Box B. Public and private sector wage increases – the real story

There has recently been scrutiny of public sector wage rises and the limits which have been placed on them since 2010. There is a perennial debate over the relative pay in the public and private sectors. Most public sector workers have been subject to either a pay freeze or only a 1% pay rise per annum in the past 7 years. Allowing for inflation this has meant that variously they have seen their real wages fall on average by 12% over this time period. In this box we track the course of public and private sector wage increases since 2004 and explain what Public Sector Pay Review Bodies are and how their remit has been curtailed since 2010.

The Public Sector Pay Review Bodies

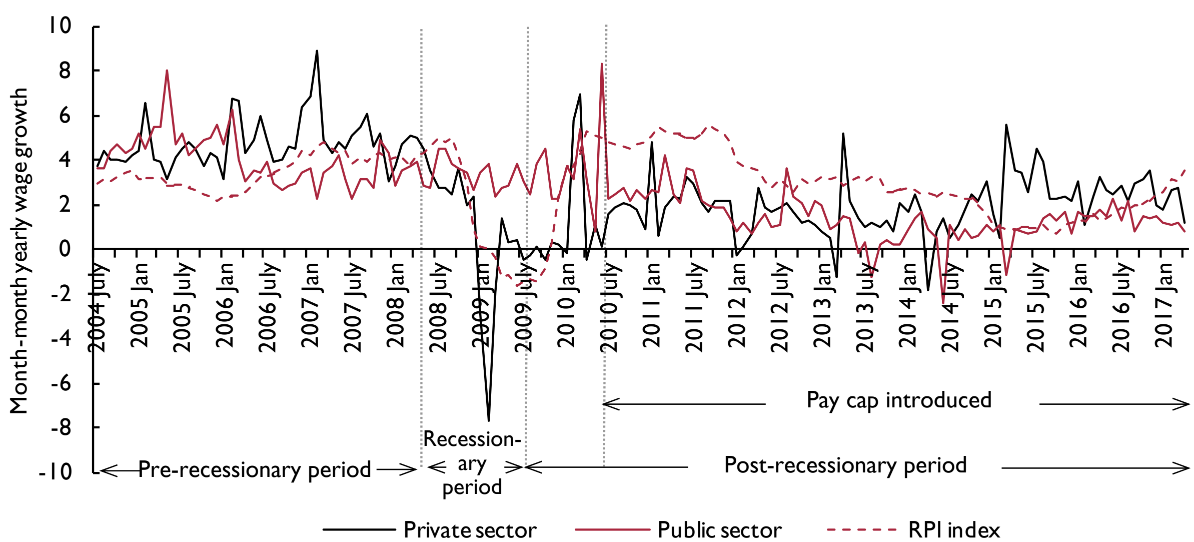
A third of all public sector workers are subject to the recommendations of the public sector Pay Review Bodies (PRBs): Armed Forces (AFPRB), Senior Salaries (SSRB), School Teachers (STRB), Doctors and Dentists (DDRB), Police, NHS workers (NHSPRB), and the Prison Service. Other public sector workers (mainly civil servants and local government officials) are not subject to the recommendations of the PRBs. These PRBs are made up of independent experts who, on an annual cycle, for the occupation in question, take evidence about: demand and supply conditions in the occupation, the extent of shortages, recruitment and retention issues, what is being paid in comparable jobs in other sectors and the evidence on inflation and cost of living changes and unemployment patterns. Each PRB then makes an annual recommendation on pay uplift to the government – which in times gone by was unfettered by the constraints of government direction. Since 2010 this pattern has changed as each PRB has been given a remit letter which determines what the pay rise will be – subject to the fiscal constraints of government spending. So in the past these independent experts made recommendations based on the evidence – coming up with a recommended pay award which took objective account of all the evidence. However, since 2010 these PRBs have been constrained by the1% pay cap.

The actual story of public/private sector pay increases

The real pattern of wage increases in the public sector is that wage increases in the public and private sector tend to follow each other with a lag. Determining whether it is public sector pay that follows private sector pay, or the reverse is true, is not a straightforward matter and would require some careful econometric analysis. What is clear is that PRBs do look at the level of the RPI and private sector wage increases in the previous year in making their recommendations. What is also likely is that higher private sector wages will have an effect on the price of goods and services and the RPI with an appropriate lag. But equally, higher public sector wages must be paid for by higher taxes, and so this will also have some effect on inflation.

It is best to consider public/private sector wage comparisons in terms of wage increases as any analysis based on levels of actual pay is fraught with comparability problems. On average public sector workers earn more than private sector workers – but they typically have very different jobs with different qualifications and years of professional training. These complexities are abstracted from if we consider changes in pay rather than the absolute level of pay.

Figure B1. Nominal public/private sector wage growth



Source: ONS AWE: Private Sector: Historic Annual Growth (%): NSA, June 2017, ONS Consumer Price Inflation time series dataset, June 2017.

