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@TheIFS

Public spending, pay, and pensions



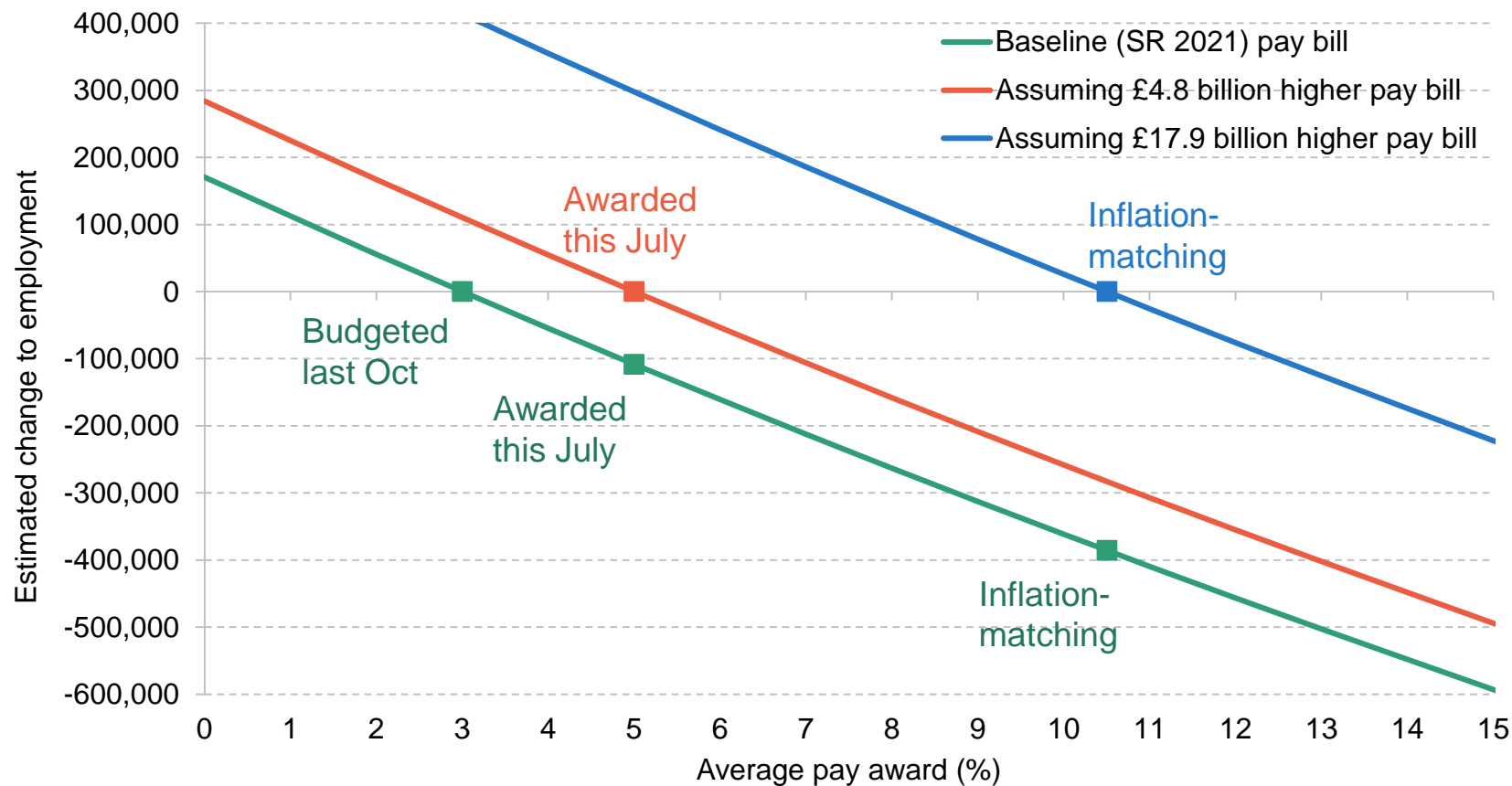
Economic
and Social
Research Council

Decisions on public sector pay

- Departmental budgets **fixed in cash terms** for the next three years last October
 - Predicated on public sector pay awards of ~3%
 - Did not predict double-digit inflation this financial year
- Public sector employees awarded a pay rise of 5% (on average) this July – **departmental budgets not topped up** to compensate
 - Estimated to increase staffing costs by approx. £5bn this year
