most health care occupations are in the health care sector. The number of components in the sample tells us that a far larger number of people enter and leave the health care sector than reflected in the annual average data given by KSH, something also supported by the high ratio of people quitting the profession. (See below).

2 We call a person inactive if based in OEP (National Health Insurance) data the person is not insured in his/her own right or was unable to appear on the labour market. People unable to appear are (a) below the age of 18, (b) have been placed in live-in welfare/social facilities, (c) are homeless, (d) are receiving sanatorium-type care (aged 18–24), (e) pay an 11 per cent health care contribution, (f) are dependent family members or g) receive cash benefits following termination of their insurance.

3 Since a person has the option of quitting more than once, the number of quitters (40,213) is higher than the number of people leaving the sector for good. (The quitters do not include people who terminated employment and then re-established it within one month. Quitting can also mean leaving a position for another job, or leaving it and becoming inactive/unemployed.)

3,349. By 2008 the number was up to 6,541 (it peaked in 2007 when 6,950 left, meaning that the 2008 figure shows a slight decline compared to 2007).

We have reliable information on the status of roughly 75 per cent of individuals after they quit public (central or local government run) health care. Over the 2002–2008 timeframe there was a 6 per cent increase in the ratio of people who quit and found other jobs, and a 9 per cent rise in the proportion of people who remained jobless after leaving the sector (*Table 4.3.1*). About 2 per cent became inactive, and the ratio of those receiving some other miscellaneous social transfer dropped significantly (by 8 per cent). Of the group within the “other care” column 78 per cent received some sort of social transfer. Some 62 per cent of these received old age pensions while 8.52 per cent were granted some child-related benefit.

**Table 4.3.1: Breakdown of people quitting public health care service in the years of the survey by their ensuing labour market status (%)**

Year	Employed	Unemployed	Inactive	Other care	Total
2002	64.88	0.85	1.94	32.32	100.00
2003	66.99	0.74	2.31	29.96	100.00
2004	64.88	0.85	1.94	32.32	100.00
2005	55.47	13.14	2.19	29.20	100.00
2006	55.81	12.26	2.14	29.79	100.00
2007	68.43	12.14	2.17	17.25	100.00
2008	70.23	9.75	2.11	17.90	100.00
Total	63.02	10.03	2.06	24.89	100.00
Total, capita	25,342	4,032	830	10,009	40,213

We know the type of jobs to which 21,031 people switched. These were the people who were re-employed. Some 36 per cent remained in health care (most of them in the private sector – here we do not know how many were transferred due to the tendency of outsourcing from the public sector), 9 per cent went into social and labour market services, 14 per cent into some other service, and 5.8 per cent into a health care activity requiring a college degree. Three per cent of the latter remained public service employees or civil servants. The rest, which is about half of the people finding new jobs, chose from a wide variety of options ranging from catering to machine operation. Most of the people remaining in the health sector were general or specialist nurses and specialist assistants who found new jobs which statistically shifted them to a different economic sector, even though they actually continued working in the same occupation. A comparatively high ratio (6.7 per cent) of people who left the sector took jobs as social service nurses.

If we look at the above numbers in their entirety we have to conclude that half the people employed in public sector health care left the sector and one quarter have also quit the profession during the seven-year timeframe of the

study. Since the overall number of people working in the sector showed only a slight decline, the obvious conclusion is that the sector attracted almost the same numbers of new workers as the number that departed.

### The people the statistics lost

As already mentioned, we know to where 75 per cent of the people in the study went and what their status was on the labour market after they left public sector health care. Exactly 10,009 people in the sample (24.8 per cent of the quitters) left the labour market altogether (see *Table 4.3.1*).

*Table 4.3.2* shows us the kind of social transfers they received, and also shows that 2,204 people received no assistance of any kind (this is equivalent to 22 per cent of all the people leaving the labour market and 5.4 per cent of all the people leaving the public health care sector).

