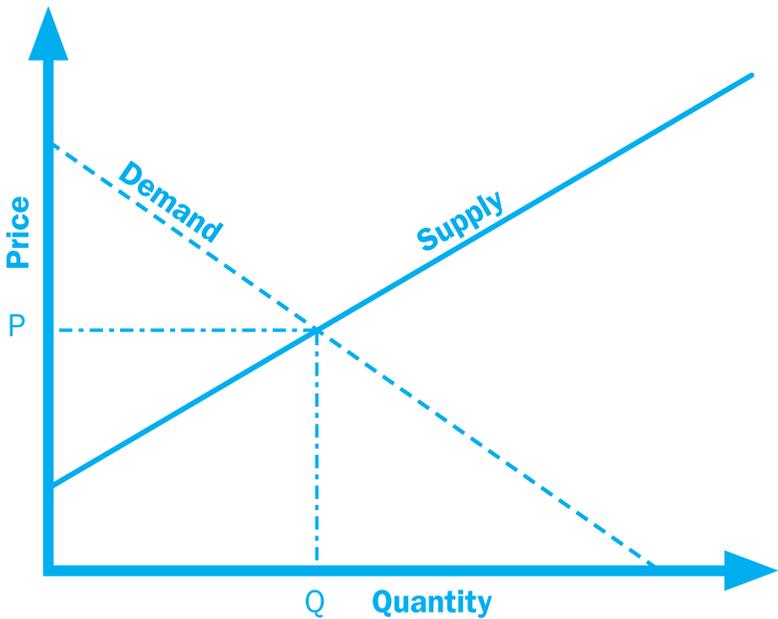


Poverty pay: How public sector pay fails deprived areas

Robin Harding



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Contents

Acknowledgements	4
1. Executive summary	5
2. Introduction	11
3. The geography of public sector labour	16
(A) Regional patterns	
(B) Local patterns	
4. Policy options – past and present	22
5. Recommendations – zonal pay	32
Appendix A: Public sector pay – 2005-06	41
Appendix B: Regional and local pay in the private sector	47

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1. Executive summary

Over the last decade, public sector pay has grown more quickly than pay in the private sector. In part this reflects catch-up from a decade where private sector pay grew much faster. This rise is also intended to ease recruitment and retention problems, and attract more workers to growing services, such as health and education. But staff shortages have continued, particularly in deprived areas, and there are concerns that the increased pay has not been effectively tied to increased performance.

Over the next few years, the rate of growth in public spending is set to slow and the government has made it clear that public sector pay must remain stable. So it is even more critical that resources, including funds for pay, are used as effectively as possible. This paper argues that the current system of public sector pay fails to target resources effectively in those areas that need them most, and so contributes to staff shortages in deprived areas.

It argues that the government should introduce a zonal pay system in the public sector, as part of national pay bargaining, to deal with shortages of well-qualified public sector workers in specific areas, where they receive what effectively amounts to poverty pay. Zonal pay already operates successfully in the private sector. Under such a system, four to five pay spines would be negotiated nationally with progressively higher wages. The baseline would be spine one. Points on spine two could be 5% higher than spine one, on spine three 10% higher, and so on. If a particular hospital, school or other provider of a public service faced recruitment and retention problems, it would move up to the next pay spine. If a facility on a high pay spine were recruiting high quality staff with ease, it would move down again.

Zonal pay has two major advantages over other local and

regional pay systems: it works at the level of individual schools and hospitals; and it uses market signals about staff shortages to set the level of local pay. Large private companies, particularly retailers like Tesco, use zonal pay to manage their national workforce. They do so because it is a cheap, flexible and effective way to manage local recruitment problems.

Zonal pay would help address two serious problems in the public sector. First, public services tend to be of worse quality in areas of greater deprivation. In the medical field, this thesis has earned the standing of a law, the ‘inverse care law’, the argument being that the ‘the availability of good medical care tends to vary inversely with the need of the population served.’¹ It holds true outside medicine as well: the poorest, most disadvantaged children are taught in the worst schools; social services struggle for capacity where they are needed most.

The reasons are various, but pay is one of them. In most cases, wages in the public services make no allowance for working conditions, and while the job description is the same, the experience of a GP in rural Dorset differs from that of her colleague in a run-down district of Sunderland. In a deprived area, patients suffer more ill health and more intractable illnesses. Living conditions for public service workers may also be worse, with higher crime, poorer housing and lower standards at local schools. However, the compensation negotiated in a statutory national agreement is the same in each location.

Second, beyond London weighting, the public sector pay regime makes little or no allowance for differing cost of living. This too can contribute to a shortage of public sector workers in certain areas.

Public sector pay suffers from central planning with too little regard for local conditions. It should be based, instead, on the market signals coming from local labour markets and, in particular, the signals those markets give about deprivation and the load placed on local public services.

The pattern of public sector labour shortages

The supply of labour in the public sector varies at both the regional and local level. At the regional level, vacancies tend to be higher where life is more expensive, particularly in London

1 J T Hart, ‘The inverse care law’ (*The Lancet*, No. 27. 1971). Graham Watt, Professor of General Practice at Glasgow University, argues that: “the inverse care law is not a relic from the past. It represents the continuing truth that progress is most difficult in areas where patients and their doctors are hard pressed.” (G C M Watt, ‘All together now: why social deprivation matters to everyone’ (*British Medical Journal*, 312, 1996), pp. 1026-1029.

and the South East. Variation is even greater at the local level, however, and whereas vacancy rates for nurses vary from 1% in the South West to 4% in London, they vary from more than 10% in Bromley to almost zero in Richmond. This suggests that potential solutions prominent in public debate, such as regional pay, would do little to address labour shortages.

There is strong evidence that a deprived catchment area is a major cause of variation in vacancies. There are fewer applicants for GP vacancies in deprived areas and posts take longer to fill. Survey evidence suggests that deprivation in the practice community is the single most important factor to a GP in choosing a job, and that the average GP would give up £4,222 of income to avoid serving deprived patients.

Policy options

Existing regional and local pay policies include London weighting, local flexibility and targeted recruitment incentives. London weighting could be improved – it is an ad hoc system at present. Although it fits well to the pattern of shortages in London and the South East, it does nothing for deprived areas in London and around the country. Deprived areas are the greater problem.

Other options to address regional pay include adjusting national pay bargaining by a regional cost of living index or by a comparison to private sector wage differentials. Both of these options would produce a pattern of regional wages that broadly matched recruitment problems: higher in London and the South East. Adjustment by the cost of living is easy to calculate and would slot into the existing wage bargaining process. The problem is that, because it takes no account of working conditions, pay will be unnecessarily high in expensive but popular areas, like the south west of London, and will be of no help to deprived areas. It is hard to find appropriate comparisons in the private sector – the London premium for a solicitor is massively greater than for a bus driver – and private pay for jobs like nursing is driven by the public sector. The private sector tends to avoid deprived areas and will not provide adequate comparison there.

Local flexibility – letting the managers of individual schools

and hospitals negotiate pay – has the potential to address staff shortages whatever the cause, but its adaptability is its flaw: when a similar system was used by the Nationwide Building Society in the 1990s, branches compared themselves to each other, and targeted the best pay available until the system became so inflationary it was scrapped.

Recruitment incentives – ‘golden hellos’ – are not large enough to overcome aversion to a deprived area for more than the first year or two. Making them greater results in a variant of local flexibility and undermines national pay bargaining.

An alternative policy is to provide pay supplements to frontline staff working in deprived areas. Higher pay could be given to public sector workers who tackle jobs in areas where the Index of Multiple Deprivation is high. This approach could be of significant help to poorer communities. A hospital, however, may stand in a deprived inner city area while serving a far wealthier population from across the city. Deprived area supplements, again, would not be sensitive to the cost of living, and pay would be unnecessarily high in poor but cheap areas, where there are already sufficient workers at the prevailing wage.

Zonal pay

Zonal pay, widely used in the private sector, tends to be negotiated in the same way as existing London supplements – a series of higher pay bands, nationally defined. The difference is that, instead of covering a defined geographic area, individual institutions can move between pay bands when they develop recruitment and retention problems. If there is a shortage of staff, they can move up. If staff are easy to find, they move down.

Because zoning is driven by actual recruitment and retention problems, rather than an abstract index, like deprivation or cost of living, it can respond to labour shortages whatever the reason for them. Because it operates at the level of the individual organisation, such as a school or hospital, it is more efficient, and does not spend money where staff are willing to work without extra incentives. Zoning is contained within a national pay structure. This is fair to staff, who can see that local pay is not being used as a tool to break down national pay bargaining, and prevents inflation from creeping into the system, because staff at

one hospital cannot ask for a pay rise based on the pay of their colleagues on the other side of town.

The major problem with zoning is the necessary process for moving facilities between pay bands. The problem splits into three parts. First, the definition of ‘recruitment problems’ is crucial: these must be objectively defined and hard to manipulate. Second, the process of negotiating each move must not break down into local pay disputes, or be traded off against moves elsewhere. Third, there must be an acceptable method of moving institutions down a pay band as well as up, so the process is symmetric, and there is no bias toward inflation.

Answers to this problem include: defining ‘recruitment problems’ on a range of measures, including staff turnover, vacancy rates for advertised posts, percentage of temporary and agency staff, and the experience of staff, that correlate with poor performance; making the criteria for a move between pay zones part of the national pay bargain, but appointing an independent adjudicator to decide on moves; and creating a rule so that moves down are enacted over a period of years through lower-than-average pay rises rather than actual pay cuts.

