



**Six  
million  
pay  
cuts**

# Six million pay cuts

## Public servants deserve fair pay

Public service workers make a huge contribution to society and the economy. Their work should be fairly rewarded.

But the Government wants public sector workers to suffer a cut in their living standards. This is why Britain's public service unions and the TUC have launched a campaign for fair pay for the six million workers in the NHS, schools, colleges, local government, emergency services, the justice system and the civil service.

Public sector workers – like everyone else – face increased energy and transport costs, rising rental and mortgage bills and general inflation. The cost of living is increasing at over four per cent a year yet they have had below-inflation awards for the second year running. The Government is also seeking another three years of reduced living standards across the public sector as the Comprehensive Spending Review requires the public sector to keep paybill costs in line with the Government's two per cent inflation target.

This campaign briefing draws on the *Public Sector Pay Policy* report undertaken by highly respected pay researchers, Incomes Data Services (IDS). It shows:

- There is no evidence that public sector pay causes inflation. Public service workers are the victims not the cause of inflation.
- Pay cuts will have a big impact on workforce morale and cause recruitment and retention problems across all parts of the public sector.
- This will hit service quality.
- The policy will undermine all efforts to tackle unfair and illegal pay discrimination.



Britain's public sector workers are calling for:

- no more below-inflation pay awards and no staging of awards
- a real commitment to equal pay
- retention of, and respect for, the independence of pay review bodies and other pay mechanisms

# Six million pay cuts

## Public sector pay – the background

During the late 1990s, the Government sought to undo the damage caused to the public sector by its predecessors – addressing severe recruitment and retention problems and responding to the big gap between private and public sector pay.

The public sector began to catch up after 2001, through efforts to modernise pay structures and tackle unequal pay. Public sector pay thus rose more than private sector pay between 2002 and 2004. But earnings growth levelled out in 2005, and the private sector has gone back into the lead since 2006.

Public sector earnings are now falling behind the private sector. The Government's focus has shifted from pay modernisation to pay restraint. Public sector pay is not keeping pace with inflation and the pay gap between the private and the public sector is widening once again.

Appendix 1 provides the context for current pay bargaining. It shows a strong economy and a strong labour market with employment at record levels, but with RPI inflation at its highest level for many years. Private sector pay settlements for the rest of 2007 and into 2008 are expected to be mostly between 3.5 per cent and 4 per cent. With a 2 per cent public sector pay policy, this puts public sector pay rises at half the level of the private sector.

## Current public sector pay policy

*“So let me be straightforward with you: pay discipline is essential to prevent inflation, to maintain growth and create more jobs, and so we will never return to the Conservative policies of boom and bust ever again.”*  
*Rt Hon Gordon Brown MP*

The clear Government message to the review bodies is that the ‘inflation target’ will remain at 2 per cent for the next three years. It expects public sector pay rises to remain in line with this target. The Government give two reasons. First, it says that after ten years of generous public sector settlements only small pay rises can be justified. Secondly, it says that public sector pay restraint is necessary to fight inflation.

## Are public sector pay rises inflationary?

Incomes Data Services (IDS) explains that there is a strong link between the level of pay and RPI inflation. Public sector awards generally follow RPI.

But this is not because public sector awards set the inflation rate. The reverse is true. Wage negotiations tend to follow inflation rates. IDS shows that the parties examine what has already happened on inflation, average earnings growth and other indicators, and react accordingly. The causal relationship is not from wage increases to inflation, but rather the other way round.



This can be seen by looking at how basic pay settlements reacted to the abrupt increase in inflation at the end of 2006. Overall pay settlements rose sharply from 3 per cent to 3.5 per cent at the end of 2006 and have remained steady at this point since then<sup>1</sup>. However, this 3.5 per cent figure for the three months to July masks a significant difference between manufacturing and production (median of 4 per cent) and both public sector and private services on the other (median of 3 per cent in each case). Any relationship between inflation and wage increases is a weak one in the public sector.

So if public sector pay is not driving inflation, are pay increases elsewhere contributing to wider price rises?

