Opening Submission to Public Service Pay Commission:

Department of Public Expenditure and Reform.

Introduction

The Department of Public Expenditure and Reform welcomes the establishment of the Public Service Pay Commission (the "PSPC") and the opportunity to provide an opening submission.

Clear impartial evidence from the PSPC on the total remuneration package available to public servants, in comparison to both the private sector and international public service, will be hugely beneficial. This will inform substantive engagement on the issue of public service remuneration between public service employers and Unions and Associations representing public servants. Objective inputs, based on the highest standard of peer reviewed analysis, will help provide a shared understanding from which to explore the real interests behind respective positions on public service remuneration.

In making this submission the Department would like to state the following principles of public service pay policy:

1. Public service pay is financed through taxation and government must ensure that scarce resources are used optimally and in a sustainable way.
2. Public service pay should not lead the private sector on competitiveness grounds and in light of Ireland's position as a small open economy.
3. The Financial Emergency Measures in the Public Interest (FEMPI) legislation currently forms the overarching legal framework for public service pay policy.
4. The public service remuneration package should be sufficient to attract and retain individuals with the qualifications and skills required to deliver quality public services.
5. The public service remuneration package includes a range of employment conditions in addition to pay rates and, accordingly, needs to be considered in its totality.

The submission will firstly set out the economic and budgetary context within which matters relating to public service pay must be considered.

Subsequent sections will briefly address the question of appropriate methodology, before outlining the priority areas where the Department anticipates input from the PSPC providing an evidence base to support future pay negotiations.

These priority areas are the:

- Totality of the public service remuneration package including pensions.
- Benefit of public service terms and conditions including security of tenure.
- Ability to consistently recruit and retain staff with difficulties emerging only in respect to certain senior and specialist positions.
- Outstanding savings under Financial Emergency Measures in the Public Interest Acts, totalling €1.4 billion after the full implementation of the Lansdowne Road Agreement and the distribution of these savings by measure and pay band.

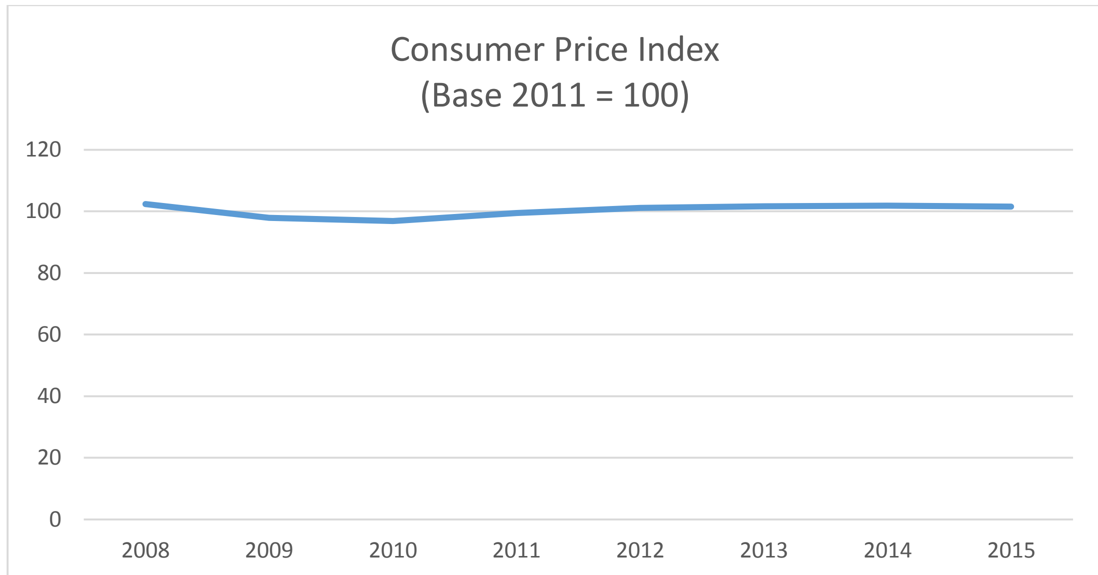
Each of these issues will be addressed in turn, presenting data that is currently available to the Department for the initial consideration of the PSPC as it begins to investigate the issues.

