The Spending Review and public sector jobs

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Introduction

The Spending Review revealed an austerity package that, by 2015, will raise taxes by £29.8 bn and cut spending by £80.5 bn. The spending cut includes £63.5 bn in current spending, of which £35.7 bn will come from public services.[1] Of £600 bn total public sector current expenditure on services in 2009-10, pay accounts for £164 bn – 27 per cent.[2] It is therefore inevitable that the package will have a large effect on public sector employment.

The government often claims that their predecessor allowed public sector employment to balloon. Public sector employment certainly rose: in the second quarter of 1997, it was 5,179,000: 872,000 lower than it is now.

Change in public sector employment, 1999 – 2010 and share of total growth

	Increase/ decrease (000s)	**Share (%)**
Construction	-67	-8.0
HM Forces	-20	-2.4
Police and support	66	7.8
Public administration	37	4.4
Education	296	35.2
NHS	399	47.4
Other health and social work	-38	-4.5
Other public sector (including banks)	169	20.1

The current figure includes 221,000 people working for "financial institutions classified to the public sector." Excluding this group

[1] R Crawford 2010, "Where Did the Axe Fall?", IFS 2010 Spending Review briefing, 21.10.10, http://www.ifs.org.uk/publications/5311

[2] Public Expenditure Statistical Analysis 2010, HM Treasury, table 5.3.

allows us to see the pattern of other public sector employment growth over the term of the last government. Initially there was a slight fall, as Labour stuck to the Conservatives' plans; this was followed by a period of steady but not spectacular growth. From 2005, however, public sector employment was cut back. It rose again during the recession – reflecting the continuing growth of the health service and recession-related measures like the recruitment of extra Jobcentre Plus staff to cope with rising unemployment. If we look at public sector employment growth under the last government, more than 80 per cent was accounted for by education and health; there is a very strong argument that this is precisely what the electorate voted for in 1997.

Criticisms of public sector workers

Public sector workers always face criticisms from right-wing commentators but the past eighteen months have been unusual in that the critique has highlighted issues that point towards key elements of a cuts agenda. Commentators have argued that the public sector is simply too large, but they have also focused on fundamental terms and conditions: pay and pensions.

Pay

A frequent complaint is that average pay is higher in the public sector than the private.[3] This is one of those comparisons that looks as if it ought to be ought to be simple, but is actually much more difficult than that. Ben Goldacre highlights the key factor that makes most of these stories unreliable: the failure to take into account the composition of the two groups.[4] There are plenty of doctors and teachers in the public sector, far fewer in the private; the reverse is true for sales assistants and bar staff.

There are other compositional factors; the proportion of workers with higher qualifications is larger in the public sector and public sector workers tend to be older, with more years' experience and accrued seniority. A study last year by the Pension Corporation[5] showed that,

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[3] See, e.g., M Brown "£7,000 year pay gap between public and private sector", *Daily Express* 15.9.2010; H Wallop, "Record Gap Between Public and Private Sector Pay", *Daily Telegraph* 21.1.2010; R Watts "Public Sector Pay Races Ahead in Recession", *Sunday Times* 3.1.2010.

[4] B Goldacre, "If you want to be trusted more: claim less", *The Guardian,* 9.1.2010.

[5] *Evaluating public and private sector pensions: The importance of sectoral pay differentials*, Frank Eich, May 2009,

compared with the private sector, public sector pay differentials between men and women and between different grades and regions are compressed: women, lower skilled workers and workers outside London do better in the public sector; higher skilled men in London do better in the private sector. At the same time, there are more highly skilled workers in the public sector, so average pay is higher. Over the past 30 years, privatisation and contracting-out have accentuated this contrast, making a rising gap in average pay inevitable.

An additional problem is that, in recent years, reporters and columnists (usually non-specialists, and working to a deadline) have often failed to take the effects of bank nationalisation into account – this is particularly true of stories about pay increases. In the October ONS *Labour Market Statistics*, for instance, the year on year change (3 month average) in public sector pay generally was 2.9 per cent, but the figure excluding financial services was 1.9 per cent.

In this year's Green Budget,[6] the Institute for Fiscal Studies considered these factors; they estimated the "raw" public sector wage premium for 2006–9 was 19 per cent for men and 26 per cent for women. Controlling for education, age and qualification, this fell to 2 and 7 per cent respectively: "almost no wage premium for men and a small one for women".

Pensions

The assault on public sector pensions has been on two fronts. It is argued both that it is unfair that public sector pensions are better than their private sector equivalents and that the cost to the taxpayer is escalating and will be unaffordable.

