



# Institute for Fiscal Studies



## Public sector pay and pensions

Carl Emmerson

# Public service pension reforms – proposals

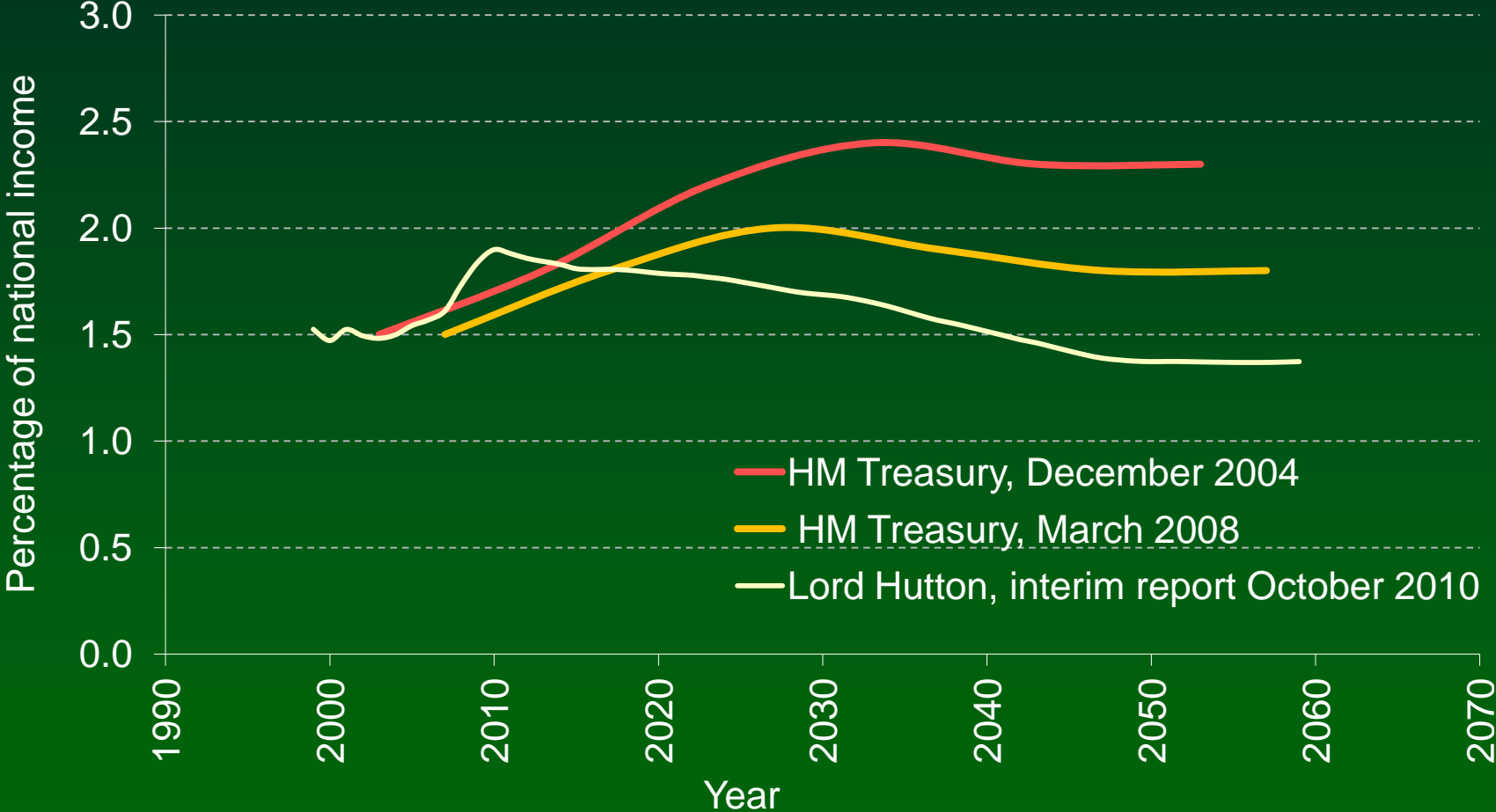
- Lord Hutton's proposal
  - accrued rights protected in full
  - defined benefit basis retained, but career average rather than final salary
  - normal pension age increased to state pension age, apart from for fire-fighters, police and armed forces where it should be age 60
- Latest Government offer is as above with
  - annual accrual rate of  $1/60^{\text{th}}$  per year of service
  - no cut for those within 10 years of current normal pension age

