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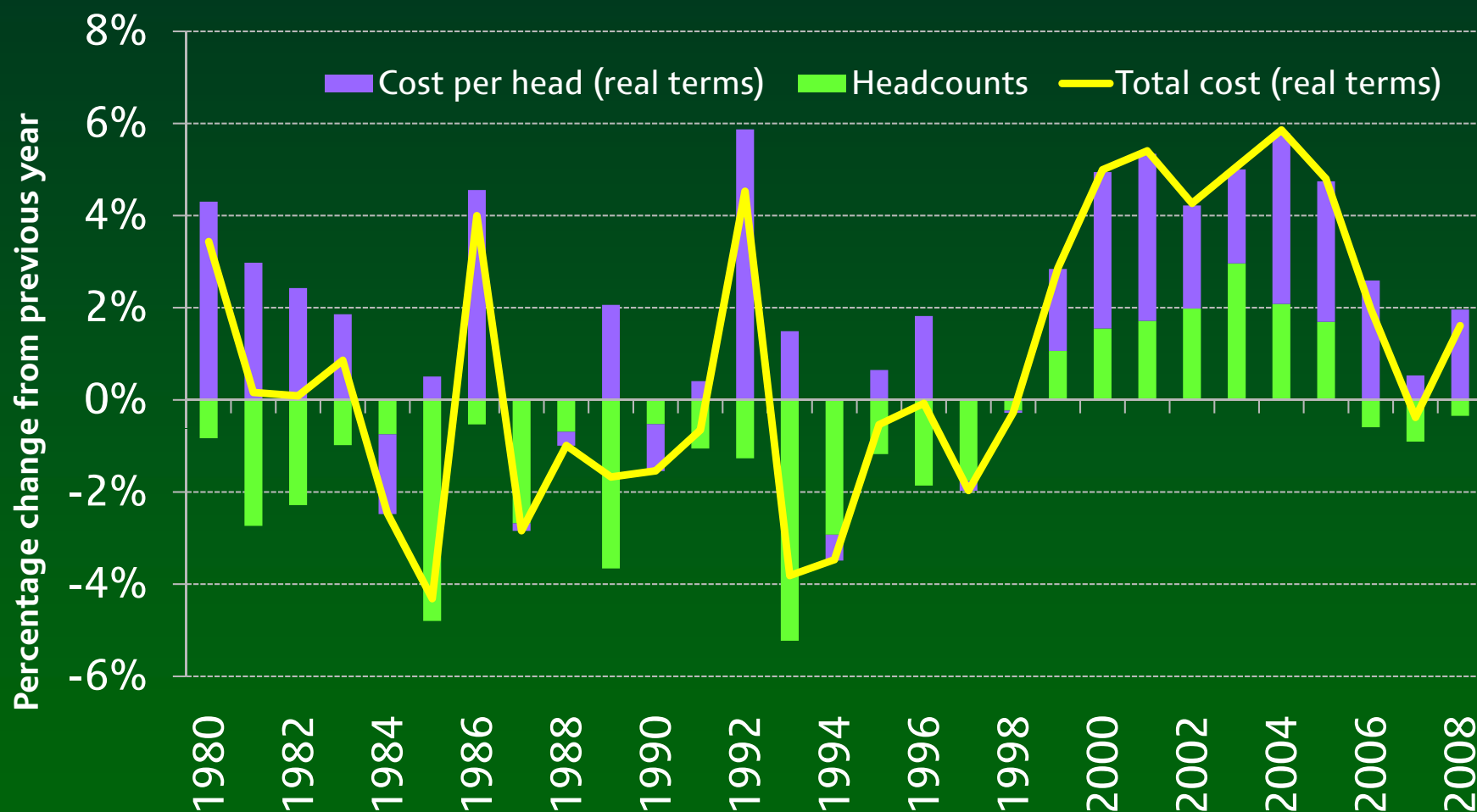
Public sector pay and pensions

Antoine Bozio and Paul Johnson

Overview

- Public sector pay bill is large: £174 bn, 30% of government expenditure in 2008
- Cutting the bill involves either
 - Cutting jobs
 - Cutting remuneration (pay and pensions)
- Main parties suggest cutting pay
- Is it justified?
- How much would it save?
- Where and how to cut public sector remuneration?
 - Regional issues
 - Fat cats
 - Pensions

Growth in the public sector pay bill



Sources: ONS, Blue Book 2009; authors' computation.