Economic Context

A recovering economy is not a recovered economy. This Department's assessment is that the fiscal position of the State remains vulnerable. The forecasts that underpin Budget 2017 estimate:

- End-2016 gross debt of €200 billion or 76 per cent of GDP. Under the EU Fiscal Rules a level of public debt above 60% is considered excessive and must be consistently reduced at a prescribed rate otherwise an Excessive Deficit Procedure can be triggered by the European Commission. Essentially this means that Ireland is currently not in a strong position to absorb any economic or fiscal shocks that may occur.
- General Government Deficit in 2016 of €2.4 billion which equates to a borrowing requirement of €6.6 million per day. In 2017 the Deficit is projected to be €1.24 billion or €3.4 million per day. In other words the current level of public expenditure is not fully supported by the tax base.
- Achievement of Ireland's Medium Term Objective by end-2018 (see box below for explanation of the impact on available resources).

- Negative rates of inflation in 2016, with inflation expectations remaining subdued in 2017 at 1.3% rising to 1.9% in 2021. Overall Ireland is in a very low inflation environment and has experienced very limited price inflation since 2007.



Source: CSO

While the above factors are manageable, the economy is vulnerable to any exogenous economic shocks. Risks to economic growth have increased internationally over the last year. Already the impact of BREXIT can be seen in the moderating GDP growth forecasts in Budget 2017[1].

If the United Kingdom opt for a “hard BREXIT” and leave the single market, a recent report by the Department of Finance and the ESRI has estimated that Irish Gross Value Added could be 3.8 per cent lower than it might have been after 10 years. They conclude that the “fall in output and employment reduces government revenue from a range of taxes while the increase in the unemployment rate would increase government spending on welfare payments. The net effect is a dis-improvement in the general government balance (GGB) over the long-term.”[2]

In light of these risks there is a danger that loading medium to long term pay expenditure commitments on a still fragile economy and tax base, could prove unsustainable. This needs to be avoided.

[1] Department of Finance, Budget 2017 Economic and Fiscal Outlook, October 2016
[2] ESRI, Modelling the Medium to Long Term Potential Macroeconomic Impact of Brexit on Ireland, Working Paper No. 548, November 2016

The Medium-term Budgetary Objective (MTO)

The key objective for Member States in the preventive arm of the Stability and Growth Pact is to achieve the Medium-term Budgetary Objective (MTO). In Ireland's case, the current MTO has been set at achieving a structural balance of -0.5% of GDP. The Structural Balance (SB) differs from the GGB by taking out the positive or negative impacts of 'one-off or temporary measures' and 'cyclical budgetary component' (i.e. unemployment payments and tax revenue attributable to the economic cycle). As of Budget 2017, the SB stands at -1.9% of GDP (larger than the headline deficit). If a Member State is not at their MTO, they must reduce their SB to converge towards the MTO.

The MTO's impact on the Expenditure Benchmark and the Fiscal Space

Within the Fiscal Rules there is an Expenditure Benchmark (EB), which is designed to assist Member States in reaching their MTO. The EB achieves this through limiting expenditure growth (net of revenue measures) to match the economy's potential growth rate, and from this the fiscal space is measured. This limit applies to all General Government Expenditure, including pay, but excluding debt interest payments, cyclical unemployment expenditure and certain special treatment for Capital spending. For Member States not yet at their MTO (such as Ireland), an agreed convergence margin is applied which further limits expenditure growth (net of revenue measures) to assist in reaching their MTO at a faster pace. As Ireland is not at the MTO currently, and is not estimated to be until end-2018, this convergence margin reduces the amount of projected fiscal space Ireland has until 2019.

