

# Regional pay scales

**O**ur nation has continuing problems in hiring and retaining public sector workers in expensive areas like the South East.

As they always have been, the consequences for our citizens are serious. Two of many examples are in education and the Health Service:

- Teacher vacancy rates are higher in London and the South East than in the North. See Blanchflower and Oswald 2003;
- The quality of hospitals, as measured by star ratings, is greater in the North than in the South East. See Burgess, Gossage and Propper 2003.

At the bottom line, the reason is remuneration levels. Our country's public sector does not pay realistically in regions where private sector wages are high. In consequence, it is hard, in those areas, to hire the best people into public sector jobs, and difficult to motivate properly those already in post.

The solution is straightforward. The concept of national pay scales has to be jettisoned and Britain needs a better designed way to fund public sector pay bills in different areas. In effect, more regional wage flexibility in the public sector is needed. The same conclusion has recently been drawn by Burgess et al, 2003.

Currently, an 'Area Cost Adjustment' is used to allocate local authority funding geographically across the country. We believe it is still not done persuasively.

The ACA is a statistical formula and has recently been altered in form. It now:

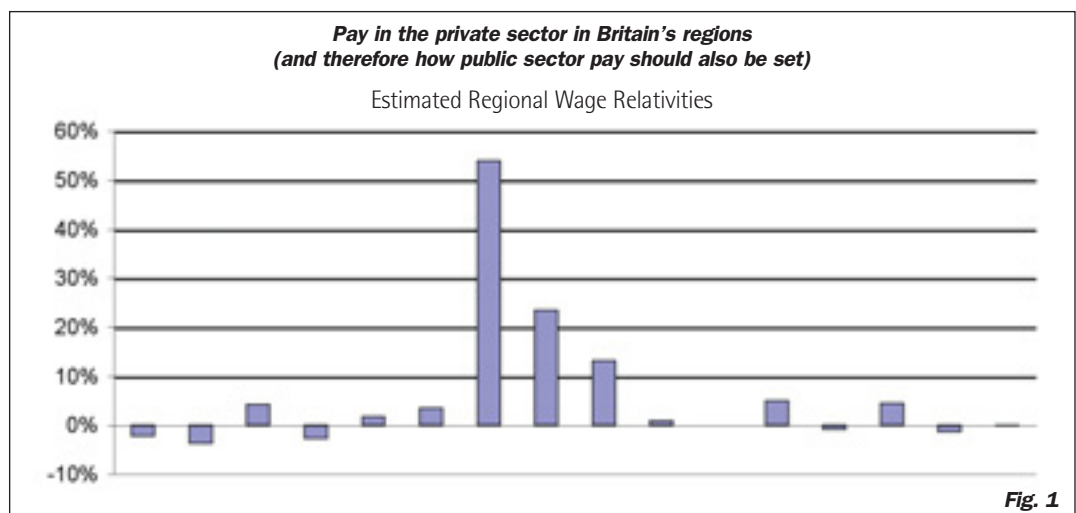
- Uses statistical equations to estimate how pay levels vary by region;
- Is based on patterns in the New Earnings Survey;
- Takes these numbers and then tries to work out how local authorities in expensive areas should have their funding adjusted upwards (to give them more cash in a way that reflects the expense of hiring in their area);
- Builds in an element for 'need' that varies by area depending on the age structure and poverty in a region.

Although the new Area Cost Adjustment system moves in the right direction, it will not fix all the problems we observe. That is because, in our opinion, the wrong data set is being used to estimate the ACA numbers. (We wrote about this in detail in the 2003 report for Worcestershire County Council.)

## Supply and demand

Intellectually, the issues are clear. Because local authorities have to compete for workers with private sector firms, public sector wages must be allowed to vary much more across Britain's regions. It is time for those who live south of Spaghetti Junction and east of Hay on Wye to stand up and speak the truth: workers in public services have to be given far bigger regional pay weightings. Southern teachers, nurses and police officers need a wage rise relative to those who work in other areas of the country. In regions where the cost of living is high, there are shortages of key people simply because Britain pretends that a

**Andrew Oswald and David Blanchflower, Professors of Economics, discuss regional pay and the public sector in light of the continuing weaknesses in the Area Cost Adjustment...**