# Estimated future public service pension costs



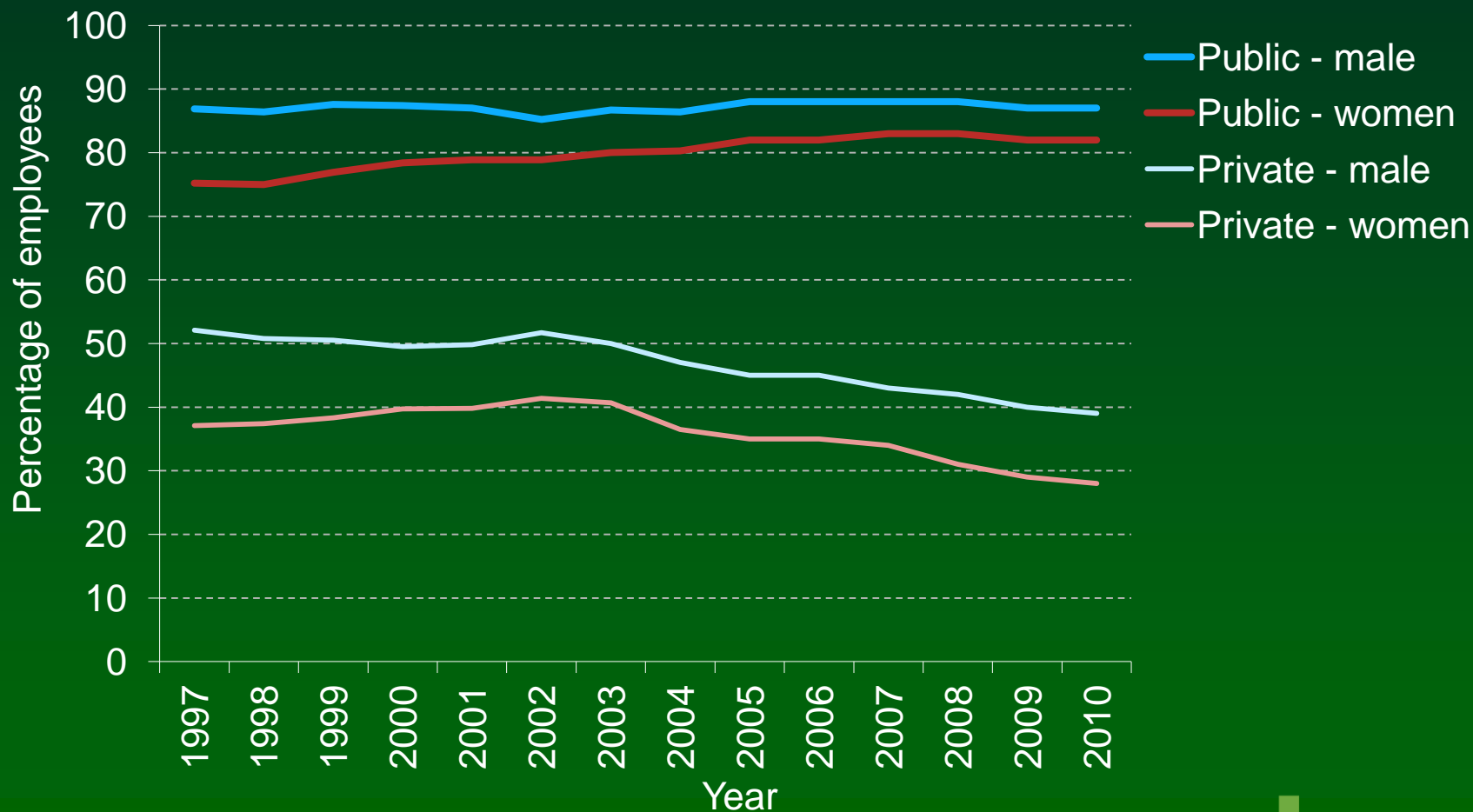
Sources: HM Treasury, *Long-term Public Finance Report*, 2004 and 2008; Lord Hutton's *Independent Public Service Pensions Commission*, interim report, October 2010.

