Local and regional pay in the public sector

TUC response to OME call for evidence

Introduction

The TUC represents 54 affiliated unions, with over 6 million members, around 4 million of whom work in the public sector.

In the Autumn Statement 2011[1], the Chancellor asked the Independent Pay Review Bodies to consider 'how public sector pay might be made more responsive to local labour markets'. We are grateful to the Office of Manpower Economics for inviting the TUC to submit evidence to inform the pay review bodies' consideration of this question.

This response has been drafted with input from the TUC's affiliated unions with members in the public sector. A number of unions are also engaged in developing evidence to the pay review bodies for the sectors in which they have members. This response does not attempt to go into the detailed sector-specific issues that will be considered by the PRBs, but looks instead at the overarching issues of relevance for the public sector as a whole.

The submission is structured around the following headings:

- The context for public sector pay
- Local and regional labour markets
- Public versus private sector pay
- Pay practice in the private sector
- The impact on local and regional economies
- The equalities impact
- The impact on public services
- Local or regional pay bargaining

The issue of fairness runs through this submission. The TUC believes that it is unfair for a public sector worker in one area, performing the same duties and with the same skills and qualifications, to be paid less than a public sector colleague doing an equivalent job elsewhere in the country. Fairness also underpins our concerns about the impact on gender inequalities, inter-regional disparities and the dangers for local economies.

The context for public sector pay

It is impossible to consider the issue of local or regional pay without addressing the current public sector pay environment.

Public sector workers have been subject to a two year pay freeze (three years in local government) at a time of rising inflation. The Chancellor announced in his 2011 Autumn Statement that this will be followed by a further two years with average increases capped at 1 per cent. Although there was a commitment that

[1] http://cdn.hm-treasury.gov.uk/autumn_statement.pdf

those earning less than £21,000 would see an increase of £250 per year during the freeze, this was not universally applied, particularly in local government.

The two-year freeze, 1 per cent cap and increased pension contributions, combined with the effect of inflation (using OBR forecasts), will have the effect of an average real terms cut of 16 per cent[2] by 2015.

This severe pay restraint is combined with redundancies and other job cuts in the public sector, and high unemployment across the economy. Last year 276,000 jobs were lost across the public sector and 710,000 public sector jobs are set to be cut by 2017, according to OBR forecasts[3].

This shows that public sector talent, far from squeezing out the private sector, is available for employers to draw on. But high unemployment means that there are multiple job seekers chasing each vacancy. Although the average national number of unemployed people per vacancy has begun to fall from a peak of 5.7 in the third quarter of 2011[4], TUC analysis shows that there are still significant regional variations, with more than 30 people chasing each vacancy in West Dunbartonshire and more than 23 per vacancy in Middlesbrough[5].

Local and regional labour markets

In announcing this review, the Chancellor referred to his wish to make public sector pay "more responsive to local labour markets". However, there is patchy evidence as to what extent clear local and regional labour markets exist, and this is especially true in the occupations covered by the pay review bodies.

Outside London and the south east of England, there is little difference in earnings between regions. Regions tend not to have homogenous labour markets, but to have pay "hotspots" within regions, where skill shortages lead to higher pay, and which are similar to hotspots elsewhere in the country. IDS research[6] based on ASHE data finds that, excluding London and the south east, the median weekly earnings for full time employees in April 2010 only differ by £48 between the lowest and highest paying regions.

Rather than geography, the main determinants of pay levels are skill level and qualification level. Large private companies often use international rather than local pay data, with a focus on skill and qualification levels.

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[2] http://www.tuc.org.uk/economy/tuc-20352-f0.cfm

[3] http://cdn.budgetresponsibility.independent.gov.uk/Autumn2011EFO_web_version138469072346.pdf

[4] http://www.ons.gov.uk/ons/dcp171778_257901.pdf

[5] http://touchstoneblog.org.uk/2012/03/employment-blackspots-update-9/

[6] 'Location-based pay differentiation: a research report for UNISON', Incomes Data Services, September 2011

This is reflected in the fact that for a number of public service professions there are national and indeed international labour markets. For instance, the labour markets for many health professions such as physiotherapy and psychology appear to operate at a national level, with some international movement. Government scientists operate in an international market, with a significant degree of mobility.