IDS examined the role of labour costs in recent movements in inflation. They looked at the most significant recent upswing in inflation that occurred in December 2006. Inflation rose sharply to 4.4 per cent, from 3.9 per cent in November, above the 4 per cent mark for the first time in many years. But according to the Office for National Statistics, the increase in inflation was caused mainly by increased housing costs; higher petrol and oil prices; and more expensive household goods. Other rises have been linked to energy and food prices and have little or nothing to do with increases in the wages of UK workers. Indeed as the National Institute Economic Review noted in its latest report: "Currently there seems to be little inflationary pressure from the labour market."<sup>2</sup>

The 2007 Pre-Budget Report justifies the public sector pay policy by saying that there exists "a risk of second-round effects of higher inflation feeding into inflation expectations and higher average earnings growth."

Yet an analysis of earnings growth figures finds that the public sector is fully and unfairly bearing the brunt of the Government's inflation policy. At a time when city bonuses and top directors' pay are at an all time high, some of the UK's lowest paid workers are being expected to take what is in effect a pay cut.

Earnings growth in the public sector has been below the private sector since the beginning of 2006. Looking at the latest annual figures for earnings growth, the low rate of growth in the public sector (2.8 per cent in the year to April 2007) is a major contributor to the relatively low whole economy figure of 3 per cent, with private sector earnings growth at 3.5 per cent.

IDS concludes that not only is this a direct impact of the Government's public sector pay policy, but that the policy is not affecting other parts of the economy in anything like the same way. Holding back public sector pay is not keeping down pay in the private sector. Cutting public sector living standards is therefore neither reducing inflationary pressure nor having any wider effect on pay in the rest of the economy.

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<sup>1</sup> *Public Sector Pay Policy*, Incomes Data Services. August 2007

<sup>2</sup> *National Institute Economic Review* 2007; 201; 37. UK economy forecast

# Six million pay cuts

## Public spending slowdown

The second justification for below inflation pay increases is that they rein in public spending, after seven years of increase. But centrally determined pay awards of this type fundamentally threaten the structures of public sector industrial relations – structures that have come into place for good reason. There are two issues at stake:

- the independence of pay review bodies and their recommendations
- the ability of government departments and agencies to negotiate and manage their own pay structures.

Pay review bodies are explicitly independent of government/management and employee groups. The review process is evidence-based. Both sides make submissions, and the bodies consider government arguments about affordability.

The review bodies were designed to remove conflict and dispute from setting the pay of much of the public sector. While unions have not always been happy with their recommendations, there is strong support for a system that allows the pay of groups of workers such as nurses to be set with a minimal risk of formal industrial disputes. Any reduction in the lead role of the review bodies risks undermining a tried and tested process of pay determination.

The centrally determined cap on public sector pay bills also places a severe restriction on the ability of government departments and agencies to negotiate their own fair pay settlements for their staff so for example they can take into account particular recruitment and retention problems. In particular it makes it difficult to address the backlog of sex discrimination issues in much of the public sector.

The centralised pay target is reinforced and policed by the Public Sector Pay Committee. Also known as the Pay Gateway, it was set up in 2006 and is made up of senior staff from the lead departments and senior officials from the Treasury and Cabinet Office.

The gateway signs off all significant pay decisions and ensures that they fall within the Government's negotiating remit. The full role of the gateway and its relationship with the pay review bodies and other negotiating machinery is unclear. However it is clear that the gateway is being used to lower expectations and ensure that pay increases are kept within the Treasury target, and may well have decided to stage awards during 2007.

More clarity on the 2 per cent cap is needed, to better understand the implications of this target on public sector pay outcomes, particularly in regard to the Government's economic assumptions. CSR07 spending figures assumed a GDP deflator of 3.25 per cent for 2007-08 and 2.75 per cent for the three consequent years. If actual inflation breaches these projected figures, the potential impact for those departments with low or negative spending settlements is substantial. There are potentially important implications for public sector pay which need to be explored and better understood for



the CSR07 period, requiring a better degree of planning and explanation than we have seen so far.

## Is the use of CPI fair?

The all-items retail price index is the measure of inflation most commonly used by wage negotiators in the private sector and it is used by the Government to index pension payments and other state benefits. This is because it covers the full range of goods and services purchased by the majority of households. It covers both essential items such as food, housing costs and heating, and also discretionary items like audio-visual products.