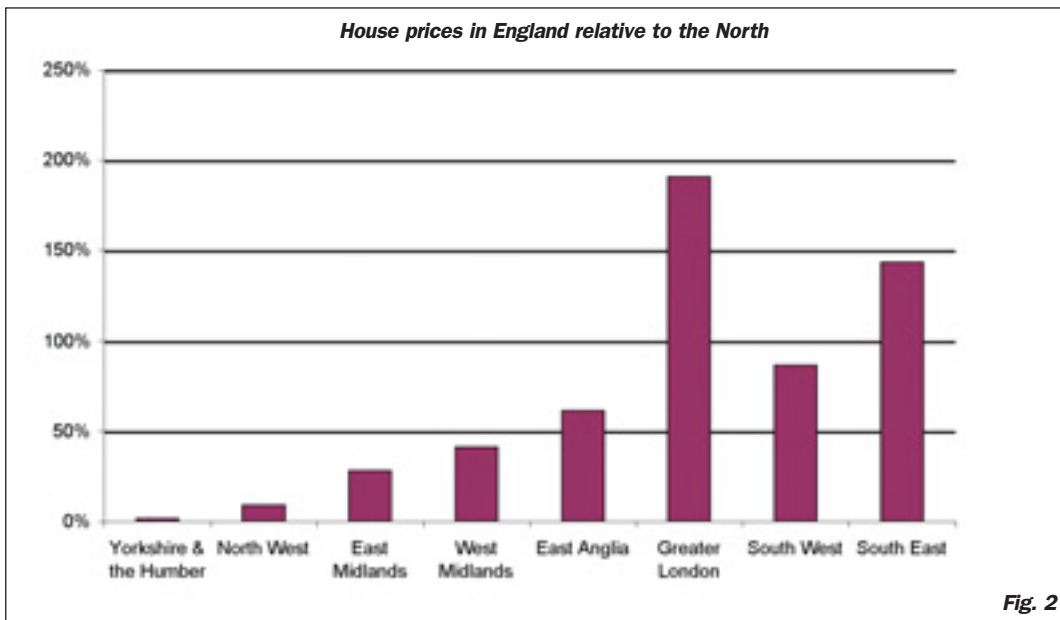


Fig. 2

public sector salary of £25,000 buys the same in each corner of the land.

In our technical work, we have calculated the spread of private sector wage rates across the areas of the country. Fig. 1 shows the pattern. It also tells us how pay should be set in the public sector – if the public sector is to compete geographically with the private sector. Fig. 1 uses Labour Force Survey data.

It has been known for a long time that it is more difficult to hire public sector workers in expensive areas. The Government response to this kind of difficulty has been to do nothing or to think of indirect remedies: cheap loans, strange allowances, overtime anomalies. The new Area Cost Adjustment system, based on the New Earnings Survey and regression equations, will, in our view, prove inadequate. It would have been better to use the Labour Force Surveys because they give a more accurate picture of regional pay in the private sector and therefore a better idea of how public funds should be adjusted to allow public sector organisations to hire competitively in each area. The problems with the New Earnings Survey are that, first, it does not sample low paid workers sufficiently well and, second, it contains no information on educational qualifications, which means that a like-for-like calculation cannot be done for workers across different areas.

Public sector remuneration ought to be allowed to differ a lot more by area – for the straightforward reason that private sector pay does. Publicly determined pay allows only a tiny London weighting and no weighting elsewhere. That does not make sense.

Much of the variation in private pay is, of course, caused by differences in the costs of accommodation (see Fig. 2). House prices within driving distance of London are many multiples of house prices in the cheapest parts of Britain. This is further evidence that a national pay scales mentality is not sensible.

Some politicians react to a diagram like Fig. 2 by arguing that special cheap housing should be made available to public sector workers. That runs away from the underlying difficulty: rates of pay in the public sector should vary more by region.

If western democracies wish to have a public sector of any appreciable size, they must accept that pay determines the quality of a workforce. Politicians are creatures of the day's programme and the Today Programme; they have short horizons and are always under pressure to keep wages as low as possible in public services. So it is up to society to decide whether it wants its teachers to have As, Bs or Es stamped on their own school certificates.