Zonal pay has to be matched by central funding so that individual institutions can meet their wage bill. National funding formulae already contain allowance for wage differences between regions and deprivation. This should be sufficient, but policymakers would need to be alert to the signals coming from the zonal pay system, and willing to adjust the funding formula where necessary.

Conclusion

Much has been written on the ‘waste’ of billions, spent on public services since 1997, that has gone to increase the pay of teachers, nurses and doctors. Improvement in output and social outcomes has not matched the increase in spending. Adopting zonal pay would do more with that extra spending, demonstrate society’s respect for those who work in the toughest public sector jobs, and tighten the focus of services on those who have always needed them most.

Failure to match pay to locality is a cause of wrong and injustice. Wrong to that part of the public sector workforce

who labour in the toughest jobs for no additional reward. And injustice to the poor, whose need for public services is great, but whose very need makes providing those services arduous and trying work. The public sector's quest for fair and equal pay is not yet over.

2. Introduction

2 D Heap, S Hicks and D Livesey, *Public Sector Employment Trends 2005* (Labour Market Trends, <http://www.statistics.gov.uk/articles/nojurnal/PublicSectorEmploymentTrends2005.pdf>), pp. 5-13.

This paper deals with the connection between locality and public sector pay. Public service pay in Britain is national, save for some crude local adjustments in London and the South East. Services, meanwhile, are delivered by primary schools, GP surgeries, and fire stations, each tied to and defined by the territory it covers. This clash creates problems, and the nature, extent of and solution to these problems are addressed below.

There are three general reasons to be concerned about the current state of public sector pay. First, labour is the main input to public services, and pay affects service delivery and improvement. Second, the public sector employs almost one-fifth of the workforce and exercises influence over the rest, so public sector pay can in itself help or hinder social justice. Third, public sector pay takes up a significant proportion of public spending, and the efficiency of that spending matters.

The structure of the paper is as follows. This introduction defines public sector pay, sets out some of the influences on existing pay systems, and points to Appendix A, which describes pay in teaching, nursing and the police in detail. Section 3 discusses the geography of public sector pay and analyses problems in the present system. Section 4 presents policy options, and examines their strengths and weaknesses, before the preferred policy, which we have termed ‘zonal pay’, is developed in Section 5.

What is public sector pay?

The public sector pays workers in organisations controlled by government: doctors, teachers, nurses, the armed forces, the civil service and the police. Almost six million people (20.4% of the workforce) were in the public sector in 2004.² Bodies like

Companies House and the Royal Mail – funded by user charges and managed at arm’s length – are in the public sector because they answer to a secretary of state. Charities and housing associations, even when funded solely by public money, are deemed to fall outside because control rests with an independent board.

Organisations delivering public services outside the public sector, particularly when transferred in an outsourcing deal or Private Finance Initiative (PFI), operate in a grey area. The terms and conditions of existing employees are guaranteed but those of newly recruited workers are not.³ This paper concentrates on public sector workers, but its conclusions apply equally to those who are transferred, and to those who deliver public services in an independent organisation.

Throughout this paper we define ‘wages’ as cash returns for labour and ‘pay’ as the full range of rewards. The main determinants of pay, in a competitive private sector market at least, are the relative supply and demand for labour. Demand will be affected by the ultimate demand for particular products in the economy and hence the need for certain skills. Supply will be affected by, among other things, the difficulty of the work – some jobs can be done by anybody, others need skills that are scarce or costly to acquire – and the explicit and implicit working conditions. A job might come with an excellent training and development programme attached, or a better physical environment in which to work. Pay will balance supply and demand in a given labour market, and across the labour market as a whole.

Workers are paid a complex mixture of rewards in return for their unique labour. Pay packets are hard to compare and, in theory, different combinations of reward (high wages and low pension, or low wages and high pension) will be acceptable to both employer and employee for the same job. An ideal pay system will offer the rewards employees most value but which cost the employer least to provide.

Economics and practice of public sector pay determination

In a pure market model of the economy, wages, including differentials between and within occupations, are determined by the relative supply and demand for labour. The observed levels of public sector pay, however, differ from the theoretical mar-

³ The current position on worker transfers is set out in Cabinet Office, *Staff Transfers in the Public Sector – Statement of practice* (http://www.hm-treasury.gov.uk/media/7BB/E3/staff_transfers_145.pdf, 2000).

ket level, mainly because both the government, a monopoly employer of some types of labour, and public sector workers, through their trade unions, have considerable market power.

As a result, pay in some sectors is better described as a bargain between trade unions and the relevant secretary of state, with a pay review body to act as referee. The outcome of the bargain will depend on a range of factors, including the number of recognised unions and the number of workers they cover, the attitude of both sides to the timing and distribution of wages, changes to technology and labour efficiency, wage bargains in other parts of the public sector, government finances and policy toward spending and services, the availability of alternative employers, the effectiveness of strikes, etc.

In areas of the economy, like academia or local government, where there are few private employers and a strike does not cause much immediate harm, the government can, up to a point, dictate the terms of the bargain and impose low wages. Where there is a strong single union or collection of unions, and where strikes would affect the wider economy, on the railways for example, the balance of power rests more with employees.

The nature of the wage-setting process depends on the relative size and accessibility of the public and private sectors. It is no coincidence that some of the best paid employees in the civil service are oil well appraisers who have private options open to them: the market is a major influence on their wages. On the other hand, nursing homes and private hospitals often adopt NHS pay scales for nurses: in this case public pay determines that of the private sector.

If the two sectors balance each other they do so only over the long-term. In the early 1990s, the Major government used its monopoly to drive public sector wages substantially below market levels, but by 1999 there were severe staff shortages, as new workers shunned the public sector in favour of the private. Similarly, the private sector has to take account of the stability and working conditions available to public sector workers.

Policy toward public sector pay, therefore, is not an analysis of what wages should be, but of the objectives the government should take to negotiations, and what framework negotiations should take place within. Any pay reform or policy has to take account of the complex institutions used to set it.

Equal pay legislation

The Equal Pay Act 1970, the Sex Discrimination Act 1975 and Article 141 of the Treaty of Amsterdam prevent pay discrimination on grounds of gender. They create a right to equal pay for equal work: an employer may only pay otherwise if they have a genuine and material reason to do so. As well as direct pay discrimination, any practice that adversely affects a considerably larger portion of women than men and is not objectively justified will be judged to be illegal.

Equal pay has serious implications for the design of pay systems because many can be discriminatory. The pay system at the reconciliation service ACAS (Advisory, Conciliation and Arbitration Service) used to reward length of service and, when it moved to performance-based progression, incorporated points of the old system. Because ACAS was historically male-dominated, and female staff were more likely to have taken time out for childcare, men were clustered at the top of the pay scale and women at the bottom. An employment tribunal ruled this illegal in 1998, and argued that, if ACAS wanted to pay by seniority, it would have to show a correlation between seniority and the requirements of the job.⁴

In another case, a female employer of the Health and Safety Executive (HSE) had been promoted quicker than her male co-workers, but was paid substantially less than them because they had been employed with the HSE longer. Before the Employment Tribunal, the employer argued that it was necessary to reward previous experience, but was unable to prove that experience added value to its business, or that it had difficulties recruiting experienced staff, and the tribunal ruled against it.⁵ This decision was reversed at the Employment Appeal Tribunal. It then went to the Court of Appeal, and was referred to the European Court of Justice (ECJ) in 2005.

The ECJ ruled, on 6 October 2006, that employers can consider length of service as a factor determining pay, as long as the objective is to reward experience that enables the employee to perform their duty to a higher standard. However, if the employee provides ‘evidence capable of raising serious doubts’ that the use of length of service as a determining factor in pay awards creates disparities in pay between men and women, the employer may be obliged to justify their actions in this regard.⁶

4 *Crossley and Others v ACAS*, Birmingham Employment Tribunal, 1304744/98, 20 December 1999.

5 *Cadman v Health and Safety Executive*, IRLR 29, 2004.

6 The European Court of Justice’s decision in *B.F. Cadman vs. Health & Safety Executive*, Case No. C-17/05 (http://eur-lex.europa.eu/LexUriServ/site/en/oj/2006/c_294/c_29420061202en00100011.pdf), for a report of the Court’s findings, see: <http://www.littler.com/presspublications/index.cfm?event=pubItem&pubItemID=15138&childViewID=401>

7 *Navy, Army & Air Force Institutes v Varley*, Employment Appeals Tribunal, IRLR 408, 1976.

The *Cadman v. Health and Safety Executive* case will now come back before the Court of Appeal.

Pay differences by region, such as London weighting, normally constitute a genuine material difference under employment legislation.⁷ In order to justify recruitment and retention premiums, however, an employer may have to provide evidence of unfilled vacancies and staff turnover, the number, level and suitability of job applicants, and details of the steps taken to discover the ‘market’ rate.

Principles underlying public sector pay

We suggest that the three principles underpinning a public sector pay system should be that: it produces good quality public services; is economically efficient and represents value for taxpayers’ money; is fair and equitable to employees. In practice, it is likely that trade-offs will need to be made between these three principles, but their adoption implies the following goals:

- (1) *Pay competitive with other employers and similar professions (taking into account the full set of benefits available to public sector workers)*. This is necessary to attract high quality workers, to be fair to the existing workforce, and to ensure value for money for the taxpayer.
- (2) *Equal pay for work of equal value*. The question of what work is of equal value will obviously remain a subject for debate and negotiation.
- (3) *A high quality workforce in every area*. Part of a reasonable definition of ‘good’ public services is that there should not be significant, arbitrary variations in the quality of service. This would require the provision of a similarly qualified and experienced workforce in any given area.
- (4) *No discrimination on grounds of sex, age, race, faith or disability*. Further than this, employment policy should be family-friendly and should make active efforts to help groups that experience discrimination in employment (including people with disabilities).
- (5) *Good career structures and opportunities for personal development*.

