



## Exploding public sector pay myths: a briefing for trade union members

### Summary

All main political parties have put forward policies to freeze or curb pay for public service workers. This briefing looks at the implications of pay freezes in the public sector. It also takes on the commentators who say that pay restraint is justified on the grounds that public sector wages are running beyond the private sector.

Several newspaper stories have appeared recently stating that earnings growth is rising more than the private sector. It is true that the public sector has fared slightly better than the private sector over the recession, with average earnings growth of 2.8% in the public sector and 0.1% in the private sector in the year to November 2009.

However, we must take care with these figures and put them in a broader context of earning growth over a longer time period. Between 1993 and 1999 public sector pay fell below the private sector and led to recruitment and retention problems. In recognition of this, pay began to catch up between 2000 and 2004, but since 2005 pay was cut back again. In 2008, the average pay increase in the public sector was 2.5% when inflation was running at 4%.

The Institute of Fiscal Studies have stated that pay levels in the public sector are not significantly out of line with those of similar workers in the private sector, once factors such as age, education and qualifications are taken into account. Average earnings in the public sector are significantly affected by workforce composition with larger number of people in professional roles and higher qualifications than the private sector and generally, lower paid jobs have been transferred out to the private sector over the last few years. This does not mean that the problem of low pay in the public sector has been eradicated. In fact, the public sector is a large employer of workers earning less than £7 per hour, accounting for a quarter of all such employees in the UK.<sup>1</sup>

Both inflation and private sector pay rates are likely to pick up later this year and next year, which will change the context in which freezes take effect. While many private sector employers froze pay levels in 2009, negative inflation meant this still translated into real earnings growth. Price inflation will become positive this year meaning that people's living standards will be hit by a freeze much harder.

The public sector pay target has been below inflation for the last three years. Further restraint or freezes would not only reduce spending power in a key part of the economy, but also lead to a return to the recruitment and retention problems last seen in the 1980s and early 1990s.

There have also been wrong-headed calls to dismantle national pay bargaining to allow public sector pay to more closely match earnings in local areas. Holding back pay to match already low average earnings could generate a downward pay spiral in areas with weakest labour markets. And any system where schools or hospitals provided different rates of pay for the same job would only result in employment instability as people moved to other areas in search of higher pay. Destabilisation of the labour market could lead to variations in the quality and delivery of a wide range of public services.

National pay structures provide an efficient and transparent mechanism for dealing with large numbers of staff, underpinned by the principle of equal pay for work of equal value; local pay arrangements would only lead to pay discrimination and expensive litigation.

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<sup>1</sup> [www.poverty.org.uk/52/index.shtml#note1](http://www.poverty.org.uk/52/index.shtml#note1)



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### Introduction

The economic downturn has undoubtedly had a huge impact on the UK workforce. Although the scale of job losses has been much less than originally feared, many people have had direct experience of redundancy, repeat spells of unemployment and pay penalties.

The recession has also had a massive impact on public finances and while the main political parties have differing ideas about how to get finances back on track, all have put forward policies to freeze or curb pay for public service workers.

This briefing looks at the implications of pay freezes in the public sector. It also takes on the commentators who say that pay restraint is justified on the grounds that public sector wages are running beyond the private sector.

"Whoever wins the election is going to have to ask from 2011 each part of the public sector to accept a one year pay freeze. I say to every public sector worker: it is the best way to try to protect your job during this period. We are all in this together."

**George Osborne, Shadow Chancellor of the Exchequer**

"The gap between public and private sector wages has widened, reinforcing the need for a freeze in the total public sector pay bill as a key measure in battling the UK's unsustainable budget deficit."

**David Kern, Chief Economist at the British Chambers of Commerce**

"At a time when inflation is likely to be between 2% and 3%, a pain-free way of cutting public spending would be to freeze public sector pay."

**Steve Bundred, outgoing Chief Executive of the Audit Commission**

"The recession was caused by the collapse of a speculative bubble driven by bankers and the finance sector. It cannot be right to single out public sector workers to pay the price of putting it right."