Public versus private sector pay

The OME is seeking evidence on comparative levels of public and private sector pay. The public debate about comparative levels of pay in the public and private sectors is one that is often characterised by a failure to compare like with like.

Median pay in the public sector is higher than that in the private sector, but this is driven by a number of important differences between the sectors. A fundamental difference is that the gap between low and high earners in the public sector is narrower than in the private sector. Low paid workers do better in the public sector and the higher paid (workers with degrees) are on average 5.7% worse off than their private sector equivalents[7]. Low pay in sectors such as catering, retail and hotels drags down the overall figures for the private sector.

Secondly, a greater proportion of public sector workers have higher levels of qualifications (degrees, diplomas or certificates): 55.8 per cent compared with 28.5 per cent of private sector employees[8]. This effect has been magnified by the outsourcing of lower-paid roles such as cleaning and catering to the private sector.

Third, as well as the narrower differential between high and low pay in the public sector, the differences between women and men's pay are smaller than in the private sector, due in part to greater transparency and to national negotiated pay systems like Agenda for Change in the NHS which have been developed to deliver equal pay.

Other influences include the fact that public sector workers tend to be older, to have more accumulated experience, are more likely to work in London and that recent figures have included employees of the nationalised banks in the public sector.

Pay practice in the private sector

The Chancellor has said that pay in the private sector tends to be set on a more a local basis than in the public sector. The TUC's view is that this is a misreading of predominant private sector pay practice. Large multi-site private sector firms have the closest parallels with the public sector given their size and the fact that they operate in multiple local areas. In fact, at these companies the practice tends to be similar to that in the public sector, in that it is dominated by national pay structures with limited higher rates in London and the South East of England.

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[7] 'Estimating differences in public and private sector pay', Office of National Statistics, 5 July 2011

[8] LFS Summer 2011

Research by Incomes Data Services (IDS) has found that multi-site private companies tend towards either national pay structures with additions for London and the South East, or limited 'zoning' arrangements. These zones tend to follow a fairly simple pattern of rates for London, the South East, and then the rest of the country. Examples of companies taking the option of complex local approaches "are rare due to resources and costs associated with design and management"[9]

The experience of UK trade unions suggests that some large multinational companies, such as in the food and drink and logistics sectors, are setting pay at the international level, and even where they have an official policy of local bargaining, this is informed by a global strategy and use of global data.

The arrangements documented by IDS, where multi-site private sector employers have national structures with limited allowances or zones to account for the higher cost of living in London and the South East, are quite similar in scope to the flexibilities that already exist in the public sector.

BT and Waterstones, for example, all have national pay structures with some inner and outer London allowance. British Gas has five pay bands, three of which are in Greater London.

IDS found that zonal pay structures were more common in supermarkets and retail banking. Of these, a four or five band structure was common, but this still tended to equate to the hierarchy of London, the South East and the rest of the country.

The research found that very few large private sector employers used local pay. This was attributed to the wish to exercise control over labour costs and to avoid the duplication of the bargaining process and the time and resources that would entail. The complexity of regional or local differentiation outweighs the potential gains for these employers. In manufacturing IDS found more evidence of local bargaining, often as a result of historical precedents, but there was little actual variation in the basic rates, which reflected skills and training.

In addition, we know that large successful firms often take a view about where their pay rates should sit in the hierarchy of their industry. This may be motivated by strategic considerations that range from the desire to control labour costs, such as in the hotel industry, to the need to attract high-skilled specialist labour, such as in the aerospace industry. The common factor is that these sectors both tend to use national pay scales.