Until December 2003, the Government's preferred measure of inflation was the RPI excluding mortgage interest payments, the 'RPIX'. The Government shifted from using the RPIX to the consumer price index (CPI) as its target measure in 2003. This measure excludes housing costs and is typically one percentage point lower than RPIX.

In a submission to the pay review bodies, the Treasury urged them to focus on 'core inflation', which would exclude "certain items from the CPI basket whose price effects might be considered temporary and/or volatile." These items include energy prices and seasonal good prices, which have recently seen strong temporary increases.

It looks like the Government wants to move wage negotiators' focus ever further away from the all-items RPI as the main indicator for wage increases. The Government's wish to focus on an even lower measure than CPI constitutes what IDS calls a 'pre-emptive strike' against any employee efforts to argue for catch-up increases.

The TUC remains committed to RPI as a more accurate and realistic indicator of the cost of living. IDS states that: "RPI inflation is used universally by pay negotiators as it is the best measure of how far the purchasing power of a salary level has been devalued over a 12-month period".<sup>3</sup> A recent survey by Industrial Relations Services of over 350 organisations, found that just 21 per cent of private sector employers stated they would use the CPI inflation index, with the majority planning to stick with the Retail Prices Index.<sup>4</sup>

The Government cannot invent a new inflation measure that leaves out a huge proportion of what makes up the living costs of the population, and ends up measuring nothing of use.

## The gender pay gap

Below inflation pay will widen the gender pay gap. This is because of the high proportion of women in the public sector workforce. The public sector accounts for around a third of total employment in the UK. Around two-thirds (65 per cent) of public sector workers are women, compared with two-fifths (42 per cent) in the private

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<sup>3</sup> *Pay in the Public Services 2007*, Incomes Data Services, March 2007

<sup>4</sup> *Employment Review*, October 2007.

# Six million pay cuts

sector. Women make up 53 per cent of the civil service workforce, 73 per cent of local government employees and 77 per cent of NHS staff.

The gender pay gap in the public sector stands at 13.6 per cent on average in average hourly earnings. In the private sector the average gender pay gap stands at 22.3 per cent<sup>5</sup>. The public sector gender pay gap has widened from 13.2 per cent since April 2005. There are signs of slippage on the commitment to equality audits, with the Cabinet Office no longer monitoring progress in the civil service. Such problems, allied to the pay discipline, will serve to widen further the gender pay gap and damage efforts to promote equality within the public sector.

## Recruitment, retention and morale

Recruitment and retention problems have eased off to a large extent in recent years, but there remain pockets in certain areas of the public sector where jobs are hard to fill or turnover is high. Job losses and the pursuit of efficiency savings mean that overall workforce numbers are falling and there are indications that these and other factors, particularly low and staged pay awards are hitting staff morale.

In the NHS, evidence from both employers and unions indicate the impact of low pay rises on morale and motivation. NHS employers conducted a survey for their 2006 evidence to the pay review body which found that "many employers acknowledged that a below inflation award would be detrimental for staff morale and motivation".

The NHS trade unions conducted their own research for next year's pay award which found that 61 per cent of NHS staff reported that their morale and motivation was worse than a year ago and almost all NHS staff thought that the 2007 pay award was too low and the decision to stage the pay award was unfair. In addition, 60 per cent of NHS staff who responded to the survey said that they had considered leaving their current position over the last year.

There is a real likelihood that the pay policy will feed discontent created by anxiety about job losses, increasing workload and organisational change among public service employees.

## PSF pay and reward principles

In April 2005, the Public Services Forum, which brings together unions, government and public sector employers, agreed on new pay and reward principles for the basis of all pay review body and collective bargaining remits<sup>6</sup>.

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<sup>5</sup> Average hourly earnings. Public sector: £16.06 full-time males; £13.87 full-time females. Private sector: £14.65 full-time males; £11.39 full-time females. ASHE 2007

<sup>6</sup> [http://archive.cabinetoffice.gov.uk/opsr/documents/doc/reward\\_principles\\_March\\_05\\_final.doc](http://archive.cabinetoffice.gov.uk/opsr/documents/doc/reward_principles_March_05_final.doc)



The principles promote action in a number of areas including investment in skills; equal pay; pension reform and systems of pay incentives. Together, they provide a common framework for future development of pay and reward systems across the public services. The Treasury pay target and the use of the Pay Gateway threaten to undermine the whole premise of the principles and erode any collective approach to pay modernisation.