‘Tough choices on public sector pay’

- Main parties have announced ‘pay freeze’ to ‘save jobs’
- Difficult to cut pay in nominal terms
- 1931 Budget in the UK
 - 10 to 20% nominal pay cuts
 - Invergordon mutiny of the Atlantic fleet (Sept. 1931)



Pay growth in the public and private sector



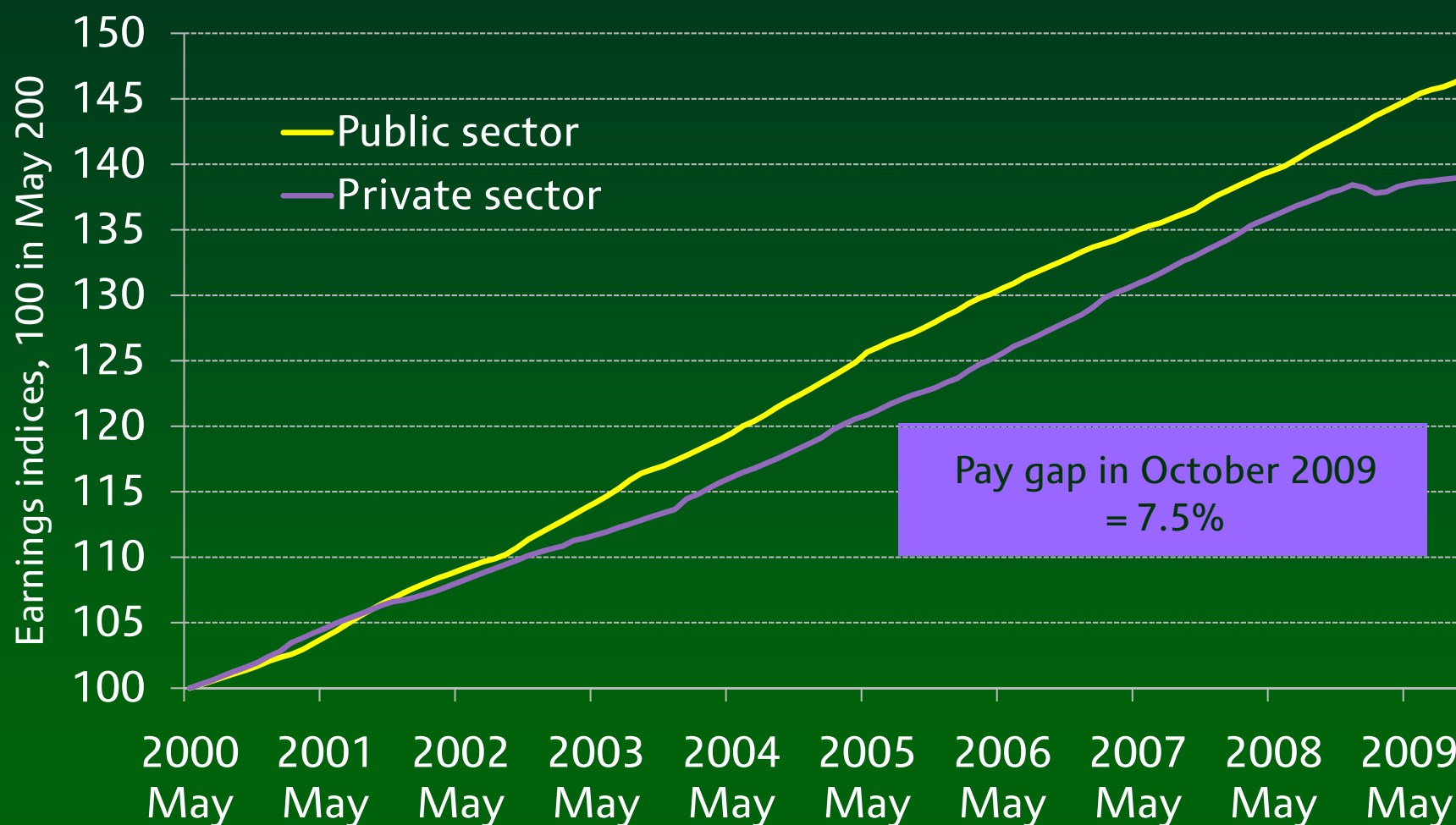
Source: ONS, Average earnings index (AEI) series