- Even higher-than-budgeted awards may be insufficient to prevent **recruitment and retention concerns** in the public sector
 - Represent a real-terms cut to public sector pay
 - Below expected private sector settlements this year
- Trade-offs over pay, employment, and spending cuts...

Difficult trade-offs this year...

Combinations of pay awards and changes to public sector employment consistent with different illustrative overall paybills for 2022–23



Notes and sources: see Figure 4.1 of Boileau, O'Brien, and Zaranko (2022)

...and for the next three years?

- Spending Review 2021 covered three years
- If pay awards matched inflation after 2022/23, departmental compensation in 2024/25 would need to be >£10bn higher
 - Or headcount would need to be cut by more than 220,000 (3.8% of the projected workforce)
- If inflation-matching pay awards offered in all three years, settlements would need to be £25bn higher in 2024/25
 - Or headcount cut by 500,000 (8.6% of the workforce)
- **Choice between funding additional pay awards or accepting a deterioration in the quality of public services**

Public sector pay has been falling relative to the private sector

Average public-private hourly pay differentials from 1993–94 to 2021–22



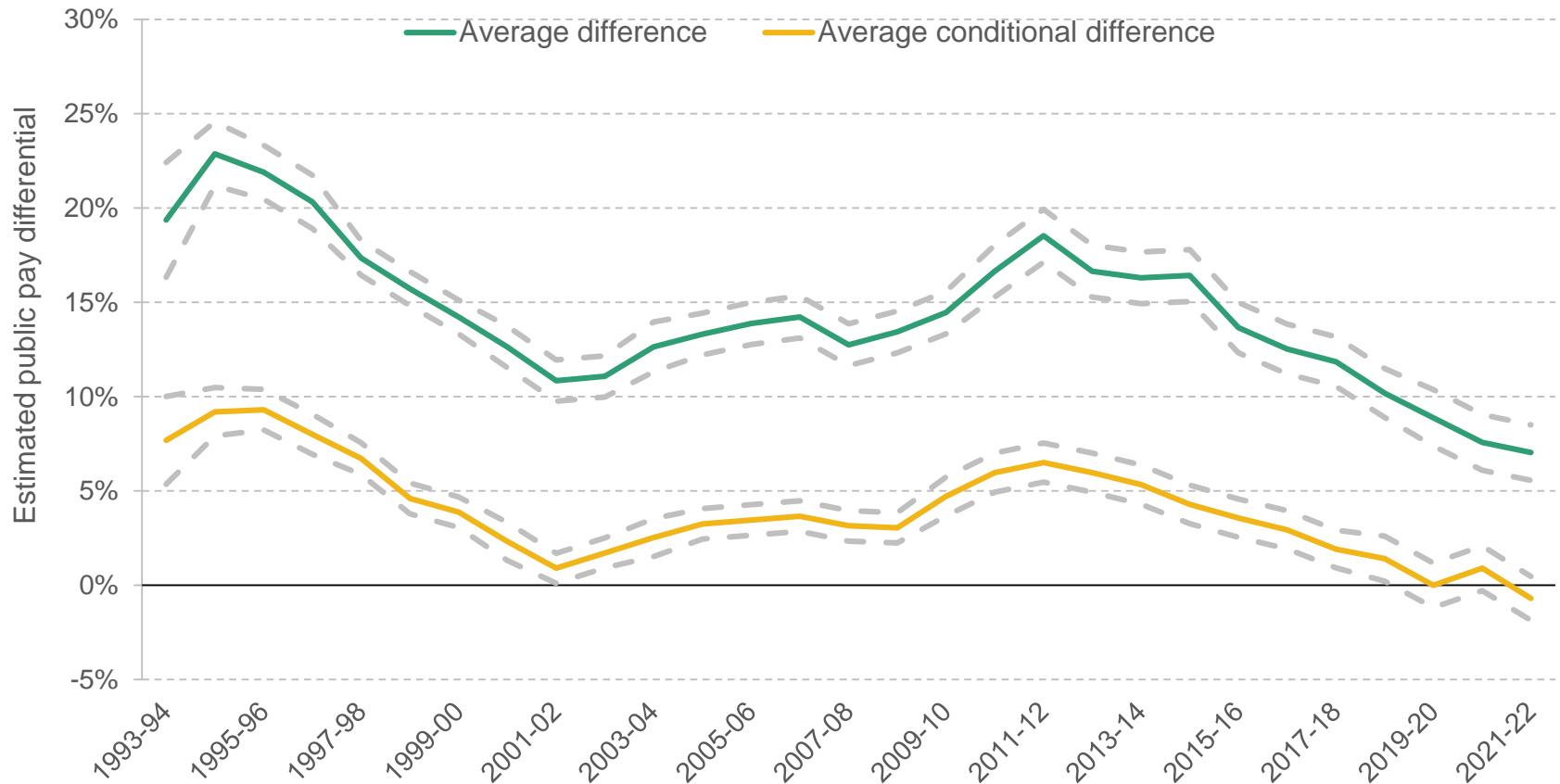
Notes and sources: see Figure 4.7 of Boileau, O'Brien, and Zaranko (2022)

