17 Kildare Street,
Dublin 2.
27th April 2018

Mr Kevin Duffy,
Chair,
Public Service Pay Commission,
3rd Floor,
St. Stephen's Green House,
Earlsfort Terrace,
Dublin 2.

> ***I have had many rows with the Minister, some in the past six months, but we have also spat on our hands and shook hands on issues and they have all been delivered. The ATM machine is nicely stacked up after today's business. I look forward to that spitting out money in all directions, including the Members of the Oireachtas, in a short period.***
>
> *Senator Joe O'Toole, Senate debate on Finance Bill 2003, 26th March 2003*

Dear Mr Duffy,

So spoke Senator Joe O'Toole at the debates on the Finance Bill 2003. 'Benchmarking' wasn't the sole topic for debate, but the implication was clear: a very significant pay deal had been struck for the public service and politicians, without any real reciprocal commitments on reform. The only firm commitment signed up to by the union side was one to avoid industrial action. Was the €1.1bn cost of the benchmarking awards merely the most expensive industrial peace clause ever struck? Perhaps it is only now, 15 years later, we can honestly evaluate the value for money enjoyed by the citizens of Ireland through benchmarking.

ISME wishes to submit its observations to the Public Service Pay Commission (PSPC) ahead of deliberations on Phase II concerning recruitment and retention in the public sector. Perversely, just as was the case in 2003, it is as the economy improves that greatest pressure will be brought to bear on the public payroll. In times of economic downturn, the public sector represents a safe harbour for employees, and remuneration demands, while present, are more muted. Today, with unemployment levels last seen in the boom period, the gloves are off.

Recruitment and Retention

Recruitment and retention, frequently referred to as the 'two 'Rs' in HR circles, are the normal and primary justifications for reconsideration of workplace remuneration. As the first report of the PSPC states: '*evidence suggests that there are not significant difficulties with regard to recruitment to the various large scale public service vocational streams. However, there are problems in the case of some specific and specialist groups across the public service. This includes the Defence Forces and those groups whose skills are in demand internationally, particularly in the health sector*.' ISME considers this a fair reflection of the broader recruitment and retention issue, and therefore no justification exists at present for improving remuneration on that basis. Where specific issues arise, such as in the Defence Forces or the Health Service, the solutions should be sector specific, and flexible in the longer term. There should not be 'read-across' to other areas of the public service, and it should be a condition of engagement with the Public Service unions that this is the case.

International Comparison

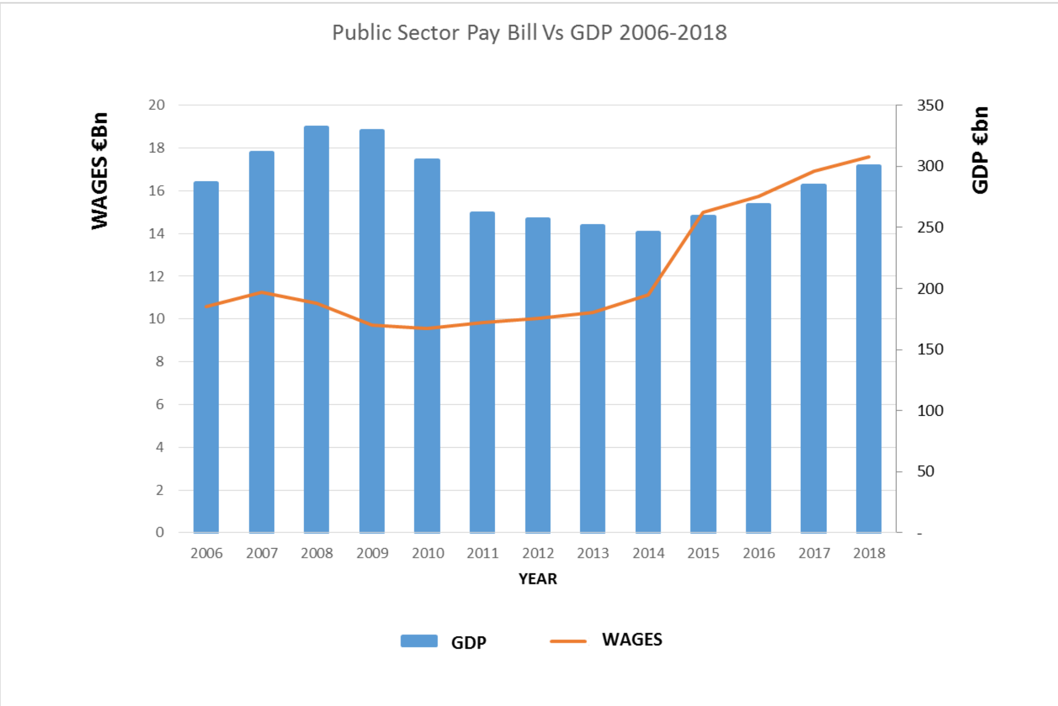
The terms of reference for Phase I of the PSPC included specifically a goal of '*Comparing appropriate rates for identifiable groups within the public service with their equivalents in other jurisdictions, particularly where internationally traded skillsets are required, having due regard to differences in living costs*.'