Pay growth in the public and private sector



Source: ONS, Average earnings index (AEI) series

Cumulated pay growth in the public and private sector since 2000

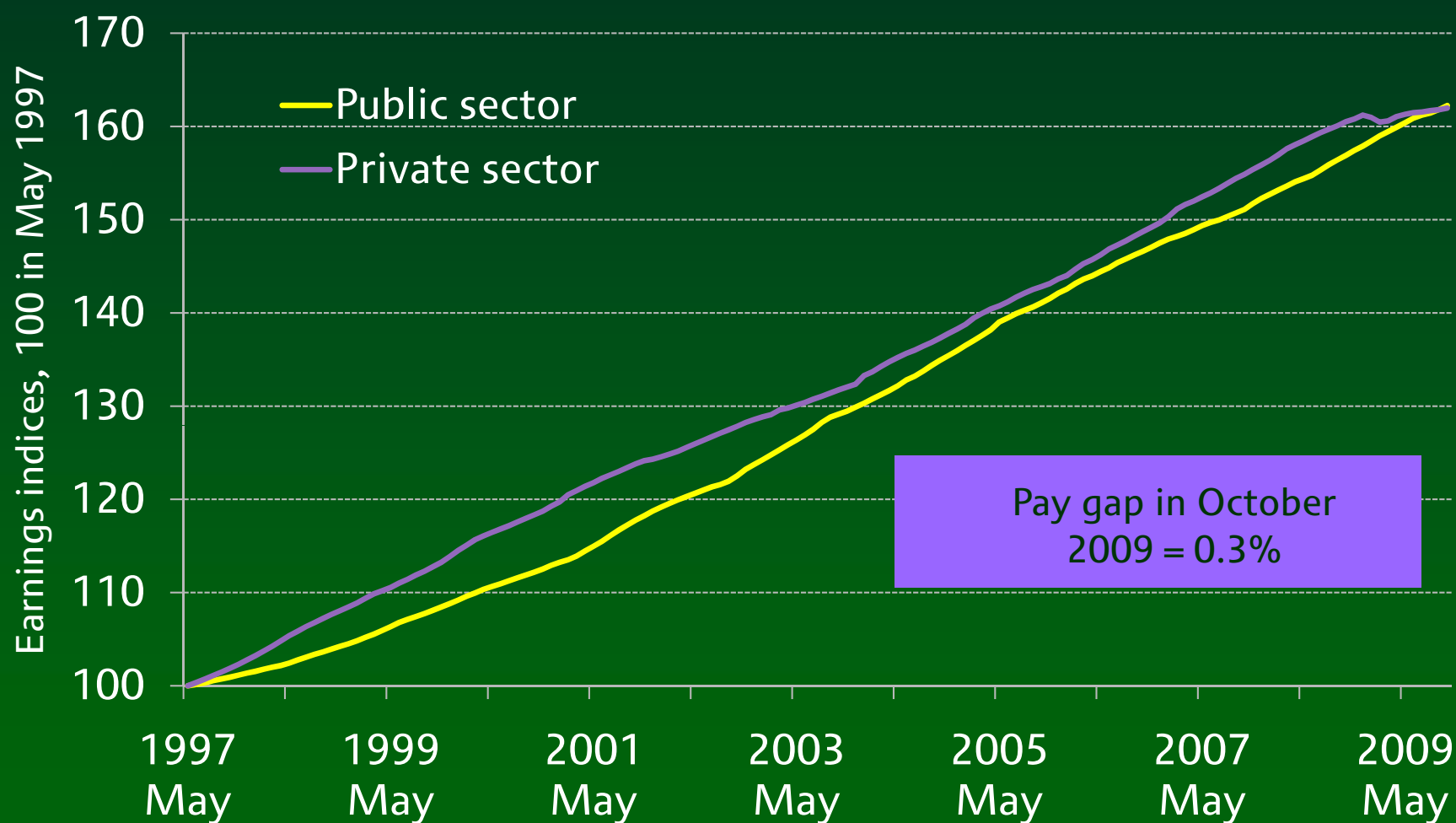


Source: ONS, Average earnings index (AEI) series



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Cumulated pay growth in the public and private sector since 1997



Source: ONS, Average earnings index (AEI) series

‘First simplify, then exaggerate’



Source: “Leviathan stirs again”, *The Economist*, 21st Jan. 2010

- Cyclical differences
- Composition differences
 - Education, qualification
 - Hours of work
 - Sex
 - Age
- Changes in the public sector
 - Increase in NHS workforce
 - Nationalisation of banks

How do you measure public sector wage premium properly?