## Conclusion

The inflationary justification does not make sense against the current economic environment. Real wage growth is historically low and is acting as a drag on overall inflation, which has risen largely as a result of higher energy and food prices, and some non-labour industrial costs.

And within an overall strong labour market, public sector pay is growing more slowly than private sector pay. The idea that public sector pay presents a particular inflationary risk at present does not stack up. Previous periods of tight public spending, such as between 1997-99, where the Government followed Conservative spending plans did little to reduce inflation in the 1990s. Cutting public servants' real pay now will not address inflation, but only serve to return to boom and bust policies damaging to public services and public service workers.

After recent years of commitment to pay modernisation in some areas of the public sector, it is deeply worrying that there appears to be a lack of coherence in the Government's policy towards public sector pay. The Comprehensive Spending Review target for public sector pay and the use of the Pay Gateway fail to acknowledge recent developments on pay modernisation and productivity and appear to contradict government pay policy that salary levels should be sufficient to recruit, retain and motivate staff. More clarity is needed on the public sector pay policy in the context of overall public spending and affordability and an agenda for public services that includes continuing efficiency savings and headcount reductions.

Appendix 2 sets out the milestones for pay sector pay developments in 2008. Time is short, and we urge the government to stop and take a serious look at their plans for public sector pay and consider the damage they will inflict on staff morale and services.

# Six million pay cuts

## Appendix 1: The Economic Environment

### Inflation

- In the year to October 2007, the all-items Retail Prices Index (RPI) rose by 4.2 per cent up from 3.9 per cent in September. RPI has regularly stood over 4 per cent for most of the year
- In the year to October 2007 the Consumer Prices Index (CPI), which excludes housing costs, rose by 2.1 per cent, up from 1.8 per cent in September
- RPI is expected to remain at around 4 per cent until the start of 2008 and then to fall to around 3 per cent by spring.

### Public sector pay

- Average earnings in the public sector grew by 3.2 per cent in the three months to September – the lowest reading since May 1998.
- Private sector earnings grew by 3.8 per cent for the three months to September.
- Expected average earnings growth for 2007 into 2008: private sector 4.5 per cent; public sector 3.5 per cent.

### Employment

- The number of people in public sector employment stands at 5.78 million, the lowest total since early 2004.
- Unemployment is at a two-year low of 5.4 per cent.
- The total number of people in work rose has risen by 82,000 in the last year to just over 29 million, as the rise in private sector employment more than offset the public sector job cuts.

### Economic growth

- The annual rate of growth stood at 3.3 per cent during the period between July and September 2007, above expectations of 3.1 per cent. This is the strongest rate since the second quarter of 2004.



## Key data

Inflation			Average earnings			Interest rates
	CPI	RPI	Whole economy	Private sector	Public sector	
October	2.1	4.2				5.75
Sept	1.8	3.9	3.7	3.7	3.2	5.75
August	1.8	4.1	3.7	3.9	3.0	5.75
July	1.9	3.8	3.6	3.7	2.7	5.75
June	2.4	4.4	3.2	3.1	2.8	5.50
May	2.5	4.3	3.6	3.7	3.4	5.50
April	2.8	4.5	3.1	3.1	3.3	5.25
March	3.1	4.8	3.5	3.6	2.7	5.25
February	2.8	4.6	5.4	6.2	2.4	5.25
January	2.7	4.2	4.8	5.2	3.4	5.25

## Appendix 2: Key public sector pay developments in 2008

February	Publication of most pay review body recommendations
March	Budget 2008 Civil service pay guidance published
April	NHS pay review body Doctors and dentists' review body Senior civil service Local government Key central government departments (HSE, DfCS, DIUS) Probation Service Further Education Schools (Scotland) Prison service
June	Central government (HMRC, Land Registry)
July	Fire service Central government (DWP, Home Office, Defra, Environment Agency)
August	Central government (BERR, Dept of Transport, DCLG, MoD)
September	Schools (England & Wales) Police Negotiating Board



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