We will judge a pay structure by how well it meets these goals.

3. The geography of public sector labour

This section examines the data on labour shortages and asks where labour shortages arise in the public sector and what makes those areas different from others. The evidence used is drawn from the health service: the 2002 Treasury review contains many more examples from across the public sector but the pattern is similar.⁸ Much of the data on local breakdowns is from 2001 – the last year for which data on this level is available – and therefore does not reflect the current position. It is, however, a good snapshot of what can happen in a local labour market.

In that local labour market, differences in shortages – within London, for example – are more significant than those between regions, and although differences in the cost and standard of living explain regional variations well, reluctance to work in deprived areas is an important factor in explaining local variation.

(A) Regional patterns

Figure 1 shows regional vacancy rates for consultant doctors, nurses and midwives. Vacancies for both nurses and midwives are higher in the Eastern, South East and London regions.⁹ The size of regional differences depends on the degree of specialism: vacancy rates vary from around 1% to 4% in the large pool of nurses, but from near zero to 8% in the smaller pool of midwives.

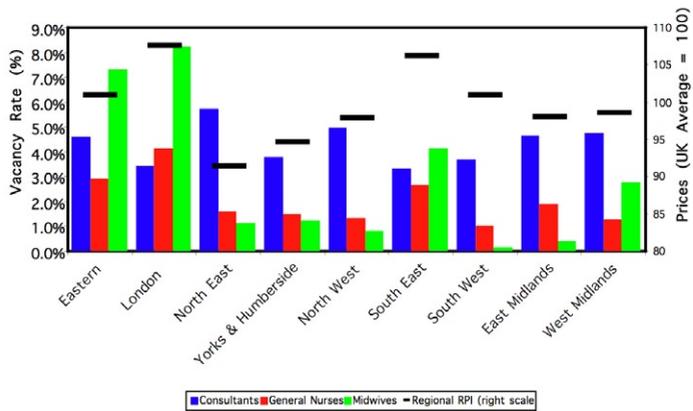
⁸ HM Treasury, *Cross-Cutting Review of the Public Sector Labour Market* (<http://www.hm-treasury.gov.uk/media/1EB/7C/ACF436.pdf>, 2002).

⁹ This is not statistically significant in a Spearman's rank test but the sample size is small.

10 All figures drawn from work by Newcastle University for the 2002 Treasury review.

11 See, for example, D Blanchflower and A Oswald, 'Regional wages and the need for a better area cost adjustment' (*Public Money and Management*, April 2005).

Figure 1: NHS vacancies by region 2004



Source: NHS Workforce Vacancy Survey, March 2004, data aggregated from Strategic Health Authority level. Regional RPI data from A Ball and D Fenwick, 'Relative regional consumer price levels in 2003' (*Economic Trends*, No. 603, 2003), pp. 44-53.

Pay varies less by region in the public sector than the private. On aggregate, pay rates for men in the two sectors are fairly similar, although women are better paid in the public sector. In South Yorkshire, however, the average male public sector worker earns 31.1% more than their private sector counterpart, while in Tyne and Wear, the average female worker in the public sector earns 46% more. In London and the South East, meanwhile, there is almost no difference between the sectors, and in Inner London the average male private sector worker is paid more.¹⁰

Two lines of evidence – apparently higher vacancy rates in expensive areas, like London, and the smaller difference between regions in public sector pay than private – lead to the argument that public sector pay is set inefficiently, an argument forcefully made by Andrew Oswald.¹¹ This inefficiency costs money, because funds are wasted on public sector workers in poorer areas who do not need an incentive to work there, and is inequitable, because those who work for the public sector in more expensive areas receive lower real wages, while the residents of those areas suffer poorer quality services due to a lack of staff as a result.

The economics of the argument appear to be right. Living

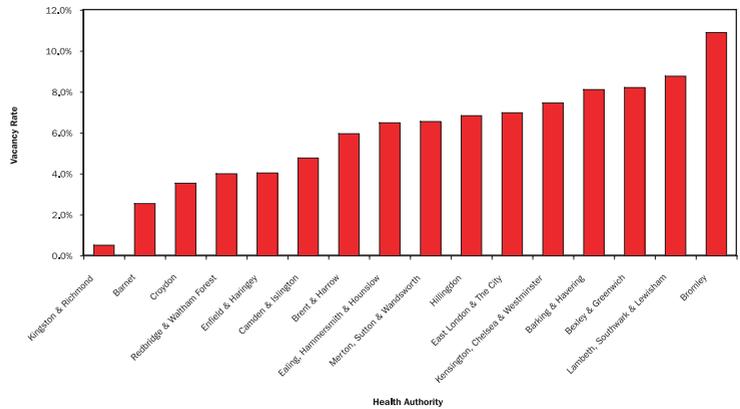
costs are not the same throughout England and Wales. The price of a basic basket of goods is 16.2% higher in the South East than the North East and housing costs 73.4% more.¹² A maisonette in Sevenoaks is a mansion in Stockton. The national bargaining process ends in a single price, as if a public servant were a commodity like oil, which can be easily shipped to any fuel station in the country. Public sector pay structures are set up as if there is a single market for teachers or police personnel; in fact there are a series of local markets.

There are two reasons, however, to think that this problem, though real, is not a vital issue in public sector pay. First, regional variations in cost do not fully explain regional variations in vacancies: the South West, for example, has a relatively high cost of living compared to the North, but no shortage of public sector workers. The answer lies in differences in the *standard* as well as the *cost* of living. The South West is a popular place to live, so workers may accept lower real wages. Second, the regional pattern of vacancies is straightforward: they are higher in London and the South East and low everywhere else. Rather than a problem of regional pay there is a problem of pay within a region: London and its periphery.

To focus on vacancies at the regional level is to overlook the greater dispersion of pay *within* regions.

(B) Local patterns

Figure 2 shows a 2001 snapshot of vacancy rates for nurses within London: the rate varies from almost zero to more than 10%. The dispersion is not well correlated with either house prices or measures of social deprivation, but what is clear is the range: vacancy rates vary more within this small area than they do across entire regions. The Scottish labour market for school-teachers shows less dispersion but still significant variation: the major cities have almost no vacancies, but remote areas, including the Shetlands, Orkneys and Western Isles, sometimes struggle to recruit staff.

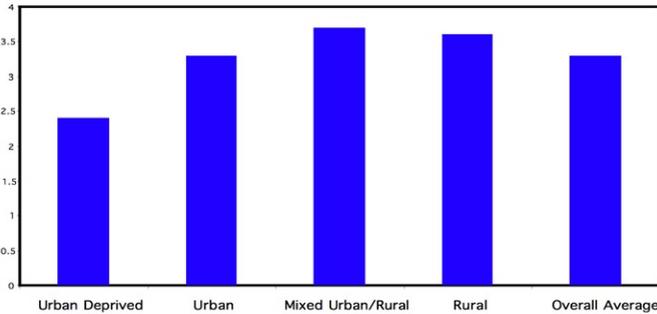
Figure 2: Qualified nurse vacancies within London 2001

Source: *NHS Workforce Vacancy Survey*, March 2001. The 2001 survey was the last to cover all NHS trusts.

Standard and cost of living are not sufficient to explain the variation of vacancies within a small area like London. Kensington, Chelsea and Westminster are expensive areas, but so are Kingston and Richmond, where vacancy rates are low. Lambeth, Southwark and Lewisham have pockets of deprivation, but much of Bromley is affluent.

One reason is that these sub-regions are not distinct labour markets: it is possible to live in one and commute to another. Hospitals and surgeries in one area may, equally, draw their patients from the next. A nurse can commute to an expensive area like Richmond from a cheaper home outside London.

Another reason is that the cost and standard of living are not the only important factors in choosing a job: stimulation, work environment, stress, danger and money all matter. In a deprived area, it is likely that the work environment will be poorer, the patients, pupils or offenders harder to deal with, and the risks to body and mind may be greater. Some people may not want to move to a remote, rural location. On the same wage, a similar job in a prosperous suburb will prove more attractive.

Figure 3: Applicants per GP vacancy by type of area, 2003

Source: General Practitioner Recruitment, Retention and Vacancy Survey 2003, England & Wales, Department of Health, October 2003. The type of area is self-defined by the GPs surveyed.

Figure 3 shows that GP vacancies in deprived areas attract fewer applicants. While deprived areas are able to fill a GP vacancy in 3.4 months on average, shorter than the national average of 3.5, this disguises the fact that, of vacancies outstanding for more than a year, 36.8% are in deprived urban areas (which made up only 19.8% of responses to the survey). Eighty-two per cent of practices in deprived urban areas had difficulty filling vacancies, compared to 70% in urban areas in general.¹³

When choosing a practice, GPs look for (in order of preference): low or moderate deprivation in the patient population; opportunities to develop outside interests; freedom from financial management responsibilities; an extended primary care team to work with; and extra pay. The average GP would be willing to give up £4,222 of income to avoid a practice with highly deprived patients.¹⁴

There is also evidence that recruitment problems in deprived areas lead to differences in the quality of provision.¹⁵ Taylor and Leese show that GP turnover and migration between 1990 and 1994 were associated with population deprivation and need: the most 'needy' health authorities suffered the greatest loss of GPs.¹⁶ Gravelle and Sutton show that this has continued over the decades, despite efforts to regulate the entry of GPs into areas that are already well supplied.¹⁷

Problems occur (for GPs and teachers at least¹⁸, if not so

13 Department of Health, *General Practitioner Recruitment, Retention & Vacancy Survey 2003*, <http://www.dh.gov.uk/assetRoot/04/07/00/98/04070098.pdf>, 2003).