The Deputy Prime Minister combined both criticisms in June when he forecast that spending on public sector pensions would rise from £4billion a year now to £9billion in 2014/15 and that it was unfair to

> "private sector workers [who] have already seen final salary schemes close, while returns from defined contribution schemes fall. So can we really ask them to keep paying their taxes into unreformed gold-plated public sector pension pots?"[7]

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http://www.pensioncorporation.com/press/evaluating_public_and_private_sector_pensions.pdf

[6] "Public sector pay and pensions", Antoine Bozio and Paul Johnson, *IFS Green Budget*, February 2010.

[7] C Hope, 2010, "Cost of paying for public sector pensions will double to £9bn in four years, Nick Clegg says", *Daily Telegraph,* 14 Jun 2010.

Earlier this year, the National Audit Office reported on the affordability of public sector pensions.[8] In 2008-9 prices, the net cost of these pensions will rise from £14.9 bn to £79 bn by 2059–60. This figure (and similar estimates) has figured large in media coverage. But the economy will almost certainly grow during that period – even the UK's (fairly low) trend rate of growth of two and a half per cent doubles the size of the economy every thirty years. As a proportion of GDP, the NAO forecast public sector pensions to rise from a current level of 1.7 per cent of GDP to a peak of 1.9 per cent between 2018-19 and 2033-34, and then back fall to 1.7 per cent by 2059-60. This projection is shared by the Office for Budget Responsibility:[9]

Future cost of public sector pensions

	2010	2020	2030	2040	2050
Percentage of GDP	1.8	1.9	1.9	1.8	1.7

The interim report of Lord Hutton's Independent Public Service Pensions Commission forecasts an even lower eventual cost – 1.4 per cent of GDP by 2060.[10] It also shows just how low the average public sector pension in payment is:[11]

Average pensions in payment, 2009-10

	Teachers (England and Wales)	Armed Forces	NHS (England & Wales)	Civil Service (UK)	Local government (England)	Total
Mean average pension	£9,806	£7,722	£7,234	£6,199	£4,052	£6,497

The Commission correctly points out that these averages reflect large numbers of low pensions paid to people who only worked in these occupations for a short time, or on a part-time basis or who are receiving survivors' pensions. Nonetheless, these figures do undermine the image of the "gold plated" public sector pension and they are

[8] The Cost of Public Service Pensions, NAO, March 2010.

[9] *Pre-Budget Forecast*, OBR, June 2010, p. 63.

[10] Independent Public Service Commission Interim Report, www.hm-treasury.gov.uk/d/hutton_pensionsinterim_071010.pdf, p 64,

[11] Ibid, p 28.

confirmed by a series of charts at the end of the NAO report. These reveal that most pensions paid in both the NHS and civil service are below £110 a week. A quarter of NHS pensions are less than £40 a week and a quarter of civil service pensions are less than £60 a week.

The Emergency Budget and the Spending Review

Measures in the Emergency Budget

The last government's final Budget, in March, announced £21.5 bn of tax increases and £50.9 bn of spending cuts by 2015. The emergency Budget, in June, tightened these plans, announcing £29.8 bn of tax increases and £82.8 bn of cuts. In addition to the spending cuts, the Chancellor announced two measures and a review that would affect public sector workers' pay and pensions:[12]

- A two-year pay freeze for public sector workers from 2011-12 (from 2010-11 for civil servants who had not yet agreed a legally binding deal for this year, but they will also exit the freeze a year early.)
- Using the Consumer Price Index to uprate public sector pensions.
- An independent commission to carry out a structural review of public service pensions by next year's Budget.

The Chancellor calculated that the pay freeze will save £3.3 billion a year by 2014-15. The freeze does not, he announced, apply to workers earning less than £21,000, who will receive an increase of at least £250 per year. Very little has been heard about that "at least", there have been no announcements about who will get more than £250.

In local government, where the employers imposed a pay freeze for 2010/11, the unions have sought to use the Chancellor's policy as a campaign objective. The National Employers' Organisation for local government services has responded[13] by refusing to move on this year's settlement or to make any commitments for future years.