**Table 4.3.2: Social transfers received by the people who left the labour market**

Social transfer	Received by (number of persons)	Breakdown (%)
Gyes (child care aid)	321	3.21
Gyed (Salary replacement for child care)	109	1.09
Gyet (Support for raising children)	360	3.60
Tgyás (Maternity/confinement assistance)	63	0.63
Old-age pension	4,847	48.43
Disability pension	1,320	13.2
Disability pension (for accident victim)	12	0.12
Other pension	31	0.31
Disability support	54	0.54
Welfare-type support	166	1.66
Nursing fee (for nursing family member)	113	1.13
Care for family member	408	4.08
Benefit/assistance received, total	7,804	456.00
No data	2,204	22.02
Grand total	10,009	100.00

This sample tells us that there are really about 4,000–5,000 people for whom we have no data following their departure from public health care, and who apparently have no job and receive no social transfer of any sort. We presume that they are among the people working on the health care black market or some other black market, or that they have left the country to work elsewhere without the knowledge of the domestic authorities. We believe that although the study period has ended, the number of people disappearing from the statistical rolls has continued to rise since there were no measures prior to the salary increases of 2013 that would have reduced the number of people leaving the sector, while it became even more difficult to access social transfers.

## Changes in the incomes of people leaving public sector health care

We have seen that the overall number of people in the sample leaving the sector was 39,331 (40,213 in all who quit), while the number of people who quit to do other work was 25,342. In other words, about 63 per cent of the quitters are still working (they are the ones who the health care sector could continue to employ if working conditions were satisfactory). When looking at the changes in incomes following the job changes we took the mean<sup>4</sup> earnings for a maximum of six months of the previous year to be the income before the job change (which led to the loss of some of the sample, because people who began working later did not have an income that fit the criteria). The post-job-change income we used was the mean salary for a maximum of six months on the new job, which did not include the salary for the first month. We had sufficient data on 16,561 people and when calculating their earnings we discounted them to the 2008 level.

Incomes for most of the job-changers – 51 per cent – went down. For 40.7 per cent incomes rose and for 8.3 per cent we were unable to make the comparison. The earnings of the individual people compared to their own specific earlier earnings yielded a 110.7 per cent combined average (standard deviation 1.35). The investigation based on income levels showed that when “before” earnings were below HUF 120,000/month the changes resulted in higher earnings, but when they had been higher, the “after” earnings declined. When earlier earnings were above HUF 160,000 the decline was over 10 per cent. The high ratio of people suffering earnings losses suggests that the majority of the people quitting public (central or local government-run) health care were unable to sustain their earnings. To be more precise, wherever they went they were faced with the same downward pressure on earning levels that were frozen somewhere in the vicinity of the minimum wage or guaranteed minimum wage for skilled workers. This was particularly true for people who abandoned health care and switched to a different skilled profession or to a job that did not require professional skills.

To double-check our calculations we also ran the numbers reflecting the earnings changes using current (non-discounted) data. Using current earnings data the earnings of 38.5 per cent of the sample went downward. However, on the whole, the average of post-job-change earnings was 20 per cent higher than pre-job-change earnings had been. This tells us that for those people whose incomes rose, they rose significantly. Losses in earnings are partially explained by movement between sectors (*Table 4.3.3*).

The number of people switching from public sector health care to the private sphere between 2002 and 2008 was 8,431 (about 1,200/year, rising slightly from one year to the next). Differences in average earnings – noting that average earnings were lower in private health care (see *Figure 4.3.1*) – were suf-

<sup>4</sup> We used this option to prevent earnings from being distorted upwards by possible severance pay. (The severance pay is included in the earnings data of the year of job-termination, divided up into months.)

ficient to explain a portion of the decline in earnings,<sup>5</sup> underlining that a shift to the private sector did not automatically increase earnings.<sup>6</sup> Overall 2,002 people switched from jobs in public sector healthcare to social care employment. This came to nearly 300 people a year. Given that in the period under investigation, average earnings in the social care sector were lower than in health care, we feel safe in assuming that people only switched to jobs in social care if their earnings were higher or at least as high on the new job. This is why a higher percentage of people in this sub-category saw their earnings increase. People who switched from jobs in the social care to ones in health care had the best chance of increasing their earnings – true at the time of the study and just as true today. In the period under investigation 1,185 people or an average of 169/year made this switch, albeit the actual number in 2002 was only 126, rising to 187 in 2008. (For information of flows in 2012–2013, see *Erzsébet Berki* in sub-chapter 3.2 of this volume.)

**Table 4.3.3: Movement between sectors, per annum**

Year	From public <sup>a</sup> health care to private health care	From public <sup>a</sup> health care to social care
2002	558	137
2003	764	291
2004	1,158	333
2005	999	282
2006	1,092	268
2007	1,903	311
2008	1,957	380
Total	8,431	2,002
Available income data	7,036	1,475
Proportion of people whose earnings increased (%)	42.08	57.08
Changes in earnings (%)	107.25	117.05

<sup>a</sup> Central and local government-run combined.