14 B Sibbald, B Leese and R Young, Executive Summary 18 - *GP Recruitment and retention 1. Why do GP principals leave practice?* (Manchester: National Primary Care Research and Development Centre, University of Manchester, 2000).

15 M Benzeval and K Judge, 'Access to health care in England: continuing inequalities in the distribution of general practitioners' (*Journal of Public Health Medicine*, 18, 1996), pp. 33-40.

16 D H Taylor and B Leese, 'General practitioner turnover and migration in England 1990-94' (*British Journal of General Practice*, 48 (428), 1998), pp. 1070-72.

17 H Gravelle and M Sutton, 'Inequality in the geographical distribution of general practitioners in England and Wales 1974-1995' (*Health Services Research and Policy*, 6, 2001), pp. 6-13.

18 The Education and Skills Select Committee suggested a system of local pay to recruit and retain teachers in deprived areas (Education and Skills Select Committee, *Fifth Report*, Volume One, 2003-04). <http://www.publications.parliament.uk/pa/cm200304/cmselect/cmcduski/1057/105702.htm> (4 June 2006).

19 HM Treasury (2002),
op.cit.

obviously for nurses) where socioeconomic deprivation is high. This has significant consequences, particularly where deprived and high-cost areas overlap – most notably in London – with the result that some schools and hospitals are doubly unattractive to public sector workers. Labour shortages within regions, as observed in the 2002 Treasury review,¹⁹ are most likely caused by undesirable jobs in deprived communities.

In short, whereas in areas where the cost of living is high it can be argued that unequal pay is given for equal work, in deprived areas equal pay is given for unequal work. Working conditions are substantially and obviously worse, but there is no recognition of this in pay. The result is a workforce of uneven quantity and quality, with a knock-on effect on public services.

4. Policy options – past and present

Pay reform since 1997

Labour came to power in 1997 determined to resist inflationary pay awards in the public sector. Gordon Brown, speaking as Shadow Chancellor, stated that ‘Labour will take a firm but fair approach to public sector pay. Decisions will be made with a view to retain, recruit and motivate staff. But these must be made within tough cash limits.’²⁰ Labour inherited, and maintained for its first two years, a policy of only increasing pay out of efficiency gains, although, unlike the mid-’90s, awards were not paid in stages to lower costs. However, high vacancy rates, high turnover and low staff morale were barriers to a wider objective of improving public services and, since 1999, recommendations by pay review bodies have been implemented in full.

Budget constraints now seem set to limit this policy. Alongside a recent call ‘to encourage local and regional pay flexibility’, Gordon Brown, the Chancellor, stated that ‘next year [2007] and the year after that [2008] we will maintain this discipline of low overall [public sector pay] settlements.’²¹

Reform of pay structures, as well as levels of pay, has been part of a wider government agenda to modernise public services. The goals have been to drive up standards and make services more responsive to users through a regime of targets, performance management and increased user choice and involvement. In pay, this translates into competency-based progression and performance incentives. The 1997 Labour election manifesto said of education: ‘We will create a new grade of teachers to recognise the best. There will, however, be speedy, but fair, proce-

20 Quoted in *Hot Topics – Setting the Agenda* (The Industrial Relations Consequences of New Labour, Warwick Business School, 1997).

21 L Elliot, ‘Brown calls for public sector pay freeze’ (*The Guardian*, 6 June 2006).

22 1997 Labour Party Election Manifesto (<http://www.psr.keele.ac.uk/area/uk/man/lab97.htm>).

23 M White, 'Blair's public sector pay hint' (*The Guardian*, 27 January 1999).

dures to remove teachers who cannot do the job.²² Tony Blair, speaking in January 1999, talked about the possibility of greater differentials between jobs, decentralised pay and the scope for extending performance-based pay.²³

The government has also given weight to social justice considerations. Pay structures have been updated, uniting disparate schemes into national pay spines, new job weighting structures have been introduced, and pay has been 'equal pay proofed', to eliminate indirect sex discrimination.

These goals are sometimes in tension. Long pay bands, in particular, which are needed to allow progression, cause problems with equal pay. Bands have been shortened in the civil service, so that it takes only four to five steps to reach a target rate for the job, and progression is automatic (subject to satisfactory performance). Job evaluation exercises have been complex and time consuming – the NHS Agenda for Change has taken years to negotiate – and have made it hard to introduce other changes. The low level from which pay started in 1999 has tended to mean that any pay award, regardless of the conditions supposed to be attached to it, has been paid in full. The government's desire for immediate improvements in public services has made fighting for contentious pay reforms more difficult.

A policy of localised pay, to improve performance in high-cost regions, gathered momentum between 1999 and 2001, culminating in the publication of the Treasury's Cross-cutting Review of the Public Sector Labour Market in 2002. A guidance note on implementation, *Progressing Local Pay*, was produced in October 2003, and locally determined recruitment and retention bonuses have now come into force.

The nature and implementation of this policy has been haphazard. The London bonus paid to the Metropolitan Police has expanded to £6,276, with the result that the Met is fully staffed, but inner London lecturers in higher education receive only £2,845, and London colleges continue to struggle.²⁴ Local supplements have appeared in nursing and for the police, but the funds to use them have not always followed.

There has been no real effort to pay public servants more in areas of deprivation, at the cost of staff and public service users.

London weighting

London weighting, which compensates for high London housing and living costs, is the traditional policy used to address regional differences in living costs and recruitment. Implementation has been haphazard and lacks coherence. As discussed above, the London bonus paid to the Metropolitan Police is treble that of lecturers in higher education, even though the Met is now fully staffed while London colleges continue to struggle with recruitment.

Recent moves have spread London weighting further out of London. Where there were once only two bands – London and without – there are now four in education and the health service: inner London, outer London, fringe and provincial. These bands fit to a stylised pattern of recruitment shortages rather than a precise measure, but Figure 2 showed how inefficient London weighting can be: Bromley, with an 11% vacancy rate for nurses, and Richmond, with 0.5%, get exactly the same London weighting, while some areas with a high cost of living – southern towns like Oxford for example – get no supplement at all.

London weighting fits with the pattern of regional pay problems in London and the South East. Raising it in professions such as academia, making it a regular part of pay negotiations, and pushing the payment area out into the South East would be a way to address those problems. The main policy advantage is minimal disruption: the existing structure does what is necessary. Some private sector companies, like British Gas, use London weighting, with pay premiums spreading in concentric circles from Charing Cross.²⁵

On the other hand, this may not be the most efficient way to address recruitment problems: the Met is paying extra to its entire staff, including those who were happy to work for it before the pay rise. Any expanded London pay zone will still only be an approximation of areas with recruitment problems and, unless combined with some other solution, will have no effect on problems outside London and between London boroughs. It does nothing to attract staff to deprived areas, even within London.

24 Further education college lecturers receive £2,725.

25 See Appendix B.

26 Home Office, *PNB Agreement of 9th May*, (<http://www.strathclydepolice federation.org.uk/circulars/PNB/PNB%202002/02-19.pdf#search=%22pnb%20agreement%209%20May%202002%22, 2002>).

27 *School Teachers' Pay and Conditions Document 2003* (London: Department for Education and Skills, 2003).

28 Income Data Services, *IDS Report 869* (2002).

Local flexibility

Some limited local flexibility has developed in recent years. The recruitment and retention bonuses allowed under Agenda for Change (the new NHS pay structure for all employees other than doctors) let hospitals attach a long-term pay bonus to posts that would not otherwise be filled. In police forces, special priority payments of £500 to £3,000 are payable from April 2003 to police officers in posts that 'present particular difficulties in recruitment and retention.'²⁶ Ten forces in the South East get extra funding to reflect higher labour costs, so there may be funds for bonuses in high-cost areas. Schools can make whatever payment they wish to recruit or retain a teacher, but can only continue the payment for a maximum of three years unless there are exceptional circumstances.²⁷

Further expanding local flexibility, on top of or even in place of the nationally negotiated structure, could help both deprived and high-cost regions. Because it operates at the level of the post, rather than the individual school or hospital, no extra wages need be spent on jobs where the basic pay is sufficient. Flexibility allows managers to use their local knowledge to negotiate wages that clear the individual, local labour market.

Despite these advantages, the precedents are bad. The Nationwide Building Society gave managers local flexibility in the 1990s. Staff quickly came to expect the payments, benchmarking themselves against colleagues in other branches and demanding parity. Managers started using them as a tool to deliver progression and reward improved skills. Flexibility became an administrative burden and a significant cost; in 1998 Nationwide was forced to introduce a more structured system.²⁸ This has generally been the experience across the private sector, and today almost no national organisation in the private sector employs any local flexibility.

Another problem, especially for the public sector, is providing the money to meet local payments. The centre can only guess how much is needed and it has no guarantee that funds it provides will be used for pay. Trade unions, meanwhile, strongly oppose any erosion of national pay bargaining.

Finally, while there is now some scope for the payment of bonuses in areas of shortage, it is hard to make use of them in areas of deprivation, as public service funding formulae do not

provide sufficient extra funds to allow for this. In the police force, however, deprivation is part of the national formula, so forces should have some funds for bonuses.