Two sectors differ in composition

- Different workforces in the two sectors
 - Public sector workers tend to be more highly educated, older, more experienced, more likely to work part-time, etc
 - Making direct comparisons between average pay does not give a full picture of the difference for similar workers
- We use Labour Force Survey data and regression analysis to control for these differences
 - Look at the public sector premium for otherwise similar workers

Public sector pay has been falling relative to the private sector

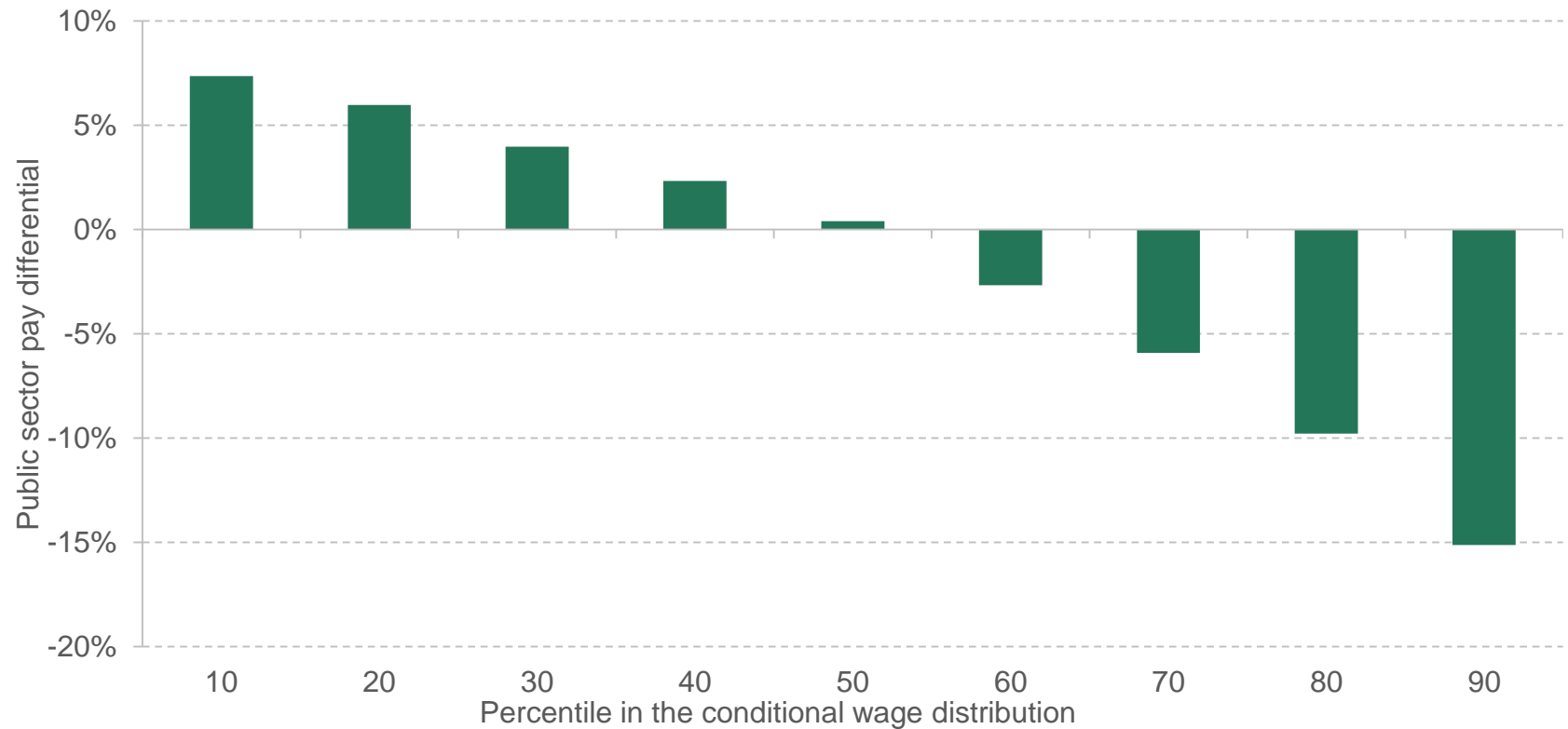
Average public-private hourly pay differentials from 1993–94 to 2021–22



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Conditional wage distribution shows relative compression