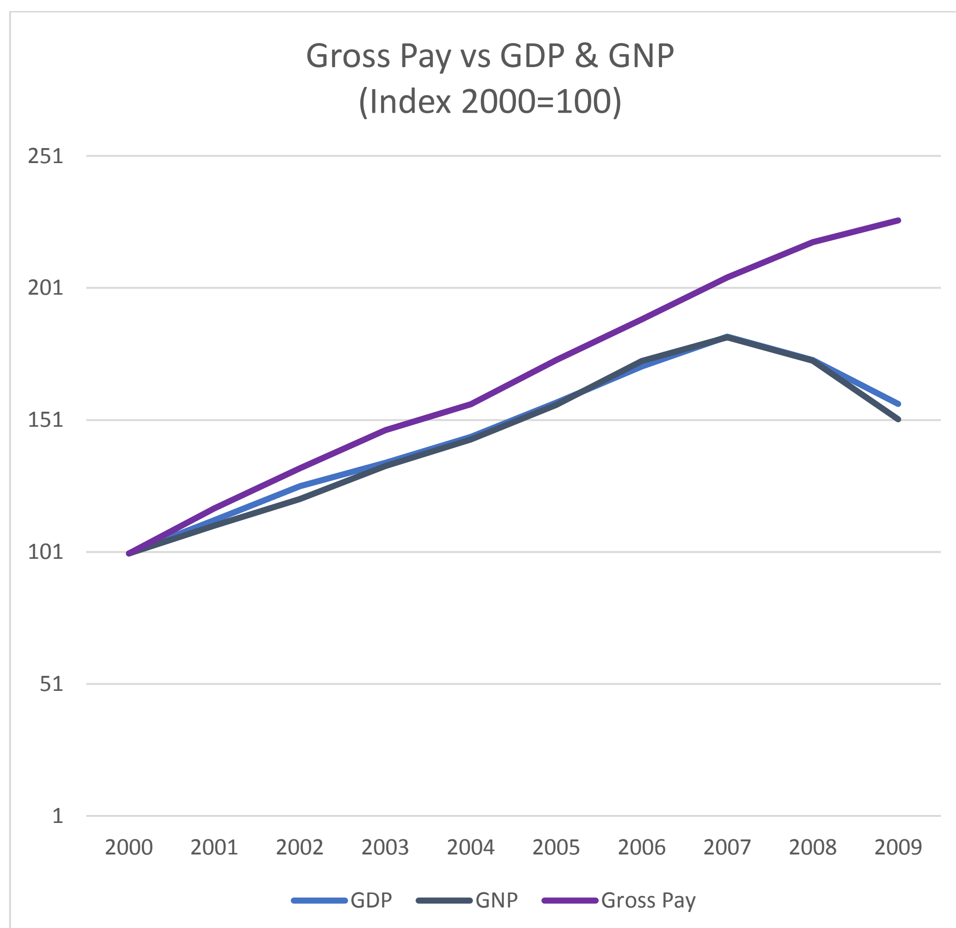
The Government has set the target of achieving the MTO by end-2018 by reducing the headline deficit to 0% of GDP and the structural deficit to 0.5% of GDP (Ireland's MTO target). This has the result of increasing the fiscal space by almost €1.5 billion in 2019 as Ireland would be at the MTO and no longer have the convergence margin applied. For this reason, the projected fiscal space in 2019 and beyond is significantly higher than in 2017 and 2018.

Budgetary Context

Public Service pay demands must be balanced against other Government priorities. Emerging from deep economic crisis and recession, there are many competing demands for expenditure to restore and improve public services and infrastructure.

Any increases in remuneration must also comply with our obligations under the European Union Stability and Growth Pact and associated fiscal rules.

These rules are designed to limit the scope for pro-cyclicality in public expenditure growth and prevent the reoccurrence of the expenditure growth that Ireland experienced during the years preceding the crises. Between 2000 and 2009 the public service pay bill more than doubled from €8.2 billion to €17.5 billion and, as shown in the graph below, the rate of increase outstripped the growth in the economy as measured by GDP or GNP.



Source: DPER, CSO

Balancing these concerns, Government has committed exchequer funding on a multi-annual basis to:

- **Capital Investment.** Capital expenditure as a proportion of total expenditure dropped from 12% in 2008 to a low of 5% in 2013. This resulted in a net depreciation of the capital stock in 2013. The lower level of expenditure on capital has placed significant pressures on simply maintaining our existing infrastructure, while at the same time demand continues to grow for additional infrastructure in areas such as housing, health, transport, education, and broadband, to meet the needs of a growing population and economy which was severely cut during the crises. Under the Capital Investment Plan 2016-21 and further resources allocated to capital expenditure in the Summer Economic Statement 2016, funding in this area will grow from €4.2bn in 2016 to €7.2bn in 2021.