Central control

From the time of the National Health Service Act in 1946, until its abolition in 2002, there was a mechanism to try and ensure an equitable distribution of GPs across the country: the Medical Practices Committee (MPC). The MPC could refuse applications to practise in a specific area if it was already well provided with family doctors. From 2002, authority over GP vacancies passed to Primary Care Trusts (PCTs), with regional equity to be managed by giving more funding to areas with greater health needs.²⁹

The MPC achieved a more equitable distribution of GPs, through central planning of the labour market, than had been the case previously, but it was never entirely successful, and harshly restricted GPs' freedom to choose their practice location. Nevertheless, in some parts of the public sector there are similar restrictions on recruitment in areas that are already well supplied. In education, for example, Local Education Authorities (LEAs) decide how many jobs there are and where: supply is not allowed to concentrate in wealthy areas.

The extra step to redistribute staff positively would require a higher degree of centralisation. It is possible to imagine a solution based on a single national employer that requires staff to serve wherever they are posted. This works in the civil service, but it is hard to imagine how a single agency, employing all social workers, for example, could ever be efficient, or adequately serve local goals and needs. It would go entirely against the policy of promoting diversity and independence among public service suppliers.

Recruitment incentives

Another policy is recruitment bonuses, paid to new public service workers, in an attempt to solve shortages. One expression of this was the NHS 'golden hello' scheme (now replaced by the Primary Care Development Scheme). This offered £5,000 to new GPs and those returning after a period out of general practice, and an extra £7,000 if the post was in an area with a short-

29 Medical Practices Committee, *Final Annual Report 1948-2002* (<http://www.dh.gov.uk/assetRoot/04/05/96/17/04059617.pdf>, 2002).

30 HM Treasury, *Well Placed to Deliver? Shaping the pattern of government service* (http://www.hm-treasury.gov.uk/consultations_and_legislation/lyons/consult_lyons_index.cfm, 2004).

31 HM Treasury, *Review of Statistics for Economic Policy Making* (http://www.hm-treasury.gov.uk/consultations_and_legislation/all_sop_review/consult_all_sopp_index.cfm, 2004).

age of GPs. From April 2005, the Primary Care Development Scheme was applied only in areas of deprivation or shortage and offers more local discretion.

The figures quoted above on GP preferences suggest that golden hellos and the like will have little effect on recruitment in deprived areas. If a practice without deprived patients is worth £4,222, then any GP who does take the bonus has little incentive to do more than work their minimum two years. Golden hellos may exacerbate staff turnover – though there is not yet sufficient evidence to judge – and their incentives are not large enough to address the real issue of shortage in deprived areas.

The Lyons' review

Sir Michael Lyons' 2004 review of public sector relocation attacks regional labour shortages from another angle.³⁰ The review identified over 20,000 jobs that could be relocated from London and the South East with a potential saving of £2 billion over fifteen years. Lyons viewed his relocation plans not simply as an efficiency exercise but as a way to address regional economic disparities. The extent to which pay falls for those who are moved will decide whether the efficiency gains accrue to central government or the regions.

Locating staff in lower wage areas has some advantages but will only work for posts where locality is not an issue.

Regional pay – cost of living differences

One option is for a national pay bargain to be agreed but modified locally according to a regional Retail Price Index (RPI). One focus of the Allsopp Review of economic statistics was better regional data, including regional prices.³¹ The outcome of this system would be higher relative pay in London and the South East, small premiums in the East and South West, and lower relative pay in the North and Yorkshire. This was the original basis of London weighting: a 1974 Pay Board report argued that the basic justification was to ensure that real earnings in London were comparable with those elsewhere in the UK. An index to calculate this was published until 1982, when the government scrapped it, arguing that the government's ability to pay was the only relevant criterion.

Benefits of this approach include the simple and trans-

parent framework for calculating pay, while, at the regional level, the pattern of higher and lower pay broadly follows the observed pattern of vacancies. If government and unions accepted the principle, it would fit easily into the existing pay setting system. It is unlikely to have a bias toward constantly rising wages.

The problem is that such a system could not end local shortages, even if the price data were available in detail, because they are caused by working conditions – by deprivation – as well as the cost of living. It does not take account of regional differences in living standards or working conditions. Consultants in the health service are attracted by the high quality of life in the South West – why should they receive a wage bonus as well? In addition, there would be major boundary issues. Workers in Winchester would get sharply higher wages than their colleagues 30-40km away in Salisbury.

In his 2003 Budget statement, the Chancellor announced plans ‘to recognise local and regional conditions in [public sector] pay.’ The emphasis at the same time on regional price indexes suggested that the Treasury was keen on such a pay structure. A subsequent guidance note, however, stated that ‘it is abundantly clear that no single system of local pay would be desirable or necessary.’³² The note argues instead for an increase in the existing local elements of national pay bargaining structures.

Regional pay – private sector comparison

Comparison with the private sector provides market-based data on the ‘correct’ wage premiums for working in different parts of the country: regional pay levels could be set in a national negotiation based on those differentials.³³ Differences in private sector pay levels tend to be even more extreme than regional price levels but, once again, the main consequence would be higher public pay in London and the South East, following the observed pattern of regional vacancies.

Private sector pay data is detailed, already published, and it should take account of different regional standards of living. It is unlikely to have any particular bias toward higher overall wages.

However, this approach raises questions about which pri-

32 *Government guidance note on progressing local pay* (HM Treasury, 9 October 2003).

33 This is the solution advocated by Professor Andrew Oswald of the University of Warwick. See, for example, *London’s Public Sector Workers Need to be Paid 50% More Than Those in the North* (<http://www2.warwick.ac.uk/fac/soc/economics/staff/faculty/oswald/regionalpublicpaymarc h2002.pdf>).

34 New Earnings Survey, cited in *Income Data Services, Pay in the public services 2002/03* (2003).

vate sector comparison to use. Different professions receive radically different London bonuses: train drivers, for example, get a 7.5% premium, but solicitors get 72.9%.³⁴ HGV drivers make more in the South East outside London than in the city itself, because of the location of major warehouses. Direct job-for-job comparison is difficult in sectors and areas where the public sector is dominant. Private hospitals set wages by comparison to the NHS, not vice versa. The choice of comparator would become a major issue in wage negotiations.

There are other problems in comparing like with like. The private sector rarely provides a universal service and it avoids disadvantaged areas; the public sector is universal by definition, and should focus at least as much on disadvantaged areas as on more affluent ones. Private wages are cyclical but public wages are not (though making them so may be beneficial). The relative level of public and private wages changes through time.

Deprived area supplements

A higher pay scale for deprived areas could be agreed as part of national pay negotiations. The main issue would be how to decide whether an area is deprived, most likely determined through the index of multiple deprivation for the area where a hospital or school is located.

Supplements would fit easily into present national wage negotiating agreements and should raise pay in most deprived areas. Detailed data on deprivation already exists and is already used as a basis for funding in health and policing, although it tends not to be sufficient to account fully for additional costs of providing public services in those areas.

The link between deprived areas and working conditions, however, is not always straightforward. An institution can be in a deprived area without suffering much from that deprivation: many hospitals have inner city locations far more deprived than their real catchment areas. Public sector workers most affected by the location of their workplace are likely to be on the front-lines and dealing with a cross-section of the general public: GPs rather than hospital consultants, and teachers rather than lecturers. The type of employment as well as the scale upon which deprivation is defined will therefore be important.

Also, these supplements would not be sensitive to the

cost of living, so hospitals in deprived but cheap areas that can already fill their vacancies would also pay more, pushing up costs. The supplement might struggle to distinguish between degrees of deprivation. A supplement set high enough to tackle the most deprived areas would waste a lot of money in areas with a lesser recruitment and retention problem.

A more cumbersome solution might be combining deprived area supplements with regional variation based on cost of living or private sector comparison.

Full pay liberalisation

A final possibility is to abandon national pay bargaining and negotiate pay locally, either at the level of the institution or at the level of the individual. In theory, this is efficient, because no worker is paid more than they ask to do the job, and flexible, because wages can be tailored for especially valued or hard-to-find employees.

In practice, however, these benefits are hard to realise. Fully liberalised pay has the same problem as local flexibility: it makes it easy for skilled workers to bid up pay by threatening to move jobs. There are also extra costs if managers have to conduct separate pay negotiations with every individual. National pay bargaining is used by large private organisations for exactly these reasons: it is not a viable option for the public sector at present.

Conclusion

British public services have always aspired to be national: to deliver the same school education and medical treatment in every part of the country. The mistake in pay policy has been to think that a national pay scale will deliver national services. Given that staff demand more or less to work in different regions, and in different schools or hospitals within regions, the opposite is true: a national pay scale guarantees that services will be of different quality in different places.

There have been calls for local or regional pay but, because of cost or administrative difficulty, they have been heeded only to cure a pressing practical problem with services. The tendency has been that whenever staff run short, as has recently happened in the South East of England, something is done to prop up services, until the whole edifice is a jumble of allowances and

bonuses collapsing under its own weight.

London weighting is an effective response to the most serious regional labour shortage – in London – but it is not applied to other regional differences, and does nothing for deprived areas. Local flexibility may have some success but in the long run will prove an expensive and ineffective policy. The same is true of full pay liberalisation.

Various systems of regional pay have been suggested but all have drawbacks. Pay based on cost-of-living differences does nothing to tackle the burden of working in deprived areas, and wastes money in areas that are popular because of a high standard of living. Pay based on private sector differentials overcomes the second problem, but still does nothing for deprived areas, and like-for-like comparisons are difficult. Supplements would help deprived areas, but are hard to calculate, and inefficient in poorer areas.