An investigation by age shows us that this is also a factor in the decline in earnings. By using the data in the Individual Wage Survey we demonstrated that earnings for 18–44-year-olds tended on average to rise, while above the age of 45 earnings went down. This is connected with the fact that earnings in the higher income brackets tend to drop more drastically after a job change (for more on this, see *János Köllő* in Chapter 1.) It is also probable that earnings prior to a job change include a significant amount of overtime, shift bonuses, and other bonuses, which older people lose because they are no longer willing to make the effort. In other words, they halt their earlier “self-exploitation” strategy.

An investigation of post-job-change occupations shows that the people whose earnings went up the most found jobs in areas requiring a college/university degree. For instance, 81 people became family doctors, and their

<sup>5</sup> In 2007 the government pushed forward the 13th month salary that would have been due in January 2008, by paying half of it in monthly instalments starting on 1 July. Then, at the start of 2008 it paid the remaining half of the 13th month salary for 2007, but given that the advance had been paid earlier, the move reduced everyone’s monthly earnings in the public sector. Over the course of the year, a uniform HUF 15,000 was paid out twice to every public sector worker. 2008 also marked the last wage tariff increase (an average of 5 per cent). For more details see *Berki et al.* (2012). Thus, the government only offered compensation for the loss of the 13th month salary to low-income people in the public sector but not in the private one, while outsourcings continued.

<sup>6</sup> We do not know how many of the shifts were voluntary – in other words, how many were actual job changes – and how many were the outcome of outsourcing, when a health care facility changed its profile from public to private sector and the person remained in the same job despite the sectoral shift.



<sup>7</sup> “According to a briefing from the ministry to our paper, and to data from the Permit-Granting and Public Administration Bureau, by 30 June 2013 some 454 people had submitted requests for certificates enabling them to work abroad from the authorities as against 542 in 2012. This year, 247 of them were doctors while last year, 342 were doctors. As far as other health care personnel with professional skills are concerned, in the first half of 2012, 300 had requested certificates enabling them to work abroad while this year the number of requests for certificates was 360. There was a significant drop in the migration of doctors and residents under the age of 35. This is probably the outcome of the Lajos Markuszovszky Stipend Program offering extra money for professions in short supply, and of gradual wage increases,” *Népszabadság* online (nol.hu) wrote on 31 August 2013 in an article on health care called “I Have No Concept Regarding the Future.”

earnings went up 2.4-fold. The people whose incomes rose the most steeply were among the ones who quit health care altogether. People who went into sales (121 people) saw their earnings go up 2.5-fold, while others (65 people) who took jobs in miscellaneous office occupations received a 2.8-fold jump in earnings.

In contrast, the biggest losers were people who took unskilled service industry jobs (such as driving a car, cleaning, or other unskilled work). The earnings of people working in occupations not requiring the type of degree needed in health care were more or less unchanged (1.0–1.2-fold differences) in other words, if their earnings went up as a result of the job change, it was not by much.

On the whole, it seems safe to say that the people with the greatest chance of increasing their earnings were college or university graduates who switched from the public sector to the private one and moved out of health care, unless he or she became a doctor or a dentist in the interim.

This brief analysis was intended to demonstrate that deeper-reaching changes within a segment of the labour market can be explored with the appropriate data, and that once the causes are exposed it becomes possible to seek new tools to remedy the labour market problems of a given professional area. Since quitting from health care appears to have remained at a high level over the timeframe following the conclusion of this study,<sup>7</sup> and while government measures taken between 2009 and 2013 (primarily the wage increases and opportunities for women to retire after 40 years of employment) have generated new flows, long timelines of data are worth analysis using similar methods, to investigate subsequent changes.

## Reference

BERKI, E.–NEUMANN, L.–EDELÉNYI, M. AND VARADOVICS, K. (2012): [Public Sector Pay and Procurement in Hungary](#). National Report.