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# Trends in workplace pension schemes



# Public service pension reforms – implications

- Retention of public sector defined benefit schemes can be justified
  - state better placed than employees to manage risks

# Public service pension reforms – implications

- Retention of public sector defined benefit schemes can be justified
- Shift to career average might be appropriate
  - high flyers currently get twice per £1 contributed than low flyers
  - pay review bodies should consider whether offsetting pay increases for some high flyers sensible

# Public service pension reforms – implications

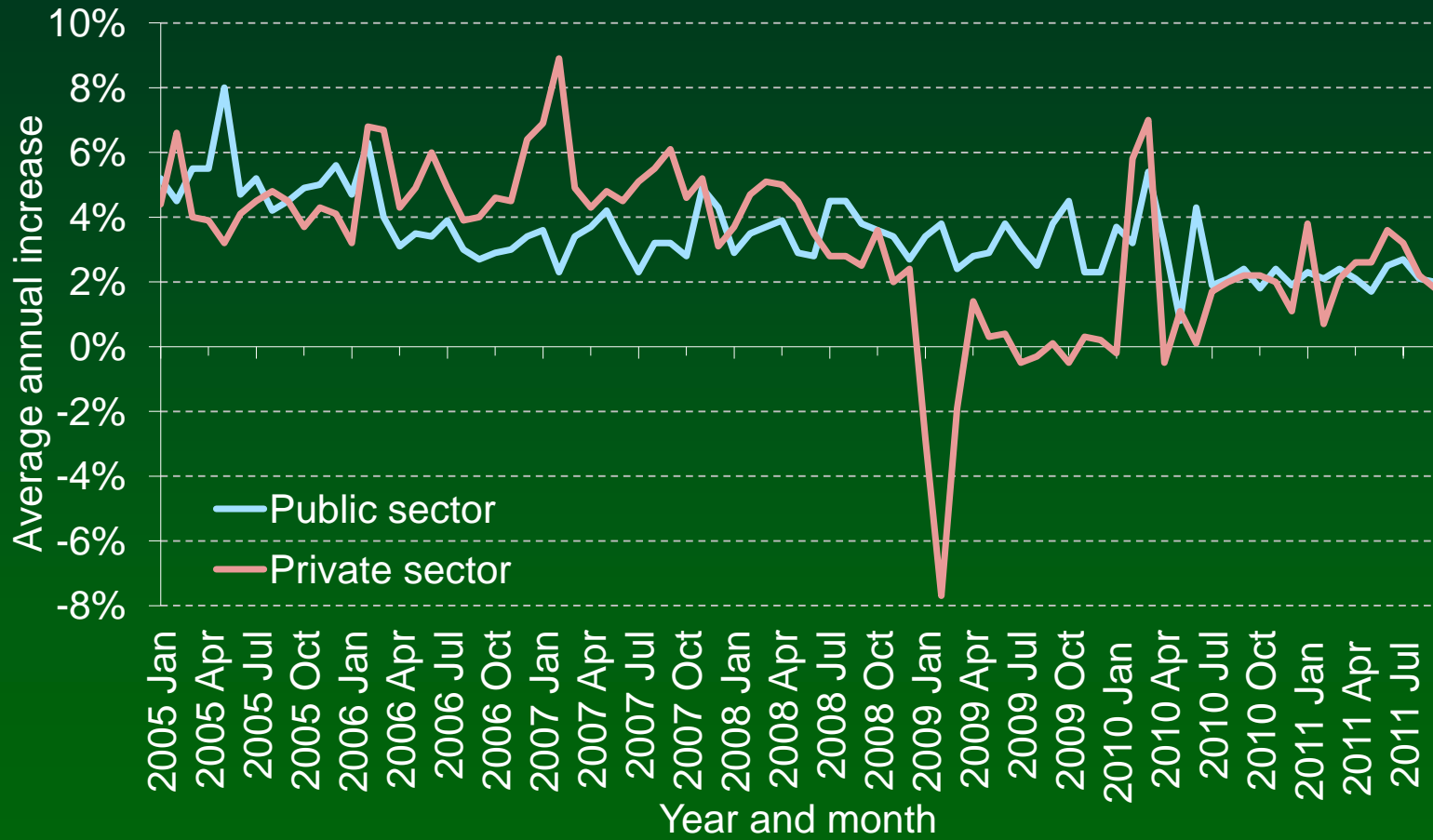
- Retention of public sector defined benefit schemes can be justified
- Shift to career average might be appropriate
- Increased NPA is (on its own) a significant reduction in generosity
  - more years of contributions to get same pension for less long
  - many new public-service workers already face NPA of 65
  - aligning NPA to SPA is a coherent response to increasing longevity
  - bringing forward the planned increase in the SPA from 66 to 67 represents a further cut for some aged 42 to 51



