Staff Side response to NHS Pay Review Body call for evidence on market-facing remit on pay in local areas

The NHS Staff Side[1] welcomes the opportunity to respond to the NHS PRB's call for evidence on a market-facing remit on pay in local areas. This submission marks our strong commitment to national pay determination and national pay structures in the NHS and other parts of the public sector. We believe that the current UK wide pay system, which sets a floor pay rate for the NHS and allows for adjustments in high cost areas or local areas with particular recruitment difficulties has proven itself as a robust, effective pay system that closely follows the realities of geographic variations in the UK labour market. We also believe that the NHS and other parts of the public sector should be a model employer, providing high quality pay and reward packages, training and development, and taking positive action on promoting equality, so supporting the recruitment and retention of a highly motivated workforce. This submission demonstrates why national pay determination and national pay structures are the best way of achieving these aims.

Summary

- NHS Staff Side rejects the Government's call to make pay more 'market facing' in local areas. This is an attempt to drive down public sector pay in lower cost areas of England, to break up national pay determination and introduce local pay structures.
- National pay determination, allied to Agenda for Change, has proven itself as a robust, effective and efficient pay system. It is the most effective and appropriate way of ensuring discipline and control over pay settlements, of delivering cost efficiency and providing transparency and fairness.
- The Government's stated aim is to ensure that public sector pay systems are appropriate to local labour markets. This submission demonstrates that the current system is indeed appropriate. By setting a floor pay rate and allowing for adjustments in high cost areas or local areas with particular recruitment difficulties, the pay system allows geographic variations in the UK labour market.

Market-facing pay will lead to regional and gender inequalities

- Market-facing pay would lead to a reduction in public sector pay in some areas of the UK and further entrench low pay in those areas. Reducing public sector pay will not stimulate economic growth but only take demand out of the economy.
- Private sector labour markets do not provide an appropriate framework on which to map NHS pay. Modelling NHS pay on private sector pay outcomes would replicate the private sector's market failures, distortions and inequalities. Income inequality among working-age in people has risen faster in the UK than in any other rich nation since the mid-1970s and is a particular feature of the private sector. The differential between highest and lowest earners and between men and women is larger in the private sector than the public sector.

[1] British Association of Occupational Therapists, British Dietetic Association, British Orthoptic Society, Chartered Society of Physiotherapy, Federation of Clinical Scientists, GMB, Royal College of Midwives, Royal College of Nursing, Society of Chiropodists and Podiatrists, Society of Radiographers, UCATT, Unison, Unite.

- Income inequality has also grown between London the rest of the country over the last decade. Reducing NHS pay rates in low income areas will widen this gap as the private sector competes for staff in a labour market with a reduced 'going rate.'

The proposals will damage recruitment and retention

- NHS staff have already borne the brunt of a pay freeze, face further pay restraint and pensions reforms. NHS staff morale and motivation have been harmed by these policies, as well as fears over job security. More attacks on pay and conditions will do further damage – and will impact on recruitment and retention.

The justification for market-facing pay is misplaced, based on over-simplistic comparisons between the private and public sectors

- The justification for these proposals is that the differential between public and private sector wages varies between local labour markets; that this potentially hurts private sector organisations and leads to unfair variations in service quality.
- We show that comparisons of private and public wages are highly complex – particularly across the NHS workforce, which is characterised as more highly qualified and older than the economy as a whole and therefore would expected to be relatively well paid. It is not the case that public sector and NHS workers in some areas of the country are overpaid. Rather, lower paid staff in the private sector are underpaid in relation to the public sector. The public sector pay advantage is not evenly distributed, but higher in lower grades.
- We also point out that pay trends are cyclical and that any decisions to alter pay determination should not be made on the basis of short-term movements in the differential between public and private sector pay awards or earnings.
- The argument that the public sector crowds out the private sector in local labour markets is rejected due to the current high levels of unemployment and underemployment. In any case, it is highly doubtful whether the private sector would automatically create jobs if public sector workers were paid less.
- This submission also looks at claims that differentials between private and public sector wages leads to variations in service quality. In particular, we critique claims that heart attack survival rates are linked to this pay differential. We show that these claims are based on highly questionable assumptions and an overly rigid interpretation of the way that labour markets operate.
- This submission goes on to consider pay determination in the private sector, particularly in larger organisations which provide the most appropriate comparator for NHS organisations. We provide evidence that most large companies operate national pay structures, with weighting for London and its surrounding areas.

Market-facing pay would be highly impractical and inefficient. The current system sufficiently adapts to regional cost of living variations

- In practical terms, making pay more 'market facing' in local areas would be highly problematic. The NHS workforce is not homogeneous, but has different sets of workers with many operating within national labour markets. This means labour costs will be difficult to both predict and contain and it directly contradicts the Government's aspiration for NHS staff costs to map local labour costs. Other practical problems arise from the inherent difficulty of accurately defining local

labour markets and the fact that many NHS staff live and work across different areas.

- We look in some detail at evidence around regional pay and cost of living data. We show that the only substantial variation in gaps between public and private sector pay, housing costs and cost of living across English regions lies between London/South East area and the rest of the country. This accords with the existing Agenda for Change structure, with national rates, plus high cost area payment zones covering London and the London fringe.

National pay structures and Agenda for Change provide a level playing field, are efficient and reduce organisational conflict

- Staff side view these proposals as a way of breaking down national pay structures and undermining Agenda for Change. The current pay system includes sufficient flexibilities to allow the NHS to adapt to local pressures and demands, without resorting to local pay determination. Moreover, the system provides a level playing field, preventing a race to the bottom or the top on pay and avoiding damaging competition for staff. It minimises transactional costs involved in pay determination and removes pay as a source of industrial relations conflict at an organisational level.
- The current pay system is equality-proof, both promoting a sense of fairness and ensuring equal pay for work of equal value. This facilitates staff mobility across the NHS and prevents highly expensive equal pay claims.
- We call upon the Pay Review Body to reflect on the arguments set out in this paper and the appendices and to reject outright any calls for the introduction of a market-facing remit for NHS pay.

1. Introduction

Strong recruitment and retention are best secured through national pay determination, supported by Agenda for Change, which is underpinned by a robust job evaluation scheme. This system ensures that NHS staff are paid and developed in a transparent, equitable and efficient manner. Any moves to a market-facing remit on pay in local areas would undermine the whole infrastructure, leading to damaging competition between trusts and organisations for staff and unequal pay issues. The introduction of market-facing pay for England would also threaten Agenda for Change as a UK-wide structure, effectively forcing the hand of the other UK countries.

Developing a system of market-facing pay in local areas would be likely to lead to a reduction in public sector pay in some areas of the country and only serve to further entrench low pay in those areas. It is clear that the private sector needs support to enable the UK economy to return to growth, but the best way to do that is not through reducing public sector pay. Instead the focus should be turned on providing support in critical areas such as skills development and infrastructure.

This submission shows that modelling public sector pay on private sector structures would be difficult, costly and inefficient. It would replicate and entrench inequalities found in the private sector. National pay determination, allied to Agenda for Change,

ensures fairness and transparency. Put simply, public services, the workforce and their pay arrangements are just too important to be left to the market.

The Governor of the Bank of England recently made a speech which made a clear link between falling real wages and consumer spending to the UK's current weak economic growth.[2] Any reductions in pay levels in the public sector are bound to have a knock-on impact on the private sector, further damaging spending power and slowing down recovery. Weakening the spending power of the largest workforce is the UK will weaken both national and regional economies. Moreover, it will affect a highly female workforce, both in the NHS and wider public sector. In the NHS, women account for around 80 per cent of staff covered by Agenda for Change. Women have been and will continue to be disproportionately hit by falling living standards as well as the withdrawal of financial support through tax credits. Lower pay levels in the public sector will impact on a large percentage of the total female workforce.

The proposal follows recent and ongoing public sector redundancies, a two-year pay freeze, as well as the autumn statement's announcement that pay will be frozen at an average of 1% for a further two years alongside plans to increase pension contributions. Public sector and NHS staff will see this development as an attack on pay, terms and conditions, risking damage to morale and motivation and to recruitment and retention. It is generally accepted that the level and quality of service provision is closely linked to employee wellbeing and motivation: further changes to pay structures will only serve to damage this link.

This review takes place at a time of great uncertainty and turmoil, both within the global and UK economies and within the NHS. It appears that the proposals to move away from national pay determination are in response to immediate pressures to boost private sector employment and economic growth. These pressures must be weighed against the consequences for industrial relations and workforce development in the NHS as well as for local and regional economies.