#### 4.4 Law enforcement workers, before and after retirement

ERZSÉBET BERKI, ÉVA CZETHOFFER & ENDRE SZABÓ

##### Significant legislative changes

The retirement system in Hungary has been under debate for decades. One topic under fire concerned the people who became entitled to pensions when comparatively young, and how to regulate the extensive group that took advantage of this perk.<sup>1</sup> One distinct group within the individuals affected by this legislation has been made up of retirees from armed public service-employment relationship, more specifically from law-enforcement occupations.<sup>2</sup> The issue of this group and of revamping retirement regulations for it came up repeatedly in the government administrations holding office from 2002 to 2010, but trade union opposition, arguments from the group in question, and a spotlight on wage issues halted any real reforms.

However, the administration that took office in 2010 did introduce a number of important retirement-related measures that impacted on this group. On 28 November 2011 Parliament adopted Act CLXVII. on Termination of Early Retirement, on Social Transfers before Retirement Age, and on Public Service Allowances. The law was promulgated on 9 December, 2011, just 22 days before it actually went into effect. Given its retroactive validity, the people affected had no way of preparing for the significant change in their living conditions.

The most important components of the law and the related amendments to the public service act that affected public servants (including law enforcement workers) and defence workers were as follows.

- As of 1 January 2012 armed service pensioners born in 1955 or earlier will now receive a service allowance instead of their armed service pension until they reach the retirement age for a standard old-age pension.
- The amount of the service allowance will be the same as the armed service pension, but is subject to a deduction equivalent to the legal personal income tax deduction (currently 16 per cent). The amount received will not be less than 1.5 times the amount of the minimum wage valid on 31 December (or HUF 117,000).
- For people in public service (including armed service) the standard retirement age will now apply.
- If a person has completed 30 years of armed service, then five years prior to the retirement age valid for their age, they may request a transfer to pre-retirement service in the “reserve corps”. The salary received will be the same amount as they would receive as a full pension at that particular time.
- If a person has completed 25 years in armed service, they may request lighter duties. The service time with this option is 35 hours/week. The person may

1 According to data from January 2011, there were 42,600 armed service retirees and the combined number of early retirees under various pension schemes was 238,400, meaning that benefits to people who retired prior to standard retirement age amounted to HUF 657 billion (Scharle and Kocsis, 2011).

2 In this chapter we generally use the terms “armed service” and “armed service pension”, nevertheless the legal changes also affected people in other occupations not necessarily using weapons but whose service employment relationship was regulated by the same law until 2012. (For instance, fire fighters, custom officers. See the list of occupations affected in detail in Table 4.4.2 – Editor’s note).

only work between 6 a.m. and 10 p.m. and may not be assigned overtime. The monthly salary in this case will be equal to the amount of absence pay the individual would receive for the last month spent in regular service.

- A recipient of the service allowance who is below the age of standard retirement may request admission to a special services (senior services) unit. (In this case the person would be transferred to the police force.) In this event the service allowance would be replaced by a net salary that must be at least as high as the service allowance had been, and may not be less than 1.5 times the minimum wage. This salary must be increased annually by the same amount as the old-age pension. Weekly working hours and limits on the work schedule are the same as lighter duty service. Members of this service may be ordered to assist civil services (such as local governments, to supervise public works programmes). These regulations resulted in a significant decline in the number of people choosing to retire (*Table 4.4.1*).<sup>3</sup>

**Table 4.4.1: Trends showing numbers of individuals leaving the National Police Force**

	2008	2009	2010	2011	2012	2013 (until May 31)
Total number of persons leaving the police force	3,872	2,732	2,298	2,974	n. a.	668
Professional officers leaving	n.a.	1,428	1,512	1,279	308	73
Professional officers retiring	1,857	n. a.	n. a.	774	55	2

n.a. = no data available.

Source: *Csikász* (2013).

The introduction of the above measures was preceded by an extensive media campaign that, in essence, called it a travesty that robust and able-bodied people clearly able to work should receive pensions. This argument shifted the problem to a moral plane. Countering this argument the unions – and other advocacy groups such as the Hungarian Solidarity Movement – possibly brought about precisely because of this type of legislation – argued that most of the people affected had completed 25 years of service, after which they were no longer fit either physically or psychologically for heavy-duty work of this kind. They cited a great many examples. They also objected to the government reneging on a “social contract”, which they termed a tacit agreement with these people to the effect that they would spend 25 years in low-wage, physically demanding or risky jobs after which they would receive a pension and be free to launch a second career.