- Estimation controlling for characteristics
 - Regression taking into account observed characteristics
 - Does not take into account unobserved characteristics
- Research by the Economic and Social Research Institute (ESRI)
 - In Ireland: public–private sector pay gap increased between 2003 and 2006, from 14% to 26%
- Largely justifies announced pay cuts in Ireland
 - 3 to 9% pension levy
 - 5 to 15% nominal pay cuts

Estimating public sector wage premium in the UK

	Men	Women
Raw wage premium	+19%	+26%

Source: Authors' calculations using data from the Labour Force Survey, 2006–09

Estimating public sector wage premium in the UK

	Men	Women
Raw wage premium	+19%	+26%
Controlling for education	+12%	+17%

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Estimating public sector wage premium in the UK

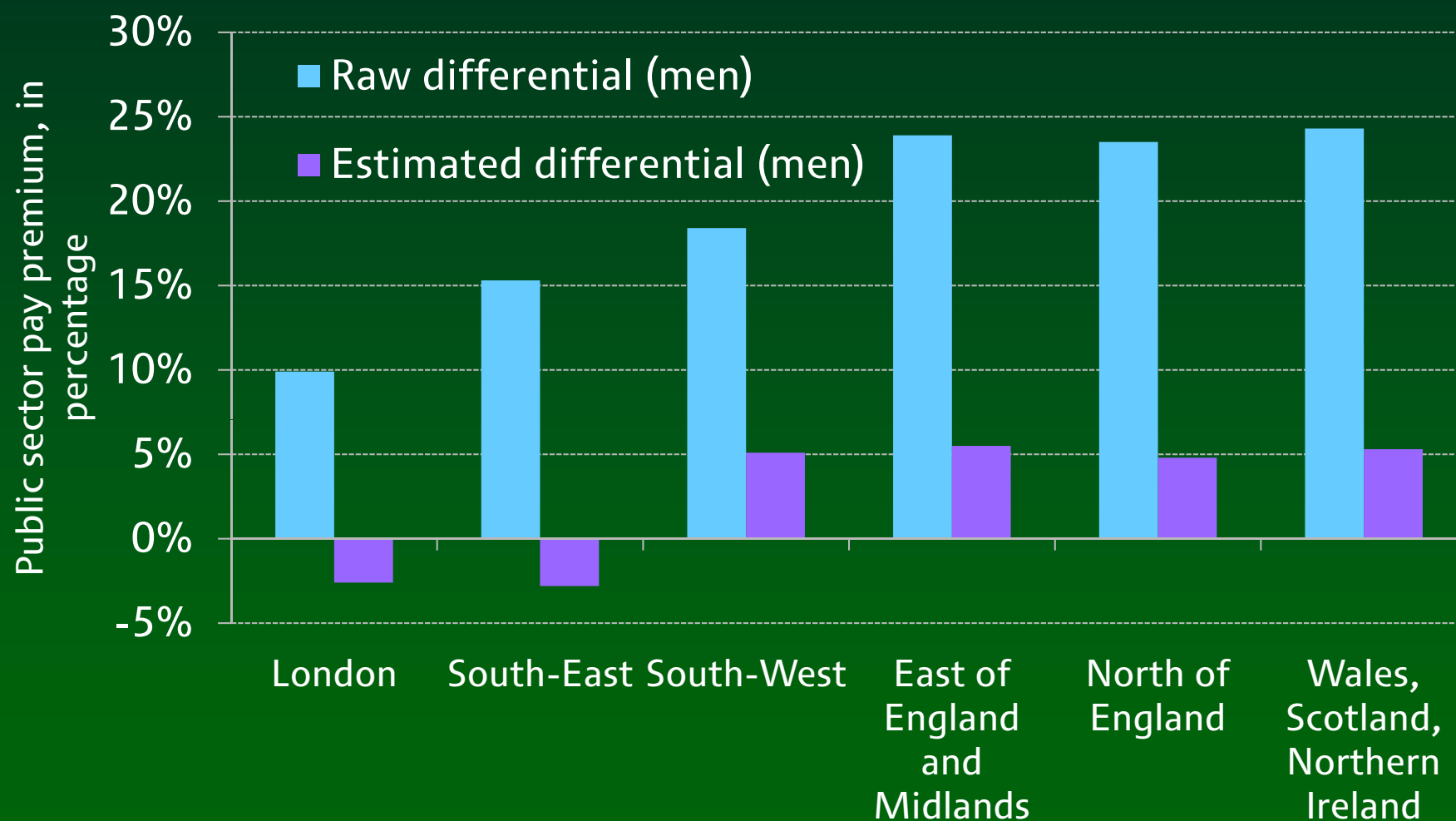
	Men	Women
Raw wage premium	+19%	+26%
Controlling for education	+12%	+17%
Controlling for education, age and qualification	+2%	+7%

Source: Authors' calculations using data from the Labour Force Survey, 2006–09

How much can it save?