The staff side submission starts by addressing the assertions made by the government in its justification for moving toward market facing pay and then goes on to look at the factors raised by the Secretary of State and the Chancellor in their letters to the NHS Pay Review Body.

2. Background

The NHS Pay Review Body has been asked by the Chancellor of the Exchequer and the Secretary of State for Health to consider how to make pay more 'market facing' in local areas for NHS Agenda for Change staff in England.

The justification for moving toward more 'market-facing' pay in local areas is that:

- The differential between public and private sector wages varies considerably between local labour markets;
- This has the potential to hurt private sector business competing with higher public sector wages;
- This leads to unfair variations in public sector service quality; and

[2] www.bankofengland.co.uk/publications/speeches/2012/speech541.pdf

- This reduces the number of jobs that the public sector can support for any given level of expenditure

The following sections examine the evidence behind these assertions.

2.1 National differentials in public and private sector pay

Comparisons of public and private sector wages are complex and fraught with problems. For example, Incomes Data Services (IDS) have written an exhaustive account of the complexities involved in comparing public and private sector earnings[3], since any comparison needs to apply regression analysis that takes account of differing profiles within the sectors in terms of skill level, age, gender, occupation and qualifications.

By analysing the 2010 Annual Survey of Hours and Earnings data, IDS showed that simply varying the measure of average pay by the mean or median method produces completely opposite results. The annual gross pay of public sector staff exceeds private sector staff when measured by the median method yet private sector staff are higher paid than public sector staff when measured by the mean.

The evidence submitted by the Department of Health for the 2012/13 pay round made repeated reference to two studies completed by the Institute of Fiscal Studies and the Office of National Statistics (ONS), which it used to support its case by quoting public sector pay premiums of 7.5% and 5.3% respectively[4].

The two reports quoted by the department claim to have taken account of the different workforce profiles in comparing public and private sector pay. However, even the ONS report acknowledges that the picture is more complex than the bald headline figure quoted by the department suggests. For example, the ONS study states that employees who have a degree or equivalent qualification earn 5.7% less than those in the private sector[5]. For the NHS, this is a hugely significant point, since around 48% of the non-medical workforce are defined as professionally qualified and therefore are required to have a degree or qualification equivalent to a degree.

Studies by the TUC confirm the disadvantage of degree level staff and go on to establish that staff educated to an A level standard or higher fail to find a pay advantage in the public sector.[6]

Other studies, such as that conducted by Dolton and Makepeace included in the publication *The Labour Market in Winter*, have found that by taking account of the 'human capital' factors of age, occupation, qualification etc to draw a fair comparison, public sector male workers were found to earn 1% less than their private sector counterparts, while female workers were found to earn 6% more. [7]

[3] Public and Private Sector Earnings: Fact and Fiction, IDS Pay Report, June 2011

[4] Written evidence from the Health Departments for England and Wales, September 2011

[5] A Damant and J Jenkins, *Estimating differences in public and private sector pay*, ONS, July 2011

[6] http://touchstoneblog.org.uk/2009/12/more-about-public-versus-private-sector-pay/

[7] Dolton P and Makepeace G (2011) *Public and Private Sector Labour Markets* in Gregg P and Wadsworth J (eds) The Labour Market in Winter: The State of Britain, Oxford: OUP

Therefore, the national evidence presents a conflicting picture of whether NHS wages are significantly different to comparable private sector jobs. However, the most probable picture is that the professionally qualified half of the non medical workforce is paid less than comparable private sector workers and the lowest paid, female dominated section of the workforce is paid more in comparison to their private sector counterparts.

Yet even where pay differentials are identified between sets of workers, staff side rejects any suggestion of levelling wages down. Indeed, any disadvantages experienced by one set of workers should only be addressed by levelling their pay up.

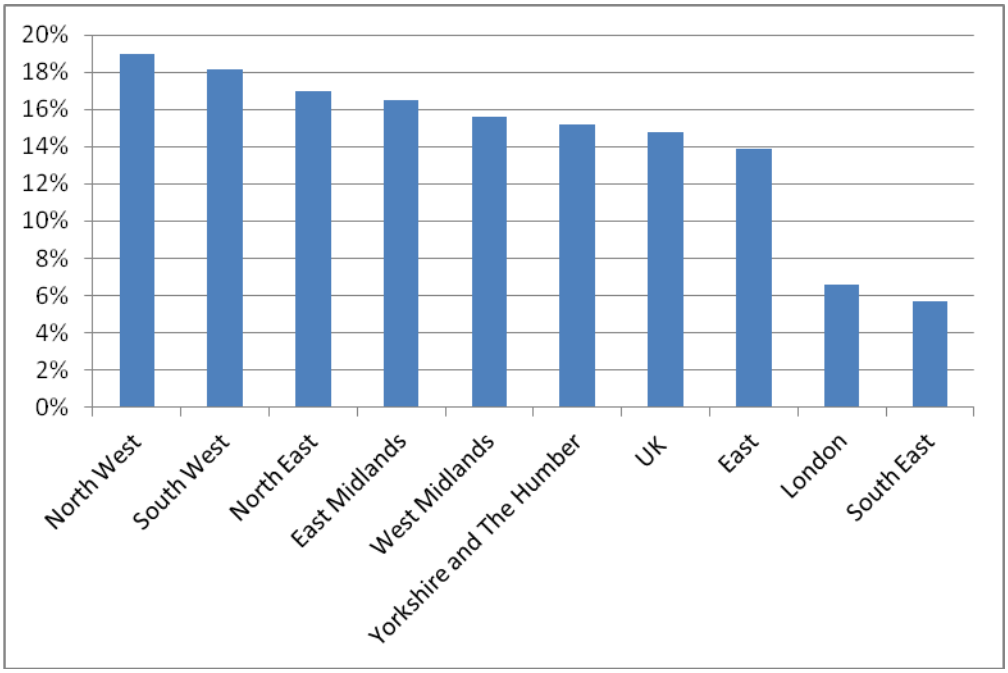
2.2 Regional differentials in public and private sector pay

The central assertion made by the government in seeking to justify moving toward 'market-facing' pay in local areas is that there is "substantial evidence that the differential between public and private sector wages varies considerably between local labour markets."

Chart 1 demonstrates the 'raw' differential between full-time weekly pay by region, before any correction for the different composition of the public and private workforces. Therefore, it does not reflect actual differentials but it does provide a useful picture about the variation of differentials across England.

This data shows that London and the South East experience a significantly different public-private wage gap compared to the rest of England, but outside of this area, the differential varies little. All seven of the regions outside the capital and South East coalesce around the 16% figure, with just a four percentage point gap between the highest (North West) and the lowest (Eastern England).

Chart 1: Differentials between public and private sector full time weekly pay



Source: Annual Survey of Hours and Earnings, gross weekly full time pay 2010

The Dolton and Makepeace study referred to above also provided a limited regional breakdown of the differential between public and private sector pay after correcting for 'human capital'. It found that male public sector staff earned less than their private sector counterparts in the South of England (East Anglia, London and the South East), while earnings were the same in the rest of England. Female public sector workers earned the same as their private sector counterparts in the South, while they earned more across the rest of the country.

Therefore, the evidence suggests that the only substantial variation in gaps between public and private sector pay across regions lies between the London/South East area and the rest of the country. This very much accords with the existing structure of Agenda for Change, with national rates providing a floor rate of pay reflecting the similar conditions prevailing across most of England, while allowing for high cost area payment zones covering inner London, outer London and the London fringe.