A £250 increase may be preferable to a freeze, but it would still leave employees substantially worse off. In September, RPI inflation stood at 4.6 per cent, CPI at 3.1 per cent. If we take the lower of the two as average inflation during a two year freeze, then a local authority worker at the bottom of the pay scale (currently £12,145[14]) – would

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[12] HM Treasury, *Budget 2010*, HC61, June 2010, http://www.hm-treasury.gov.uk/d/junebudget_complete.pdf

[13] Letter from LGE to local authority Chief Executives, 8 July 2010, http://www.lge.gov.uk/lge/aio/6516537

[14] No Lolly – The Council Pay Freeze Continues, UNISON Eastern Region, June 2010.

need to increase her pay by £765 to maintain its value; a £500 increase will leave her 2 per cent worse off in real terms. Someone who only just qualified for the flat rate increase (i.e., earning £20,500 at present) would be more than 3½ per cent worse off. The shift to the use of the Consumer Price Index for uprating also applies to benefits and tax credits and the government expects the total savings to be £5.8 bn a year by 2015.

This change results in huge savings because CPI has two features that lead to lower increases than RPI. One is the exclusion of housing costs; when these are rising faster than other prices – usually the case – the CPI will be lower.[15] Even when housing costs are stagnant, the CPI will still produce lower increases in pensions because of the 'formula effect' – RPI is calculated using an arithmetic mean, the CPI a geometric mean, which the ONS calculate will typically lead to CPI being half a percentage point higher. The Office for Budget Responsibility's economic forecast set out in the *Budget Report*[16] forecasts the increases expected in both indices over the next few years:

Forecast percentage increases, CPI and PRI

	2011	**2012**	**2013**	**2014**	**2015**	**2016**	**Overall**
CPI	2.7	2.4	1.9	2	2	2	13.7
RPI	3.7	3.2	3.2	3.3	3.4	3.5	22.1

Someone receiving a pension of £6500 a year in 2010 could expect, if it was increased in line with RPI, a pension of £9,690 by 2016. If the increases were in line with CPI she could expect £8,400 – a thirteen per cent shortfall after just six years. Lord Hutton's interim report noted that the change from RPI to CPI

> "may have reduced the value of benefits to scheme members by around 15 per cent on average. When this change is combined with other reforms to date across the major schemes the value to current members of reformed schemes with CPI indexation is, on average, around 25 per cent less than the pre-reform schemes with RPI indexation."[17]

[15] Consumer Price Indices Technical Manual, ONS, 2007, p 84.

[16] Op cit, p 84.

[17] Op cit, p 9.

Measures in the Spending Review

The Spending Review sets out some broad principles for the delivery of public services. One that will have sounded ominous to public sector workers is a commitment to change "the role of the state and how services are provided" with the government contracting for services "rather than be the default provider" and with more provision by "non-state providers including voluntary groups." There is not, as yet, much detail about what this will mean, but the *Spending Review* states that the government is considering "setting proportions of appropriate services across the public sector that should be delivered by independent providers, such as the voluntary and community sectors and social and private enterprises."[18]

Under the heading of "workforce reform", the Spending Review comments on the "generous" public sector reward package but makes no changes to public sector pay, other than to confirm the freeze announced in the Budget. Will Hutton's Review of Fair Pay in the Public Sector will publish an interim report in late November, but the Spending Review does not speculate about its contents or give any commitments to implementing its recommendations.

John Hutton's interim recommendations on pensions are largely accepted by the Spending Review and the Chancellor expects them to save £1.8 bn a year by 2014-15. On the positive side, this means the retention of a defined benefit pension scheme, which many commentators had demanded should be replaced by a defined contribution scheme. More depressing was the news that, in return for a pension whose value, as we have seen, has been cut by 25 per cent in recent years, public sector workers will have to pay on average an extra 3 per centage points in contributions. This increase will be phased in from April 2012 – that is, from the point at which the pay freeze finishes. The Chancellor also accepted Hutton's recommendations that the armed forces should be exempted from the increased contributions and that the low paid should be partially protected by a "progressive contribution."[19]

The Spending Review accepts the Office for Budget Responsibility's forecast of a reduction in general government employment (i.e., central

[18] Cm 7942 (2010) Spending Review 2010, London: HM Treasury pp 32 & 34, http://cdn.hm-treasury.gov.uk/sr2010_completereport.pdf

[19] Ibid, p 37.

and local government) of 490,000 by 2014–15. The OBR forecasts for are:[20]