**Brendan Barber, General Secretary TUC**

### MYTHS AND FACTS ABOUT PUBLIC SECTOR PAY

According to the Institute of Fiscal Studies, public sector workers 'have fared better than their private sector counterparts in the recession.'<sup>2</sup> It is true that the public sector has not been subjected the same degree of job losses and pay freezes or pay curbs. It is also true that average earnings may have grown slightly faster during the recession in the public sector than the private sector but closer examination of pay and earnings reveals a much more complex story.

#### Tales of average earnings

Reports have recently appeared in several newspapers stating that earnings growth is rising more than the private sector. These reports use data from the Office of National Statistics and this data should come with a large sign attached saying "Danger, Handle with Care."

Most of these newspaper stories attempt to show that in the year to November 2009, earnings growth in the public sector was rising at 3.8% compared to -0.1% in the private sector. This is based on Average Weekly Earnings (AWE) data.

<sup>2</sup> The IFS Green Budget: February 2010. [www.ifs.org.uk/budgets/gb2010/10chap9.pdf](http://www.ifs.org.uk/budgets/gb2010/10chap9.pdf)



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However, in reality, earnings in the public sector rose by 2.8%. The figure appears to have been artificially inflated to 3.8% by the inclusion of data from the nationalised banks, including Lloyds, Northern Rock and Royal Bank of Scotland.

Some newspapers tried to show that public sector workers earn more than £2,000 a year more than private sector workers. But the way they used the data was highly misleading.

They compared weekly earnings excluding bonuses. As Alastair Hatchett from leading pay analysts Incomes Data Services (IDS) explains, this is not really comparing like with like. He says that the most realistic comparison should be with total pay which includes bonuses – an important part of pay in much of the private sector. This shows that public sector workers on average earn just £6 a week or £313 a year more than private sector workers. Average weekly earnings in the private sector are £447 and the £453 in the public sector. If we include the nationalised banks in the public sector figure, this rises to £459. But as shown below, comparing private and public sector earnings is much like comparing apples and oranges and great care must be taken with these figures.

### How is pay data measured?

The AWE data includes three measures:

- Total pay, including bonuses;
- Regular pay, excluding bonuses; and
- Bonuses themselves to assess trends in bonus payments.

The way that AWE is measured and its treatment of bonuses is important because the bonus element of total earnings has become more significant in private sector pay in recent years and fluctuations have a bigger impact. Bonuses or incentive schemes are particularly prevalent in the finance sector, but are also widespread in the manufacturing and production sectors.

The use of bonuses payments has reduced considerably since the start of the recession, particularly in the finance sector. In the first part of 2009, the contraction of large City bonuses in the first quarter of 2009 was so large that it pushed earnings growth figures for the whole economy down by 6.3%.

The presentation of this data illustrates the difficulties of comparing private and public sector earnings. The public and private sector have different skills compositions and earnings distributions and attempting to identify private sector counterparts for public sector workers is near impossible.

The public sector employs around 23% of the workforce, is dominated by women (around 70%) and has a larger number of people in professional roles and with higher qualifications than the private sector. The TUC's own analysis of data from the ONS Labour Force Survey shows that the need for high-level qualifications in many public sector jobs accounts for much of the pay gap. For example, public sector employees are almost twice as likely to have higher education qualifications (the ratio is 53% public:28% private).

Another important factor is that lower paid jobs have over the last few years generally been transferred out to the private sector also affects workforce composition and average earnings. The Institute of Fiscal Studies confirms this, stating that 'overall, pay levels in the public sector are