### Retirement – when?

First of all, we set out to determine whether the rumours of “young people” enjoying armed service pensions were true or not. We used data available in the databank of the Hungarian Academy of Sciences Centre for Economic

<sup>3</sup> There is no data on the number of allowance recipients. The data is not consistent but since, according to *Csikász* (2012), the average age of the police officers working actively on the force is 26, we do get some idea of proportions.

and Regional Studies (MTA KRTK), which includes information on the various legal setups under which people in the law enforcement professions are employed. Fully 50 per cent of the people involved were included in the sample, including 27,411 people whose work history included service in an armed service or law enforcement body, in either a military (defence) or law enforcement occupation between January 2002 and December 2008. Nearly 90 per cent of the sample, we found, was made up of people in four professions (*Table 4.4.2*)

**Table 4.4.2: Employment categories listed in the International Standard Classification of Occupations (ISCO), with the number of persons in the given occupation, as of the dates on which they were first reported**

ISCO 08	Occupation	Number of persons	(%)
110	<i>Commissioned armed forces officers</i>	5.917	21.59
210	<i>Non-commissioned armed forces officers</i>	9.315	33.98
310	<i>Armed forces occupations, other ranks</i>	7.499	27.36
3351	Customs and border inspectors	748	2.73
*	Civil defence employee	2	0.01
3355	Police inspectors and detectives	21	0.08
5412	Police officers	754	2.75
5411	Fire fighter	2,043	7.45
5413	Prison guards	765	2.79
5414	Security guards	6	0.02
5419	Protective services workers not elsewhere classified	341	1.24
	Total	27,411	100.00

\* Occupation defined by the Hungarian system (FEOR 97) with no equivalent in ISCO 08.

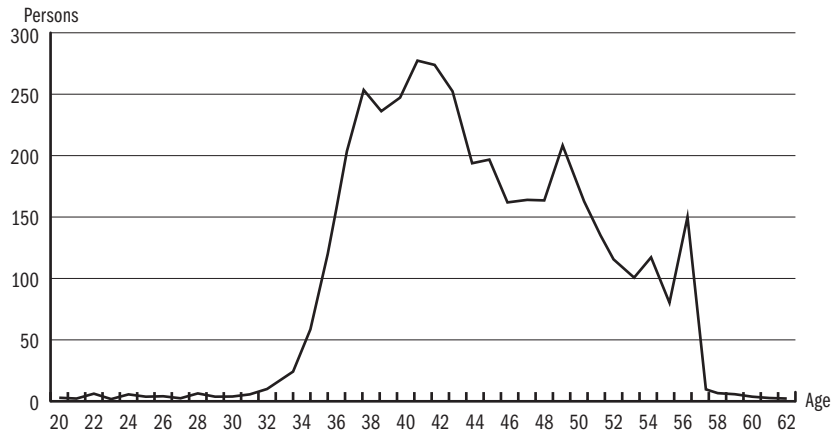
Exactly 4,949 (18 per cent) of the people who spent any time at all between 2002 and 2008 in any law enforcement occupation, retired during that period. These people either retired from their law enforcement position or from some other employer and occupation. The first group (those retiring from a law enforcement role) consisted of 4,519 people, not a particularly large number, even if we set up ratios and round out numbers and say that ten thousand people took armed service retirement over the seven years. In fact the annual average number of retirees was less than 1,500. There were exactly 3,954 people, or 87.5 per cent of all retirees, serving in a law enforcement body at the time of their retirement or in the three months prior to it. (The people not included in this category were last observed in law enforcement positions on the database 4 to 78 months prior to their retirement.)<sup>4</sup>

*Figure 4.4.1* shows an overall age profile. We can see that there are three significant age groups: 40–41 year olds, 49–50 year olds, and 56 year olds. The particularly high level of 40–41 year olds is clearly because of the law. This group has been building service time since the age of 15 when it entered voca-

<sup>4</sup> In this connection please note that when determining whether a person has the necessary service time, the years of service were added to the years of civilian service using a multiplier, so the rules of the service pension also influence the possible date on which the person may retire as a civilian.

tional secondary school and at age 40, obtained the 25 years of service required to retire. (Anyone retiring earlier does not receive a full pension, and anyone retiring later is not likely to have begun their career in law enforcement, and thus needs to put in more time to reach the 25 years. However, some people eligible for retirement may simply want to work longer. These latter factors are particularly true for officers with full secondary or college educations.)