This was not completed in any degree of detail in the Phase I report, albeit that the report did summarise high-level aggregated data which concluded that Irish public servants were amongst the best paid in Europe in their peer groupings.

Similarly, the relative enormity of our public sector pay bill can be seen when compared with the rest of Europe. In 2012 (the last year for which comparable figures are available) Ireland's bill stood at 11.5pc of GDP. As a share of GNP, often considered a better measure of the real size of the Irish economy, it stood at 14.1pc. That was the sixth-highest level among the 28 members of the EU. With the currently in vogue GNI* measurement, which has a run rate of 68% of GDP, our current rate of spend of national wealth on payroll is approximately 8%. GNI* removes repatriated MNC profits, IP-related balance sheet transfers, and the balance sheet effects of leased aircraft, and is a much more realistic indicator of our ability to pay for our public service.

What is of greatest concern at the moment is the velocity of increase (See Figure 1) of the public sector payroll cost; which exceeds the rate of expansion of both GDP and GNI*. ISME is worried about the long-term affordability of the public sector payroll.

Figure 1. Public Sector Pay V GDP



'Restoration' and 'Equality'

The size of pay increases in the public sector up to 2008 were enormous, and were utterly without justification. Most commentators now acknowledge that the 'Benchmarking' process which effected this outcome was a political, rather than an empirical exercise. Its effects, however, were real and profound. Had benchmarking never occurred, the fiscal crisis of 2008-2012 would not have been nearly as severe as it has proved.

'Restoring' public pay packets now, as unions are seeking, is unjustifiable given the perilous state of the public finances and the spending pressures generated by population growth. It also ignores the very substantial public private pay gap that exists in Ireland, which is consistently about 40% of gross pay (see below). To give already well-paid public servants more money would be grossly inequitable and an inefficient use of scarce resources. It must be resisted, and the outputs of the PSPC are essential in this regard.

While public sector workers have taken pay cuts since the crash, they have retained most of their bubble-era gains. The public sector pay bill in 2014 was still more than 50% higher than when the bubble began in 2002.

Regarding Ireland's national debt; while 'The Banks' are blamed in the collective and colloquial memory for Ireland's enormous debt level, in reality, they were responsible for approximately 31% of today's debt of €208bn in absolute terms. Our national debt in 2006 stood at €35.92bn. The bank bailout cost Ireland €64.6bn from 2008-2016. Thus the debt added to Ireland's balance sheet net of the original 2006 national debt, and the bank bailout, was €107.5bn. The vast majority of that additional debt was incurred in financing the current side, since capital spending was so drastically reduced.

Since payroll makes up such a large proportion of total Government current spend, and will come to approximately €17.1bn in 2018 (see Appendix I), what Ireland did during the fiscal crisis was to transfer the future wealth of our children to fund our civil servants' salaries today via long-term government debt. This wealth transfer continues in 2018, since Ireland continues to borrow. ISME considers the profligacy involved in this wealth transfer to be deeply objectionable, and morally indefensible.

ISME notes with great concern that the officer who resigned from the original Benchmarking body in 2002 has expressed reservations about many of the assumptions and conclusions in the Phase I report of the PSPC.

Public-Private Sector Pay Gap

This has been an area of considerable debate in recent years, and in ISME's view, must be taken into account in any consideration of future public sector pay increases. As of Q4 2017, the average public sector pay was €946.55pw, while the private sector average was €674.94pw, a difference of 40%. This gap is quite consistently maintained in the CSO data releases, generally moving in a range +/- 2%.

Unfortunately, the issue has descended into adversarial positioning; the private sector pointing out the gap, while public service unions deny its existence, or try explain away its real extent. The most recent study produced by the CSO[1] placed the gap at a maximum of 5.05%, after accounting for variables that would not normally be attributed to employees in the private sector. The study purported to generate an accurate comparison between public and private sector by correcting for the following factors: Gender; Nationality; Age; Full-time/Part-time status; Supervisor status; Temporary/Permanent status; Shift work status; Usual Hours worked; Overtime Hours; Length of service with current employer; Union Membership Status; Occupation (UK SOC 10) Highest level of education; Firm Size class (1-99 & 100 +) – based on local unit; and a 'Grossing Factor.'

