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Southern discomfort

SETTING PAY IN THE PUBLIC SECTOR

The gap between public and private sector pay in the South East of England has led to recruitment and retention problems in public services, which make it difficult for the Government to meet its commitments to provide the same quality of service in all parts of the country. Frontier Economics was engaged by the Learning and Skills Council to help calculate the wage adjustments for its funding formula needed to solve this problem.

The public sector's ability to recruit and retain staff in all areas of the country is crucial to its ability to provide the same quality of service, a basic principle of government policy. However, the public services face well-known recruitment and retention problems in the South East. In 2002, vacancy rates in London for qualified nurses, midwives and health visiting staff were more than three times the vacancy rates for the same posts in the West Midlands, Trent, Northern and Yorkshire regions¹. The pattern was broadly similar in teaching². In his April 2003 Budget speech, the Chancellor highlighted the need for the public sector to respond. →

But if the problem is well known, there is less agreement on the best way to solve it. Work that Frontier Economics has carried out for the Learning and Skills Council highlights the importance of introducing regional variations in public pay, and provides a framework for calculating the appropriate levels.

To maintain a consistent level of service, government needs to be able to attract workforces of the same quality in different parts of the country. Since many services – for example, education, police and fire services – are actually provided by local rather than central government, the key mechanism by which Whitehall attempts to maintain a consistency of provision is the amount of central funding that is allocated to councils. Central funding is varied between councils to a degree intended (as the 2000 Green Paper on local government finance put it) to allow “... local authorities to provide a standard level of service for a standard rate of council tax”.

The distribution of grant is calibrated (with more or less success) to different local circumstances, needs and the size of the council tax base. In this distribution, account is taken of the difference in local labour markets: that is to say, more is given to areas where pay levels tend to be higher. However, the actual pay of many public sector workers is heavily constrained by the application of national pay scales and pay agreements, so that the extra funding provided does not automatically flow into higher wages.

Even those services that are centrally-provided face difficulties in deciding how to vary funding between institutions in different parts of the country. The Learning and Skills Council, for example, has a remit to provide a similar quality of provision in the colleges and other learning institutions that it funds throughout England and Wales. These institutions are, however, seeking to recruit staff in very different local labour market conditions. The problem that the Learning and Skills Council asked Frontier to address was: how to work out by how much it would be appropriate to vary the funding of these institutions, in turn depending on how much it was necessary to vary pay.

ATTRACTING WORKERS

Some argue that pay is “not the problem”: that local retention and recruitment difficulties are a function of other problems, such as poor morale, housing shortages or social conditions. Of course pay is not the only factor affecting people’s choice of a job. They choose a package in which job satisfaction and security, flexibility, the local cost of living and lifestyle will all form part. Pay, however, is the factor that employers can use to correct for these differences – to make the package sufficiently attractive taken in the round. In general, this is what the private sector tries to do, adjusting pay rates until it attracts the quality of workers it wants, wherever it needs them.

The public sector has not, however, always been able to do this. Local government workers, teachers, policemen and firemen are paid according to fairly rigid national pay scales. Bonuses, cost-of-living supplements and London weighting allowances are tools that public sector employers can and do use to introduce some variation. Their freedom to do so is greater for some employee groups, such as teachers, than for others. The results, however, appear to suggest that existing adjustments are insufficient to cope with regional differences in labour markets. In announcing that the various pay review bodies should take account of regional differences, the Chancellor has made it clear this is his view. How should they go about this?

Frontier’s work started from the basis that the variation in private-sector pay around the country provided an important, independent benchmark. That is to say, this variation shows the answers an unconstrained labour market provides on regional differences. Frontier therefore carried out a detailed analysis of the geographical variation in both public and private sector pay, over the period 1997–2001, correcting for any differences, such as occupation, that could arise between the two categories. This involved examining in detail data for over a quarter of a million employees.

GETTING WAGES RIGHT

To establish the appropriate private sector comparators, it is not however enough simply to calculate average private sector wages in each region. A comparison of such raw data may be distorted by some factors and disguise others. On the one hand, a difference in average wages between areas may be at least partly explained by differences in the mix of jobs there. On the other hand, a similarity in wages may mask regional differences in labour market conditions, which will manifest themselves instead in differences in the quality of employees recruited to do similar jobs. The first step, therefore, is to calculate private sector wages for “equivalent employees” in different parts of the country, using the data in the Labour Force Survey.

Econometric analysis allows the wages paid to equivalent workers in different regions to be identified, by stripping out the effect of a variety of other characteristics that may cause an individual’s wage to vary. Characteristics such as age, gender, experience, education, occupation and sector can be controlled for. All that should then remain is a pure average wage premium for each region, relative to whatever region is chosen as the base for comparison.