A new way forward is needed, to address the problem of local rather than just regional pay. The aim of that policy should be that schools and hospitals in deprived areas be the best staffed, rather than the worst staffed, in the country.

5. Recommendations – zonal pay

The best option open to the government is ‘zonal pay’. Used with success by large retailers such as Tesco (see Appendix B), which, like the public sector, employ many staff in different areas of the country, a zonal system would replace London weighting and local supplements but would retain national pay bargaining.

Table 1: Sample zonal pay structure – teachers

	Zone 1	Zone 2	Zone 3	Zone 4	Zone 5
M1	£19,641	£20,623	£21,605	£22,587	£23,569
M2	£21,195	£22,255	£23,315	£24,374	£25,434
M3	£22,899	£24,044	£25,189	£26,344	£27,479
M4	£24,660	£25,893	£27,126	£28,359	£29,592
M5	£26,604	£27,934	£29,264	£30,594	£31,925
M6	£28,707	£30,142	£31,578	£33,013	£34,448

Author’s calculations, based on England and Wales lower pay spine as at 01/09/2006

A zonal pay structure would first require the negotiation of a basic national pay structure. The example above shows an application to the basic pay spine for teachers: the salaries set out for Zone 1 are the same as the 2006-07 salaries for England and Wales (see Appendix A). On top of the basic structure, a parallel set of higher pay spines would be negotiated: in the example above, 5%, 10%, 15% and 20% above the basic, although the rule would not need to be so rigid.

Up to this point, the system is identical to the existing system of London weighting, and the Zone 5 salaries above would

be close to the current salaries for Inner London. The difference is that, unlike London weighting, the zones would not equate to a defined geographic area. Instead, individual institutions – be they schools, hospitals, prisons or police stations – would move between zones depending on their current ability to recruit staff.

For example, consider two schools, one in a prosperous area of North London, and the other in a deprived area of Manchester. Based on the existing system, the North London school might start in Zone 4, reflecting higher pay for outer London, while the Manchester school would start in Zone 1. If the North London school were attractive to teachers, however, and easily filled its posts, it would fall into Zone 3. If the Manchester school, in a deprived area, proved unattractive to teachers and was unable to hire, it would rise over time into Zone 2 and then Zone 3, and keep moving until pay compensated for the more difficult conditions, and posts could be filled.

The system would work slightly differently in a service based on less specific locations, e.g. policing or social work. Here, zones would have to equate to defined geographic areas, which were covered by an employee in the course of his or her work. The pay band that an area fell into, however, could still change according to recruitment conditions. If it were proving hard to recruit social workers to cover Benwell, Newcastle, the area could move up from Zone 1 to Zone 2.

Zonal pay in the private sector

For most employers, the basic model is a tiered system of allowances based on distance from central London. This system, traditionally justified by the greater costs of housing and travel, are increasingly justified as a mechanism to deal with recruitment and retention pressures. Thus location allowances have now spread beyond London into hot spots, such as the South East, where there is intense competition for staff.

In heavily location-based services, retail for example, employers like Argos and WH Smith determine supplements at the level of the individual store. For work within an area, such as that of a British Gas service engineer, pay is often set in bands around a point. For employers with a few, large locations, pay is set for each, and in an organisation like the BBC, this boils

down to a supplement for London.

Some sample private sector pay systems are given in Appendix B.

Arguments for zonal pay

The arguments for zonal pay are strong. Zoning operates at the level of the individual school or hospital, so unlike systems based on the cost of living or a geographic area, it can distinguish between two urban hospitals, standing next door to each other, but with one serving an affluent and the other a deprived population. It can respond to recruitment problems regardless of the reason for them.

Because zoning responds directly to recruitment shortages, it is a sensitive and dynamic tool. Central decision-makers would not need to collect reams of data on local prices and wages: the system would automatically respond to a lack of staff. Extra funds would be targeted directly at the institutions that need them, so Kensington and Chelsea could only pay more to teachers if it needed to, and not because Southwark and Hackney could not hire for their schools.

The system would also help to tackle a problem that has bedevilled public services since the inception of the welfare state – the tendency for those living in deprivation to receive less rather than more support, and worse rather than better services. Zoning would push up pay in deprived areas until they were able to recruit as easily as their more affluent counterparts. That would be a major step toward more equal delivery of services.

Finally, all of this local flexibility would be contained within a national pay structure. This is fair to staff, who can see that local pay is not being used as a tool to break down national pay bargaining, and prevents inflation from creeping into the system, because staff at one hospital cannot ask for a pay rise based on what their colleagues receive on the other side of town.

Movement between zones

The success of a zoning scheme depends on the process for moving facilities between pay bands. The problem splits into three parts.

First, the definition of ‘recruitment problems’ is crucial: these need to be objectively defined and measured in ways that

are hard to manipulate, as the incentive for public sector institutions will be to try and secure higher pay.

Second, if every institution's move between pay zones were part of pay negotiations between government and unions it would prove inflationary, bureaucratic and create bad feeling.

Third, it would be easier to move a school or hospital up a pay zone than move it down, so the rule might not be symmetric. Both staff and the law would object to pay cuts, and this could create a bias toward higher pay.

All three parts of the problem can be solved. On the first, the best measures of 'recruitment problems' will be those that: are accurate and sensitive measures of problems finding staff; have a negative effect on performance, so any attempt to manipulate them will clash with an institution's performance objectives; are outside an institution's direct or indirect control; and are easily collected and measured.

There is a range of candidate measures, including:

- *Vacancy rates* – simple surveys of vacancy rates are easy to carry out and there is evidence that high levels of vacancies have a negative effect on performance. Vacancies, however, do not reflect the quality and experience of staff, or the amount of time they stay in the job: a school staffed entirely by supply teachers would have no vacancies. It is easy to manipulate vacancy rates simply by declaring as 'vacant' posts that an institution cannot realistically expect to fill. A better measure of vacancies might be "advertised posts unfilled after three months".
- *Staff turnover* – staff turnover is easy to measure and has a negative effect on performance. Turnover reflects the quality, as well as the quantity, of staff and it is hard to inflate artificially. Care needs to be taken with turnover because some institutions, like a city centre hospital, will have higher turnover than others, because the local labour market offers more options to staff and not because of any particular difficulty recruiting staff. Turnover has tended to increase in all workplaces over time and can also be a function of bad management.
- *Percentage of supply/agency/locum staff* – the use of temporary staff is associated with recruitment problems, can reduce service quality, and is easy to measure. It is, however, within an institution's direct control, and there may be good reasons to use a lot

of temporary staff – flexibility and cost control, for example – that have nothing to do with recruitment problems.

- *Staff experience* – employing relatively inexperienced staff in a given role may indicate recruitment problems and have a negative effect on performance. Data is somewhat harder to collect and this is within an employer’s direct control.

The best definition of ‘recruitment problems’ is likely to combine some of these measures. Institutions could compile their own data, supported by audits, particularly when a move between zones is likely, although a standardised approach to how and what data is collected would be needed.

To solve the second, a process would be needed to decide when recruitment problems should trigger a move between zones. This will be a matter of crucial interest to both employers and, through their union, to employees. Negotiation over each move would be bureaucratic and would be likely to lead to manipulation of the system so, instead, the rules for movement between zones should be set as part of the national pay bargain between employers and unions. These rules should set out numbers for some of the above measures that would trigger a move. The rules should then be applied by an independent adjudicator, which could be the existing pay review body for the sector or a new entity.

On the third part of the problem, a realistic way to move institutions down a zone is essential – otherwise zonal pay would tend to be inflationary. Again, rules should be established as part of the pay bargain, but moves down could occur when (a) there are no red lights on recruitment and retention measures, and (b) the independent adjudicator considers it unlikely that problems will emerge in the next pay zone down. There should be a presumption, however, that an institution in a high zone should move down if it has no current recruitment problems: a ‘normal’ institution will be at the base, Zone 1.

In practice, though, zonal pay re-ratings would be rare: deprivation in an area does not disappear quickly. Any review would happen over a long timescale, perhaps every decade in line with census data, and when a move down did occur it could be phased in gradually. Thus managed, moving down a pay zone need not demotivate staff who have worked hard to

improve their school or hospital.

Furthermore, movement to a lower pay band would not involve an actual pay cut for staff. Rather, it would be likely to involve several years of below-average pay increases so that pay was in line with the lower band after, say, three years.

Zoning and performance management

There is a risk that zoning, or any form of extra pay in deprived areas, would reward institutions that fail. Recruitment problems could emerge because of a difficult working environment, but it would be hard to distinguish whether that environment was the result of external factors, such as deprivation among the local population, or internal issues, such as mismanagement. Because recruitment problems would trigger extra pay, failing institutions might be bailed out and not address their difficulties.

Zonal pay, however, would operate alongside stringent performance management regimes run by Ofsted and the Healthcare Commission. Both institutions have procedures to replace the management of individual schools and hospitals that are failing and, given the long timescales over which pay zones would change, management would probably be gone before higher pay could help them out. Zonal pay would be more likely to assist turnarounds by attracting more, and more experienced, staff to a school or hospital that, due to its poor reputation (i.e. being placed in special measures by Ofsted), had been experiencing recruitment problems.

Funding a zonal pay system

An essential issue for any local pay system is how funds are made available from the centre to pay for it. A system that raises pay in an area of shortage is counterproductive if there is no money – the result is cutbacks in jobs and service.