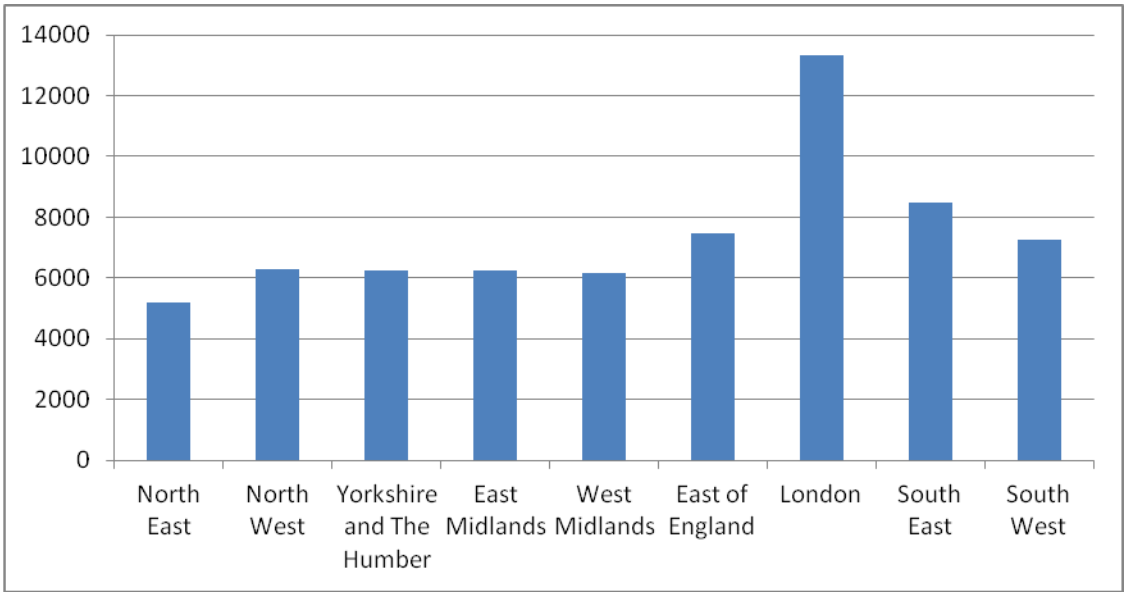
2.3 Impact of regional pay differentials

2.3.1 Company profitability

The government asserts that local variations in public/private pay differentials have the "potential to hurt private sector business competing with higher public sector wages."

However, again the evidence does not display large variations in company profitability across the English regions, other than the London/South East corner. Data collected by the Office of National Statistics provides a regional breakdown of the gross operating surplus as an approximation for profitability and when divided by the regional population, the per capita picture can be seen in Chart 2 below. [8]

Chart 2: Gross operating surplus per capita by English region



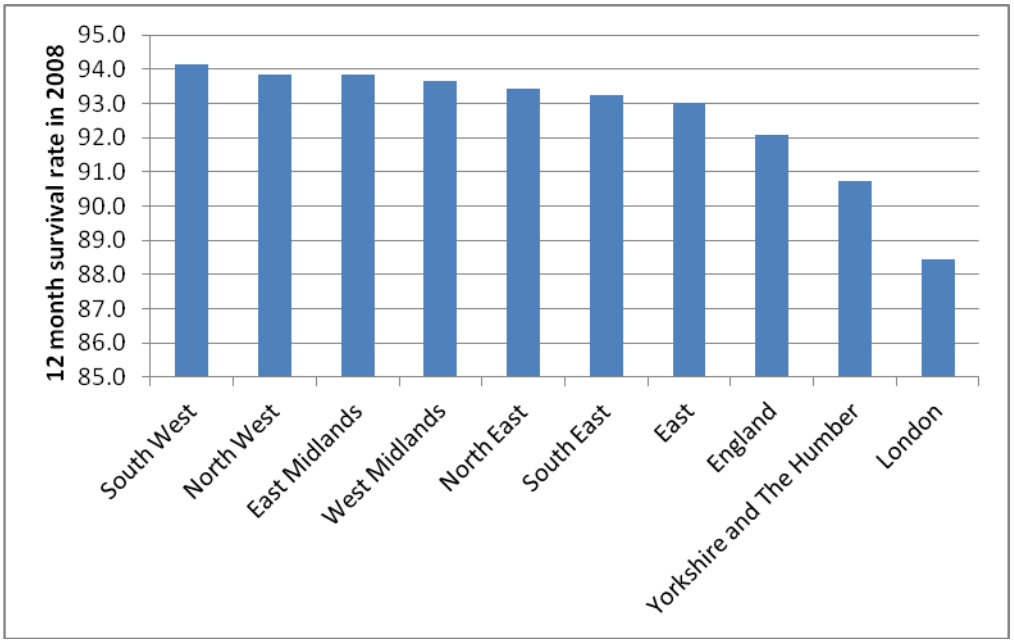
[8] Regional Trends Online: The Labour Market, 8 June 2011

Profitability appears similar across northern England and the Midlands, with a slightly higher band across the South and Eastern England, while London stands alone again, running at a different level to all others.

Therefore, just as there is no evidence of considerable variations in the differential between public and private pay at a regional level, there is no evidence of damaging variations in company profitability.

Figures on company survival rates produced by the Office of National Statistics further challenge claims of the damaging impact on the private sector, since regions such as the South West and North West, with the largest 'raw' differential between public and private pay, enjoy the highest survival rates of company start ups.

Chart 3: Company survival rates across English regions

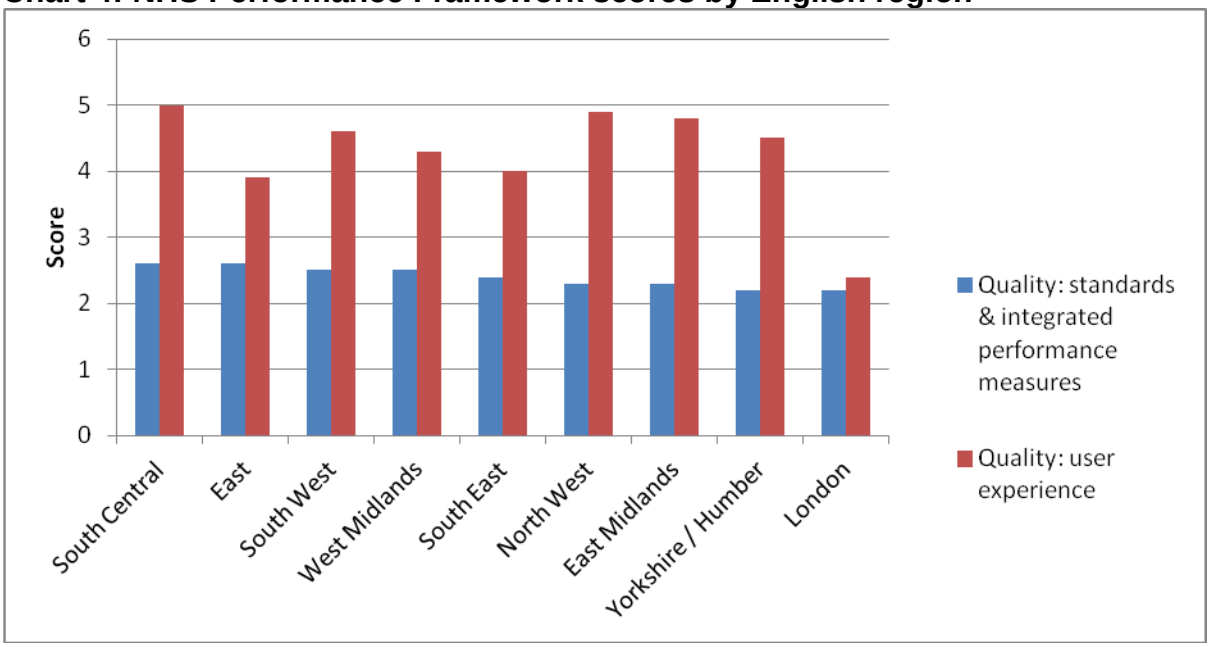


Source: Office of National Statistics, Regional Tends Online, 8 June 2011

2.3.2 Service quality

The government asserts that variations in public-private sector wage differentials lead to "unfair variations in public sector service quality." Chart 4 shows the average NHS performance framework scores for standards and user experience within each strategic health authority for trusts under their direction (ie excluding foundation trusts, which are not required to submit the information).

Chart 4: NHS Performance Framework scores by English region



Source: The Quarter: An Update from David Flory, Deputy NHS Chief Executive, Quarter 2 2011/12, Department of Health

According to the logic of the government's argument - areas with a large private/public sector pay differential are able to attract higher quality staff than the areas with a low differential and this will be reflected in service quality. However, taking three of the regions with the largest differential – the South West, North West and East Midlands, two of those regions are in the bottom half of performance as measured against standards and integrated performance measures.

Therefore, NHS performance figures offer no obvious correlation between service quality and region that enables anyone to draw any conclusions about the impact of pay differentials.

2.4 Conclusion

The arguments suggested by the government to support market facing pay lack convincing supporting evidence. Cuts to pay in low income areas as part of a market facing package will exacerbate the existing regional inequality between the South East and the rest of the country. The existing structure of Agenda for Change accords closely with the reality of the labour market and affords flexibility to address exceptional local circumstances that do not accord with the regional picture.