- **Demographics.** A growing and ageing population has expenditure implications for our education system, social welfare arrangements and health sector in particular. An additional €450m has been allocated in both 2017 and 2018 to meet the costs of our changing demographic structure; however, medium term pressures of approximately €400m-€450m exist out to 2021.

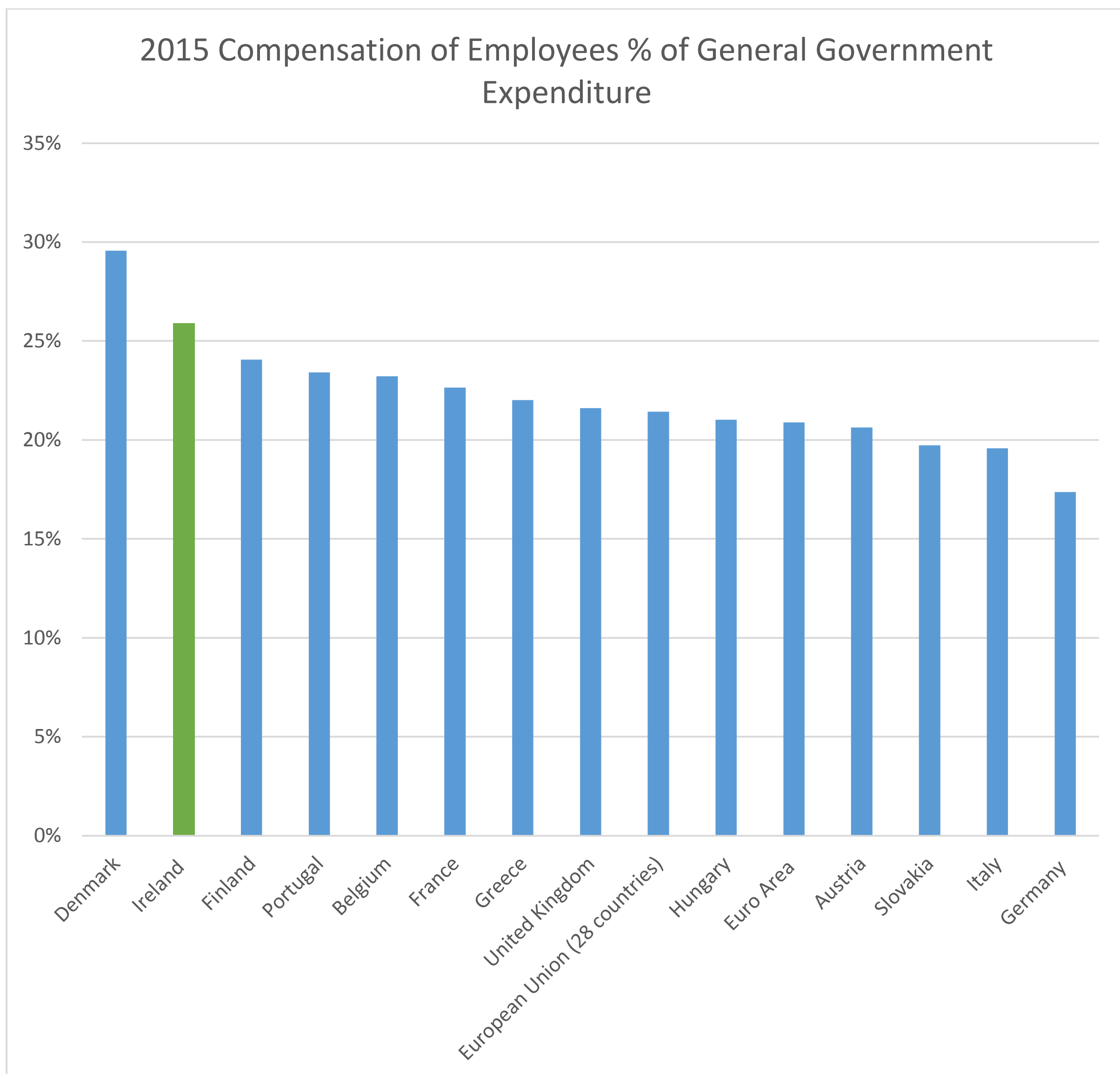
- **Public Service Pay.** Budgetary allocations of €290m in 2017 and €287m in 2018 have been made with respect to public service pay commitments under the Lansdowne Road Agreement. This is a very significant sum which provides for affordable and sustainable pay increases. A further €20m has been allocated for implementation of the agreement with the INTO and TUI on new entrant teacher pay. Budget 2017 also provided €430m for additional recruitment of staff in 2017.