The present system of funding regional pay variation in all local authority services (schools, policing, social services, fire, highways etc.) is the Labour Cost Adjustment. This is calculated by regressing regional differences in the Annual Survey of Hours and Earnings against control variables, such as gender, age and occupation, to produce a measure of relative wages. The areas used in England are the counties on 1991 borders, save for further subdivisions within London. There is then

a further adjustment on the basis of property values to reach the Area Cost Adjustment (ACA).³⁵ For education in Inner London, for example, the 2006-07 ACA amounts to 27.6% compared to the average.

The switch to using Annual Survey of Hours and Earnings data has removed one criticism of the ACA, but another, that the geographic boundaries used are somewhat arbitrary, particularly in London and the South East, remains.³⁶

The funding formula also adjusts for deprivation. In children's social care, for example, there is a deprivation-related adjustment based on the number of children without good health, income support claimants, children of income support claimants, and children in black and minority ethnic groups. Similar adjustments apply for local services across the public sector.

All of this gives scope to vary pay according to deprivation and local living costs. The potential problem is that the funding system is based on arbitrary geographic distinctions rather than responding directly to local labour market conditions. This could mean a gap between need and the funding structure, leaving some schools or hospitals struggling to manage on a budget that did not reflect its pay zone.

The solution lies in central government being willing to change the boundaries of the ACA and the deprivation funding regions receive in line with the pressures revealed by the zonal system. If, for example, schools in Horsham were suffering recruitment problems and moving up the pay bands, the central authorities should be willing to move Horsham into the outer London ACA region. Over time, the funding regions could become defined less by lines on the map, and more by what the zonal system revealed about the true pattern of labour shortages.

Funding, therefore, ought to be a surmountable problem for a zonal system.

Zoning and the overall level of public sector pay

Zoning reduces the government's ability to squeeze public sector pay relative to that of the private sector. If overall pay in the public sector becomes uncompetitive, and there is a general shortage of public servants, as in the late 1990s, then schools

35 A full description of the area cost adjustment system can be found in *Methodology Guide for the Area Cost Adjustment 2006/07 and 2007/08* (ODPM, <http://www.local.odpm.gov.uk/finance/0607/acameth067.pdf>).

36 D Blanchflower, R Hernand and A Oswald, *Area Cost Adjustment: A review* (NERA Economic Consulting, http://www.nera.com/image/ACARreport_5.2005.pdf, 30 May 2005).

37 Sibbald, Leese and Young (2000), op.cit.

and hospitals everywhere will face recruitment shortages, and start to move up the pay zones.

This is a desirable constraint on government: making pay in one sector of the economy uncompetitive is inequitable, and a bad way to run policy, even for a government that wants to cut the role of the public sector. It is, however, a reason for public sector unions to support a zonal pay system.

Career structures in the public sector

One further way to support deprived areas is to develop career incentives for public service professionals to work in them. For example, chances of promotion to senior positions – a deputy head teacher or chief inspector, perhaps – might be helped by prior service in a deprived area. Work in deprived areas could be linked to the opportunity to pursue research or further training: the same study that says GPs place a negative value of £4,222 on deprived areas says opportunities for personal development are worth an extra £3,549.³⁷

In a sense this already happens: young professionals who want to get on sometimes seek work in deprived areas because it is easier to get senior jobs. Offering formal recognition, support and funding would support the strong ideal of service held by many public sector workers and recognise the value of the extra skills acquired by those working in challenging situations.

Conclusion

A zonal pay system, in which public sector institutions would move between pay bands depending on the actual labour market pressures that they face, would be responsive to local labour shortages regardless of the reason for them, be it deprivation, the cost of living, the standard of living or a combination of all three. This is in contrast to other approaches that focus on the cost of living as the reason for local staff shortages.

A zonal system would work without the central authorities having to collect extensive data on prices and deprivation: it would use existing figures on recruitment and staffing instead. Zonal pay would work at the level of the school, hospital or PCT. The deadweight cost would be low: higher pay would not be awarded to everybody in an area, whether they need it to take a job or not. Zoning would deliver local pay within a

national pay structure, which is fair to staff, easy to manage, and prevents spirals of wage competition.

There are challenges to implementing zonal pay – fair mechanisms for movement between zones, accurate measures of recruitment problems, avoiding rewards for failure – but they can be overcome. The rewards of the system would be great: better public services in deprived areas, fairness to the staff who work in them, and higher returns on the money we invest in British health and education. Zoning will pay.

Appendix A: Public sector pay – 2005-06

(A) Teachers

Table 1: Schoolteachers' pay 2006

	Spine point	England and Wales	Inner London	Outer London	London Fringe
MAIN PAY SPINE	M1	£19,641	£23,577	£22,554	£20,586
	M2	£21,195	£24,924	£23,901	£22,137
	M3	£22,899	£26,658	£25,605	£23,841
	M4	£24,660	£28,452	£27,366	£25,608
	M5	£26,604	£30,594	£29,478	£27,549
	M6	£28,707	£32,820	£31,674	£29,649
Performance Threshold					
UPPER PAY SPINE	U1	£31,098	£36,885	£33,804	£32,043
	U2	£32,253	£38,697	£34,956	£33,195
	U3	£33,444	£40,002	£36,255	£34,389
Leadership Pay Spine 43 points up to £95,631			Advanced Skills Teachers 18 points up to £51,819*		

Source: Department for Education and Skills, *School Teachers' Pay and Conditions Document 2006* (<http://www.teachernet.gov.uk/management/payandperformance/pay/2006/>).

Pay scales – the main pay scale was shortened from nine points to six in 2002 to help recruitment and retention. Promotion within the teaching profession is automatic: where it used to take seven to nine years to reach the top, it can now be done in five to six years. The upper pay scale was introduced in 2000 (originally with five points, now reduced to three) to deal with the problem of unmotivated teachers at the top of the main scale – once on it, a teacher can only advance to the next point

every other year.

The Advanced Skills Teacher (AST) grade was introduced to offer an alternative to management for senior teachers: it involves 80% teaching and 20% outreach and support work. ASTs must pass an independent national assessment, currently carried out under contract by Westminster Education Consultants, and then find a position: there is independent funding for ASTs, and the number of positions is limited.

Incentive pay – the upper pay scale was supposed to introduce performance-based progression. Applicants at the top of the main pay scale undergo a performance assessment by their headteacher that they must pass to advance. The assessment requires teachers to demonstrate knowledge and effective use of up-to-date teaching methods, a wider contribution to the school and, most contentious of all, test scores showing: ‘pupils making progress as good as, or better than, similar pupils nationally.’³⁸

In fact, in the first round of applications in 2001, headteachers passed 97% of applicants. The review body has developed new procedures in response, including assessment training for school heads, which came into force in September 2005. By contrast, because teachers are in competition for limited places, the leap to the AST pay scale requires a real demonstration of performance. There have not been any other attempts to introduce individual incentive pay in schools.

An experiment with team Performance Related Pay (PRP), the School Achievement Award Scheme, was also introduced in 2000, and then scrapped three years later. The scheme paid bonuses to schools with significantly improved exam results over a four-year period, or where results significantly exceeded those in neighbouring schools. The money was then distributed to teachers and support staff, resulting in average bonuses of £100 to £300. The scheme was scrapped when funding from the 2000 Spending Review ran out because there was no evidence of a positive effect on performance.³⁹

Recruitment and retention – schools now have the most sophisticated system of regional pay in the public sector, with one provincial and three London pay scales. The maximum London allowance, however, of £3,501 for a new teacher, is moderate by public sector standards. New teachers in shortage

38 Department for Education and Skills, *School Teachers' Pay and Conditions Document 2005* (<http://www.teachernet.gov.uk/management/payandperformance/pay/2005/>, 2005).

39 J Stevens, C Simm and H Shaw, 'Evaluation of the School Achievement Award Scheme (SAAS)' (Report No. 427, MORI Social Research Institute, 2003).

40 For example, 'Progression should not be automatic but on a basis which distinguishes the contribution of one teacher from another, with excellence as our goal.' (Written evidence to the School Teachers' Review Body, Department for Education and Skills, July 2003).

41 National Union of Teachers, *Promoting the Professionalism of Teachers* (<http://www.teachers.org.uk/resources/pdf/NUTSTRBReport4080.pdf>, 2005).

subjects (including English, maths, science and languages) can get a £4,000 'golden hello' and/or repayment of their student loans and there are non-taxable £6,000 bursaries for trainee teachers.

Current issues – the failure of the performance threshold means that pay is, as before, a nine-point scale with an ongoing problem of experienced teachers being stuck at the top of the scale. The government's stated desire to link progression to performance suggests that it will consider further reform.⁴⁰ A new Excellent Teachers grade, proposed by the School Teachers' Review Body (STRB), came into force on 1 September 2006. This is effectively an extra point above the upper pay scale, reached after external assessment, and with responsibility for mentoring other teachers. Initial consultation suggested only 20% of teachers would be eligible to advance: the actual outcome remains to be seen.

