A new myth about public sector pay: Freezing pay will save public money

The Chancellor used the recent Budget to call for a public sector pay freeze. But in reality, pay in many public sector organisations is outside government control. In this viewpoint, Peter Smith outlines the reasons for this and calls for a much more radical approach to reforming public sector pay.

The first five myths about public sector pay

Myth one: The public sector is overpaid

Myth two: Nobody should be paid more than the Prime Minister

Myth three: Measuring and managing performance is difficult

Myth four: Bonuses don’t work

Myth five: Disclosure of executive salaries causes trouble

In an interesting turn of phrase, the Chancellor is ‘asking’ the public sector to freeze pay for two years. There is extreme pressure on public finances and the government needs to show that it is serious about cutting the deficit. Employees in the private sector – who make up around 80 per cent of the UK workforce – have suffered job losses, pay freezes and cuts over the past two years, and there is a demand from business leaders and private sector workers for the public sector to share the burden. A freeze will cause all sorts of practical difficulties, but it is an obvious step and it was expected.

But there is room for doubt about whether the measure really will have the intended impact on public spending and on public sector earnings. First, the government doesn’t have direct control over pay throughout the public sector. It can regulate the civil service and all the groups covered by review bodies, but some areas are covered by independent national settlements or by local negotiations. Ministers have a strong influence and can certainly hold back funding but they do not always have a veto. Perhaps that explains George Osborne’s choice of words.

Second, even if the whole of the public sector had zero per cent annual settlements in 2011 and 2012, this would not necessarily stop public sector pay from rising. There are two factors involved:

- Most pay in the public sector is based on incremental pay ranges. Every member of staff who is not at the top of their range receives an increment automatically each year, in addition to whatever increase is agreed in negotiations. These incremental payments would continue even if the ranges themselves did not change in value. It is likely that some parts of the public sector will investigate freezing increments as well, but incremental progression is an explicit or implied part of employment contracts and anyone who tries to stop it would surely face a legal challenge.

- Where there are skill shortages or market pay pressures, new recruits for certain jobs can cost more than those they replace. This has been visible for the past year among very senior managers in the NHS, where the earnings increase far exceeds the government’s prescribed change in basic rates – average earnings levels have risen mainly because of staff turnover.

So we could be in a position where public sector pay is ostensibly frozen but the public sector earnings figures released each month by the Office for National Statistics continue to rise. However, there is a more fundamental concern. Politicians and the media have become obsessed with how much public sector employees earn. This is likely to continue, the latest expression being a maximum ratio of 20 to one between a chief executive and the lowest paid worker in public service organisations. Yet the real issue with public sector pay is that it is inflexible and unconnected to performance.

The inflexibility is a significant problem, both for future public finances and for public sector employment. Long term pay deals, large scale negotiations and automatic incremental progression all play their part. In addition, most public sector reward takes the form of fixed salary plus pension; there is very little variable pay, which can be used to reflect financial
In the private sector in the past two years, employers have found it possible to hold or even cut pay levels. This has helped them to cope with recession whilst retaining the people they will need as the economy recovers. This has significantly limited the number of redundancies in the downturn. The public sector does not at the moment have the tools or the mentality to do the same.

The lack of connection between pay and performance is a related issue and arguably even harder to tackle. No one should underestimate the cultural barriers to reform in this area. A recent survey asked how employees would like to be rewarded; in the public sector, only 36 per cent wanted pay to be based on how they perform, only 10 per cent on how well their team/department performs and as few as six per cent on the performance of their organisation (CIPD 2010). They have their wish at the moment, as most public sector pay systems are linked to none of these things. But how sensible can it be that a hospital, school or university that is losing money has to pay centrally determined salary increases? And is it good use of taxpayers’ money to reward teams in central or local government who are failing to deliver effective public services?

The final dimension to consider is the overall pay bill. What matters in cutting the deficit is not the pay of individual public sector workers but rather the overall people and other costs of delivering a service. A focus on the total pay bill allows public sector employers to deal with specific problems around recruitment and retention for certain types of employee whilst keeping overall costs under control. It also allows organisations to share some of the benefits from improved productivity with the employees that deliver it.

The truth is that the announcement about a pay freeze is far too timid. Even if there is a short term impact, there is a risk that in two years the public sector will resume pay growth with the same old inflexible and unsuitable systems. The Chancellor should be concentrating attention on how the public sector is paid, rather than just on how much each employee gets. The government already has a localisation agenda in health and education and could also encourage more devolved pay systems, which can take into account the circumstances of the organisation and local market conditions within clear overall pay bill limits. And it could release public sector organisations from the constraints of a two year freeze if they reform pay to make it more flexible and better linked to performance. Such reform would take time and might need a small investment, but the returns would be worth it for all of us.

For more information
If you have a question about pay in the public sector, or to request a copy of the first five myths, please contact:

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