However, this study and estimate is, itself, an outlier. In a meta-study of the public-private sector pay gap produced by Davy Research[2] in March 2017 shown in Table 1 below, the CSO (2017) gap was significantly out of kilter with other estimates, including the CSO's own 2012 study.

Table 1. Davy study on the public sector pay premium.

Estimates of Ireland's public/private pay premium	
Boyle, McElligot and O'Leary (2004)	13%
Murphy, Ernst and Young (2007)	10%
Kelly, McGuinness and O'Connell (2009)	26%
Foley & O'Callaghan (2009)	10%-21%
European Central Bank (2011)	19%
Central Statistics Office (2012)	6%-19%
Kelly, McGuinness and O'Connell (2012)	17%
European Commission (2013)	21%
Central Statistics Office (2017)	5%

Source: Davy

Furthermore, it is out of kilter with the acknowledged pay gap in our nearest neighbour, the UK. ISME is not an advocate of the policy position that everything in Irish society should mimic that found in the UK, but in understanding the basis of the CSO's 2017 study, we would be most interested to compare the compositional characteristics used in the Irish and UK studies.

Large scale studies by the ONS in the UK put the difference between public and private pay at a level substantially smaller than in Ireland, and certain studies show private sector pay exceeds public sector for some deciles.

Figure 2 below shows the analysis of factors affecting earnings using the Annual Survey of Hours and Earnings 2016 produced by the Office for National Statistics in the UK. This showed a positive wage variation in favour of the private sector after correction for age, gender, occupational group, region of employment, job tenure, job status, and size of employer.

[1] http://www.cso.ie/en/media/csoie/newsevents/researchpaper/EconA20112014.pdf
[2] https://www.davy.ie/research/public/printPdf.htm?id=publicsectorpay20170327_24032017.htm