General government employment levels, millions, end of each financial year

March 2011	March 2012	March 2013	March 2014	March 2015
5.53	5.47	5.39	5.23	5.04

This equates to the loss of one public sector job in every eleven (8.9 per cent), a revised OBR forecast is to be published in November. The OBR *Budget Forecast* estimated jobs lost in 2010/11 at 0.1 per cent of the total, equal to about 50,000 jobs. By 2015/16 general government employment would be 4.92 million, a total loss of 660,000 jobs.[21] The Chartered Institute for Personnel and Development has said that, based on discussions with public sector managers, they believe that this is an under-estimate, and they forecast total public sector job losses between 2009/10 and 2015/16 at 725,000.[22] These figures do not include public corporations, such as the Post Office or Remploy. A study by PWC estimated that the cuts will lead to half a million jobs being lost in private sector businesses providing supplies for the public sector.[23]

The OBR has forecast that between 2010/11 and 2015/16, whole economy employment will grow from 28.89 million to 30.23 million – an increase of 1.34 million.[24] Taking into account the loss of 660,000 public sector jobs and the associated loss of 500,000 private sector jobs, this amounts to 2.5 million jobs to be created by the private sector in six years. This calculation does not take into account any jobs to be lost because of the increase in VAT, which CIPD estimates at 250,000.[25] Nor does it take into account the labour hoarding that held down unemployment during the recession and which may mean that it is some time before growth is matched by rising employment.

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[20] General Government Employment Growth Forecasts, OBR, July 2010, table 1.

[21] OBR forecast: Employment, OBR, June 2010, p 2.

[22] “CIPD estimates 1.6 million extra private sector jobs needed by 2015-16 simply to offset full impact of Coalition Government’s spending cuts and VAT rise”, CIPD press release, 01 November 2010.

[23] Sectoral and regional impact of the fiscal squeeze, PricewaterhouseCoopers, October 2010.

[24] OBR forecast: Employment, OBR, June 2010, p 1.

[25] CIPD, op cit.

My colleague Adam Lent has pointed out that this would be a far superior performance to previous recoveries:[26]

- After the recession of 1980/81, it took eight years with GDP growth of 3.5% to create 2.5 million jobs.
- After the recession of 1991/92, it took eleven years with growth of 3.1% to create 2.5 million jobs.

Where will the jobs be lost? The OBR has pointed out that the key determinants of forecast job losses overall are the paybill and Resource Departmental Expenditure Limits.[27] If we look at projected Resource DEL from 2011 to 2025 we can get an idea of the Departments likely to suffer most.[28]

Planned cumulative real growth in Resource DEL to 2014/15, main departments

Department	Growth	Department	Growth
CLG Communities	- 51%	Justice	- 23%
Treasury	- 33%	Transport	- 21%
Environment, Food, Rural Affairs	- 29%	Energy & Climate Change	- 18%
CLG Local Government	- 27%	Revenue & Customs	- 15%
Business, Innovation & Skills	- 25%	Defence	- 7.5%
Law Officers	- 24%	Education	- 3.4%
Foreign & Commonwealth Office	- 24%	NHS	+ 1.3%
Culture, Media & Sport	- 24%	Work & Pensions	+ 2.3%
Home Office	– 23%	International Development	+ 37%

The big losers here are DCLG and this is reflected in large cuts in central government support for local authorities, which will be cut by 26 per cent over the next four years *after* taking into account the extra £1 bn Personal Social Services grant for social care announced by the Chancellor. The Review announced that, because local authorities' revenue from Council Tax is not being frozen, total local government spending should fall by 14 per cent. Even a 14 per cent cut will leave

[26] "Budget office's forecasts of 2m jobs questioned", Phillip Inman, *Guardian,* 1 July 2010.

[27] General Government Employment Growth Forecasts, OBR, July 2010, p1.

[28] *Spending Review 2010*, table A5, http://cdn.hm-treasury.gov.uk/sr2010_completereport.pdf

Councils highly exposed, and the Local Government Association has warned that 100,000 jobs may be lost, ten per cent of the Council workforce.[29] This may be an under-estimate – the GMB says that reports from officials around the country suggest that 20 per cent of the social care workforce may be at risk of losing their jobs.[30]

Conclusion

The Spending Review and the emergency Budget have to be seen as a package, and they have to be seen in the context of the "softening-up" of the public sector that has been taking place for two years. The belief that the public sector has grown unstoppably and that public sector workers have unfairly generous pay and pensions has fed directly into measures that will lead to job losses and reduced pay and terms of employment. The campaign against the cuts must prioritise the task of persuading the public that the cuts are unnecessary and unfair to workers as well as service users.

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[29] "100,000 local government job losses", Dean Shoesmith, *Local Government Chronicle,* 28 October 2010.

[30] "Up to 50,000 jobs at risk in social care, union warns", Daniel Lombard, *Community Care,* 25 October 2010.