- **Carryover of Budget 2017 measures.** In 2018 there is an estimated €450m allocated for the carryover impact of Budget 2017 measures for example the full year cost of social welfare payment increases (Table 9 in the Budget 2017 Expenditure Report).

As a result, the additional resources available in 2017 and 2018, in excess of those required for existing commitments, are extremely limited and the Department of Public Expenditure and

Reform remains committed to the Lansdowne Road Agreement as the negotiated mechanism for FEMPI unwinding. If Ireland meets its Medium Term Objective as planned under the fiscal rules, further resources will become available from 2019 (see box on the Medium Term Objective).

It is also worth noting, in light of the international comparisons that the PSPC has been tasked with examining, that according to Eurostat 2015 figures Ireland is ahead of both the Euro Area and EU average on the measure of Compensation of Employees as a share of General Government Expenditure. A selection of countries is presented below covering comparable levels of development and/or size.



Source: Eurostat

Methodological Approach

The issue of public/private pay disparities has been examined closely over the years: Boyle et al., 2004; Ernst & Young and Murphy, 2007; Kelly et al., 2009a and 2009b; Foley and O'Callaghan, 2010 and most recently the CSO in 2012 using 2009/10 data. All of these have reported a pay premium for public sector workers.

Comparative research by the European Commission also suggests that the wage premium in Ireland is amongst the highest in the European Union[3].

Research from the ESRI has reported that treatment of organisational size and the weighting decision can have significant impacts on the estimated premiums and recommends that "greater emphasis should be placed on the results generated from equations containing the weighted estimates and excluding organisational size, since it cannot be measured at establishment level"[4].

Core Concerns

The Department of Public Expenditure and Reform supports the Commission's work programme based on the agreed Terms of Reference. In general terms, the PSPC will have to carefully account for both the range of professions/roles within the public service and the individual level characteristics of public servants.

More specifically, as outlined in the introduction, the Department contends that pay cannot be examined in isolation and must be viewed as part of a total employment package that includes other elements that have a significant tangible value such as pensions, security of tenure and other relevant terms and conditions. The Department considers that these benefits and conditions are extremely valuable. Any assessment of public service remuneration must also explore the ability of the current remuneration package, including new entrant salaries, to deliver on the recruitment and retention of staff. In the view of the Department, the following are priority areas where input from the PSPC should provide a solid evidence base to support negotiations on a new collective agreement to succeed the Lansdowne Road Agreement.

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[3] European Commission, EUROPEAN ECONOMY Economic Papers 508, *The gap between public and private wages: new evidence for the EU*, 2013

[4] ESRI, Quarterly Economic Commentary, *Comparing Public and Private Sector Pay in Ireland: Size Matters*, Winter 2012.

1. Differences in Pension Entitlements

The PSPC is asked to fully take account of the question of superannuation in the public service. The Department considers that the relative value of public service pensions is a significant component of pay remuneration and that the value of this element is greater now than it has been historically. This conclusion is based on trends in relation to defined benefit schemes in the private sector; the funding difficulties currently being encountered; and the adjustments to scheme benefits being introduced as a consequence. The PSPC should ensure that appropriate account is taken of the full value of public service pension terms when considering remuneration terms of public servants.

The Department of Public Expenditure and Reform is currently working on an actuarial assessment of public service occupational pension obligations in order to meet its obligations under EU Regulation (EU) 549/2013[5]. The output from this project will provide valuable information on the expected cost of public service occupational pension obligations (including under the new Single Scheme) and the benefit of those pensions. Accordingly, the Department of Public Expenditure and Reform will make a further substantial submission to the PSPC by the end of Q1 2017 once this work has been completed.