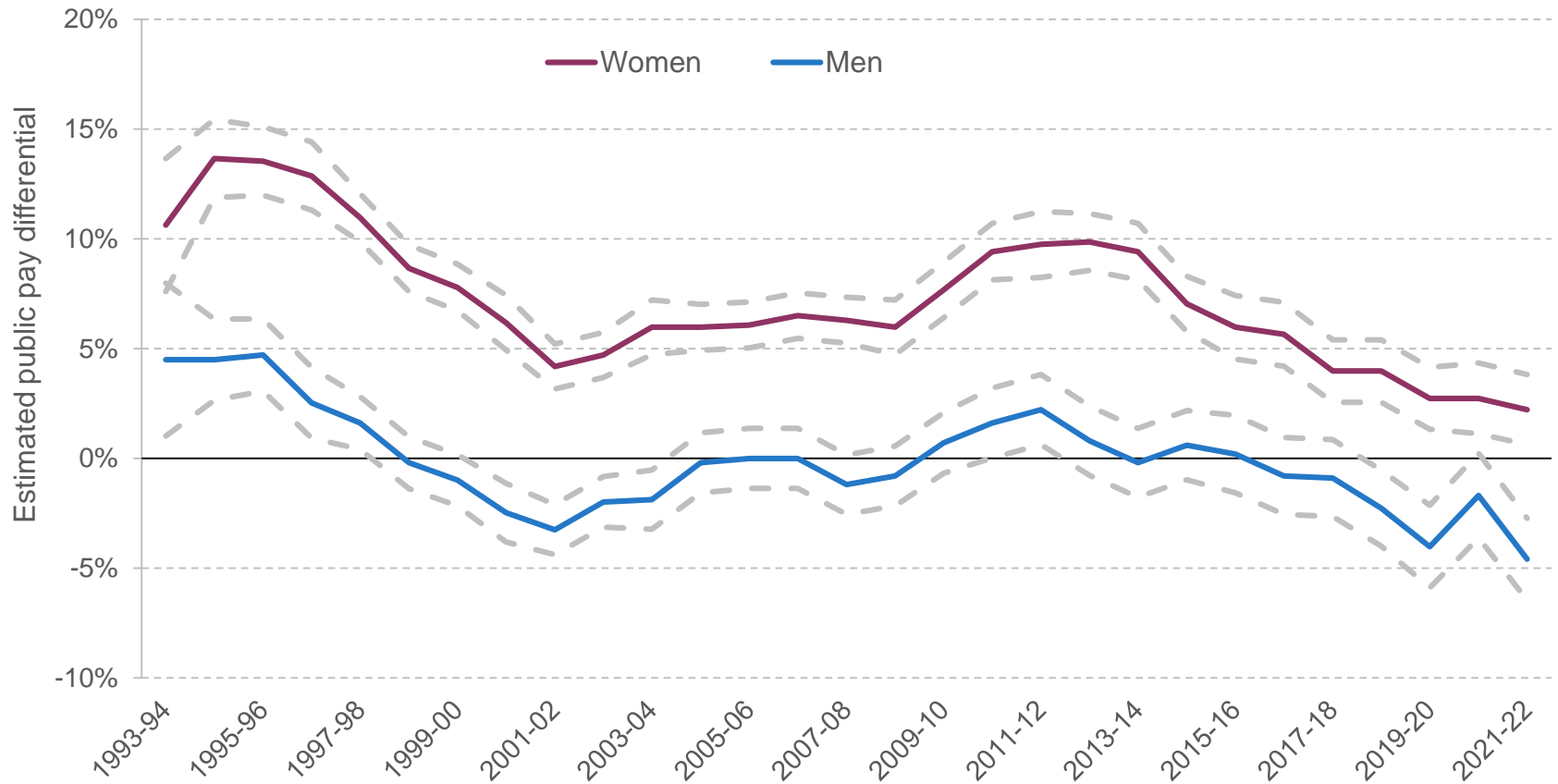
Estimated public-private hourly pay differential by percentile in the conditional wage distribution, 2021-22



Notes and sources: see Figure 4.8 of Boileau, O'Brien, and Zaranko (2022)