# Public sector pay

- Grew more quickly than private sector pay during the recession
  - unintended and has led to higher average wages

# Growth in public and private sector pay



# Estimated public sector wage differentials (1/3)

2010q1 to 2011q1

	Men	Women	All
Mean difference in wages	+20.3% (1.5%)	+28.1% (1.1%)	+24.7% (0.9%)

Notes: Standard errors are reported in parentheses.

Source: Authors' calculations using data from the Labour Force Survey, 2010q1 to 2011q1 (inclusive).

# Estimated public sector wage differentials (1/3)

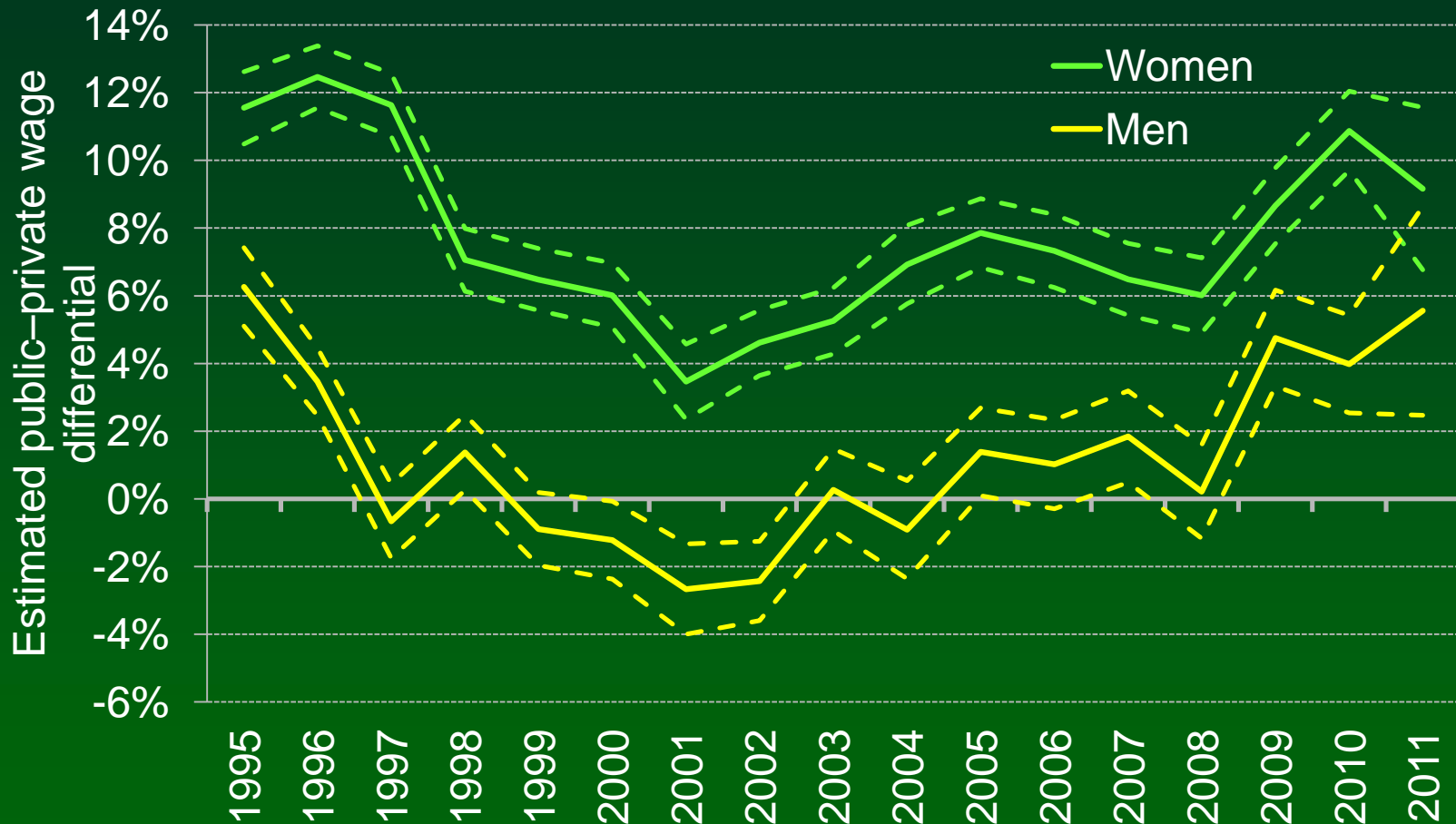
2010q1 to 2011q1

	Men	Women	All
Mean difference in wages	+20.3% (1.5%)	+28.1% (1.1%)	+24.7% (0.9%)
Controlling for education, age and qualification	+4.3% (1.3%)	+10.5% (1.1%)	+7.5% (0.8%)

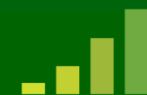
Notes: Standard errors are reported in parentheses. The wage differentials controlling for various factors are estimated by ordinary least squares (OLS), regressing log hourly wages on control variables for public sector, age left full-time education, highest qualification, age, age squared and interactions between age and age squared with age left full-time education. Hourly wages are computed using actual hours reported by survey respondents.

Source: Authors' calculations using data from the Labour Force Survey, 2010q1 to 2011q1 (inclusive).

# Estimated public sector wage differentials (2/3)



Note & sources: see previous slide.



# Public sector pay

- Grew more quickly than private sector pay during the recession
- Estimated headline male differential to be eliminated by 2014–15