The 2006 pay review reduced the number of points on the AST scale. The major issue for the 2007 round looks likely to be a review of the leadership pay spine. Unions argue that the London allowance is too low and the system of regional payments is likely to remain a subject of contention.⁴¹

(B) Nurses and other health professionals

Table 2: Nurses and other health professionals pay 2006

Pay band	Incremental points											
Band 1	£11,494	£11,879	£12,209	£12,539								
Band 2	£11,494	£12,209	£12,539	£12,924	£13,309	£13,694	£14,189	£14,739				
Band 3	£12,044	£12,539	£13,144	£13,694	£14,189	£14,739	£15,069	£15,509	£16,004	£16,389		
Band 4	£13,914	£14,739	£15,289	£16,004	£16,994	£17,598	£18,148	£18,698	£19,248			
Band 5	£16,389	£17,049	£17,598	£18,698	£19,248	£19,798	£20,458	£21,118	£21,723	£22,328	£23,208	£24,198
Band 6	£19,532	£20,458	£21,448	£22,328	£23,208	£24,198	£25,188	£26,048	£26,948	£27,828	£28,817	£30,247
Band 7	£22,768	£24,198	£25,628	£26,948	£27,828	£28,817	£30,247	£31,127	£32,117	£33,217	£34,372	£35,527
Band 8A	£31,127	£32,117	£33,217	£34,372	£35,527	£36,957	£38,387	£40,036	£41,246			
Band 8B	£35,527	£36,957	£38,387	£40,036	£41,246	£43,336	£45,756	£48,176	£49,496			
Band 8C	£41,246	£43,336	£45,756	£48,176	£49,496	£51,695	£54,115	£57,745	£59,395			
Band 8D	£49,496	£51,695	£54,115	£57,745	£59,395	£61,870	£64,894	£68,194	£71,494			
Band 9	£59,395	£61,870	£64,894	£68,194	£71,494	£74,925	£78,521	£82,291	£86,240			

Source: Agenda for Change Agreement: 2005.

Some extra funds are available for ad hoc recruitment and retention premiums in high-cost areas.

Pay scales – Agenda for Change unites over a million staff in a range of health professions on to a single pay scale. The aim is to base pay on the content of the job and to reduce hierarchy. Progression within a band is automatic, subject to satisfactory performance. Promotion to the next band is not automatic, and there may be several applicants for the same position.

Incentive pay – there is no individual incentive pay in the health service and, though there are two ‘gateway’ points near the top and bottom of each pay band, where progress is reviewed against a national knowledge and skills framework, there is little performance-based progression. Because of the structure of nursing, however, there are opportunities for promotion to a more responsible job allowing for competition and offering an incentive for improved performance.

The Department of Health set up seventeen team PRP pilots in 2002. Clear, attainable targets, good communication and staff involvement in target setting seemed to be major contributing factors for success. PRP was either paid as cash or spent on improving staff facilities; it did not seem to affect the results of the scheme. The early indication is that the trials were a success.⁴²

Recruitment and retention – the new London allowance system replaces flat-rate London bonuses and a series of ad hoc cost of living allowances. NHS trusts can also pay whatever recruitment and retention bonuses they choose for posts that they consider hard to fill (n.b. the bonus is attached to the post and not the individual).

Current issues – the Agenda for Change programme is a major reform and will take a number of years to settle down. There is no system for rewarding staff who do an especially good job; employers may try to use retention bonuses to do so.

42 P Reilly, J Phillipson and P Smith, ‘Cheek by jowl’ (*People Management*, 2004).

43 Police Negotiating Board, 'Agreement reached in the Federated Ranks Committee' (PNB Circular 02/17, <http://www.ome.uk.com/downloads/17-02%20Threshold%20Payments.pdf>, 2002). Police Negotiating Board, 'Agreement reached in the Police Negotiating Board' (PNB Circular 02/19, <http://www.ome.uk.com/downloads/19-02%20-%20new%20pay%20scales.doc>, 2002).

(C) Police officers

Table 3: Police officers' pay (federated officers) 2005

Pay band	Constables	Sergeants	Inspectors
On starting service	£20,397		
On completing training	£22,777	£32,025	£41,034
2	£24,090	£33,123	£42,192
3	£25,563	£34,233	£43,350
4	£26,367	£34,965	£44,508
5	£27,213	£35,991	
6	£27,990		
7	£28,683		
8	£29,601		
9	£31,392		
10	£32,025		

Source: *Jane's Police Review, Pay and Conditions*, 9 November 2005 (http://pr.janes.com/public/jprjob/pay_condition.shtml).

Officers in the Metropolitan Police receive London weighting of £6,219 on top of national pay scales; officers transferring into the Met may receive a rent subsidy of £5,863 per year; and all police officers receive free rail travel within 70 miles of central London. Success in London recruitment has been such that the Met now has a freeze on new cadets.

Pay scales – pay scales for sergeants and inspectors have been shortened to ensure faster progression; constables still have a wide band.

Incentive pay – The Competence Related Threshold Payment was set up in 2002. This makes it possible for officers who have served at least a year at 'the maximum point of their pay scale' to apply for an additional £1,002 a year, to be granted after a performance assessment, open to at least 75 % of applicants who fulfil the assessment criteria.⁴³ To receive the payment the officer has to meet national standards designed to indicate 'high professional competence'.

Recruitment and retention – special priority payments, for posts that are especially demanding or dangerous, carry an unusual level of responsibility, or present particular problems with recruitment and retention, were launched in December 2003.

Payments range from £500 to £3,000, reaching £5,000 in 'exceptional circumstances'. These have the potential to be used in a number of ways: to reward officers working in high crime areas; to award merit within the existing pay structure (a young constable who cannot be moved up the pay scale might be given more responsibility and a priority payment to go with it); or to compensate for particularly unpleasant work. How they are actually used remains to be seen.

A new retention scheme called '30+' is intended to retain personnel who have served for 30 years and could retire with maximum benefits; it adjusts pension provision so there is an economic incentive to keep working. One aim of the new police pension scheme, which came into force in April 2006, is to further improve retention.⁴⁴

Current issues – the negotiating body representing police officers has rejected the proposed pay scales for 2006-07 and these remain in dispute.

44 Home Office, *Government Proposals for a New Police Pensions Scheme for Future Entrants* (Scottish Executive and Northern Ireland Office consultation document, <http://www.homeoffice.gov.uk/docs2/policepensionscheme.pdf>, 2003).

Appendix B: Regional and local pay in the private sector

Unless otherwise stated, allowances are shown as annual salaries, and distances quoted are from Charing Cross. The fourth column (Pen) indicates whether an allowance is pensionable. The next column (Enh) shows whether it is enhanceable (i.e. is considered part of basic pay for the purpose of calculating overtime and/or shift premium payments).

Table 4: Selected private sector location allowances

Organisation & effective date	Location	Allowance (in £s)	Pen	Enh	Other information
Alliance & Leicester 1.7.92	0-4 miles	3,520 4,200* 4,625**	No	No	* After two years' satisfactory service ** After five years' satisfactory service. A 'hotspot' location payment of £1,000 is payable on minimum salaries where certain qualifying criteria are met
	4-7 miles	2,575 3,205* 3,570**			
	7-16 miles	1,470 2,050* 2,465**			
	16-22 miles	735 995*			
		1,315**			
Argos 1.4.05	Zone F (previously West End)	1.39ph*	Yes	Yes	* Differential over Zone A rate (previously Provincial) ** Inc. Basildon, Slough, etc. *** Includes Cambridge, Eastbourne, Milton Keynes, etc.
	Zone E (previously Central London)	1.15ph			
	Zone D (previously Surrey and Crawley)	0.91ph			
	Zone C** (previously Greater London)	0.51ph			
	Zone B*** (previously South East)	0.14ph			

48 Poverty pay: How public sector pay fails deprived areas

BBC 1.8.04	Metropolitan Police District	3,104 – for employees earning £22,000 and above; 3,465 – for employees earning less than £22,000	Yes	No	
British Gas Services 1.4.05	Inner London Metropolitan (up to 15 miles) Industrials Outer London (within M25) Up to 30 miles Up to 50 miles	4,318 3,875 3,432 1,106 553		Yes	No
Staff	0-4 miles 4-16 miles Outer Metropolitan area	3,289 1,802 656			
Littlewoods Staff* 1.10.04	Location 1: Bromley, Douglas (Isle of Man) Location 2: inc. Brighton, Hounslow, Sutton etc. Location 3: inc. Camberley, Slough, etc. Special Provincial: inc. Aberdeen, Leeds, Newcastle, etc.	0.75ph** 0.41ph 0.23ph 0.06ph	Yes	Yes	*Location allowances for staff recruited after 1.5.99. Staff in post prior to this date remain on separate pay scales. ** Differential over provincial pay scale at Step 1 rate.
Oxfam 1.9.04	0-5 miles 5.1 miles to M25 'Hot spots' (Epsom, Guildford, Jersey, Oxford, Woking)	2,215 1,720 1,000*	No No	No No	System of allowances charged. Previously, there was a single London allowance (£1,675) *Only paid in full to those earning less than £17,650. Pro-rata for those earning up to £18,650.
Scottish Equitable (part of Aegon) 1.1.01	Central London Reading Harrow Croydon Guildford Maidstone Chelmsford Bristol	3,500 2,000 1,900 1,850 1,350 900 850 800		No	No
Tesco Section Managers 23.10.02	Band 5: City of London Band 4: London, Thames Valley etc. Band 3: Around M25 etc. Band 2: South East and selected other stores	5,350* 3,800 1,800 800	Yes	Yes	*Differential over band 1 stores
Staff 23.10.02	Band 5 Band 4 Band 3 Band 2	1.01ph* 0.68ph 0.45ph 0.03ph			
WH Smith 1.9.02	Zone H** Zone G Zone F Zone E Zone D Zone C Zone B	1.40ph 1.25ph 1.00ph 0.75ph 0.60ph 0.40ph 0.20ph	Yes	No*	* location allowance is not paid on any overtime worked over 39 hours ** Zone H: Oxford Street; Zones G-B progressively further out up to Luton, Milton Keynes etc.