Figure 2. ONS (UK) Survey 2016

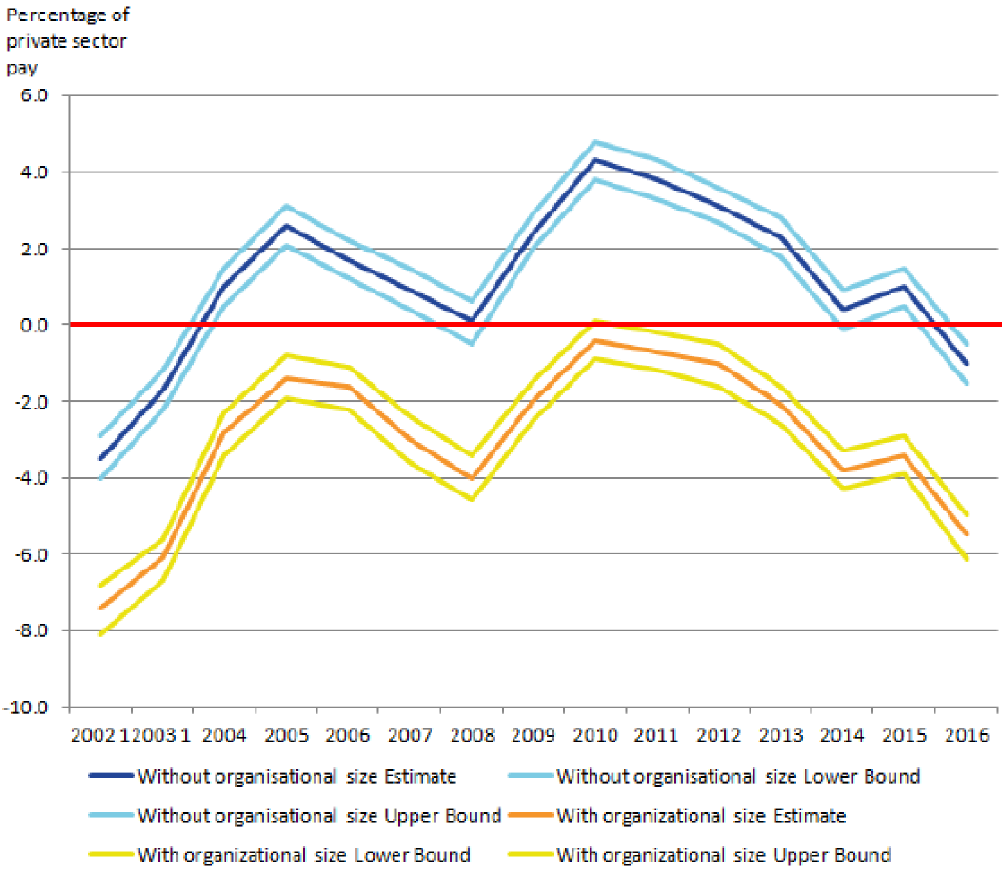
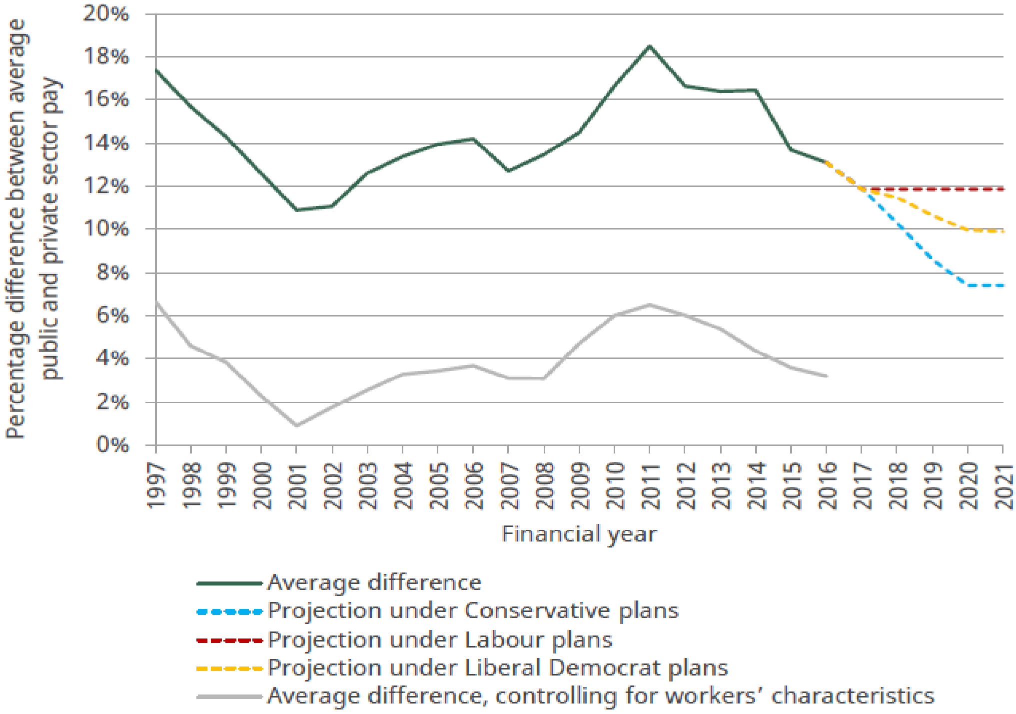


Figure 3 below shows the data produced by the Institute of Fiscal Studies (UK) in its parliamentary briefing note of May 2017. While, unlike the ONS data above, this shows a small but positive difference in favour of the public sector (after control for employment characteristics), the gap is consistently below 20% *before control*, and below 7% *after control*. In other words, the magnitude of difference between public and private sectors in the United Kingdom is *consistently smaller, irrespective of the sampling and control methodologies used*.

Figure 3. Difference between average public and private sector pay, including projections under different parties' policies



Note: Data to 2016–17 estimated using Labour Force Survey data (2016–17 only includes up to 2016Q4). Difference controlling for workers' characteristics controls for differences in age, sex, education, experience and region. Projections based on author's calculations using OBR Economic and Fiscal Outlook March 2017, Labour manifesto and Liberal Democrat manifesto. We assume that a Labour government delegating public sector pay to Pay Review Bodies will lead to them increasing public sector pay at the same rate as private sector pay. We interpret Liberal Democrat policy to be to increase public sector pay in line with expected CPI inflation in 2018–19 and 2019–20 and to delegate decisions to Pay Review Bodies after that.

Reverting to our exhortation not to be tethered to UK comparisons; an exceptionally broad study of the public private sector pay gap was conducted by Campos et al in the IZA Journal of Labour Policy[3] 2017. This study is interesting in stating that '*Conditional wage gaps are larger for countries that suffered fiscal stress over the crisis (Cyprus, Spain, Ireland, Portugal, Greece, and Italy) and Luxembourg and tend to be higher when a more restricted definition of the government sector… is considered*.' A further quotation from this study is noteworthy: '*Luxembourg and Ireland undergo the third and fourth largest pay gaps, respectively, in our sample, yet they enjoy high-quality governments and a fair amount of public employees. Despite this, they behave according to the theory* [of government monopolistic power] *in the sense that they allocate a relatively high amount of workers to Public Administration, rather than to Health and Education*.'