  - average increase set at 1% in 2013–14 and 2014–15
  - follows two years of freezes for many public sector workers
  - increases in employee pension contributions are effectively a pay cut and come on top of this
- In the next Parliament
  - pay pressures could return suggesting a further squeeze difficult
  - keeping pace with private sector pay would require larger settlements than OBR assumes
  - doing this unlikely given public spending totals and knock-on implications for public sector employment

# Forecast pay differential

	2011–12	2012–13	2013–14	2014–15	2015–16	2016–17
Public sector av. earnings growth	2.0%	0.8%	2.6%	2.6%	3.1%	3.1%

# Forecast pay differential

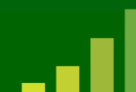
	2011–12	2012–13	2013–14	2014–15	2015–16	2016–17
Public sector employment	5.5m	5.4m	5.3m	5.1m	4.9m	4.8m
Public sector av. earnings growth	2.0%	0.8%	2.6%	2.6%	3.1%	3.1%





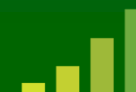
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Private sector av. earnings growth	1.4%	2.5%	3.8%	4.8%	4.8%	4.8%



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Private sector av. earnings growth	1.4%	2.5%	3.8%	4.8%	4.8%	4.8%
In year impact on pay differential	+0.5ppts	-1.7ppts	-1.2ppts	-2.2ppts	-1.7ppts	-1.7ppts



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Public sector employment	5.5m	5.4m	5.3m	5.1m	4.9m	4.8m
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Cumulative impact on pay differential	+0.5ppts	–1.1ppts	–2.3ppts	–4.4ppts		



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Cumulative impact on pay differential	+0.5ppts	–1.1ppts	–2.3ppts	–4.4ppts	–6.1ppts	–7.8ppts