The impact on local and regional economies

A major concern about introducing local or regional pay in the public sector is that it is highly likely to be counterproductive, acting to dampen economic growth and increase regional disparities. If the outcome of local pay is to reduce wages in the less wealthy areas of the country, this would withdraw resources from these

[9]' Location-based pay differentiation: a research report for UNISON', Incomes Data Services, September 2011

economies, reducing demand for private sector goods and services as public sector workers have less money to spend.

The idea that the private sector is being "squeezed out" as a result of an inability to match public sector wages is not credible, particularly in the current economic context. For example, the North East has both the lowest overall wages and the highest unemployment rate of any of the English regions. With unemployment so high, an otherwise healthy private sector would be able to recruit irrespective of public sector wages. That this is not happening suggests that the problem lies elsewhere, most likely in low demand and the unavailability of affordable credit.

Reducing public sector wages in struggling areas would lead to fewer jobs, as a further fall in consumer spending would drive more private sector enterprises out of business. The failure of these enterprises would then cause further ripple effects. Economists estimate that this could double the impact of any public sector wage cut. In addition, falling public sector wages could trigger a race to the bottom in private sector pay in these areas, further squeezing spending power and damaging the economy.

According to the ONS Labour Force Survey, average public sector pay varies by 10.4 per cent between the regions and nations of the UK. It is most likely that public sector pay would fall furthest in the poorest parts of the UK. The table below estimates the regional effect of cutting public sector pay by just one per cent.

The effect of reducing public sector pay by 1 per cent

Government Office Region 2 and 3 combined	Public sector employees (thousands)	Direct effect of a 1 per cent reduction in income on public sector earnings per year (£millions)
North East	300	78
North West (inc Merseyside)	780	189
Yorkshire and Humberside	574	130
East Midlands	492	119
West Midlands	561	131
Eastern	647	158
London	815	242
South East	908	231
South West	574	140
Wales	399	97
Scotland	680	162
Northern Ireland	220	54
Total	6,950	1,730

Source: ONS Labour Force Survey (Summer 2011) Note: this table shows the direct first round effect of pay reduction. The actual impact would be higher given the multiplier effect of cutting public sector wages on private sector businesses.

- A one per cent reduction in public sector wages would be likely to reduce overall UK income by about £1.7 billion per year. The actual effect would be much higher, given the multiplier effect of dampened consumer spending power on private sector businesses.
- A five per cent reduction in public sector wages would be likely to reduce overall UK income by about £8.5 billion per year, plus the multiplier effects.

Academic research demonstrates that highly co-ordinated systems of collective bargaining have a more positive macroeconomic effect than fragmented systems[10]. Indeed, this impact is now recognised in OECD guidance[11], in recognition of the role of co-ordinated collective bargaining systems in Scandinavia in driving economic growth and job creation.

The equalities impact

The current national pay arrangements have been designed with a focus on the need to deliver equal pay and minimise the risk of challenges. Indeed, this was a driving force behind the development of Agenda for Change, which was a response to legal challenges to earlier NHS pay practices.

Devolving pay - and bargaining in particular – to the local level decreases transparency and increases the chances of mistakes and omissions that can lead to unequal pay.

In addition there is a risk that competition within the public sector could lead to inflation in top salaries, widening the overall gap between upper and lower earners and exacerbating the gender pay gap.

At the other end of the scale, there is a significant danger that local or regional pay could trigger a race to the bottom on low pay. Professor Richard Disney has been reported as highlighting the difficulty of imposing lower pay at a time when pay is already frozen[12].

Localised bargaining in smaller private sector enterprises has already led to wider social inequalities. A report by the European Federation of Public Service Unions (EPSU) showed that that decline of national bargaining in most sectors outside health, local government and education was a significant factor in the UK becoming one of the most unequal countries in the EU in terms of pay distribution. In contrast, in most other EU countries where national or sectoral bargaining prevails, a more equal pay distribution has been maintained[13].

