

Setting Public-Sector Pay More Sensibly by Region

by

Andrew Oswald, Professor of Economics, University of Warwick

It is time for Britain and other industrial nations to make public-sector pay more flexible.

London cannot recruit enough police officers to protect its citizens. Surrey and other parts of the south-east are unable to hold on to their teachers and nurses. Yet the response to this has been to think of indirect remedies: cheap loans, strange allowances, overtime anomalies. Such steps run away from the simple truth.

Public sector pay has to be allowed to vary by area for the straightforward reason that private sector pay does. Ultimately there is competition for workers between the two. It is no secret that recruitment problems in southern England's hospitals and high schools occur because private sector wage rates are much higher in those areas of the country.

Partly as an inheritance from a trade-union-inspired view of the world, which has always argued, inexplicably from an economist's point of view, that a Swansea fireman should receive the same number of pound notes as a Guildford fireman even though a pound note buys more in Wales, the system for setting public pay generally allows only a tiny London weighting and nothing elsewhere.

This is illogical and creates distortions. So it is proving.

Areas where the costs of living are high have now to resort to subterfuge and rule-bending to make the public sector function.

Someone who would be a junior worker in Humberside has to be promoted to a senior grade in an expensive area. This is the tyranny of rigid remuneration scales and has unpleasant side effects. It puts people of average ability into grades where, of necessity to get anyone in the first place, they are called on to make decisions that may be beyond their competence.

Equivalent problems are visible in data on the quality of British schools. It is probably not widely known, but Ofsted school statistics from the late 1990s show a clear quality gradient by geographical location. The lowest measured quality of school lessons was in Inner London, followed by Outer London, followed by the regions where the cost of living is progressively lower. Turnover and wastage rates for the police show the same pattern.

Three steps are required.

First, if western democracies wish to have a public sector of any appreciable size, they must accept that pay determines the quality of the workforce. At the moment we all pretend it does not. Politicians have short horizons and will always be under pressure to keep wages low in the public sector. It is up to society to decide whether it wants its school teachers to have had As, Bs or Es when at school. Currently the nation prefers not to think about this.

Second, once the desirable level of quality has been decided, the pattern of public-sector wages across regions should be set to be the same as in the private sector. If the banks in region X pay secretaries thirty per cent more, so must the hospitals in region X. Otherwise they will end up with the secretaries of the lowest quality and those who wish to work as little as possible.

Third, there are ways to calculate how much private rates of remuneration vary from Cornwall to Canterbury. Economists do so in the following way. Choose a large random sample of people who have private sector jobs in different parts of the country. Measure the types of tasks they do, their pay, and their qualifications. With some help from basic statistics and economic theory, it is possible to factor out the influences on wage levels. The effect of region of residence alone is thus calculated. All this

is done for a representative worker: we know that there are more judges in London than outside, so it is not enough to just take average pay levels in each region.

Although the nature of the workforce differs from one part of a country to another, the calculations to correct for such differences are not complicated.

My colleague David Blanchflower and I have found that, for a standardized worker, private sector wages are 48% higher in Central London than in Tyne and Wear. In Inner London the figure is 35%, and outer London 26%. The rest of the South-East pays a regional premium of 14%. The metropolitan part of the West Midlands pays 6% more than the cheapest area in England. And so on.

These figures are known in spirit, if not in statistical detail, to large firms across Great Britain. Most would not consider paying identically in different parts of the country. But the public sector is forced to maintain the façade that it is feasible.

Much of the variation in private pay is, of course, caused by differences in the costs of accommodation. The average price of a house in County Durham is £48,000, in Hertfordshire £140,000.

But there is more to it than housing. Some areas have clean air and pretty green lanes. Others have roads that are more gently undulating car park than uninhabited idyll. Market forces take this into account and, where demand and supply curves intersect, feed out the wage rates needed to attract workers of the right quality into the private sector. We should have the same in the part of the economy organized by the state.

Public-sector pay should vary by region.