
José A. Pagán1, Jorge Valero Gil and José A. Tijerina Guajardo2

1 Department of Economics and Finance, College of Business Administration, The University of Texas-Pan American, 1201 W. University Dr., Edinburg, Texas USA 78539
(e-mail: jpagan@panam.edu)
2 Facultad de Economía, Universidad Autónoma de Nuevo León, Loma Redonda 1515-A Pte., Col. Loma Larga, Monterrey, NL, México CP 64710
(e-mail: jvalero@ccr.dsi.uanl.mx; tijerin@ccr.dsi.uanl.mx)

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Abstract. Over the last decade, the public sector in Mexico experienced substantial fiscal reform, divestiture of public enterprises, and the elimination of many regulations affecting pay and employment. This study analyzes the changes in the public/private sector differences in wages during the 1987–1997 period. The results from analyzing microdata from the Encuesta Nacional de Empleo Urbano show that relative public sector wages increased from 1987 to 1997. Most of the relative wage increase in the public sector can be explained by increases in the price of skills and by changes in sorting across sectors. The results have important public policy implications since they suggest that public sector workers earn more and their wages have grown faster than those of their private sector counterparts. As such, policies contemplating public sector reform should take into account the effect of these measures on the inter-sectoral income distribution and the overall economic growth.

JEL Classification: H11, J21, J31, J41

Key words: Earnings; Public Sector, Wage Structure; Mexico

I. Introduction

During the mid-1980s, and partly as a result of the 1982 economic crisis, Mexico undertook major trade reform, privatization and deregulation measures. The public sector labor market experienced major structural changes during this period as a result of two important developments: the reduction in

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the size of the federal government resulting from the privatization of publicly-owned firms, and the gradual transfer of government duties and responsibilities from the federal government to state and local governments. These various measures have certainly had a tremendous impact in the structure of the labor market in Mexico in terms of changes in relative employment and earnings.

This study analyzes the evolution of wages in the public and private sectors in lieu of the major structural changes that have occurred over the last decade.\(^1\) Our empirical analysis uses microdata from the National Urban Employment Survey for 1987 and 1997, and applies the methodology devised by Juhn, Murphy and Pierce (1991) (JMP) to study the changes in the private/public sector wage differential during the last decade. This methodology allows us to decompose the 1987–1997 changes in the private/public sector wage differential into observed and unobserved characteristics components, and observed and unobserved price components.\(^2\) Some researchers have found that relative labor demand changes in Mexico might be partly responsible for the observed increases in sectoral earnings. Craig and Epelbaum (1995) and Valero (1995) found that earnings dispersion increased due to increases in the demand for skilled labor. It is thus policy relevant to analyze the 1987–1997 changes in public/private sector earnings using a methodology that allows us to study how government sector earnings have evolved in the face of substantial labor market structural changes benefiting mostly those who are relatively skilled.

We find that from 1987 to 1997 the private/public sector wage ratio fell from 0.634 to 0.520. About two thirds of the inter-temporal change in the private/public sector wage ratio can be attributed to changes in the observed prices of skills that have been favorable to public sector workers. Labor market structural changes seem to have benefited public sector workers more than proportionally, particularly through increases in the rate of return to schooling and through changes in occupation and firm size premiums. We also find that changes in sorting across sectors explain a large portion of the increasing sectoral wage gap. The relative improvements in the unobserved skills of workers in the public sector could be due to, perhaps, reductions across time in employment that have forced out of the public sector the less skilled, or due to conscious government efforts to attract better workers via efficiency wages. Alternatively, changes in sorting could have also taken place as a result of increases in public sector rents over time.

The paper is organized as follows. Section II examines the evolution of employment and earnings in the public sector in Mexico vis-à-vis the private sector. Sections III and IV present the methodology and the empirical results. Section V discusses the public policy implications of the findings and provides some concluding remarks.

II. The public sector in Mexico: Conceptual issues

During the last decade, the Mexican economy experienced substantial structural changes through trade reform, privatization and deregulation. Two important developments related to public sector employment are connected to

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1 The public sector includes individuals employed in the federal government, state/local government, and government-owned firms.

2 See also the work of Blau and Kahn (1992; 1994).