The public sector has led the way in establishing equal pay. Moving away from national pay systems would risk undoing this good work.

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10 http://www.strongerunions.org/wp-content/uploads/2011/08/TUC-ESRC-Research-Bulletin-No-2-July-2011.pdf

11 OECD, Employment Outlook, 2006 (OECD: Paris)

12 ‘Plan to vary public pay in regions attacked’, Financial Times, 16 January 2012

13 ‘Collective bargaining and social dialogue in the public services – tackling low pay’, EPSU, 2006

The impact on public services

Public services require national co-ordination in order to manage resources and ensure compliance with national legislation and standards. The TUC is concerned that moves to localise pay would undermine the ability to plan and deliver public services in a consistent and co-ordinated manner.

If public sector wages were to fall in the poorer regions and nations of the UK, it would make it more difficult to attract senior and specialist staff to posts outside London and the South East, and create a perverse 'internal market' with competition over pay rates leading to increased turnover. Recruitment and retention issues such as this would drive up the costs of delivering public services, diverting money and staff resources into dealing with this churn rather than putting in place sustainable staffing arrangements.

The risk that skilled public sector workers working in economically disadvantaged areas might be tempted to move in search of higher wages would exacerbate regional inequalities in service provision by taking staff away from the very areas that have the highest levels of need.

It has also been suggested by some commentators that it is hard to attract good quality staff to the public sector in high cost areas like London. The evidence does not support this assertion. National bargaining already allows enough flexibility for employers to be able to deal with skill shortages. It therefore seems most likely that any move away from national bargaining would lead to lower wages in the poorer parts of the UK but no general increase in pay in the wealthier areas.

Local and regional pay bargaining

One source of concern about attempts to move away from national pay in the public sector has been that the process of pay bargaining itself would be localised or regionalised.

National bargaining brings significant economies of scale to public sector pay setting. Regional pay setting would clearly be unwise, since labour markets simply do not operate on a regional basis. Localised pay bargaining would be inefficient and wasteful compared to national approaches, involving significantly increased resources.

The thousands of local public sector employers would need to replicate the research, analysis and negotiating machinery that currently takes place at the national level. This would absorb the time and resources of local managers and staff that could otherwise be spent on managing and delivering effective services.

For example, the NHS has 161 acute hospital trusts. Each of these would have to gather labour market intelligence, draw up a negotiating position, hold negotiating meetings involving senior staff, and set up new payroll systems.

In the early 1990s the Government introduced local bargaining to the NHS.

Hospitals were concerned that they might pay too much or too little, so the annual pay negotiations took well over a year, after which all of the trusts settled within

0.1 per cent of each other. The experiment was then halted because the Chancellor wanted to take back tighter control of the overall paybill.

Localising bargaining would also increase the number of potential pay disputes, further absorbing time and resources and damaging local industrial relations.

It is also far from clear that local employers have the skills and inclination to conduct local pay bargaining. Managers are used to working in a centralized system and there has not been widespread take-up of the flexibilities that are currently available, given the increased resource requirements and potential for local industrial tensions. It is therefore likely that localised bargaining would be accompanied by an increase in the use of external advisors and consultants, meaning public money increasingly being channeled into these unnecessary additional transaction costs.

Conclusion

As this submission has argued, the evidence does not support the case for regional or local pay in the public sector. At the most fundamental level, the TUC believes that it is unfair that public sector staff who have the same skills and qualifications should be paid differently simply because of where they live. In the current economic context it is misleading to suggest that public sector pay is 'crowding out' the private sector. In fact, the public sector is an important economic bulwark, and moves that led to lower public sector pay in the poorer areas would have a significant knock-on effect on private businesses by taking spending power out of the economy. We urge the pay review bodies and the Government to recognise this in developing future policy, and would be happy to provide further input to the OME's investigation into the issue.