**Figure 4.4.1: Age profile of retirees from law enforcement bodies, by age at retirement (2002–2008)**



The average 45-year-old armed service retiree with 25–30 years of service is clearly younger than a civilian retiree. However, this configuration made it possible for these people to begin a second career, particularly if they had a profession they could use in civilian life. From a social point of view they are therefore in a positive and not a negative position. It was this second career path that was partially stifled by the law on early retirement and by a decree introduced in 2013 which banned recipients of pensions and allowances from working for public (central government) bodies.<sup>5</sup>

We do need to point out that there was a very significant difference between the overall number of people in the sample and the ISCO breakdown of the retirees. According to *Table 4.4.3*, occupations requiring a college education accounted for 21.6 per cent of the sample entering the field and for 48.2 per cent of those leaving to retire. The situation was exactly the reverse for occupations not requiring a secondary education, where 27.4 per cent of the sample entered the field in the period in question and only 1.1 per cent retired (the differences were not this great in the other categories). This suggests that people with college educations tend to follow the career paths expected of them and obtain their entitlement to pensions within the organization, while a significant portion of the low-education group leaves after a time and does not retire from law enforcement.

<sup>5</sup> To be precise: if the person receiving the benefit is employed by a non-public sector employer and their annual earnings are less than 18 times the monthly minimum wage (which in 2013 was HUF 1,764,000) that person may receive their full retirement benefits along with the salary. For more details see: <http://nyugdij.adohirek.hu/> and Act CCVIII of 2012. Note that since benefits granted before retirement age do not qualify as pensions and that the 16 per cent deduction does not qualify as personal income tax, this raises a number of problems. For instance, these incomes are not eligible for family tax deductions. The 16 per cent is not deducted from the remuneration given to reserve soldiers.

**Table 4.4.3: Breakdown of occupations at the time the person first appeared in the database and at the time of retirement, and the age of retirement, 2002–2008**

ISCO 08	Occupation	When first appearing	When retiring	Difference	Average age at retirement
110	<i>Commissioned armed forces officers</i>	21,59	48,15	26,56	48
210	<i>Non-commissioned armed forces officers</i>	33,98	37,66	3,68	42
310	<i>Armed forces occupations, other ranks</i>	27,36	1,11	-26,25	40
3351	Customs and border inspectors	2,73	0,35	-2,38	49
*	Civil defence employee	0,01	0,03	0,02	-
3355	Police inspectors and detectives	0,08	0,03	-0,05	-
5412	Police officers	2,75	1,77	-0,98	42
5411	Fire fighter	7,45	9,96	2,51	45
5413	Prison guards	2,79	0,68	-2,11	43
5414	Security guards	0,02	0,03	0,01	-
5419	Protective services workers not elsewhere classified	1,24	0,23	-1,01	50
	Total	100,00	100,00	0,00	45

\* Occupation defined by the Hungarian system (FEOR 97) with no equivalent in ISCO 08.

There are differences in the mean retirement age depending on occupation. Customs and financial service workers were the last to retire (age 49), while police and people with a secondary education retired earliest in all areas. People with college degrees worked six years longer than their counterparts with secondary education but four of those six years were likely to have been spent full-time in college and another four years would have been spent in secondary school, which cuts the actual number of years spent working to 26.

### Re-entering the workforce

Post-retirement employment data was available for 1,448 of the overall number of law enforcement retirees (3,954), or 36 per cent of the sample. Within this, only 6 per cent continued working in the same occupation, while the others found new occupations. The sample included retirees working in 37 different occupations<sup>6</sup> (see *Table 4.4.4*).<sup>7</sup>

The largest number of retirees in any one category was in *non-material services* (227), within which 182 people (80 per cent) again chose a law enforcement type occupation.

6 Using the combined (two digit) ISCO group and the four-digit ISCO code, there are 217 different occupations.

7 Note that the first data on post-retirement employment for 82.5 per cent of people was from 2007–2008. The reason is that the requirement to pay a contribution on a pension when employed dates from this time, thus this is when pension + employment became visible in the database.



**Table 4.4.4: Occupations of retired law enforcement workers**

Occupation	Number of people <sup>a</sup>	Breakdown (%)	Cumulative breakdown
Occupations in non-material services	227	15,7	15,7
Commissioned armed forces officers	125	8,6	24,3
Simple service occupations	91	6,3	30,6
Miscellaneous, highly qualified, administrators	79	5,5	36,1
Operators of moving machinery	75	5,2	41,2
Heads of businesses or budget-sponsored organizations	75	5,2	46,4
Non-commissioned armed forces officers	74	5,1	51,5
Administrators in business or financial institutions	69	4,8	56,3
Miscellaneous administrators	64	4,4	60,7
Technicians and similar technical occupations	51	3,5	64,2
Miscellaneous	414	28,5	92,9
No data available	104	7,2	100,0
Total	1,448	100,0	

<sup>a</sup> Details provided for only those occupations in which over 50 people worked.