# Public sector pay

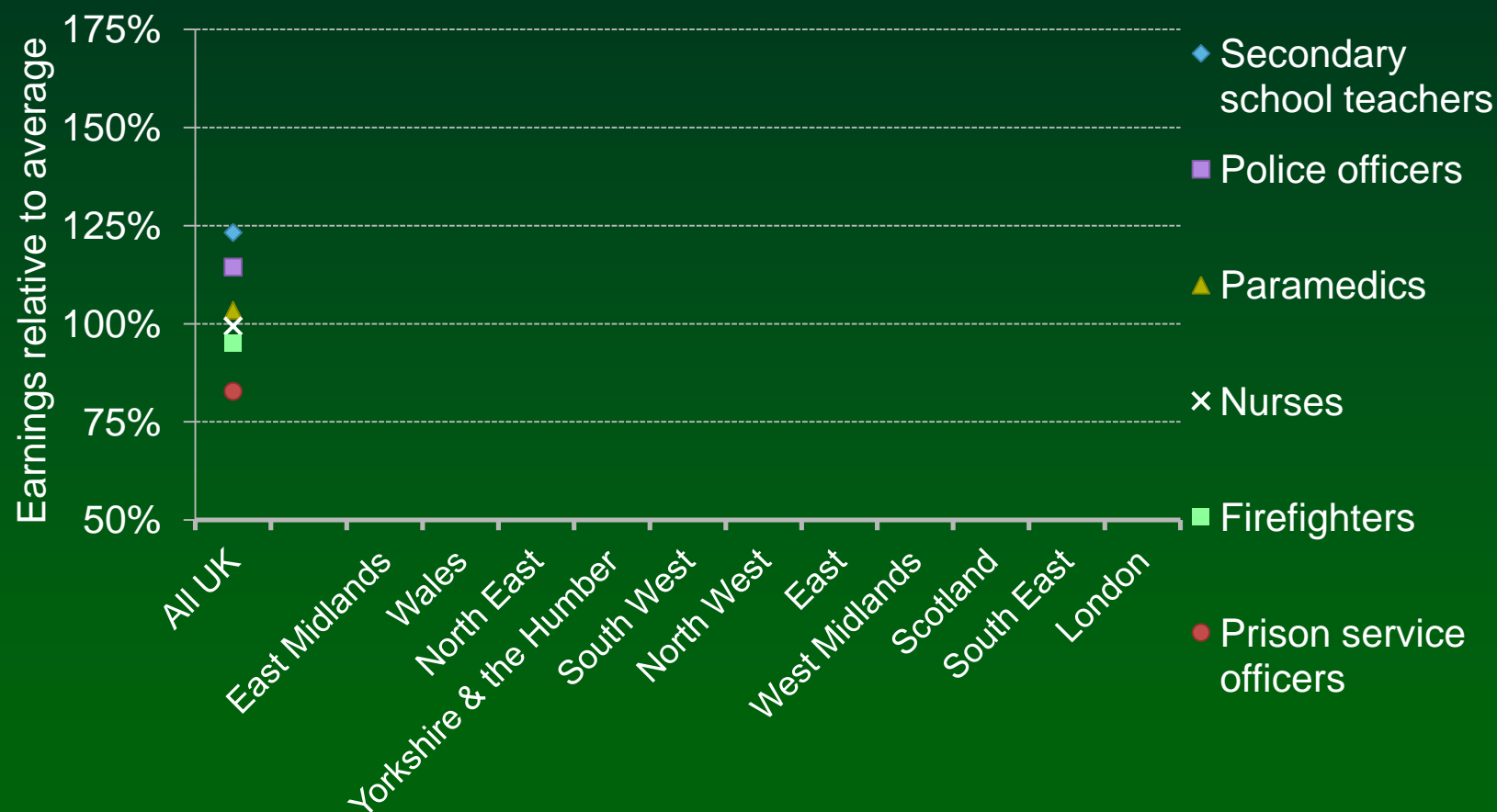
- Grew more quickly than private sector pay during the recession
- Estimated headline male differential to be eliminated by 2014–15
- Significant regional variation in estimated pay differentials
  - pay not statistically higher in London or the South East, suggests nationally set regional pay could be more efficient
  - but the degree to which this is true varies by occupation suggesting that regional pay would need to be carefully implemented