Figure 4 below shows the graphic comparison of pay gaps across 15 EU countries. These data are consistent with those quoted in many other places; which is to say that the Irish public private sector pay gap is real, it is consistent, and it is matched (generally) only in Italy, Spain and Portugal, where average wages are far lower.

[3] https://link.springer.com/content/pdf/10.1186%2Fs40173-017-0086-0.pdf

Figure 4. Campos et al

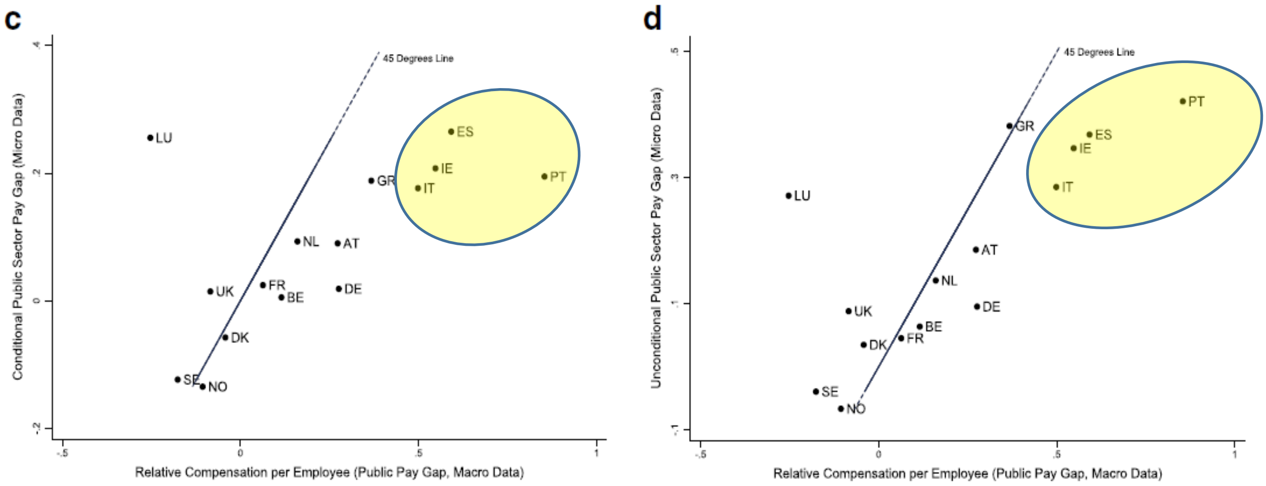


Fig. 1 Public-private pay differentials computed from macro data and comparison with micro-based pay gaps. Notes: Panels **a** and **b** show the evolution of public-private pay differentials (computed from macro data) for a selection of countries. Panel **c** compares the public sector pay gap conditional on observed worker characteristics (EU-SILC, see Eq. 1) with the wage gap computed from aggregate macro data (National Accounts). Panel **d** compares the latter with the public sector pay gap computed from micro data (EU-SILC) unconditional on observed characteristics. With the exception of Luxembourg, the cross-country patterns of micro vs. macro pay gaps are similar

In attempting to counter the fact of the yawning pay gap between public and private sectors, ICTU has published, and continues to update, its '*Because We're Worth It*' survey of CEO remuneration[4] in Irish PLCs and commercial semi-states. Other than trying to distract public and media attention away from the real remuneration issues, ISME is unsure why ICTU persists with this. Firstly, Irish SME owners can only dream about the pay packages of the CEOs of the 27 PLCs and 12 commercial semi-states surveyed. Secondly, this sample group comprises only 0.00016% of Ireland's 250,643 active enterprises (EU Commission, 2017 figures). To what legitimate or truthful end can ICTU claim this sample is representative of the real remuneration issue in Irish society?

In short, the argument about the existence of the public-private pay gap is over. It is time for the CSO, the Government, the trades unions, and now the Public Service Pay Commission, to acknowledge the truth and act accordingly.

The SME perspective

ISME surveys its membership quarterly on business sentiment, issues, and intentions in its 'Trends Survey.' One of the questions concerns employer intentions to increase employee pay in the coming year. The Q4 2017 results are shown in Table 2 below. While 59% of our members intend to increase pay in the months ahead, 38% do not, a very significant number in the current employment climate.