In advance of its further submission the Department of Public Expenditure and Reform requests the PSPC to note the following:

i. According to the CSO QNHS Q4 2015 Special Module on Pensions, 46.7% of those in employment between the ages of 20 and 69 have an occupational or private pension. With 100% occupational pension coverage in the public service, the coverage in the private sector is considerably less. Based on the QNHS results, and using certain assumptions, the Department of Social Protection estimate that private sector occupational pension coverage is in the region of 35%. Groups least likely to have an occupational pension include: young; self-employed; part-time; workers in the accommodation and food service activities sector; workers in sales and customer service.

[5] http://www.per.gov.ie/en/public-service-pensions-accrued-liability/

ii. Public service employees continue to enjoy defined benefit (DB) pension accrual, with the majority of employees in final salary DB pension schemes where indexation has traditionally been linked to pay parity.

iii. In the private sector, nearly all DB schemes are closed to new entrants with defined contribution (DC) pension provision being the replacement for most employers who are providing pension benefits to their employees. Recent years have seen many of the private sector DB schemes close to new entrants and wind up. Most recent statistics published by the Pensions Authority show that there are 670 DB schemes continuing which is a reduction of over 50% over the last 10 years.

iv. DB pensions are increasingly onerous to fund and many private sector firms are having difficulty in meeting their obligations to current and former staff. It is estimated that approximately 30% - 40% of DB schemes in Ireland are in deficit on the statutory minimum Funding Standard basis at present. The primary reasons for this are as follows:

   - **Increasing liabilities:** historically low bond yields as well as increasing longevity;
   - **Lower than expected asset performance:** poor equity market returns over the periods 2002-2003, 2007-2009 as well as low expected future returns from traditional asset classes.

v. Pension costs are not static. Estimates of the long term costs of pensions have been rising as the assumptions underlying the critical factors affecting costs have become more conservative as a consequence of experience over time. The increased cost of DB pensions has caused a significant number of private sector employers to move to DC pension provision which is a trend which is likely to continue.

vi. The benefits of the above arrangements for public service employees are significant and have likely increased the value of pensions from the 12% discount that was utilised in the 2007 Benchmarking Report.

2. Value of Terms and Conditions including Security of Tenure

During the crises, when employment in the economy dropped by 327,600, there were no compulsory redundancies in the public service. Instead pay measures were accepted in return for security of tenure. The significant reduction in the public service workforce of 10% over the period of the crises was achieved entirely through natural wastage and voluntary exit schemes. Security of tenure, even in times of severe economic recession and fiscal consolidation, provides a value to public servants which is not generally available in the private sector. This needs to be reflected in any consideration of pay.

3. Recruitment, Retention and New Entrant Pay

Based on the evidence available there is no problem recruiting new entrants in general to the public service - measured by number of applications received, number of appointments made and the overall growth in employee numbers.

Total public service numbers have increased by some 16,052 Full Time Equivalents from Q1 2014 to Q3 2016 with the largest increases in the Health and Education sectors. Actual recruitment would be higher in order to cover replacement demand (retirements and leavers).

By the end of 2016, it is anticipated there will be an additional 2,324 public servants recruited. Budget 2017 makes provision for the recruitment of c. 6,100 additional staff (FTE) next year, increasing from an estimate of 306,800 at end 2016 to 312,800 in 2017 up 2.0%.

Between Q1 2014 and Q3 2016 the following additional staff have been recruited:

- → Teachers: + 4,525
- → Special Needs Assistants: +1,507
- → Garda: +352
- → Consultants/Doctors/Dentists: +1,254
- → Nurses: +1,234
- → Health & Social Care Professionals (mainly Social Workers): +1,792

There has also been successful recruitment to the main civil servant entry grades (Clerical Officer, Executive Officer, Administrative Officer), and senior grades (Assistant Principal Officer and

Principal Officers). For competitions run through the Public Appointments Service in 2014 and 2015:

- Across the main civil servant entrant grades (Clerical Officer, Executive Officer, Administrative Officer) there were 46,938 applications and 3,091 appointments made.
- For the senior management grades of Assistant Principal Officer and Principal Officer there were nearly 3,333 applicants and, to date, 124 appointments made with recruitment ongoing from the panels established.
- A recruitment campaign for Temporary Clerical Officers was held in March 2015, there were 14,153 applications and 2,613 appointments made.