### Earnings before and after retirement

Earnings data have been summarized in *Table 4.4.5*, discounted to the 2008 level.<sup>8</sup> We had wage data for 3,823 of the 3,834 people in law enforcement occupations. We also had other wage-type income data for 143 people.

**Table 4.4.5: Monthly earnings of retirees from public servant status prior to retirement (HUF)**

ISCO 08	Occupation	Average wages of law enforcement personnel exclusively from law enforcement job	Other income from wages	Wages of law enforcement personnel from all jobs <sup>a</sup>
110	<i>Commissioned armed forces officers</i>	525,167	99,250	528,986
210	<i>Non-commissioned armed forces officers</i>	313,382	85,047	316,618
310	<i>Armed forces occupations, other ranks</i>	244,747	34,800	247,357
3351	Customs and border inspectors	277,326		277,326
*	Civil defence employee	274,500		274,500
3355	Police inspectors and detectives	530,372		530,372
5412	Police officers	407,031	38,194	407,180
5411	Fire fighter	345,857	79,186	347,528
5413	Prison guards	274,049		274,049
5414	Security guards	304,240		304,240
5419	Protective services workers not elsewhere classified	263,181		263,181
	Overall mean	419,279	90,407	422,494

<sup>a</sup> The earnings data of the various occupational groups cannot be added up because of the differing numbers of people in each group.

\* Occupation with no equivalent in ISCO 08.

<sup>8</sup> Earnings data include all extras received before departure (including possible severance pay and/or disarmament assistance, etc.) Given the practice of granting people extra benefits before retirement from public administration in order to jack up the pension, the earnings level prior to quitting is generally higher than the normal earnings level. The two, three, and four month average of wages prior to retirement are 4.5 per cent higher than the average of the seven, eight or nine months of wages prior to retirement.

The first thing we see from the data is that the earnings of people with college degrees are significantly higher than the other groups – a conclusion we can also draw from the wages system (see this issue of *In Focus* sub-chapter 3.2). We also can see that there are significant differences from one occupational group to the next. For instance, investigators/detectives and police officers earn significantly more than people working in non-police organizations. Average earnings were also relatively high for private security guards, a comparatively new profession only a few decades old. People with college degrees tended most often to augment their law enforcement earnings with some other work-related income. Overall earnings were highest for this group but other work-related income also significantly improved the earnings status of people with a secondary education.

Post-retirement wage data are available for the occupations qualifying as valid at the time of retirement. We have no data on the amount of pension money received so we were unable to compare overall incomes. But we did compare earnings. Our point of departure when making this comparison was the mean wage for all occupations (which differs just minimally from the incomes of law enforcement personnel within the sector, but is more precise in describing changes in the wages of the persons and groups we are observing.)

As we can see from *Table 4.4.6*, we were able to link up the pre and post retirement earnings of 1,333 people. We were only able to obtain post-retirement wage data for 1,162 people, which is rather a small sample. When interpreting the data we need to be aware that the earnings data include inflow to a person employed in a public service configuration that did not come from the person's full-time job, meaning the job from which the person actually retired. Thus, post-retirement earnings may be made up of wages from this secondary work or from a new occupation or a different job.

As we can see, retirement came with a 50–70 per cent loss of earnings. However, given the rules of pension calculation, if the person had been continuously employed their pension would not have been much less than their earnings from their full time job. Thus, we have estimated the overall income of retirees working in other jobs to come to 130–150 per cent of their pre-retirement incomes. At the same time, we need to point out that this is not a particularly high income level although it is substantially higher than nationwide average earnings.

This was the income status which was reduced by changes in the law in 2012 and 2013, partly by slapping a 16 per cent deduction onto the incomes of people below full retirement age and partly by requiring anyone continuing to work in the public sector to suspend their pension or allowance. The result is that the 130–150 per cent earning position could sink to one of 84–95 per cent in roughly a month. This is why the measures generated so high a level of dissatisfaction among armed service workers.

