National Audit Office

Report
by the Comptroller
and Auditor General

Cabinet Office, HM Treasury

Central government staff costs

HC 79 SESSION 2015-16 5 JUNE 2015

Summary

1 In 2010, the world economy was in recession and the UK faced its own financial crisis, with the government posting its highest-ever budget deficit in 2009-10. The coalition government announced that a main priority would be to control the government's finances, including public spending.

2 A substantial proportion of public spending is for human resources: staff directly employed, with temporary staff paid directly or through agencies, and consultants paid through firms. In 2013-14, the public sector workforce of 4.4 million employees cost £164 billion, representing 23% of the total public expenditure. The civil service accounts for 9% of the workforce (405,000 people in December 2014).[1] In the 2010 Budget, the government clarified that a key part of its fiscal policy would be to cut staff costs to help reduce the deficit. However, we concluded in 2011 that departments did not have a structured approach to reducing staff costs.[2]

Our report

3 This report examines:

- how far departments have reduced civil service staff costs and how they have done so (Part One);
- whether departments are managing their workforces strategically to make sustainable reductions (Part Two);
- how the Cabinet Office, HM Treasury and Civil Service Human Resources are supporting staff cost reduction (Part Three).

4 We analysed data from the Office for National Statistics and departments' resource accounts. We looked at workforce planning in four case study departments: HM Revenue & Customs (HMRC), Ministry of Defence (MoD), Department for Transport (DfT) and Department for International Development (DFID). We discussed the centre of government's role with the Cabinet Office and HM Treasury (the Treasury), and consulted public bodies, private sector representatives and trades unions.

5 We focus primarily on the civil service, and its departments and agencies, as the centre of government has more influence and accountability for this part of the workforce. The wider workforce in these bodies includes consultants and temporary staff but these, as well as outsourced functions, are outside the scope of this report.

1 All staff numbers in the report are presented on 'full-time equivalent' basis.
2 Comptroller and Auditor General, *Managing staff costs in central government*, Session 2010-11, HC 818, National Audit Office, March 2011.

Key findings

Civil service staff costs

6 **Government departments reduced their salary bill substantially between 2010 and 2014, while the cost of temporary staff and consultants was also lower**. As at 31 March 2014, the civil service annualised salary bill stood at £11.13 billion. After adjusting for transfers of functions into and out of the civil service, this was £2.49 billion (18%) lower in real terms than at 31 March 2010. Other data the Cabinet Office collected suggest the wider costs of departments' workforces in 2013-14 included £1.1 billion spent on temporary agency staff and consultants, which was £1.6 billion (58%) lower in real terms than in 2009-10 (paragraphs 1.5 to 1.6).

7 **The number of civil servants has fallen significantly, reducing annual salary costs by around £2.29 billion**. The *Civil Service Reform Plan* (June 2012) set out a vision of a smaller and more strategic civil service with a projection of 380,000 staff (23% smaller than March 2010) by March 2015. Overall, the number of civil servants fell by 18%, from 492,000 in March 2010 to 405,000 in December 2014, which is slightly above the projection adjusted for organisational changes that brought some existing public sector employees into the civil service. The reduction in staff numbers has reduced salary costs by around £2.29 billion, representing most of the £2.49 billion net decrease in salary costs overall (paragraphs 1.3 to 1.4 and 1.14 and Figure 2).

8 **Departments reduced the number of civil servants mainly by minimising recruitment, which has affected the age profile**. Reducing headcount by restricting recruitment costs less in the short term than paying staff to leave. The Cabinet Office restricted departments' ability to recruit externally. The number of new entrants to the civil service therefore declined from an average of 9,400 per quarter in 2009-10 to only 2,800 in 2011-12 (less than 1% of the civil service). In comparison, the number of leavers per quarter averaged 8,700 between 2009-10 and 2013-14, with a peak of 12,300 leavers April–June 2011. Following the low level of recruitment the age profile of the civil service has changed, creating a generational gap: 20- to 29-year-olds reduced from 14% to 9% of the civil service (2010 to 2014), while 50- to 59-year-olds increased from 26% to 31%. We consider it fair to assume that low levels of recruitment and the creation of a generational gap potentially heightens the risk that the civil service will not have the talent and skills needed for future challenges. Although there is a growing awareness in government of this risk, there is not yet a clear understanding of the potential consequences and the necessary management actions (paragraphs 1.8 to 1.9).

9 **Departments also reduced staff salary costs by holding back average salaries within grades**. In May 2010, the government introduced a two-year pay freeze, later extended to a 1% increase for each of the next two years, but deferred for those departments that had already agreed multi-year pay deals. Pay increases have been affected by a move to remove automatic increases (‘progression pay’). We estimate that changes in average salaries, including by restraining pay awards, reduced annualised salary costs by around £191 million in real terms between 2010 and 2014 (paragraphs 1.11, 1.12 and 1.14).

10 **Departments’ workforces have become more senior in grade, which can reflect new ways of working but increases the average cost per head**. Departments made bigger reductions of staff in junior grades, including reducing the proportion of staff in the two junior administrative grades from 46% in 2010 to 40% in 2014. This is compared with an increase in middle management staff (grade 7, senior and higher executive officers) from 26% to 30%. This, at least in part, reflects departments introducing new ways of working, including reducing clerical roles and increasing the need for digital skills. We estimate that although overall salary costs have reduced by £2.49 billion, the change in grade mix resulted in additional annualised salary costs of around £292 million in 2014 compared with 2010 (paragraphs 1.13 and 1.15 and Figure 5).