3. Factors from the Secretary of State for Health's remit letter

3.1 The extent to which Agenda for Change already recognises the impact of local differences in pay through RRP and HCAS and whether these could be used more effectively

The Agenda for Change pay structure already allows for a wide range of tools to address particular local labour market circumstances. High Cost Area Supplements (HCASs) are graded from Inner London to Outer London and the London Fringe (covering parts of Kent, Essex, Bedfordshire, Hertfordshire, Thames Valley, Surrey and Sussex). HCASs are also permissible in other parts of the UK where a sufficient case can be made. Former Cost of Living Supplements have been consolidated into long-term Recruitment and Retention Premia (RRPs) and short term RRPs can be established on both a national and local basis once again where the case can be made to justify them. Therefore, Agenda for Change adapts to both regional cost of living factors and occupational recruitment problems.

There has generally been a lack of adequate central data collection to establish the prevalence of these options within the NHS, however, a study conducted in 2009 examined the use of local RRPs, with 39% of trusts in England reporting that they paid RRPs and 18% stating that they were considering introducing them within the following 12 months. [9] Furthermore, trusts paying local premia generally considered them to have been effective in tackling any recruitment and retention problems.

3.2 The way in which the Department uses the Market Forces Factor to reflect local labour market costs in PCT allocations and whether these might be used (or amended) to support more market-facing pay.

The Market Forces Factor (MFF) is another example of the flexibility of Agenda for Change, since 67% of the MFF payment is pegged to geographical variations in private sector wages, enabling trusts to utilise extra funding that recognises local circumstances.

3.3 The need to recognise the implications of market-facing pay for the different staff groups within AfC at a local level, including any implications for equal pay

The Government has set out its wish to put public sector pay on a market-facing footing. We object to this proposition because moving public sector rates of pay more closely into alignment with those paid in local markets would mean greater inequality of pay in the public sector.

The rationale behind the Government's proposals is clearly that employers in the those areas with higher costs of living will tend to offer the highest rates of pay and those in the lower costs will tend to pay the least. However, the labour market which is a structural outcome of many different political, economic and cultural decisions, is characterised by market failures and distortions. Looking to the private sector to

[9] Capita Health Partners (2009) *Scoping Study on the Payment of Local Recruitment and Retention Premia*

provide a model against which to set the NHS wage structure risks replicating and entrenching these failures and distortions.

A recent report by the OECD demonstrated that income inequality among working age people has risen faster in Britain than in any other rich nation since the mid-1970s.[10] It states that the annual average income in the UK of the top 10% in 2008 was just under £55,000, about 12 times higher than that of the bottom 10%, who had an average income of £4,700. This has increased from a ratio of eight to one in 1985 and higher than the average income gap in developed nations of nine to one.

Among other factors, growing wage inequality is the result of changes in the demand for people with high, mid-level and low skills, with the relative bargaining position of many low and mid-wage workers having shrunk substantially over the last few decades.

At the other end of the labour market the increasing influence of the finance sector has enabled senior finance workers to gain a growing share of the wage bill, and also pushed up top pay in other sectors. The IPPR reports that this growing influence has been accompanied by the proliferation of performance-related pay, and this spread of performance-related pay and individually negotiated pay deals has led to ever wider pay disparities within similar jobs, and for the most articulate to argue for ever bigger pay deals.[11]

The private sector, then is highly disparate and complex, with levels and trends of earnings in such sectors as retailing, hotels and restaurants very different to those in other sectors such as finance and business services. There has been a large growth in part-time work since the recession, keeping earnings growth relatively moderate in lower paying sectors, while large bonuses in the finance sector supply an opposite pressure.

As acknowledged in Will Hutton's report on pay in the public sector, the differential between highest and lowest earners is much smaller than in the private sector. For example, in the private sector the top 10 per cent of earners are paid around 8.1 times more than the bottom 10 per cent. The gap is 5.8 times in the public sector.[12]

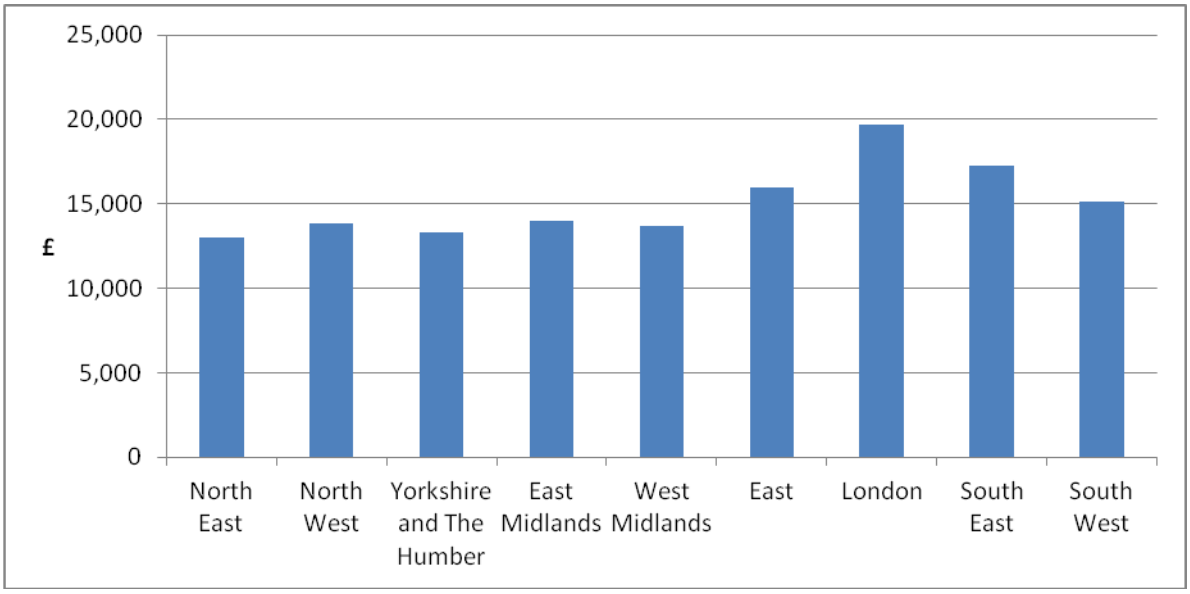
To model public sector pay on the private sector merely risks replicating and ingraining market failures, which have led to wide gaps both between the lowest and higher earners and between men and women. The gender pay gap is smaller in the public than the private sector, which is due to several different factors, including greater transparency in pay setting in the public sector. In addition, Bradley et al's (2011) research on the gender pay gap points to the dominating influence of large feminised occupational groups such as those in nursing and teaching, both of which are relatively high skilled and have relatively flat job hierarchies and hence low overall wage variance. In the private sector, female-dominated roles tend to be lower-skilled and lower-paid, in comparison to the public sector. [13]

Chart 5 shows the variation of gross household income per head across regions. Most regions are in a similar bracket around the £13,600 mark, London and the

[10] www.oecd.org/dataoecd/40/22/49170234.pdf
[11] www.ipa-involve.com/news/how-do-we-get-fair-pay/
[12] Based on ASHE 2011 provisional figures for gross weekly earnings.
[13] Bradley S, Green C and Mangan J (2011). *Gender wage gaps within a public sector: Evidence from personnel data.* Lancaster University Management School.

South East are markedly ahead, and the South West and East of England fill a position between these regional groups.