# Estimated public sector wage differentials (3/3)



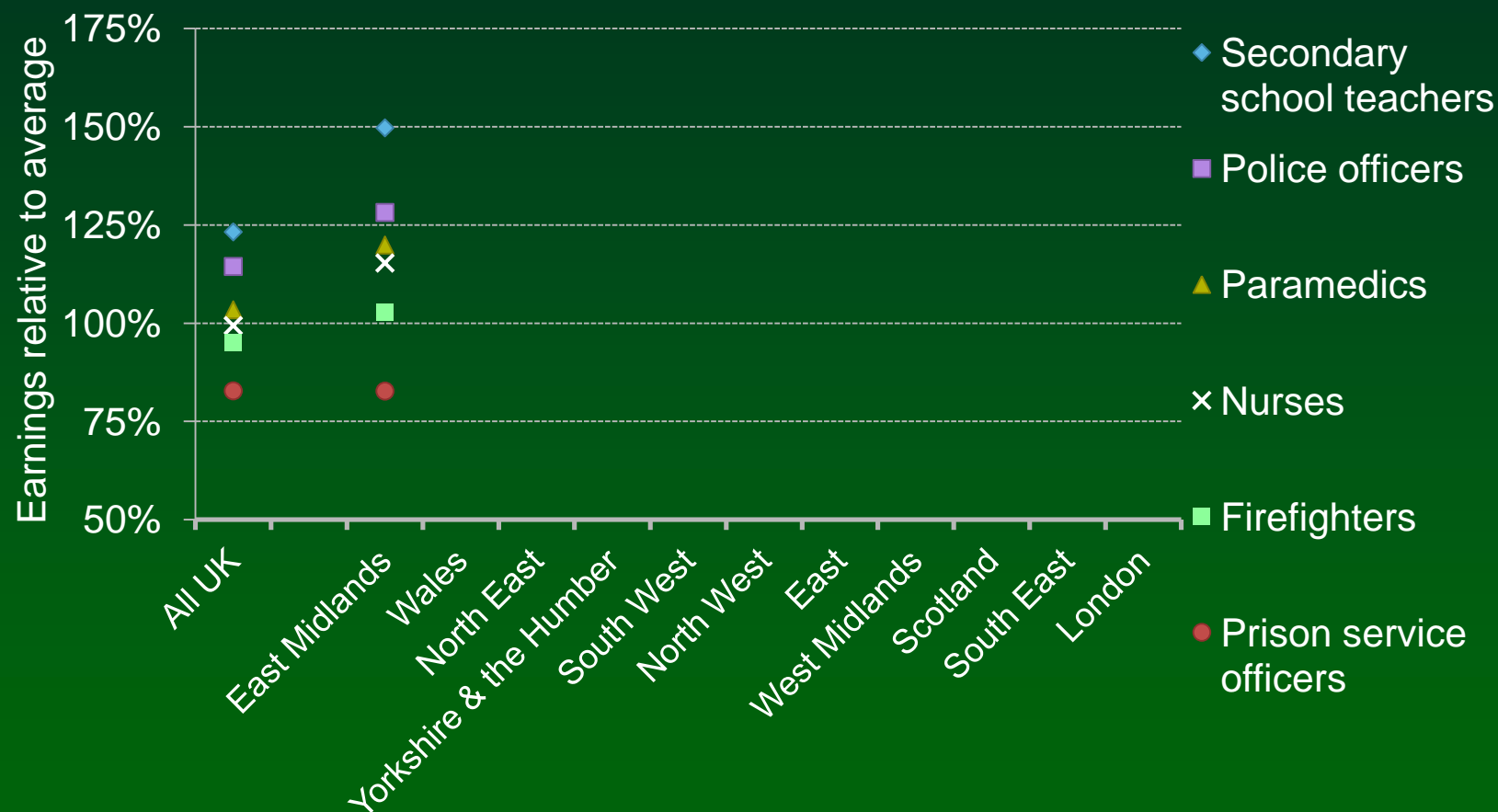
Note & sources: see previous slide.

# Relative pay across regions, selected occupations



Notes: Full-time male average earnings by occupation relative to all earnings.  
 Source: Authors' calculations using data from the Annual Survey of Hours and Earnings.