11 **Departments are likely to have to reduce staff costs further during this Parliament**. The coalition government committed to balancing the current budget by 2017-18, and its spending plans would require further reductions in day-to-day public spending. If some public spending is protected, the burden of reductions will be uneven. Departments will have to manage staff cost reductions strategically, to reduce the risk of damaging public service delivery (paragraph 1.16).

Strategic workforce planning

12 **Some departments have made good progress in setting out long-term operating models, but others have made less progress**. The Committee of Public Accounts reported in 2012 that departments did not have long-term plans to work with fewer staff. The government agreed that all departments should set out these plans. Since then, two of our case study departments have undergone significant change. HMRC has reduced its workforce by 20% since 2010 and is undergoing further major transformation. The MoD introduced a new operating model in 2014, following Lord Levene’s Defence Reform report in 2011. However, transformation in departments is not as widespread or advanced as we expected, and departments need information-based operating models that facilitate more efficient working practices (paragraphs 2.2 to 2.5).

13 **Progress in planning for the period after 2015 varies among our case study departments**. There is some planning for existing long-term projects or programmes. Of our case study departments, three had not completed detailed plans for other business activities after the 2010–2015 Parliament, which would improve their readiness for negotiations within the next spending review. The departments ascribed this to uncertainties over a future government's priorities and whether their departmental responsibilities will change (paragraph 2.10).

14 **Our case study departments have weaknesses in their approaches to developing strategic workforce plans, which could hinder staff cost reductions**. In 2011, we reported a lack of a structured approach to staff cost reduction. This time we have found that departments had good intentions to develop strategic approaches. But none had progressed to implementing them across their group. Other than developing workforce options as part of its estates strategy, HMRC's strategic workforce planning was mainly qualitative and DFID's workforce plan only included projected total staff numbers in each area of the business. Although operating a group human resources function, DfT does not plan across the group. It believes its agencies are best placed to do their workforce planning and there is no need to produce an overall plan. Similarly, MoD expects its business areas to carry out workforce planning (paragraph 2.9).

15 **Case study departments continue to lack comprehensive and reliable information on the skills their workforce possesses and their needs**. In 2011, we reported that departments lacked information on their workforce's skills. This time, we have found that case study departments continue to lack systems to monitor all staff skills, restricting how they assess capability. Departments also find it challenging to assess their skills needs, as they have not sufficiently developed new long-term operating models to be clear about the skills they will need (paragraphs 2.11 to 2.14).

The centre of government's role

16 **The centre of government is supporting and monitoring, but not yet leading, strategic workforce management across government**. The Cabinet Office, HM Treasury and Civil Service Human Resources are all involved with workforce management, including giving pay guidance, approving workforce restructuring plans and providing central services. Departments are increasingly using Civil Service HR's expert services. This is likely to have reduced government HR costs, which highlights potential efficiencies in centralising corporate functions. However, the centre has done little so far to help departments with strategic workforce planning. The relevant expert service launched only in April 2015, which left little time to help departments in producing workforce plans to underpin their submissions for the next spending review, currently expected to take place in autumn 2015 (paragraph 3.2 to 3.5).

17 **The centre is not producing an overall strategic workforce plan for the civil service.** The 2013 capabilities plan set out actions to address skills gaps in key areas in the civil service. However, an overall strategic workforce plan for the civil service would help the centre to plan better for, and support departments in making, reductions. The centre cannot yet produce a plan because departments' workforce information and projections are incomplete and not comparable. Improved information would strengthen how well the centre understands the cross-government picture and its ability to provide strategic leadership (paragraphs 3.3, 3.6 to 3.7).

18 **HM Treasury has promoted pay restraint and is starting to give more pay bill flexibility to departments, but could engage more consistently with their workforce plans.** As well as assigning department budgets, the Treasury sets the pay frameworks for departments. It also considers their applications for extra funding to address capability shortages or to reform employment terms and conditions. To give more flexibility on pay, the Treasury is piloting arrangements that allow organisations flexibility and autonomy over their pay bill. Departments welcome this, as it allows them to target their pay budget more flexibly. The Treasury is informing and challenging departments by carrying out statistical analysis of pay data that highlight possible inconsistencies between how much departments pay similar staff. In running the next spending review, the Treasury can consider how to create sufficient incentives for departments to continue looking for reductions throughout the spending review period (paragraphs 3.8 to 3.15).

Conclusion on value for money

19 Departments have significantly reduced their staff costs and numbers. They reduced staff numbers mainly by minimising recruitment, and the age profile of the civil service has changed. It remains to be seen what effect this has had on the future pipeline of talent and skills. In addition, departments' progress in developing and implementing long-term operating models is not advanced enough to sustain existing reductions and to be well placed to make the expected reductions during the 2015–2020 Parliament.

20 To achieve value for money, departments face the challenge of ensuring that their reductions are sustainable. They must prioritise developing and strengthening their long-term operating models and strategic workforce plans, and ensure they recruit or develop the critical skills needed. The centre of government is building its strategic role, but must do more to support departments to meet these challenges; for example, by giving them more expert services and more flexibility to manage their pay bill.

Recommendations

21 For all departments:

a Develop long-term operating models that are more information-based to allow them to get the best possible levels of service with reduced budgets.

b Develop strategic workforce plans to support the transition to, and operation of, their long-term operating model.

c As part of strategic workforce planning, use better approaches to assessing skills gaps and whether to fill them by recruitment or staff development.

22 For the centre of government:

d Lead efforts across government to make sustainable reductions through strategic workforce planning as part of the spending review, developing a workforce plan for central government, and supporting departments through the workforce planning expert service.

e Consider departments' recent history of staff cost reduction, not penalising those departments that continued to make reductions throughout the spending review period.

f Get better value by allowing departments more flexibility in how they manage their overall pay bill and not only prescribing specific controls on pay awards.