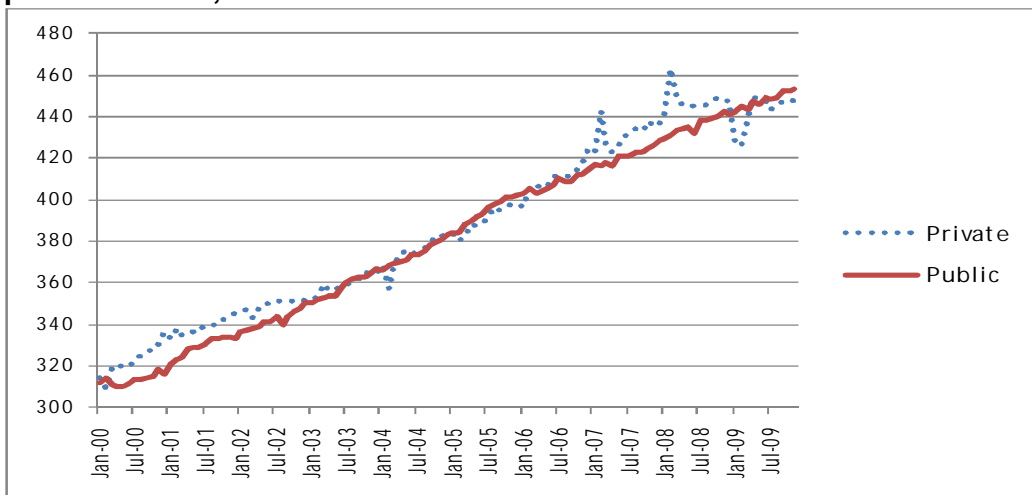
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probably not significantly out of line with those of similar workers in the private sector, once you take into account factors such as their age, education and qualifications.'

### Comparing private and public pay

The Government held a policy of public sector pay restraint from 2007 in the belief that this was necessary to control inflation. This policy, which led to below inflation rises, meant that earnings growth in the sector had been behind the private sector pretty much until the recession took hold at the end of 2008. In 2008, Last year when inflation was 4% the public sector got 2.5%.

### Average weekly earnings (pay including bonuses) public (excluding financial services) and private sectors, Jan 2000 – November 2009



The table above compares public and private sector earnings growth since 2000, and shows that growth was often higher in the private sector. Since 1999, the average annual increase in total pay in the public sector has been 3.5%, compared to 3.97% in the private sector.

In April 2008, average weekly pay in the private sector was £445, compared to £434 in the public sector. The public sector average only overtook that in the private sector as the recession started to take hold and employers put in place pay freezes and pay restraint. As the economy picks up in the next year or so, we would expect that the private sector would take the lead again.

Incomes Data Services show the impact of the recession on pay settlements, with much lower pay settlements in the private sector in 2009 compared with 2008. They estimate that one-third of firms imposed pay freezes, while in some cases business paid lower bonuses and continued progression payments. The AWE data shows that large reductions in bonus payments contributed to lower earnings growth in 2009 compared with 2008.

IDS also show that earnings in the private sector were also reduced by the changing composition of the workforce, in particular the loss of full-time roles and the increase in part-time roles (repeating a trend from the recession in the early 1990s). Employees who are made redundant appear to be taking lower skilled and lower paid jobs and more women are entering the labour market.



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Bonuses and pay settlements will probably pick up as the economy returns to growth. But since average earnings in the private sector are low at the moment, any increase in bonuses and pay increases in the future will look comparatively high and the rate of increase in the private sector will run faster than the public sector. And a return to the same old hullabaloo about who earns what and why.

### **What does the future hold?**

The Government and the main opposition parties have all called for pay freezes or cuts.

The Government plans a freeze for senior groups and a 0%-1% limit for others not covered by long-term deals. The December 2009 Pre-Budget Report indicated that this approach should be extended for two years from 2011.

Labour is not seeking to reopen three-year deals for non-senior workforces, including NHS staff (due to get 2.25% or £420 in April), the teachers review body award (2.3% from September) or police officers (2.55% from September).

The 0%-1% limit would apply to doctors and dentists (over 180,000 workers), prison officers (over 30,000 staff) and about 300,000 civil servants not in three-year deals. The Treasury estimates that this would cover 750,000 people out of a total workforce of just over six million and save around £300 million a year.

The Conservative Party have promised a called for a one-year freeze but would “honour commitments already made” and exclude public servants earning less than £18,000 (around a third of all public sector jobs) or those “risking their lives for this country in Afghanistan”. This is estimated to save around £3.2 billion a year. Plans were also announced to reduce the size of Whitehall by a third, which would lead to thousands of job losses.

The Conservatives currently control most local authorities, where the employers have rejected the unions’ 2010 pay claim (£500 or 2.5%, whichever is the greater). Instead they have offered a pay freeze.

The Liberal Democrats propose zero growth overall for public sector pay, a 25% reduction in the total paybill of staff earning over £100,000, and a salary freeze plus a reduction in the use of bonuses for the civil service.