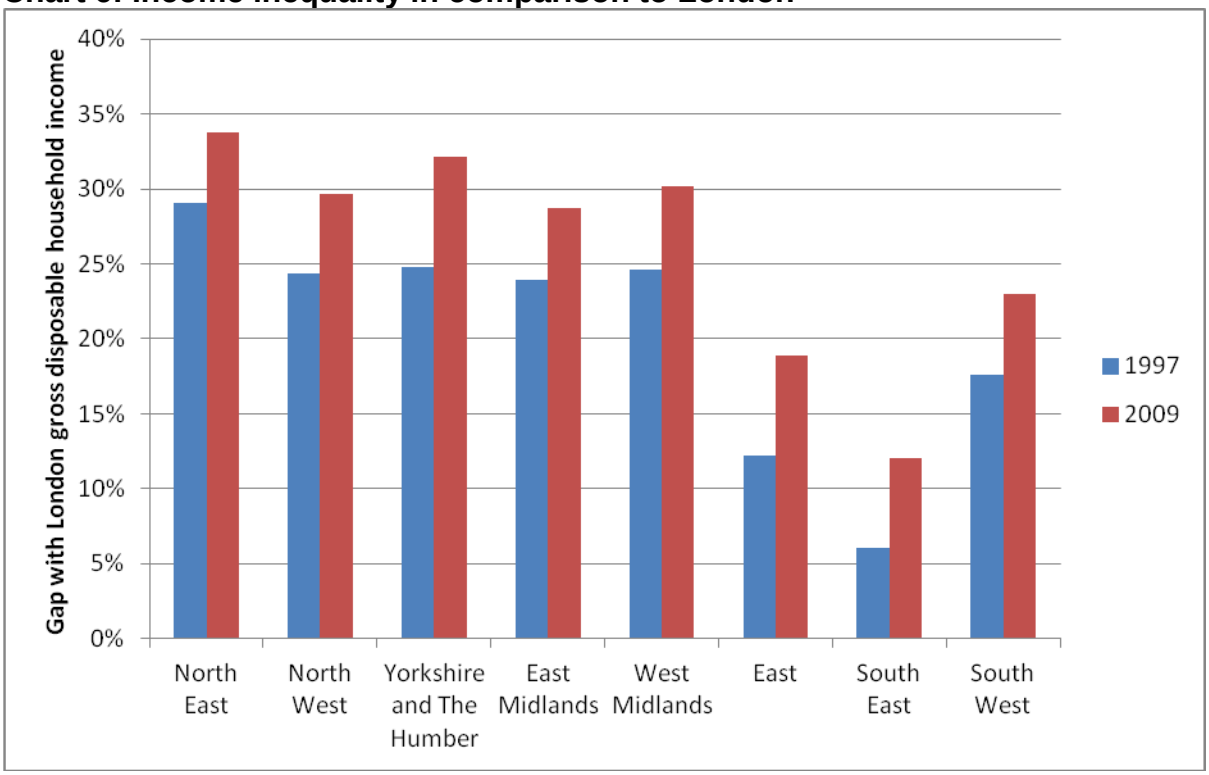
Chart 5: Gross disposable income per head by English region



Source: Office of National Statistics, Regional Trends Online, 8 June 2011

Chart 6 shows how the inequality in income between London and the regions has grown over the last decade. At one end of the scale, gross disposable income per head in the North East was 29% behind that of London in 1997, but had fallen to 34% behind by 2009. In fact, every region fell further behind London, as the highest income area in England, over the same period.

Chart 6: Income inequality in comparison to London



Therefore, it is clear that any move toward more market facing pay that reduces rates in low income areas can only serve to widen this gap in income inequality across England as the NHS introduces lower pay levels, enabling private companies in those areas to follow suit as they compete for staff in a labour market with a reduced 'going rate'.

3.3.1 Current AfC staff shortages

We address the main points made in a paper produced by researchers at Bristol University, as this work has been previously considered by the NHSPRB and cited by other commentators in relation to market-facing pay in the public sector.

The main argument set out in the paper, '*Can Pay Regulation Kill? Panel Data Evidence on the Effect of Labour Markets on Hospital Performance'* is that 'when the outside market wage is high, the regulated wage acts as a pay ceiling and we would expect this cause difficulties in recruitment and retention, especially if higher quality workers, which in turn should lead to lower service quality. '

According to this argument – the nationally set pay ceiling deters nurses in high cost regions from working in hospitals in that area. This results in shortages of nurses, leading to a detrimental impact on patient care. This assumes that nurses generally make well informed and accurate evaluations of living costs in a region, assessing how their pay relates to those costs and the consequences for their standard of living. We dispute this premise. Nurses and other healthcare workers do not base their decisions to work in the NHS purely on remuneration. Neither are job choices made solely on the basis of comparing pay to cost of living in area.

The paper's measure of care quality uses 'the in hospital death rate within 30 days of emergency admission for acute myocardial infarction (AMI), commonly called heart attacks'. This is just one measure of care quality, and in any case we would question whether it is an appropriate one. Nowhere does the paper explain the link between the number of registered nurses and the level of heart attacks. Nor does it explore other pertinent factors such as quality and number of clinicians, the use of protocols or other factors associated with the hospital systems and organisation which might impact on AMI. Moreover, the paper states that 'about half of deaths from AMI occur within the first day of admission.' It is not clear in the paper how more flexible pay would attract a better standard or nurses and impact on these sudden deaths or whether other factors which impact on people's immediate care are more important. They state that 'AMI is a good marker of hospital quality', but do not fully establish why it is a good marker for nursing quality.

The paper compares health outcomes in hospitals and nursing homes. But these are two very different types of healthcare setting and the key difference in this respect is scale. Local pay in small nursing homes is much easier to regulate than in the NHS, which employs over a million health service employees in many separate trusts. Moreover, the paper acknowledges that clinical outcome data for nursing homes was not available, so they cannot directly compare with the AMI outcomes in their hospitals. Instead they use volume of activity per employee in nursing homes as their outcome, so do not compare like with like.

The authors also question whether employers avoid pay regulation in the NHS and refer to substitution of nurses by Health Care Assistants. However, they state that: 'This (substitution) is limited by regulation since most nurse task cannot be legally performed by unqualified employees and much of health care requires human services'. Trusts generally find a range of ways to deal with shortages in nurses ranging from skill to the use of agency and bank staff. The report fails to acknowledge how trusts manage around nursing staff shortages.

3.4 The impact of any 'cliff edges' in pay between local labour markets and how these might be managed

3.4.1 Cross-border labour markets

Staff side is particularly worried about the impact of this review on cross-border labour markets. This review only covers England, and governments in Wales, Scotland and Northern Ireland have been invited to take their own position. Recruitment and retention problems are particularly likely to emerge at England's border regions with Scotland and Wales. For instance, the north of England displays one of the larger gaps between public and private sector pay and therefore if a market facing system imposes lower pay on large chunks of the north while Scotland continues to pay existing Agenda for Change rates, employment patterns are likely to respond accordingly.

3.4.2 Regional earnings

The table below shows average gross weekly earnings for the five main travel to work areas in the West Midlands. It demonstrates the variation in earnings across the five areas, despite their proximity and commutability. While each is defined as a

travel to work area, the West Midlands Regional Observatory estimate that around a third of workers living in the West Midlands travel to a different strategic local authority area to work. This example demonstrates both the inherent difficulties of defining local labour markets and the possibility of an NHS worker living in one area but receiving a salary associated with a different area.

Table 1: West Midlands regional earnings by travel to work area

	£	variation
UK	**403.90**	**100**
Birmingham	407.90	101
Coventry	394.10	98
Wolverhampton	357.00	88
Walsall & Cannock	354.40	88
Dudley & Sandwell	345.00	85

4. Factors from the Chancellor of the Exchequer's letter

4.1 The need to recruit, retain and motivate suitably able and qualified staff across the UK

To maintain a consistent level of service, the NHS needs to be able to attract a workforce of the same quality in different parts of the country. This is best achieved by a national system for pay and reward. Agenda for Change, underpinned by a robust job evaluation scheme, ensures that job roles and worth are assessed relative to other roles.

HR consultants, Attractor Consulting state that pay decentralisation only makes sense where there are real differences between employers in the way services are delivered. It warns against pay decentralisation where employers deliver services which 'exhibit high levels of operational interdependence with neighbours.' When operational pressures must be shared between neighbours and workforce supply and career patterns are closely intertwined, as in the NHS, the case for pay delegation is far from clear. It also states that 'regardless of the fine balances applicable for each organisation, the issue is a distraction from the work needed to respond to achieve cost reductions.'[14]

Ian Kessler, in his review of national pay determination in the NHS points out that the NHS Review Body process, alongside Agenda for Change ensures several overlapping and reinforcing advantages. This paper (attached as an appendix) states that the system provides discipline and control, allowing central government some control over pay settlements, as well as a 'level playing field' set for pay and conditions which prevents a 'race to the bottom' or indeed the top. National pay determination also minimises the transaction costs expended by trusts, and removes pay as a source of conflict in trusts' relations with employees and their

[14] www.attractorconsulting.com/2010/02/decentralise-pay/

representatives. The arrangements also provide transparency and consistency by contributing to the perceived fairness of the pay system, which is crucial in stimulating employee motivation. Kessler states that: 'In ensuring the pay structure is equality-proof, the arrangements have also promoted a sense of fairness, but more tangibly also ensured equal pay for work of equal value. Moreover the transparency and consistency of the arrangements have facilitated staff mobility across the NHS.'