[4] https://www.ictu.ie/download/pdf/because_were_worth_it_ceo_pay_survey.pdf

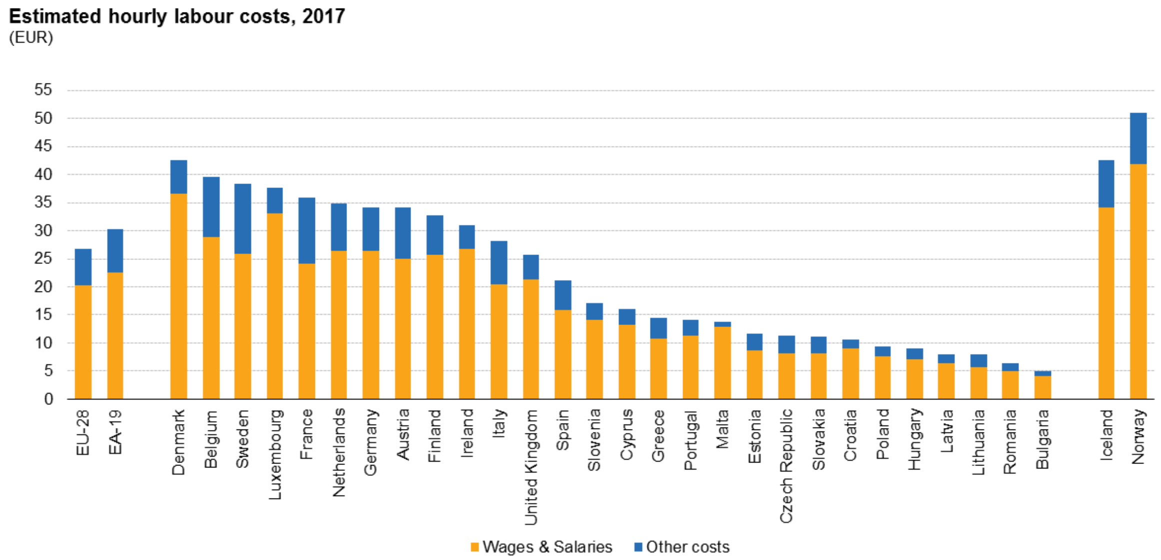
Table 2. ISME members' payroll intentions

Increase pay by more than 5%	7%
Increase pay by Plus 2.5% to 5%	26%
Increase pay by Plus 0.5% to 2.4%	26%
No pay increase (0%)	38%

We are not suggesting that the pay increases available to ISME members should represent a ceiling for those available in the public sector. We are suggesting that they represent the market reality of the tax base from which the money to pay public service pay increases will be extracted. As such, we think it unwise and immoral to compound what is already a highly unequal share of societal wealth by transferring from the lower paid (and relatively unprotected) to the higher paid, and highly protected.

A refrain from the public sector unions in response to this macro-economic reality has been to suggest that it is shareholder greed that is restraining payrolls in the private sector. This is simply untrue. Eurostat consistently lists Ireland in amongst the most costly labour markets in the EU, and as shown in Figure 5, the wages and salary element of our local labour cost is the fourth highest in the EU, after Denmark, Luxembourg, and Belgium. Despite this, Irish enterprises are trying to survive in a highly competitive marketplace in a peripheral, small, open economy.