- Real cut in pay of 5% across the board
 - Could be achieved by 3-year nominal pay freeze using PBR inflation forecast
 - Saving wage bill £7.5 billion
- Public spending would fall by more
 - Reduced employer NICs and pension contributions
- Net savings to the government would be smaller
 - Reduced income tax and employee NICs
 - Increase tax credits and benefits
- Estimation with the IFS microsimulation model TAXBEN
 - Public spending would fall by £8.9 billion
 - Net savings would be £5.5 billion

Estimating public sector wage premium by region



Some facts about fat cats



- Obese cats (top 0.1% of income distribution)
 - Income above £350,000
 - 69% work in ‘financial intermediation’ and ‘real estate, renting and other business activities’
 - Very few public sector workers

Some facts about fat cats



- Fat cats (1-0.1% of income distribution)
 - Income between £100,000 and £350,000
 - 46.5% in finance and other business activities
 - Public sector under-represented, except health sector

Some facts about fat cats

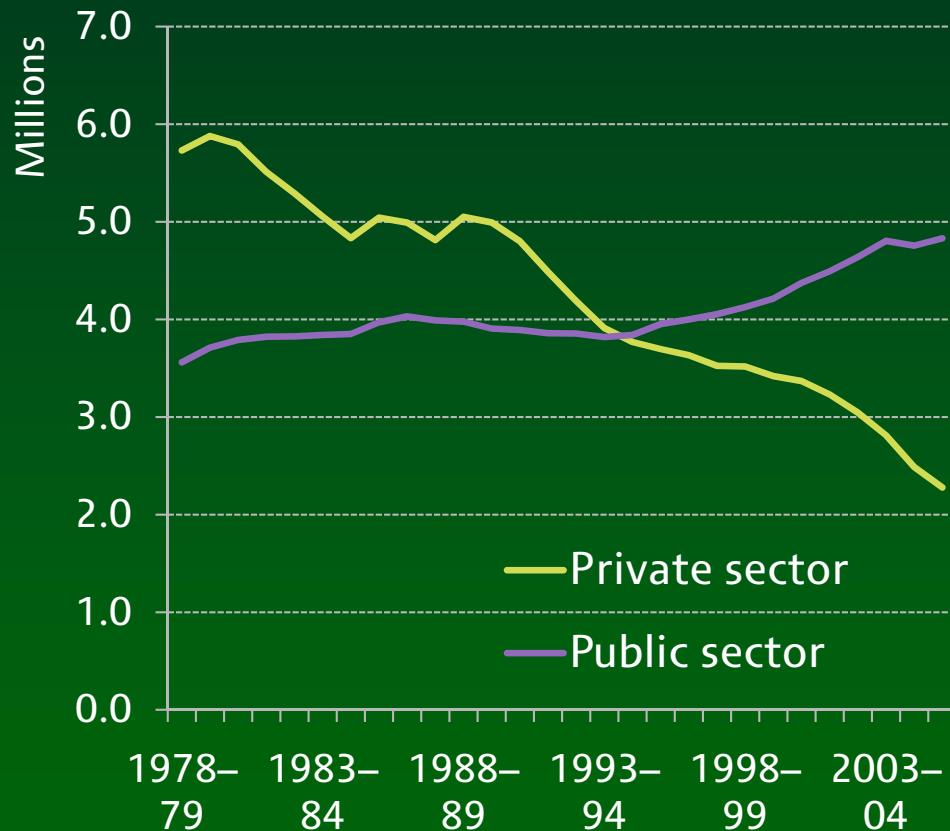


- Chubby cats (10-1% of income distribution)
 - Income between £35,000 and £100,000
 - Here public sector workers are slightly over-represented

Pensions

- Pensions are also part of the remuneration package
- Public sector workers:
 - are much more likely to enjoy membership of a defined benefit pension scheme;
 - have, on average, more generous pensions than those in the private sector who are members of a DB scheme;
 - have seen the *relative* generosity of their pension provision improve as private sector schemes have seen their benefits cut.

Numbers of members of contracted-out defined benefit pension schemes by sector



- IFS research (based on 2001 data)
 - in the public sector, membership of a DB scheme: 26% of earnings
 - in the private sector, membership of a DB scheme: 19% of earnings
- Overall the estimated average difference: 12% of earnings