The graph shows the average wage premiums for public and private sector employees in different regions, when a number of the other factors that affect wages have been controlled for. Wages for public sector workers and for private sector workers are each compared to those in the base region, Tyne and Wear. The table sums up the key differences. Over the period 1997-2001, private sector wages in inner London were on average 38% higher than in Tyne and Wear. Public sector wages in inner London were only 27% higher than in Tyne and Wear.

The analysis suggests a slightly smaller, but still significant, difference between the public and private sector premiums paid in outer London. And in the rest of the South East, there appears to have been as great a difference as in inner London. Although the private sector was paying only 13% more than in Tyne and Wear in the outer South East, the public sector was paying hardly any premium at all - a mere 2% more, on average, than in Tyne and Wear.

Although these are the averages for the whole period, year-by-year comparisons suggest a broadly consistent pattern of difference in the behaviour of the public and private sectors. Furthermore, the graph shows that while the problem is not confined to the South East, it is far more acute there than in any other part of the country: in no other region is the private sector premium as marked, or the gap between public and private premiums as great.

Region	Private sector wage differential (Compared to Tyne and Wear)	Public sector wage differential (Compared to Tyne and Wear)
Inner London	1.38	1.27
Outer London	1.24	1.16
South East (excl. London)	1.13	1.02
Tyne and Wear	1	1

Table 1: Private and public sector regional wage differentials

Source: *Frontier Economics and Labour Force Survey (1997-2001)*

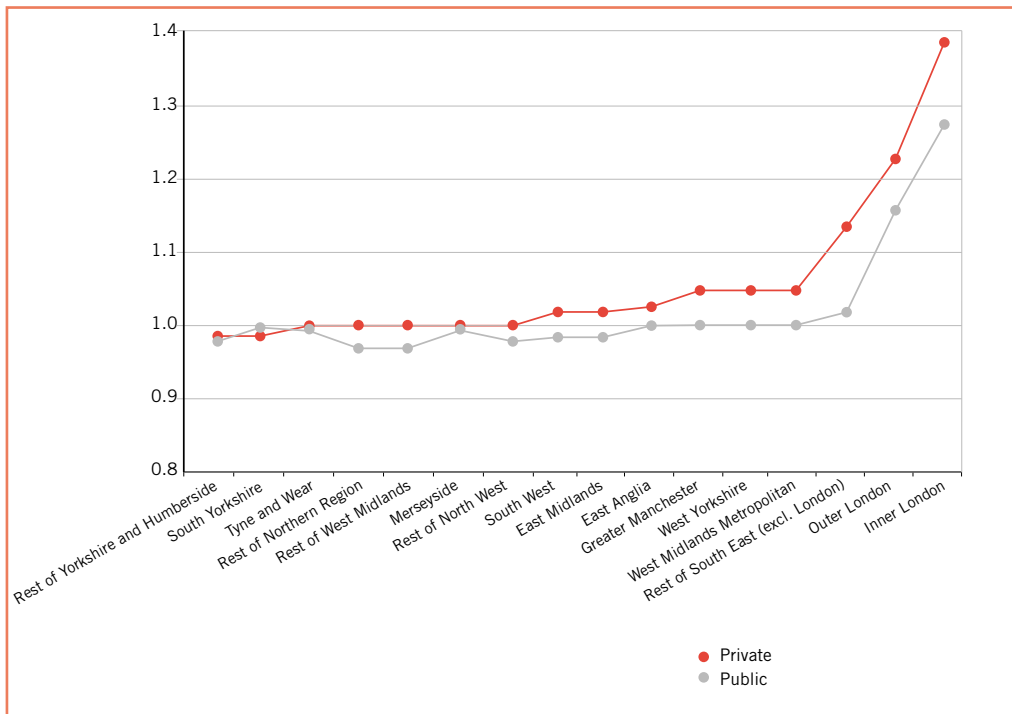



Figure 1: Wage differentials throughout the country
 Source: Frontier Economics and Labour Force Survey (1997 - 2001)

CONCLUSION

The key question, of course, is what this analysis suggests in terms of the increases in public-sector pay needed in areas of labour market pressure. These may not be as great as the differences between the public and private sector premiums suggest. This is because, after the adjustments needed to compare like for like have been made, average public sector wages in the base region (Tyne and Wear) are somewhat higher than average private sector wages in the relevant occupations. So, for example, the actual increases needed in London to make public sector pay “competitive” there may not be as great as the difference between 27% (the present public-sector average premium) and 38% (the private-sector premium). Further analysis suggests that public sector wages might need to be increased by about 5% in inner London, 3% in outer London and 7% in the South East, although the figures will vary for different groups.

<p>SOURCE</p>	<ol style="list-style-type: none"> Department of Health vacancies survey, March 2002 Department for Education and Skills, Education and Training SFR 18/2002
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