



Llywodraeth Cymru
Welsh Government

**WRITTEN STATEMENT
BY
THE WELSH GOVERNMENT**

TITLE **Regional Pay and Crowding Out**

DATE **5 July 2012**

BY **Jane Hutt, Minister for Finance and Leader of the House**

On May the 8th I published the evidence on Regional and Local Market Pay that the Welsh Government submitted for consideration by the Pay Review Bodies. That evidence, assembled by the Welsh Government's Chief Economist, demonstrates convincingly that the case for introducing public sector pay that varies on a regional, or "local, market facing", basis is deeply flawed. The Pay Review Bodies have yet to publish their recommendations.

In respect of the civil service, the UK Government stated in March that it expects all departments to consider local, market facing pay as part of their pay strategies for the next three years. However, the recent announcement on Civil Service Reform included a clear statement that 'there will be no change unless there is strong evidence to support it and a rational case for proceeding'. The Welsh Government firmly believes that introducing local, market facing pay for the civil service, as for other parts of the public sector, is clearly unjustified and we will not therefore be introducing it for Welsh Government staff. We hope that the departments employing the 28,000 or so civil servants in non-devolved occupations in Wales will come to the same

conclusion. Freezing or cutting the pay for the majority of these staff lacks justification and will take more money out of local economies in some of the poorest parts of the UK at a time when this would be most keenly felt.

The evidence we submitted to the Pay Review Bodies shows that:

- If the analysis the Treasury endorses is re-calculated with a larger and more recent data source, the apparent premium for Wales is considerably reduced, and the situation in Wales is shown to not differ in a statistically significant way from a number of other UK countries and regions.
- A number of important factors have simply been ignored in the Treasury's evidence, and that once these are factored in, there is no clear case that a persistent pay differential exists at all. (These factors include a proper estimate of the value of private sector bonuses, differences in pay that exist between occupations, whether in public or private sectors, and the need to assess pay over a period, rather than by taking a snapshot at a point in time when differences between public and private pay are likely to be at their greatest.)
- In so far as there are differences in pay between public and private sectors in Wales, these are largely driven by the fact that the low paid, and low paid women in particular, may be paid even less in the private sector.
- The apparent pay differential in Wales is influenced in part by the fact that the share of "top end" private sector jobs (the kind that are found in company headquarters and regional head offices) is lower in Wales than in other UK countries and regions.
- The evidence shows that large, multi-site private sector companies do not generally have pay which varies regionally outside of London and the South East, consistent with current public sector pay.

There has been no serious challenge to this evidence; indeed the most credible analyses published by others, including those submitted to the Pay Review Bodies and the Office of Manpower Economics by the Scottish Government and Northern Ireland Assembly respectively, have reached broadly similar conclusions.

Since my last Statement we have undertaken further analysis on the issue of whether there is any evidence that "excessive" levels of public sector pay or employment displace, or "crowd out", private sector employment. The Chief Economist has concluded that there is no evidence of that happening in Wales.

He has reviewed the existing research on 'crowding out' and has noted that it is both limited in extent and ambiguous in its conclusions – consistent with other findings from independent academic economists¹. Very little of the existing research is directly applicable to Welsh circumstances, especially in the current economic environment.

A key limitation of the much of the existing evidence is that that it does not take account of variation in labour market conditions. Economic theory suggests that crowding out is unlikely to cause problems in places, and at times, where labour markets are relatively weak. This is clearly a critical consideration in Welsh circumstances, particularly at present.

¹ Faggio, G. and Overman, H. G. (2012) *The Effect of Public Sector Employment on Local Labour Markets* SERC Discussion Paper 111 June 2012.

Relevant recent research includes that undertaken by Department for Business, Innovation and Skills (BIS) for the UK Government in 2010². This research did take account of local labour market conditions. The key finding is that any crowding out is likely to be minor in most circumstances, and is unlikely to occur at all where levels of unemployment are above a figure of about 5 per cent. This finding - consistent with economic theory - indicates that crowding out is very unlikely to have occurred to any significant extent in Wales in recent times and even in the past is unlikely to have been a major issue.

Beyond this, if we look to the record of job creation in Wales, we see absolutely no evidence that the private sector has been 'crowded out'. From the start of devolution in 1999 until the recession, Wales had seen more jobs created in the private sector than in the public sector. Across the UK as a whole, the reverse happened. So Wales had been outperforming the UK on private sector job creation during a period of relatively strong economic performance, which is at odds with the theories of crowding out.

As just noted, 'crowding out' is least likely to happen at times, and in places, where unemployment is relatively high. These are also the circumstances in which reductions in public sector pay, leading to lower levels of spending, are most likely to result in the largest knock-on effects and an associated loss of jobs. Therefore attempts by the UK Government to engineer reductions or long term freezes in public sector pay in Wales are likely to be particularly harmful in present circumstances.

As I noted in my last Statement, all Political Parties represented in the National Assembly for Wales have welcomed the evidence by our Chief Economist and supported the Welsh Government's call for these proposals to be withdrawn. I hope we can continue to work in a united way to encourage the UK Government to stand by its Statement that there will be no change unless there is strong evidence to support it. As it is now clear that there is no strong evidence to support this change the UK Government should immediately announce the withdrawal of this misguided policy.

² *Understanding Local Growth*. BIS Economics Paper No 7. Department for Business Innovation and Skills. November 2010. See Appendix 3.