A King's Fund report from 2007 underlines that Agenda for Change supports 'fairness' particularly in addressing pay equalities. The authors state that; 'While it cannot be confirmed that Agenda for Change has guaranteed equal pay, it does appear to have been an important factor in limiting the exposure of the NHS to equal pay claims.'[15] The *Hartley* judgement also confirmed that Agenda for Change is an equal pay proofed system, with the tribunal ruling that the job evaluation scheme is robust and that the pay system is fair.[16]

Evidence from the introduction of local pay bargaining in the 1990s provides some vital lessons. The Secretary of State for Health stated in 1997 that 'the introduction of local pay for staff on national contracts has failed. It has proved unpopular and divisive. It has dissipated goodwill and the negotiations have consumed effort vastly disproportionate to the sums involved.'

In the 1997 staff side evidence to the Review Body, we reported that despite Trusts having had the opportunity to introduce local pay and conditions since 1991, they had failed to deliver. We reported that while some Trusts wanted local pay, they did not want local bargaining, that they had 'no interest in negotiation' and were 'not prepared to engage' in the process which the Review Body was attempting to facilitate.

We reported that very few Trusts had introduced local pay and even in these cases, not all had markedly different terms and conditions and that a number of local schemes had been imposed, rather than negotiated.

Kessler notes the high transaction costs involved in local pay determination and refers to a study by Corby et al (2001) which found that the development of local pay systems in the NHS was seen as 'less resource efficient than national pay determination as there was a need to reinvent the wheel.'[17]

In its 1997 report, the Review Body explained that its main rationale for supporting the concept of local pay determination lay in its potential to support organisational change and innovation through pay and grading structures which reward the acquisition of skills and/or the achievement of high performance. These objectives are now effectively encapsulated in Agenda for Change.

There is also interesting evidence from the introduction of individualised teachers' pay in Sweden in the 1990s which was agreed through collective bargaining. A report by UNESCO found that individualised pay has led to some competition for staff and reports that 'schools and municipalities within larger labour market areas have been forced to compete with each other by raising wages for teachers already

[15] Buchan J and Evans D (2007) *Realising the Benefits? Assessing the Implementation of Agenda for Change,* King's Fund.

[16] Hartley and others v Northumbria Healthcare NHS Foundation Trust 2009

[17] Corby S, Millward L, White G, Druker J and Meerabeau E (2001) *Innovations in Pay and Grading in NHS Trusts.* London: University of Greenwich.

in the system.' It also warns of the extensive resources and support needed to introduce and implement the pay structure, stating "it requires a great deal of know how among local stakeholders and among managers at different levels throughout the local educational sector." It also warns that: "With limited resources there is a great risk that the system will lose credibility, especially if the ability to pay teachers varies across municipalities. This will have an impact on the equality of employment conditions and the possibility to recruit and retain teachers on equal grounds. A lack of resources is also problematic if a municipality or school has to deal with a shortage of teachers, while at the same time it has to use financial incentives to reward effective teachers."[18] This experience demonstrates clear dangers of introducing a new pay structure without the necessary resources for either the infrastructure, or to address staff shortages. At a time of budgetary constraints in the NHS, extra resources would certainly not be available.

4.2 The difference in total reward between the NHS workforce and those of similar skills working in the private sector by location – and the impact of these differences on local labour markets

The ONS has recently undertaken work to estimate the difference in public and private sector pay. Their study found that, allowing for differences in types of job and employee characteristics as much as possible, public sector employees were paid on average 7.8% more than private sector employees. However, comparing employees who have a degree or equivalent qualification shows that on average, public sector employees earned around 5.7% less than those in the private sector.

It is not the case that public sector workers in some areas are overpaid, but lower paid staff in the private sector are underpaid in relation to the public sector. For example, around a quarter of the UK workforce is employed in wholesaling, retailing, hotels and restaurants, where average weekly pay is £283 or 65% of the average for the whole economy. The public sector pay advantage is therefore not evenly distributed – but higher in lower grades. Looking specifically at the adult social care sector, this is an area of healthcare primarily delivered by the private sector, yet where many staff are paid at or even below the National Minimum Wage. Failure to invest in care workers (one in four leave within a year[19]), undermines both continuity and quality of care.

The public sector workforce is also generally older and holds higher qualifications than the economy as a whole. This is particularly true of the NHS, with Labour Force Survey figures showing that the health sector has a large proportion of employees (61%) qualified to National Qualifications Framework (NQF) Level 4 or above, compared with just 36% of the whole economy. Almost half (48%) of the NHS workforce is aged 45 years or older, compared to 43% of the whole economy. These two factors will translate into higher pay levels in the public sector than the whole economy.

[18] Strath A (2004) *Teacher Policy Reforms in Sweden: The Case of Individualised Pay*, UNESCO
[19] Skills for Care (2010) *State of the Adult Social Care Workforce 2010*

Table 2: Level of Highest Qualification Held

	Health	Whole
NQF Level or equivalent	**%**	**%**
No Qualifications	3	7
NQF Level 1 or below	8	12
NQF Level 2	12	18
NQF Level 3	11	19
NQF Level 4 or above	61	36
Other qualifications	6	9

Source: Labour Force Survey (4 quarter average Q3 2009 to Q2 2010)

Table 3: Age Profile of the Health Sector

	NHS	Whole
	%	**%**
16-24 yrs	6	3
25-34 yrs	20	22
35-44 yrs	28	18
45-54 yrs	29	23
55+ yrs	17	17
65+ yrs	2	3

Source: Labour Force Survey (4 quarter average Q3 2009 to Q2 2010)

Dolton and Makepeace (2011) found that by taking account of the 'human capital' factors including age, occupation, qualifications to draw a fair comparison, public sector male workers were found to earn 1% less than their private sector counterparts, while female workers were found to earn 6% more. [20]

4.2.1 Pay trends

Pay trends are cyclical, with the public sector generally faring better than the private sector in a recession.

Using Labour Force Survey data from 1999 to 2009, Dolton and Makepeace state that: 'Periods of public sector pay growing faster than private sector pay roughly matched the amount of time private sector pay growth had outstripped that in the public sector. The per-period difference in the two series is only 0.02% – negligible indeed.'[21]

[20] Dolton P and Makepeace G (2011) *Public and Private Sector Labour Markets* in Gregg P and Wadsworth J (eds) The Labour Market in Winter: The State of Britain, Oxford: OUP

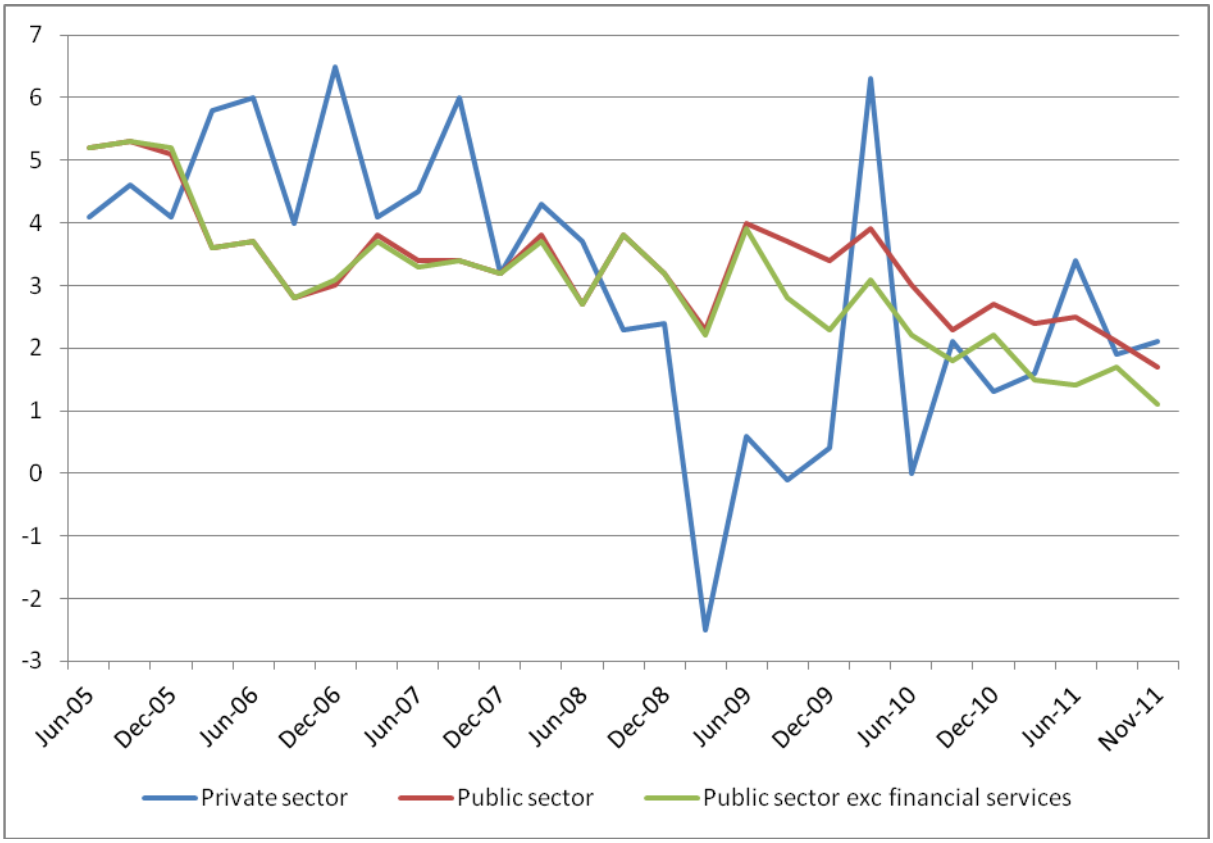
[21] Dolton P and Makepeace G (2011) *ibid*

They go on to state that ‘taken over the whole 1999-2009 period, there is no difference between public sector and private sector pay rises. By the end of 2009, there was already an indication that the private sector pay had bounced back.’