The public-private pay differential is higher for women

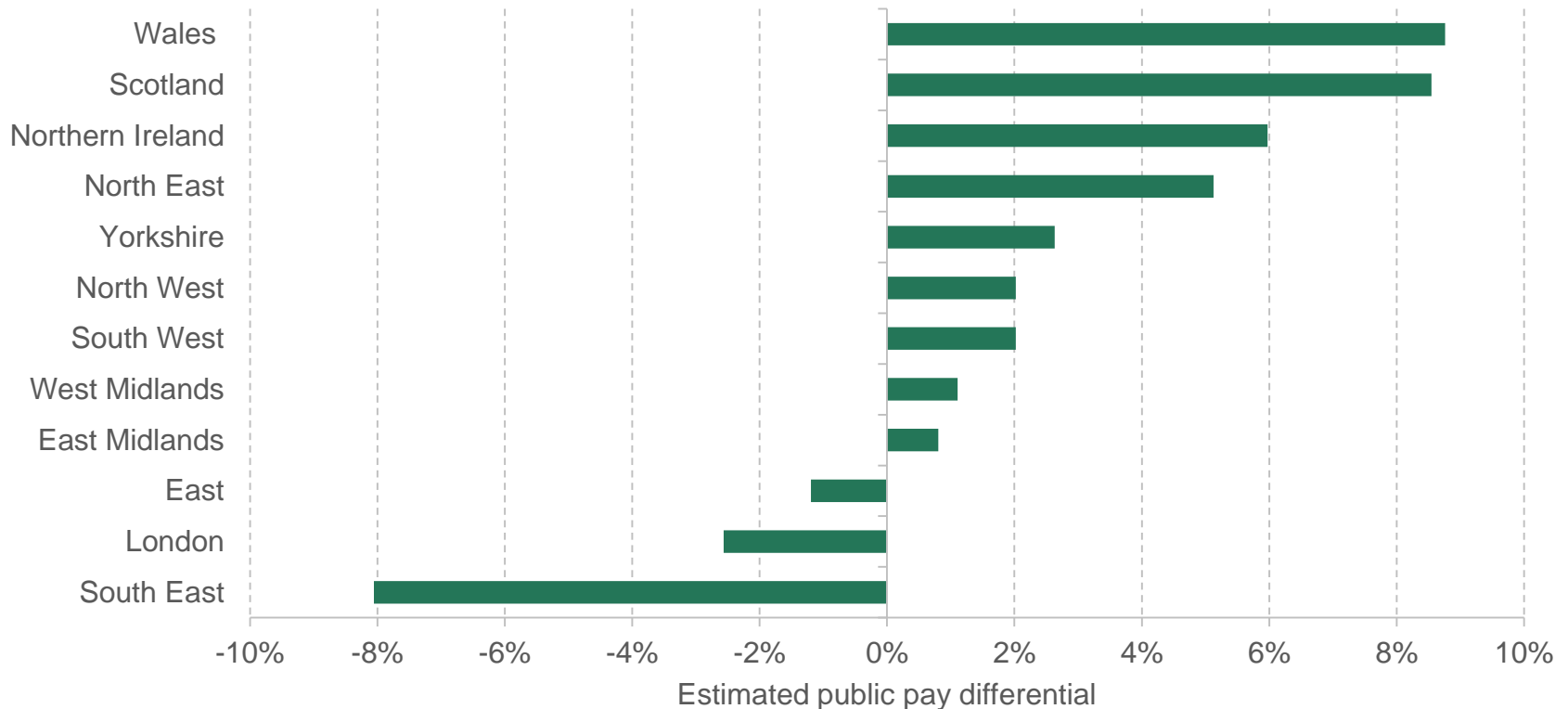
Average public-private hourly pay conditional differential over time, by sex



Notes and sources: see Figure 4.9 of Boileau, O'Brien, and Zaranko (2022)

Variation in the public pay differential across the UK

Public-private pay differential conditional on workers' characteristics, by UK region and nation, 2019-2021



Notes and sources: see Figure 4.10 of Boileau, O'Brien, and Zaranko (2022)