### **What will a pay freeze mean for public sector workers?**

In December the Chancellor announced a 1% cap on public sector pay settlements for 2011-12 and 2012-13. In the Pre-Budget Report, this was changed to a cap on “basic pay uplifts.”

The real impact of a pay freeze depends on how it is implemented and which parts of the pay structure are affected. This is due in to the way pay settlements are handled in different parts of the public sector, particularly in relation to pay progression.

Most pay structures include pay progression to allow employees to move through a pay band, reflecting additional experience, performance or skills. This allows individuals to move though a pay band, reflecting additional experience, skills or performance. For example, salary steps for



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NHS staff are worth around 3.5% at the middle of the range. School teachers in England and Wales on the main scale progress by steps worth around 7%.

In the civil service, pay settlements tend to be based on changes to the total paybill. An overall budget may be set which includes increase to pay bands (revalorisation) plus other aspects including allowances, progression payments and performance pay. Therefore a budget increase of 4% may only result in a 2% increase on pay bands, as part of the budget uplift is used for other parts of the pay structure.

So if a pay limit applies just to the revalorisation of pay rates, then this would mean that pay progression may continue.

A Treasury spokesperson said that in 2010-11 the limit would apply to staff in post rather than pay progression or the bottom and top of pay scales, and that the 0%-1% figure would not represent the change in paybill. What this means in practice, however, will depend on what the Treasury remit for 2010-11 says when it is published.

The pay freeze planned for local authorities excludes incremental pay rises awarded to more than half the local government workforce which are on average worth between 1% and 2%. Those staff at the top of their grades will receive nothing.

### **What will be the impact of pay restraint?**

In the short term, economic circumstances will change the context in which pay freezes will take place. For example, forecasts predict that inflation will rise to between 1.75% and 1.9%, on the Consumer Price Index and 2.9% on the Retail Price Index. Private sector pay rates are also likely to pick up this year.

As Duncan Brown, director of reward services at the Institute for Employment Studies has pointed out, while many private sector employers froze pay levels in 2009, negative inflation meant this action still translated into real earnings growth. However, in 2010, the situation in the public sector will not be similar to that experienced by the private sector in 2009. Last year, a pay freeze still delivered real income growth but price inflation will become positive this year meaning that people's living standards will be hit by a freeze much harder.

The longer-term implications are harder to predict, but are potentially serious. Labour Research Department warns that the pay limit for 2010-11 and the interpretation of limits over the next three years could impact on pay comparability across the public sector. They say that for example, the current local government pay claim is based largely on comparisons with other public sector workers, especially in the NHS. Local authorities are well aware of this role and some have developed it further by adopting living wages. Mayor Johnson continues to back the London Living Wage, which has put him somewhat at odds with his party.

Since 1998 cumulative increases in basic pay have been worth almost 41% in health as against just under 37% in local government. The result is higher pay levels for jobs like cleaner, catering assistant, residential carer, social worker and nursery nurse. Minimum pay levels average £13,481 across a range of named public sector organisations, compared with the NJC minimum of £11,995.

Civil service unions have also been active in promoting the need for coherence across the many different government departments and agencies in order to address the inequalities in the different



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bodies, where similar jobs in the civil service can attract very different wage levels, terms and conditions.

A government policy towards pay freezes also threatens to undermine the independence of the pay review body system. Pay review bodies make independent recommendations on pay for certain groups of employees in the public sector, after considering evidence from the Government, employers and unions, with the long-held expectation that the Government honours those recommendations. Imposed pay restraint undermines the pay review bodies and a tried and tested process of pay determination. It also places restrictions on the ability of government departments and agencies to negotiate their own pay settlements and to take into account particular equal pay and recruitment and retention problems.

### Why calls to dismantle national pay bargaining are wrong

The Conservative Party has proposed an end to national bargaining for teacher's pay, replaced by a pay body to set a national benchmark for salaries, allowing schools to pay over or under it as they see fit. The Chartered Institute of Personnel and Development, and the Public Sector People Managers' Association also advised that the Government should scrap national pay rates and introduce more performance-related pay to cut the public sector wage bill, rather than cap pay awards.