Looking in more detail at pay trends since 2005, a review of ASHE data shows that public sector earnings growth ran faster than in the private sector in that year. The graph below shows that between 2006 and 2008 the picture was reversed. From late 2008, the private sector fell back again – mostly due to a sharp reduction in bonuses. Since mid-2010 the two sectors have been tracking one another more closely, but with signs that private sector earnings are starting to pick up again.

It is therefore not justified to make such a fundamental change to pay determination based on short-term, relative differences between public and private sector earnings. It is clear that pay trends are cyclical, with private sector earnings generally outpacing those in the public sector during economic downturn, then forcing public sector earnings to catch up to competitively match those in the private sector.

Chart 7: Annual percentage increase in average weekly pay: public and private sectors



4.2.2 Total reward

Bonuses are a much more significant part of total pay in the private sector. Across the whole economy, bonus payments during the financial year April 2010 to March 2011 totalled £35 billion, the same as the previous financial year. Bonus payments are now 58% higher than in 2000-01 and appear to have been largely unaffected by the recession.

Looking at ASHE 2011 figures, gross annual pay for full-time nurses stood at £30,742, which includes £599 (1.9% bonuses).[22] By contrast, comparable figures include £35,185 median gross earnings for civil engineers, of which 4.5% are accounted for by bonuses and £32,074 for office managers (7.8% bonuses).

4.2.3 Crowding out

The Chancellor's letter asserts that the differential between the public and private sector wages in local labour markets 'has the potential to hurt private sector businesses that need to compete with higher public sector wages: lead to unfair variations in public sector service quality; and reduce the number of jobs that the public sector can support for any given level of expenditure.' This argument rests on the notion that the public sector crowds out the private sector in local labour markets. However, it is our assertion that crowding out can only happen when all resources in the economy are utilised and not at the current, high levels of unemployment. As Michaillat (2011) points out: 'Recessions are periods of acute job shortage without much competition for workers among recruiting firms; hiring in the public sector does not crowd out hiring in the private sector much.'[23] Unemployment currently stands at 2.68 million, with an additional 590,000 people who have temporary jobs because they cannot find permanent jobs and 1.3 million who have a part-time job because they cannot get a full time job, meaning that there is sufficient supply in the labour market to match demand. Moreover, there is no evidence that private sector will automatically create jobs if public sector workers are paid less.

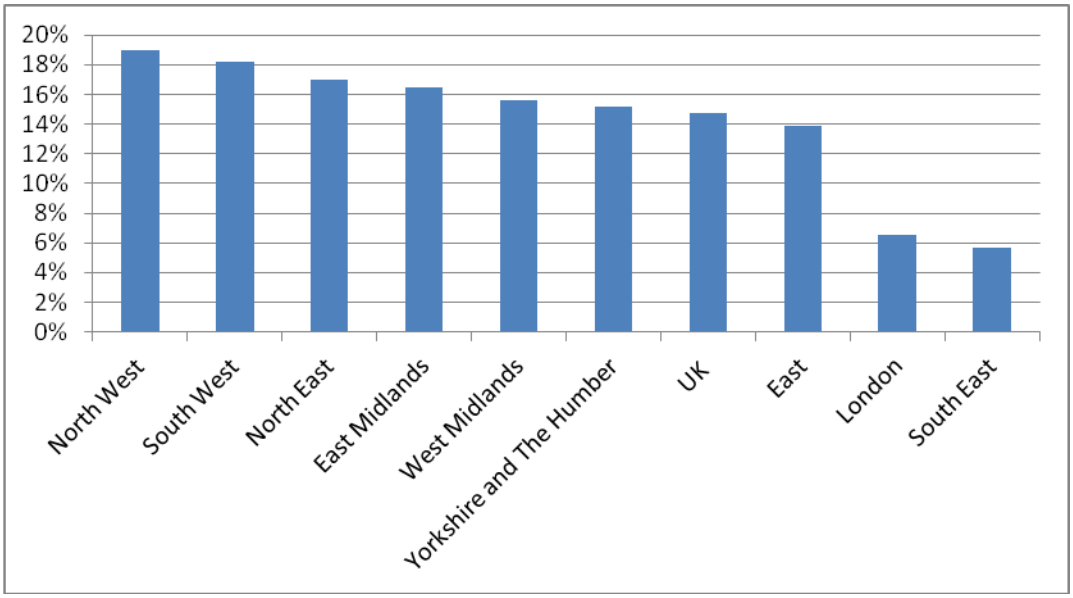
4.2.4 Regional pay differences

Chart 8 demonstrates the 'raw' differential between full-time weekly pay by region, before any correction for the different composition of the public and private workforces. Therefore, it does not reflect actual differentials but it does provide a useful picture about the variation of differentials across England.

[22] This figure will include some nursing staff working outside the NHS

[23] Michaillat P (2012) *Fiscal Multipliers Over the Business Cycle*. London School of Economics & Political Science

Chart 8: Differentials between public and private sector full time weekly pay



This data shows that London and the South East experience a significantly different public-private wage gap compared to the rest of England, but outside of this area, the differential varies little. All seven of the regions outside the capital and South East coalesce around the 16% figure, with just a 4% gap between the highest (North West) and the lowest (Eastern England).

Dolton and Makepeace provide a limited regional breakdown of the differential between public and private sector pay after correcting for 'human capital.' They found that male public sector staff earned less than their private sector counterparts in East Anglia and the South East, while earnings were the same in the two other regions. Female public sector workers earned the same as their private sector counterparts in London and the surrounding area, while they earned more across the three other regions.

Therefore, the evidence suggests that the only substantial variation in gaps between public and private sector pay across regions lies between the London/South East area and the rest of the country. This accords with the existing structure of Agenda for Change, with national rates providing a floor rate of pay reflecting the similar conditions prevailing across most of England, while allowing for high cost area payment zones covering inner London, outer London and the London fringe.

4.3 How private sector employers determine wages for staff in different areas of the country

The Chancellor's letter stated that 'while private sector pay is set in accordance with local labour markets, public sector pay is usually set on a national basis.' However, the difference between large public and private sector employers is less pronounced that the Chancellor allows. Dispelling the 'myths' surrounding local pay determination, Incomes Data Services demonstrates that 'most large private sector companies continue to operate with national pay structures, with the aim of

controlling costs and also of preventing locations from “leap-frogging” each other in pay terms’. These structures usually incorporate supplements for London and its environs—‘arguably the sole distinct regional labour market in the UK’. Zonal pay systems, which are common in retail and financial services, tend to pay only ‘relatively small’ premiums for ‘hot spots’ outside of London. Increases in the National Minimum Wage can very quickly significantly narrow or even close the gap between zones, especially in retail.[24] We attach a report by IDS on location-based pay differentials as an appendix which explores this issue in greater depth.

4.4 What the most appropriate areas or zones by which to differentiate pay levels should be.

NHS Staff Side rejects the need for a market-facing remit on pay and that pay structures for NHS workers should organised into areas or zones beyond the current arrangements. In addition to the arguments set out elsewhere in this submission, we believe that in practical terms, it would be difficult, costly and inefficient to decide on appropriate pay zones beyond the existing structures. NHS trusts and organisations lie within and across many different localised and sub-regional labour markets and NHS staff live and work across these markets. In addition, travel to work costs and times vary across the UK and are dependent, among other things, on the availability of efficient public transport systems. Making a judgment about appropriate areas or zones which would accurately reflect travel to work costs, times and convenience would be a very difficult undertaking.