Pension participation differs between sectors

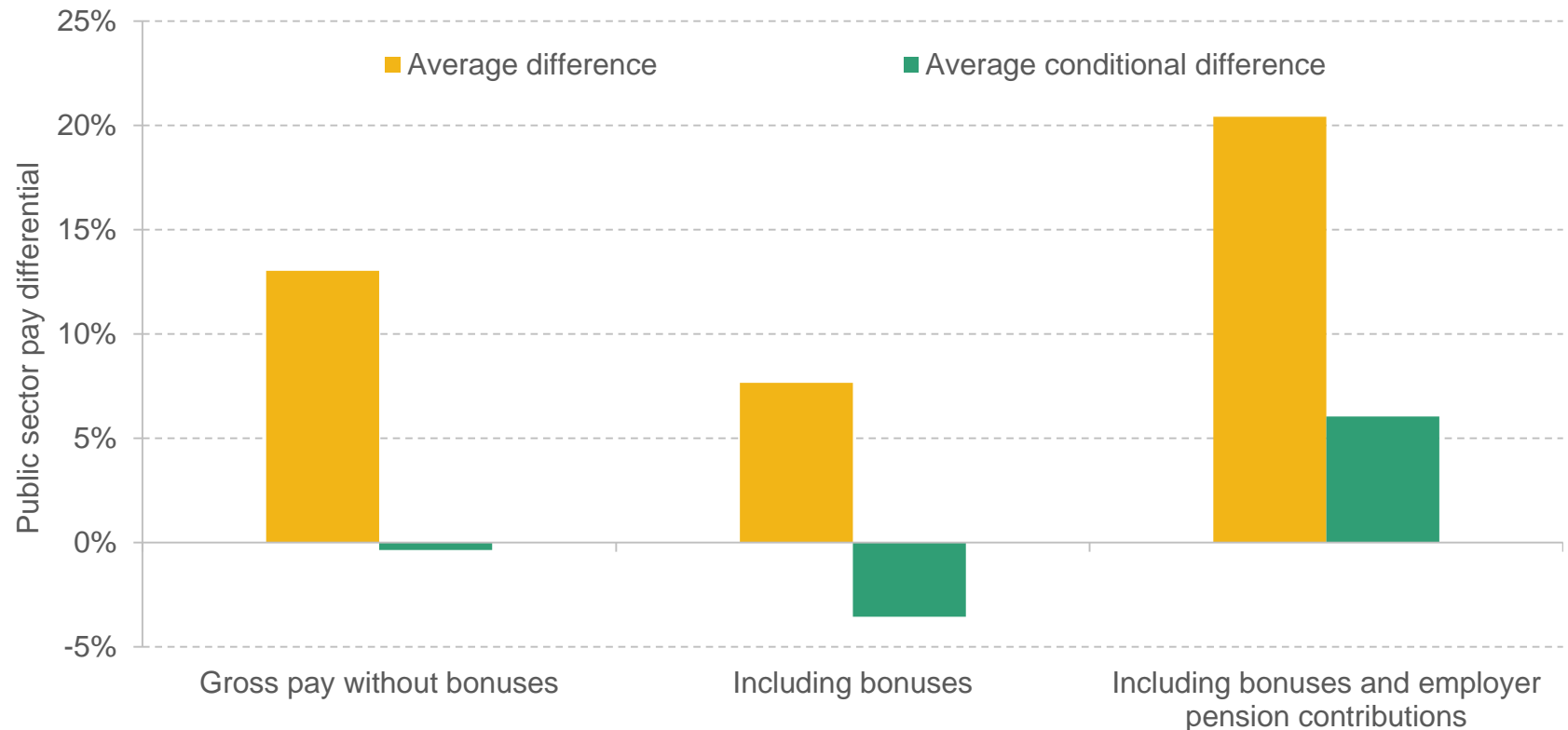
- Have only been looking at pay – pensions another important part of overall remuneration
- Public sector pension provision more generous

	Private sector	Public sector
Pension participation	75%	91%
% in a Defined Benefit pension scheme	7%	82%
% with employer contribution...		
>10%	11%	86%
>20%	2%	47%