Once the appropriate level of quality for teachers and others has been decided by society, the regional pattern of public sector wages should be set to be the same as in the private sector. That is efficient and fair. Local authority jobs compete for staff with private sector jobs; hospitals and police stations face competition for staff from health clubs and security firms. In the long run, indeed, workers choose their whole career, and again public must beat off private if we are to have qualified nurses and head teachers willing to do these jobs.

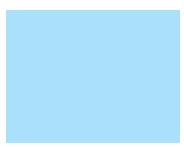
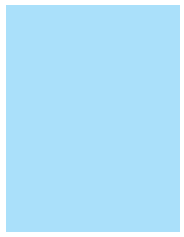
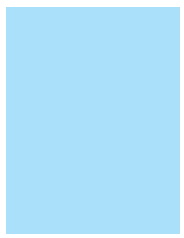
### Practicalities of computation

There are statistical ways to calculate how much private sector 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 can thus be calculated. This was done in the late

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**The estimates behind Fig. 1**  
 Estimated regional wage relativities  
 (using private sector Labour Force Survey data)

<b>Region</b>	<b>Wage Relativity</b>
Central Et Inner London	53.9%
Outer London	23.6%
Rest of South East	13.2%
West Midlands	5.0%
Greater Manchester	4.5%
West Yorkshire	4.3%
East Anglia	3.5%
Rest of North East	2.2%
East Midlands	1.8%
South West	0.9%
Tyne and Wear	0%
Rest of North West	-0.1%
Rest of West Midlands	-0.8%
Merseyside	-1.4%
Rest of Yorkshire and Humberside	-2.7%
South Yorkshire	-3.6%

Note: all estimates are relative to the region Tyne and Wear

1990s in a long independent inquiry headed by Professor Robert Elliott, of Aberdeen University.

Our research depicted in Fig. 1 finds that, for a typical worker, wages are 55% higher in Central London than in Tyne and Wear. In Inner London, the figure is 34% and Outer London 21%. The rest of the South East pays a regional premium averaging 13%. The metropolitan part of the West Midlands pays 6% more than the cheapest area in England. And so on.

If New Earnings Survey data are used, the geographical spread of wages is squeezed. We believe this is because of an under sampling of low paid workers. For this and other reasons, we view the NES data as an unreliable basis for ACA calculations.

The Labour Force Surveys should be used in the ACA calculations. Moreover, it is desirable to get rid of so-called 'cliff edges' in funding levels and rates of pay across regions. A cliff edge is the idea that one might get much larger pay merely by being half a mile down the road from a lower wage band area.

Cliff edges will be a continuing difficulty in the new ACA system. This is discussed in the Blanchflower-Oswald report to Worcestershire.

### One important problem

Currently, the Government (or, more precisely, the Office of National Statistics, ONS) has said that it will not release the data used in the latest Area Cost Adjustment calculations. It is therefore impossible for researchers to check the numbers properly.

In a free society, we view this as unacceptable. The Government should release the data it uses in its ACA calculations.

### Conclusion

Public sector pay and funding policy has to change.

First, national pay scales are continuing to hurt our public services. In this country, there is too much geographical variation in private sector rates of pay to make national public sector pay schedules workable. The spatial variation is documented in Fig. 1. Pay in Britain's public sector needs, in the future, to be similarly flexible across regions.

Second, we do not believe that the new Area Cost Adjustment system, based on the New Earnings Survey, will work effectively. It would be better to use the Labour Force Surveys in the calculations (and indeed Professor Robert Elliott's independent inquiry recommended that the LFS be used). Until that is done, we anticipate that severe problems will continue.

Third, the Government should release to researchers the data it uses to calculate its Area Cost Adjustment numbers. To do otherwise is unacceptable in a free society.

#### References:

Blanchflower, David and Oswald, Andrew (December 2003) 'Calculating an Appropriate Regional Funding Adjustment for Worcestershire: A Report for Worcestershire County Council', Worcestershire County Council.

Burgess, S, Gossage, D and Propper, C (September 2003) 'Explaining Differences in Hospital Performance: Does the Answer Lie in the Labour Market?' CMPO Working Paper 03/091, Bristol University, Department of Economics.

Elliott, R F, McDonald, D R, MacIver (July 1996) 'Review of the Area Cost Adjustment', Waverley Press, University of Aberdeen and the Department of Environment.

This is a revised version of a lecture given in 2004 at The Work Foundation, Carlton House Terrace, London