Figure 5. Eurostat Wage Costs

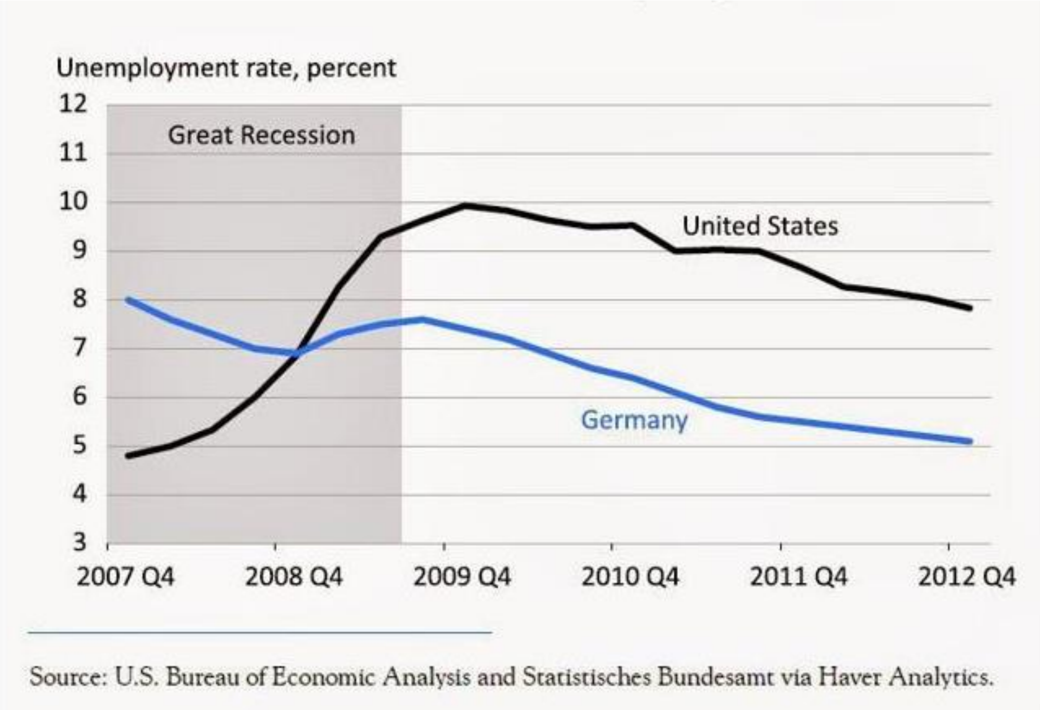


Note: whole economy (excluding agriculture and public administration); in enterprises with 10 or more employees. Provisional data.
Source: Eurostat (online data code: lc_lci_lev)

Similarly, SMEs are chided by the trade union sector that the public-private sector pay gap would narrow if SMEs increased their wages (presumably by more than that suggested in Table 2). We note on behalf of the employers that with consumer inflation currently running at about 1%, the only way for indigenous enterprise to absorb larger pay increases is with an increase in productivity. Furthermore, ISME member companies acknowledge the productivity issue, and it forms part of every submission we make on indigenous industrial policy.

Wage setting in the Irish economy does not have to be the zero-sum game that trade unionists portray it to be. When faced with similar issues of productivity (and high unemployment) in the 1990's, German trade unions agreed to wage restraint. The outcome of this mutually agreed, consistently applied German wage restraint was not merely a gradual increase in competitiveness; it was a much higher resilience to the down-turn when it eventually came. The rise in unemployment in the 2008-09 recession was not nearly as acute as that which the Irish (private sector) workforce endured. Employers repaid the wage restraint of the workforce by reducing hours, not jobs, resulting in a (relatively) benign increase in unemployment[5] for the German workforce, as illustrated in Figure 6, below. Topping out at 14.9% unemployment in 2012, the Irish workforce was literally decimated by comparison.

Figure 6. German Vs US unemployment during the Great Recession



Wage restraint thus avoids (or reduces) the boom-bust cycle in employment, and is counter-cyclical. Reflexively seeking large wage increases as the economy improves is inherently pro-cyclical. There is, therefore, a trade-off to be made between the long-term resilience of the Irish workforce and the pay levels attracted by it. The levels of pay in the public service cannot be divorced from this. Wage-setting in the public service directly impacts that in the private sector by establishing benchmark pay rates, and reducing the supply of talent to the wealth-creating sectors of the economy overall.

Unfortunately, there is no reason to believe that the main interest groups have developed a shared vision of how Ireland, its economy, and its public services should be managed and paid for. Despite the overwhelming failures to deliver and modernise our health, education and justice services, the

[5] https://seekingalpha.com/article/2733855-how-did-germany-limit-unemployment-in-the-recession

only calls from those groupings are for more numbers, increased pay, reduced hours, and absolute resistance to change. In the absence of fundamental service-reengineering, modernisation, and pre-delivered productivity, these demands are simply unsustainable and unaffordable.

ISME acknowledges that it will never be possible, nor would it be logical or desirable, to have no differences at all between the terms and conditions of public service employment and those within the private sector. However the fact remains that perquisites such as job security, longer holidays, more generous in-lieu arrangements, and absence of redundancy are very major benefits of employment, which remain unacknowledged and uncosted.

Moreover, and with the greatest of respect to the PSPC, the observations and evaluation of the value of public service pensions in your May 2017 report would not withstand the most cursory, or even charitable, actuarial analysis. In the current global macro-economic environment and with increasing life expectancies post-retirement, public service defined-benefit pensions are the gold standard for those lucky enough to possess them. The net present value (future deficits expressed as current capital) of public service pension debt is €100bn, equivalent to half of our national debt- which takes no account of this. The currently applied pension-related deductions in the public service make only a nominal contribution to this unfunded debt; yet any private sector pot which even approaches the value of a public sector pension pot is subject to pecuniary levy. Simply put, our taxation system actively and heavily discriminates against the accumulation of private pensions of far lower benefit to those enjoyed by the public sector.