Source: Authors' calculations using ONS ASHE Pension Tables 2021, P2.1 and P10.1

Pension contributions increase the public pay differential

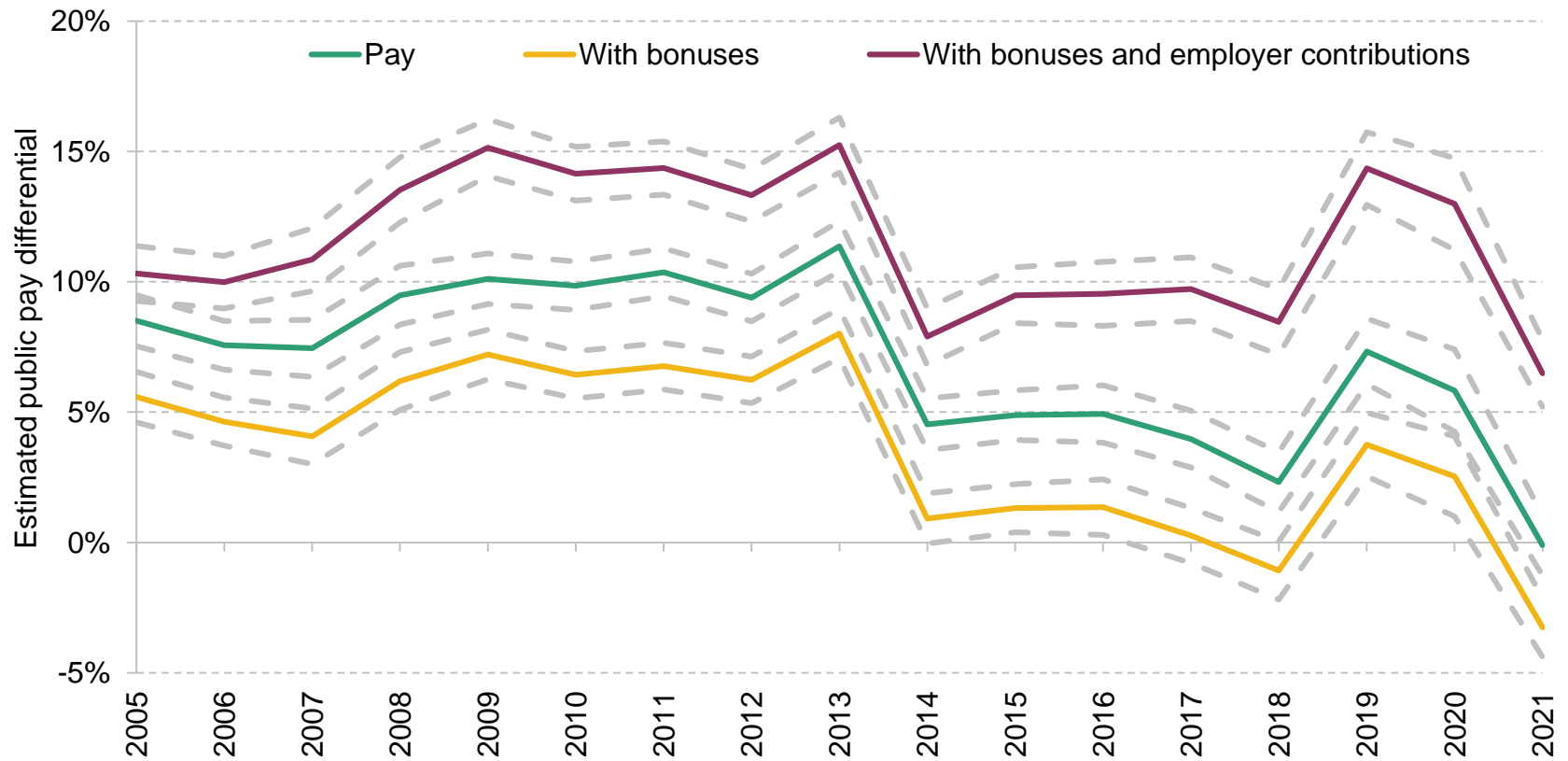
Average public remuneration differential in 2021



Notes and sources: see Figure 4.14 of Boileau, O'Brien, and Zaranko (2022)

The total remuneration gap has fallen

Average conditional public pay differential from 2012 to 2021



Notes and sources: see Figure 4.15 of Boileau, O'Brien, and Zaranko (2022)

Longer-term policy issues

- **Structure of public sector remuneration**
 - Remuneration in the public sector increasingly skewed towards deferred pay
 - 20% of average public sector remuneration deferred, against less than 8% in the private sector
 - Take-home (non-deferred) pay may be more important to employees, especially during a cost of living crisis
 - Can't reduce DB pension contributions: binary in-out decision
 - Starting point: reducing employee pension contributions and increasing take-home pay
 - Prevent rise in opt-outs, increase public sector workers' welfare

Conclusion

- Public sector pay awards need to be higher than assumed a year ago
- This cannot be accommodated within existing spending plans without painful headcount cuts
- Either spending plans must be topped up or it must be accepted that the quality of public services will deteriorate
- Pay awards announced so far will be below inflation, and likely below private sector pay settlements
- This comes after a decade of public sector pay falling relative to the private sector
- Public sector pension contributions are more generous – strong case for rebalancing public sector remuneration

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