4.4.1 Cost of living

An examination of different cost of living indices across the UK paints a complex picture, and demonstrates the inherent difficulties in designing potential pay areas or zones. In general, the UK economy displays a great deal of variation in housing prices and rental costs, but little variation in other costs. As shown in the table below, there is little variation in the cost of living (except house prices) between UK countries and regions in England, with the exception of London where it is around 8% higher than across the UK.

[24] ‘The purpose and risks of zonal pay’, *IDS Pay Report* 1074 (June 2011); ‘Regional pay differences are minimal outside South East’, *IDS Pay Report* 1066 (February 2011). See also ‘Ten myths about local pay determination’, *IDS Pay Report* 1090 (February 2012).

Table 4: Regional cost of living index

Region	Price Level
UK	100
London	107.9
South East	102.3
East	101.2
West Midlands	100.6
South West	99.5
East Midlands	99.4
North West	98.2
North East	98.2
Yorkshire and the Humber	97.0

ONS UK Relative Regional Consumer Price levels for Goods and Services for 2010

4.4.2 Housing costs

The graph below shows the variation in house prices in England outside of London and the South East, with the highest prices in the East of England and South West of England. However, Chart 9 shows that this variation in house prices is not matched by earnings patterns. The major anomaly is the South West of England, which has high house prices yet the lowest regional median earnings in England.

Chart 9: Regional house prices outside London & the South East. Index England =100

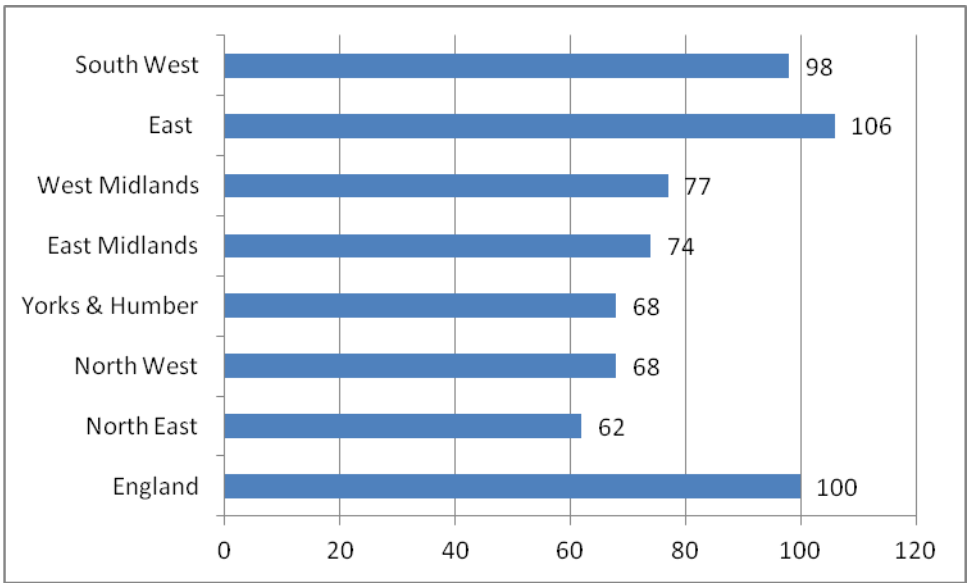
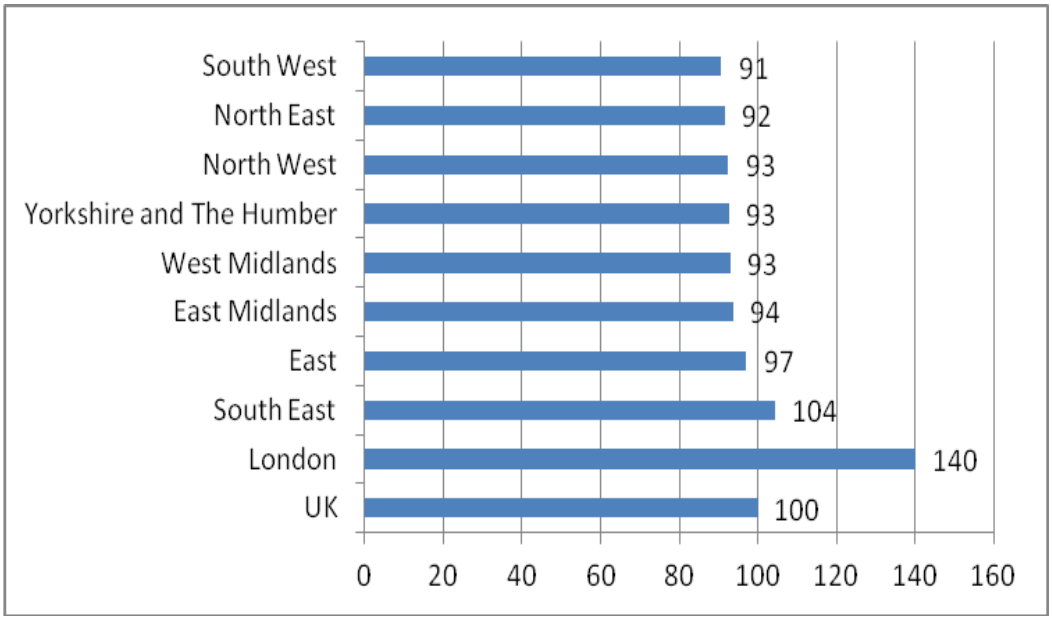


Chart 10: Regional median gross weekly earnings. Index UK=100



Kessler concludes that there are a few areas, in particular London and the South East, where a broadly defined and identifiable regional labour market has remained consistently tight, and with high living costs. In general, however, regions do not equate with labour markets: it is more common to find isolated labour market 'hot spots' within them. National pay agreements in public services have usually made provision for local supplements to address such conditions and private sector organisations with nationwide networks of organisation (such as banks and supermarkets) typically retain national pay systems and structures.

Reflecting on the data on regional cost of living, it might be assumed that wage disparities reflect relative advantages and disadvantages of living in a particular area – especially housing costs. However, wage disparities reflect a mixture of many other factors including qualifications, composition of workforce and occupations. Indeed, research by Gibbons et al (2010) from the London School of Economics shows that there is a positive correlation between area effects and individual characteristics associated with higher wages. [25]

The authors found that the main driver of wage disparities between places is the composition of types of workers in different areas ('sorting'), which accounts for at least 70% of area disparities. At most, 30% are caused by area-specific effects (where the same types of workers experience different outcomes depending on the area they work in).

Regional disparities are therefore closely linked to the type of workers within each local economy. As the authors point out: 'Who you are is much more important than where you live in determining earnings.' Skewing pay to reflect local wage variations would force NHS wage structures to copy local labour markets which have very different compositions in terms of occupations and qualifications. As shown above, the NHS workforce has generally higher levels of qualifications and is employed in higher level occupations and professions.

[25] Gibbons S, Overman H, Pelkonen P (2010) *Wage Disparities in Britain: People or Place?*

4.5 The affordability of any proposals

Any moves to local pay determination would significantly increase transaction costs related to setting up and administering local systems and structures. It would reduce career mobility and dissuade health workers from moving to lower cost areas, requiring local managers to pay ever higher wages to attract staff.

The Government's review holds the implicit assumption that the labour market for all NHS staff groups will react in the same way to changes in pay determination. While some NHS groups operate within clearly national labour markets, others are more locally focused. On a practical level, this means that local labour costs will be difficult to predict and contain across many different occupational groups, but more perhaps importantly is a direct contradiction of the Government's aspiration for NHS staff costs to map local labour costs. We have described how the private sector labour markets are beset by distortions and market failures and do not provide an appropriate framework on which to map public sector pay. While the NHS workforce is complex, with overlapping national and local labour markets, these are best governed by national pay determination underpinned by Agenda for Change, to prevent staff and skills shortages.

The introduction of market-facing pay is only a logical step if local pay effectively and efficiently responds to local recruitment and retention issues. We have demonstrated throughout this submission why this is not the case. Following this process would result in the government losing national control of the pay envelope. It would also lead to a reduced role for the NHS PRB and reduce its ability to respond to recruitment retention issues in a controlled, sustainable manner. We call upon the Pay Review Body to reflect on the arguments set out in this paper and the appendices and to reject outright any calls for the introduction of a market-facing remit for NHS pay.