Table 4.4.6: Mean wages before and after retirement

ISCO 08	Occupation	Before retirement		After retirement		Change from pre-retirement, wages in per cent
		average earnings from all jobs, HUF	number of people	average earnings from all jobs, HUF	number of people	
110	<i>Commissioned armed forces officers</i>	529,284	739	263,264	642	49,7
210	<i>Non-commissioned armed forces officers</i>	313,595	472	121,401	413	38,7
310	<i>Armed forces occupations, other ranks</i>	225,623	17	82,383	16	36,5
3351	Customs and border inspectors	269,680	4	82,107	3	30,4
*	Civil defense employee		0		0	
3355	Police inspectors and detectives	530,372	1		0	
5412	Police officers	421,122	13	202,730	12	48,1
5411	Fire fighter	325,919	80	170,689	69	52,4
5413	Prison guards	231,667	5	72,187	5	31,2
5414	Security guards		0		0	
5419	Protective services workers not elsewhere classified	201,779	2	147,681	2	73,2
	Total/overall mean	433,402	1,333	203,514	1,162	47,0

\* Occupation with no equivalent in ISCO 08.

### The position and actions of interest advocacy groups

All the trade unions operating in the area sought to protect the pension system and organized demonstrations and rallies to that effect starting in the spring of 2011. As opposed to outcomes prior to 2010, these interest-advocacy negotiations failed. They based their legal stance primarily on the portion of the law that transformed pensions to allowances for people who had already retired, in other words, on the retroactive nature of the law. The principle of legal security was also violated, they argued, when the people impacted by the change were not notified in sufficient time to have been able to prepare for the changes in their living conditions. Unions operating in the area, in particular the Trade Union of Interior Affairs, Law Enforcement, and Public Service Workers, and the Independent Police Union – as well as other NGOs – began preparations in December 2011 to take the case to the European Court of Human Rights in Strasbourg, and eventually ended up with 13,000 individual submissions. In the first half of 2013 the court resolved to call upon the Hungarian government to submit its position in writing regarding the petition for legal remedy, giving the government four months to do so.

The Independent Police Trade Union also called on the Ministry of Human Resources, proposing that it amend the law given that the people whose entitlement qualification was changed from entitlement to an armed service pen-

sion to entitlement to a service allowance, could be hit by the reduced amount until the age of 65. The Ministry rejected the proposal on the grounds that the 16 per cent deduction was not a tax. As we have seen the deduction is neither a tax nor a contribution. According to the website of the Independent Police Trade Union “it is quite simply a deduction!”

The unions also petitioned the Constitutional Court, which after five days of debate issued the decision that neither the termination of pensions for early retirement nor the 16 per cent deduction on public service allowances was unconstitutional. At the same time, in 2011, the Hungarian Helsinki Committee (OSCE) stated its position, declaring that the withdrawal of the pensions ran contrary to the legal practices of the European Court of Human Rights, and the issue could therefore be taken before the court in Strasbourg. The ombudsman was one of the entities taking the issue to the Constitutional Court ([szakszervezetek.hu](http://szakszervezetek.hu)). The investigation conducted at the request of the trade unions found that the portion of the decree banning dual benefits for retirees working in the public sector ran counter to the right to property, to protection of rights equivalent to assets, and violated the requirement for proportionality if significant changes were introduced to the pension system within a short period of time (For more detail see [szakszervezetek.hu](http://szakszervezetek.hu)).

Individuals submitted petitions to the European Parliament, but only a portion of these proceedings have progressed to a conclusion).<sup>9</sup> According to a legally binding decision reached by the Strasbourg court in 2014, transforming service pensions to allowances and taxing them for people who have not reached standard retirement age did not violate the European Convention on Human Rights.

As to the extent to which the decisions of 2010–2013 altered the careers of law enforcement workers, as yet the timeline has not been sufficient to draw a chart, but the media has reported that in 2013, for instance, the average age of police officers on the force was 26. In the first five months of 2013 fully 688 people quit the police force. Of these, 73 retired and only two continued working in public services as retirees (*Csikász*, 2013). The overwhelming presence of young people on the current police force is likely to cause human resource management problems later on. Therefore it is definitely worth monitoring labour turnover in an occupation-by-occupation breakdown.

<sup>9</sup> Please note that as far as the retirement age of judges is concerned, the government accepted the position of the European Union, that a measure like this may not be introduced without a preparatory period because it violates social security.

## References

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