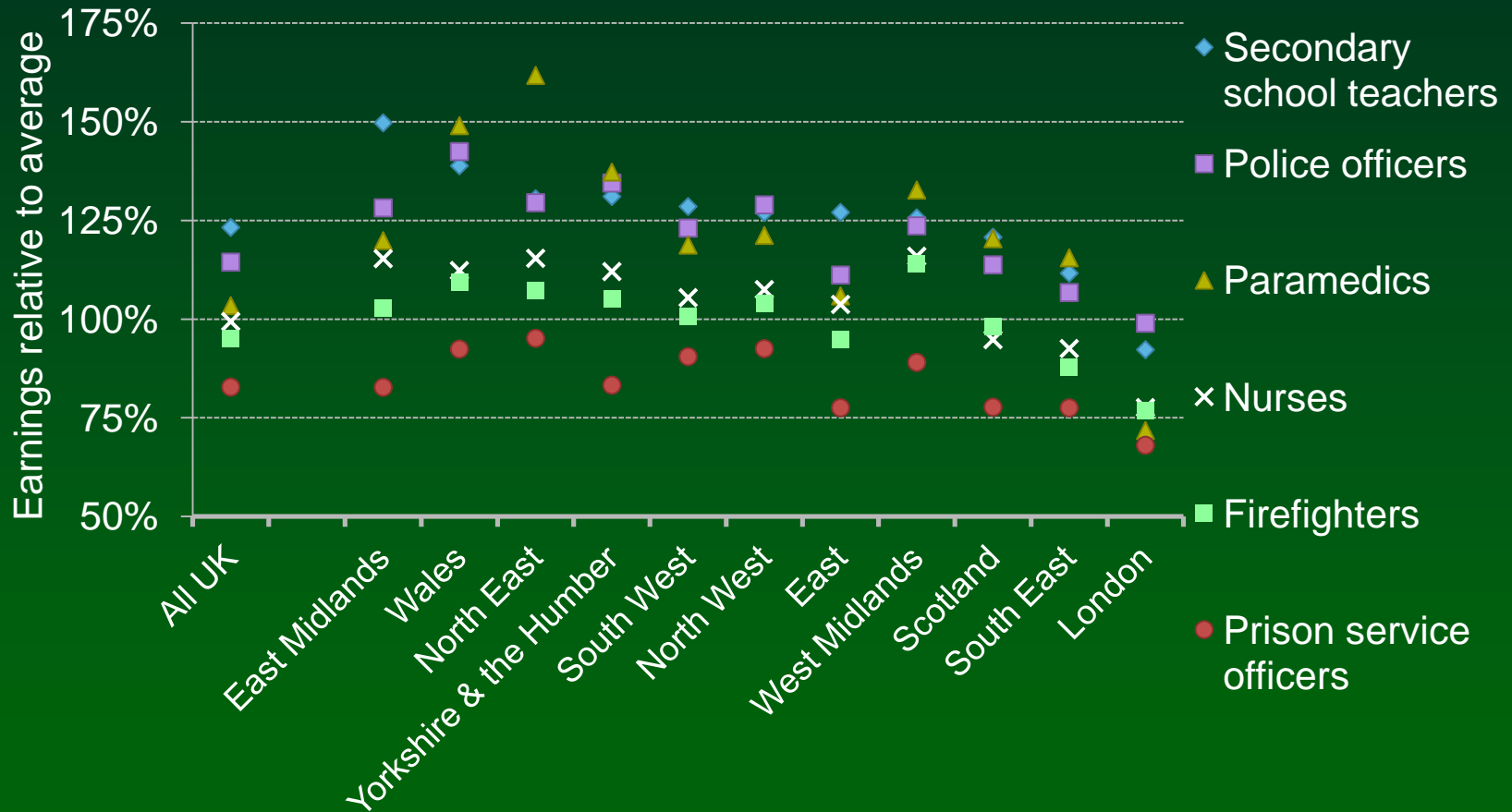
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# Conclusions: public service pensions

- Current schemes not unaffordable
  - but might not represent best use of taxpayer funds
- Many aspects of Lord Hutton's proposals sensible
- Would remain more important overall in the public sector than in the private sector

# Conclusions: public sector pay

- Grown more quickly than private sector pay during recession
  - not intended
- Over this Parliament
  - Government's pay policy set to unwind this by 2014–15
  - increases in employee pension contributions are effectively a pay cut and come on top of this
  - could be more efficient to have nationally set regional pay increases, but would need to be done carefully by occupation
- In next Parliament
  - pay pressures could return suggesting a further squeeze difficult
  - more generous pay deals unlikely given public spending totals and knock-on implications for public sector employment
  - but pension premia would continue to exist and could be used to justify further pay restraint relative to the private sector