Box B. (continued)

Figure B1 graphs the year-on-year growth in average weekly earnings in the two sectors by month and compares it to the basic level of price inflation as measured by the RPI. We choose 2004 as our starting point as at this time average weekly earnings growth were the same in the two sectors. We graph on the same axis the level of inflation as measured by the RPI so that it is easy to see what has happened to declining real pay in the two sectors. Notice that public sector pay, even after the 2010 pay restraint, is rising by more than 1% – this is due to the 'wage drift' associated with increment scales and the balance of the age structure in the public sector, as workers age and retirees are replaced by younger, less expensive employees. Prior to the recession public and private sectors each had a time of relative pay advantage in the sense that their pay was growing faster than inflation. During the worst years of the recession from 2008 to mid-2009, public sector wages rose by more than the private sector. Especially marked was the huge fall in private sector earnings in early 2009. In the post recessionary period all wages were falling in real terms as the RPI was higher than wage increases in both sectors. For nearly all of the past 5 years private sector wage rises have outstripped those in the public sector.

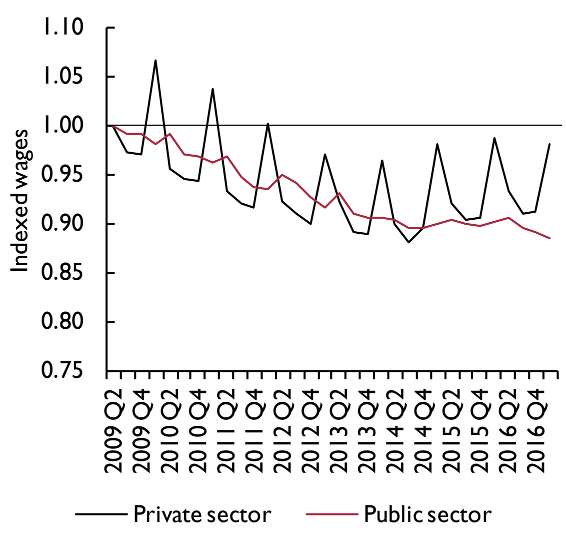
For most of the post 2010 period, public sector pay has grown more slowly than inflation and private sector pay. Hence real wages have been falling. The picture is best seen in figure B2 which graphs the cumulative loss of value of real wages in the two sectors from 2010. Measured as an index starting in 2010, we see that public sector pay is worth only around 88% of what it was in 2010. So, we can see that public sector workers have lost around 12% of their pay in real terms since 2010. The corresponding fall in real wages in the private sector is 2%. What is also clear in this graph is the huge seasonal element to private sector weekly earnings which rises at the beginning of the calendar year, every year, and then falls back. In reality the public sector pay round does not usually take place on a calendar year basis – and is different for each occupation. Hence we do not see such a big seasonal element to public sector earnings.

Total reward and pay drift

There are some important complications to this story. Firstly, public sector jobs tend to have: longer holidays, shorter working hours, less chance of redundancy and better pensions. Until recently most public sector pension schemes have been based on a final salary (defined benefit) scheme which gives retirees some fraction of their final salary based on their years of service. For example, civil servants used to have a scheme which was in 60ths – so that a worker serving 30 years could retire on half their final pay. In contrast, private sector employees were more usually in defined contribution (DC) schemes where they pay the same fraction of their earnings into a pot each year and the total is then used to buy an annuity on retirement. Typically these schemes were much less generous. In compensation, many comparable jobs are more highly paid in the private sector than their counterparts in the public sector. So there was a 'compensating wage differential' paid to private sector employees in recompense for their worse conditions of service. Typically, private sector workers are paid more, earlier in their career, but suffer later on and particularly so into their retirement. All this means that simple wage comparisons are not sensible. What needs to be done is to factor all compensation conditions into the calculation of 'Total Reward' – i.e. the value of pay and pensions and conditions of employment over the whole life cycle.[1]

A second complication is that in many occupations there is an increment scale which most employees advance up each year giving them a pay enhancement. This was not part of the 1% pay rise which has been talked about as the public sector 'pay cap'. So for a young teacher rising up the increment scale (from point 5 to 6 on the main scale in London) this could mean a pay rise that year of 8.5%. So – in effect – their pay was not capped. The problem comes when we look at the older worker who is stuck at the top of their pay increment scale – since they do not get an increment their nominal wage rise is capped at 1% and in real terms this means their pay has been shrinking. Taking the mix of workers who do get increments (other than cost of living rises) and workers who only get their 1% explains why – on average – public sector pay has risen by more than 1% for most years in figure B1 – this difference is part of what is called 'Pay Drift'.

Figure B2. Real indexed public and private sector wages



Source: ONS Average Weekly Earnings time series dataset (EMP).

Note

1 Danzer, A. and Dolton, P. (2012), 'Total reward and pensions in the UK in the public and private sectors', *Labour Economics*, 19, pp. 584–94.

This box was prepared by Peter Dolton.