- A new Clerical Officer recruitment campaign is currently underway and 30,000 applications have been received.

In total for the above campaigns (excluding the Clerical Officer Competition underway) 64,424 applications were received and 5,828 appointments made to date.

The available evidence presented above suggests that public service pay remains very attractive, particularly for new entrants and the Department of Public Expenditure and Reform does not therefore accept that there is any generalised recruitment problem.

According to the Public Appointments Service (PAS), who can provide a significant resource on recruitment issues to the Commission, recruitment issues that may exist are at Senior Level and for specialist skills. A review of Senior Executive Campaigns completed by PAS in 2015 found that average number of applications for senior positions had declined from 29 in 2014 to 25 in 2015 and that private sector applications had declined from 45% to 22% overall. The number of appointments from outside the Civil Service continued to fall somewhat from previous years with 20% of appointees being non-Civil Service candidates, compared with 23% of appointments in 2014 and 24% of appointments in 2013.

PAS achieved its target in 2015 of filling at least 95% of advertised vacancies. However, there are some roles where PAS is finding it more challenging to source candidates. In 2015, PAS

managed the recruitment process for a number of specialist roles primarily in HR, IT and Finance at a senior level in Government Departments and the broader Civil Service. Feedback from their executive search function suggests that candidates have been very interested in these roles, particularly given the opportunity to make a difference at a senior level in large scale organisations, such as Government Departments. However, the challenge has been that the remuneration (salary and benefits) the candidates currently earn is at least 30% higher than that on offer in the Civil Service. Remuneration has become more of a competitive issue in public service recruitment as private sector organisations use remuneration as part of their overall approach to develop, attract and retain talent. This has now become a real disincentive to potential candidates from the private sector who are interested in working in the public service[6].

Continued ability to recruit public servants and increase the overall number of public servants indicates that, in general, retention of staff is not a problem as inflows outweigh outflows. It also suggests that public service entry level salaries (including overtime and allowances) are, competitive in the wider labour market. The Department would welcome input from the PSPC on these points and whether remuneration offered to new entrants would normally be varied in line with the economic cycle.

4. FEMPI Savings and the Lansdowne Road Agreement

Under the Lansdowne Road Agreement the parties noted that "notwithstanding the improvement of the country's fiscal position, the legislative constraints imposed on public service employers under the financial emergency legislation will continue to be the context for pay determination during the lifetime of this Agreement. They are agreed on the importance of achieving a sustainable public pay policy that will continue to support the ongoing economic recovery over the coming years as the financial emergency legislation comes to be amended and repealed."

The Department of Public Expenditure and Reform remains committed to a fiscally sustainable public pay policy that balances demands for pay increases with other Government priorities.

The Financial Emergency Measures in the Public Interest (FEMPI) Acts provided combined savings of €2.2 billion through reductions in public service remuneration. Under the terms of the

[6] Public Appointments Service, *2015 Annual Report,* 2016

Lansdowne Road Agreement a total of €844 million of FEMPI measures are being unwound over the period 2016-2018. This represents a considerable investment by the Government in public service pay increases at a time when resources for additional expenditure are scarce.

After the Lansdowne Road Agreement in 2018, a further €1.4 billion will remain in FEMPI pay measures. Notwithstanding the FEMPI reductions still in place, the public service gross pay bill in 2016 is estimated at €15.68 billion or €15.16 billion net. This represents 28% of gross and 34% of net total Government expenditure respectively.

Clearly, the scope to address the further €1.4 billion in FEMPI pay reductions will continue to be severely constrained by the available fiscal space and the full range of other competing expenditure priorities over the medium term.

In accordance with statutory obligations under the FEMPI Act 2013, the Minister for Public Expenditure and Reform is required to annually review the operation, effectiveness and continued necessity of the Financial Emergency Measures in the Public Interest Acts. The latest review provides detailed background information on the specific measures and the total savings[7].

Of crucial importance for the further unwinding of FEMPI will be questions of progressivity. Firstly, it must be acknowledged, the application of the FEMPI pay reductions was extremely progressive, with pay reductions ranging from 5% at lower pay levels to 29% at higher pay levels.