Meanwhile, Professor Alison Wolf has written a report for the CentreForum think tank, which is linked to the Liberal Democrats. This calls for an end to national pay bargaining, stating that national pay systems ignore local differences, handicap struggling regional economies, and make it impossible for public sector managers and institutions to cope with the fiscal crisis. The report states that public sector workers should receive individual contracts from their employers, instead of pay and conditions set at national level. It argues that poorer regions, inflexible public sector salary scales handicap the private sector because employers cannot compete through lower costs.

It is difficult to see how the answer to helping tackle poverty in poorer areas is to lower the wages of those who work there. In many areas of the UK, the public sector provides a benchmark for decent pay and conditions and protection for lower paid workers. Holding back public sector pay to match already low average earnings could generate a downward pay spiral in those areas with the weakest labour markets, this could drive down pay rates further. This would particularly affect disadvantaged areas, women and those in low paid occupations. It would also create huge problems in keeping control of the overall national pay bill in the public sector.

Individual contracts would create a huge level of bureaucracy, requiring public sector organisations to conduct their own salary surveys, set their own job grading structures for local pay, conduct local negotiations and investigate individual complaints over pay and grading. The use of local pay bargaining in the NHS was attempted in the 1990s. This proved to be a costly experiment which led to clinicians and other frontline staff spending long hours in negotiations with employers, thus diverting them away from their work of treating and caring for patients.

A system where schools or hospitals provided different rates of pay for the same job would only result in instability as people moved to other areas in search of higher pay and variations in the quality of the service provided to the local community. In contrast, national pay structures provide an efficient, consistent and transparent mechanism for dealing with large numbers of staff. They



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are underpinned by the principle of equal pay for work of equal value; local pay arrangements would only lead to pay discrimination and expensive litigation.

National pay structures also provide a way of ensuring that many public sector workers receive the appropriate training and regulation for their posts. This also allows geographical mobility as experience and skills are established and recognised. At the moment, recruitment and retention problems can be satisfactorily dealt with by recruitment and retention premia and high cost areas with high cost supplements within existing pay frameworks without resorting to local pay bargaining.

### **Cutting public sector pay would only store up problems for the future**

The Institute for Fiscal Studies explains that 'the Government would not benefit from the full reduction in public sector remuneration because public sector workers pay taxes on earnings received and may also receive benefits or tax credits.' They estimate that for every £1 cut in public sector earnings, public spending is reduced by £1.19 but the government would save only 73 pence once loss of taxes and increased spending on benefits and tax credits are taken into account.

If the public sector pay workers less, then they will pay less employers' national insurance, and their employees will pay less income tax and employees' national insurance, as well as possibly being entitled to larger amounts of tax credits or other means-tested benefits. It will also lead to essential demand

Pay restraint in the early 1990s caused serious recruitment and retention problems across the public sector, only rectified by efforts to bring pay in line with the private sector. This also badly impacted on staff morale and motivation. Pay freezes will only make it more expensive to hire the next generation of public sector employees – leading to a boom/bust approach to workforce planning.

### **Fat Cats and Thin Facts**

Following the MP's expense scandal, there has been increased, and justified, scrutiny over how taxpayer's money is used. This scrutiny has extended to senior pay levels and so-called fat cats in the public sector earning more than the Prime Minister.

Although there are some instances of very high pay in the public sector, this is not widespread, with most appearing to be employed by such organisations as the Royal Mail, BBC, Network Rail, Channel 4 and various regulators. Indeed, IFS explain that the distribution of wages in the public sector is significantly more compressed than that in the private sector. In general, there are fewer who are very poorly paid and fewer who are exceptionally well paid. They state that the public sector worker at the 95th percentile of the public sector wage distribution (for full-time males) earns 3.8 times the amount earned by his colleague at the 10th percentile. The private sector relativity is 4.7 times, representing a big difference between the sectors.

IFS conclude that there is little serious evidence that the highest-paid employees in the public sector are overpaid relative to their private sector counterparts. While it is unfair that there is a huge gulf between those paid most and the lowest paid, it is unfair to paint a picture of uncontrollable pay in the public sector.



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**Speak up for Public Services** represents 26 public sector trade unions, together with the TUC.