The narrative at play among many of the public service unions at the moment is the elimination of 'two-tiered' pay arrangements. This argument is a canard. As every experienced industrial relations negotiator knows, this issue regularly arises in private sector situations. Invariably the remuneration, terms and conditions of the older or more established employees cannot or will not be reduced, but cannot be sustained for new entrants. The widely accepted solution to the conundrum is 'red-circling.' While the numbers of employees involved in some public sector areas are larger, the principle is exactly the same. We are at a loss to understand why any other solution could be credibly proposed.

Finally, we ask you to address the 'industrial peace' arguments which are posited in pursuit of public sector pay increases. A key issue in the past was the extent to which pay rises were justified solely by reference to, or in fear of, industrial relations issues or strike action. This not merely makes no sense, but it is entirely counter-productive. The recent series of strikes in the public transport sector, and the threatened strike by members of An Garda Síochána, illustrate the positive correlation between increased remuneration and Exchequer willingness to fund pay increases. If this were replicated throughout the public sector, Ireland would hit the fiscal buffers it last hit in 2008-10. It falls to you and your colleagues to avoid this.

If the cost of avoiding the fiscal and employment crash of 2008-2012 is a period of widespread, prolonged, and even damaging industrial disputes, this is a price worth paying. Industrial peace is not worth having *at any price*, especially if that price entails further widening of the inequalities between public and private sector workers.

You and your colleagues in the Commission represent a significant line of defence for society against the recurrence of the carnage inflicted by the Great Recession. While we understand and accept that your deliberations are focussed on those within the public sector, we implore you not to forget the impact your decisions will have on society in general, and on the 85% of the Irish workforce employed outside the public sector.

Yours sincerely,

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Neil McDonnell
Chief Executive

APPENDIX I

Net Expenditure Analysis By Vote €000

		2018	
		Current Pay	Total
V42 - Rural & Community Development (net)		12,215	**12,215**
Social Protection & Sif		306,028	**306,028**
V1 - President's Establishment (net)		1,712	**1,712**
V2 - Department Of The Taoiseach (net)		16,608	**16,608**
V3 - Office Of The Attorney General (net)		12,201	**12,201**
V4 - Central Statistics Office (net)		38,787	**38,787**
V5 - Director Of Public Prosecutions (net)		14,449	**14,449**
V6 - Chief State Solicitor's Office (net)		16,487	**16,487**
V7 - Department Of Finance (net)		17,870	**17,870**
V8 - Office Of The Comptroller And Auditor General (net)		10,466	**10,466**
V9 - Office Of The Revenue Commissioners (net)		270,500	**270,500**
V10 - Tax Appeals Commission (net)		1,226	**1,226**
V11 - Public Expenditure And Reform (net)		27,328	**27,328**
V13 - Office Of Public Works (net)		96,674	**96,674**
V14 - State Laboratory (net)		5,663	**5,663**
V16 - Valuation Office (net)		8,203	**8,203**
V17 - Public Appointments Service (net)		7,184	**7,184**
V18 - National Shared Services Office (net)		27,994	**27,994**
V19 - Office Of The Ombudsman (net)		8,363	**8,363**
V20 - Garda Síochána (net)		1,034,409	**1,034,409**
V21 - Prisons (net)		236,812	**236,812**
V22 - Courts Service (net)		52,031	**52,031**
V23 - Property Registration Authority (net)		24,020	**24,020**
V24 - Justice And Equality (net)		157,272	**157,272**
V25 - Irish Human Rights & Equality Commission (net)		3,495	**3,495**
V26 - Education And Skills (net)		5,754,610	**5,754,610**
V26 - National Training Fund (net)		0	**0**
V27 - International Co-operation (net)		15,541	**15,541**
V28 - Foreign Affairs And Trade (net)		89,620	**89,620**
V29 - Communications, Climate Action & Environment (net)		60,861	**60,861**
V30 - Agriculture, Food And The Marine (net)		248,810	**248,810**
V31 - Transport, Tourism & Sport (net)		86,472	**86,472**
V32 - Business, Enterprise & Innovation (net)		157,954	**157,954**
V33 - Culture, Heritage & The Gaeltacht (net)		78,767	**78,767**
V34 - Housing, Planning & Local Government (net)		16,093	**16,093**
V35 - Army Pensions (net)		67	**67**
V36 - Defence (net)		495,877	**495,877**
V37 - Employment Affairs & Social Protection (net)		296,348	**296,348**
V38 - Health (net)		7,100,572	**7,100,572**
V39 - Office Of Government Procurement (net)		14,000	**14,000**
V40 - Children And Youth Affairs (net)		309,814	**309,814**
V41 - Policing Authority (net)		2,086	**2,086**
Total		**17,135,489**	**17,135,489**

Source: DPER