Again the measures applied under the phased unwinding of the FEMPI reductions through the LRA were also progressive - it provided the greatest benefit at the fastest pace to lower paid public servants. As a result public servants earning under €24,000 will be fully restored under the LRA, while those earning under €30,000 will have approx. 80% of their FEMPI reductions unwound. In contrast, public servants who are earning €70,000 will receive 32% of their FEMPI reduction and those earning €120,000 will receive 28% of the FEMPI reduction that was applied to their remuneration. The impact of the pay reductions and amount restored by pay band can be seen in the Appendix.

[7] http://www.per.gov.ie/wp-content/uploads/Annual-review-and-report-to-the-Houses-of-the-Oireachtas-by-the-Minister-for-Public-Expenditure-and-Reform-under-section-12-of-the-Act-2016.pdf

Due to the progressivity of the FEMPI reductions and the first phase of unwinding, on completion of the Lansdowne Road Agreement the table below shows that €710 million will remain to be restored on salaries of over €60,000.

FEMPI Measures Remaining Post Lansdowne Road Agreement by Pay Band

	Pay	PRD	Total
Less than 25k	-	-	-
25 to 40k	€78.3m	€70m	€148m
40 to 60k	€254m	€300m	€553m
60 to 80k	€211m	€223m	€434m
80 to 100k	€48.3m	€50.5m	€98.8m
100 to 150k	€36.6m	€37.1m	€73.6m
150k plus	€63.3m	€41m	€104m
Total Post LRA (excluding PRSI)	**€692m**	**€720m**	**€1,412m**

Conclusion

In conclusion, the Department of Public Expenditure and Reform submits that:

- substantial resources (full year cost of €844m) have already been allocated for public service pay increases out to 2018 under the terms of the Lansdowne Road Agreement.
- further resources for pay in advance of the expiration of the agreement are limited in light of the economic and budgetary context.
- additional pay increases must also be considered in light of the low inflation environment
- diverting resources to public service pay increases would compromise service delivery including necessary recruitment and infrastructure investment
- valuable public service pensions must be included in any analysis of remuneration
- public service terms and conditions including security of tenure should also be valued as these provide a material benefit to public servants

- there are currently no general recruitment or retention problems in the public service – where problems are emerging is in respect of senior management and specialist skills.

In all areas, the Department of Public Expenditure and Reform will assist the Commission in any way possible with access to accurate and timely data. As a Department, we are committed to the principles of open government and access to information.

APPENDIX: IMPACT OF FEMPI MEASURES, LRA BENEFITS & AMOUNT REMAINING POST LRA BY PAY BAND

2015 Remuneration (Pre LRA Restoration)	Reduction Under FEMPI 2009 Act (PRD)	Reduction Under FEMPI 2009 (No. 2) Act (PAY)	Reduction Under FEMPI 2013 Act. (PAY)	Total FEMPI Reduction	LRA Benefit	% Benefit	% Restored
€22,000	€325	€1,158	€0	€1,483	€1,875	8.5%	126%
€23,000	€425	€1,211	€0	€1,636	€2,000	8.7%	122%
€24,000	€525	€1,263	€0	€1,788	€2,125	8.9%	119%
€25,000	€625	€1,316	€0	€1,941	€1,875	7.5%	97%
€26,000	€725	€1,368	€0	€2,093	€1,985	7.6%	95%
€27,000	€825	€1,421	€0	€2,246	€2,095	7.8%	93%
€28,000	€925	€1,474	€0	€2,399	€2,152	7.7%	90%
€29,000	€1,025	€1,541	€0	€2,566	€2,161	7.5%	84%
€30,000	€1,125	€1,622	€0	€2,747	€2,170	7.2%	79%
€31,000	€1,225	€1,703	€0	€2,928	€2,179	7.0%	74%
€32,000	€1,325	€1,784	€0	€3,109	€1,900	5.9%	61%
€40,000	€2,125	€2,432	€0	€4,557	€1,900	4.8%	42%
€70,000	€5,175	€5,453	€4,074	€14,702	€4,646	6.6%	32%
€80,000	€6,225	€6,643	€4,783	€17,651	€5,280	6.6%	30%
€100,000	€8,325	€9,058	€6,522	€23,905	€6,837	6.8%	29%
€120,000	€10,425	€11,153	€8,261	€29,839	€8,394	7.0%	28%