Five myths about public sector pay

11 | 2010

There has been a great deal of comment in the past few months about public sector pay, some of it ill informed and much of it missing the point. This article looks at five myths which seem to have developed and comments on the real issues in each case.

Myth one

The public sector is overpaid

This is a relatively recent claim, prompted by the impact of the recession on jobs and on pay in the private sector. It has been fuelled by a misreading of recent figures, showing that pay in the public sector is rising faster than that in the private sector and that the overall average salary is higher in the public sector.

In fact, neither of these figures from National Statistics tells us whether the public sector pays more (let alone whether the term 'overpaid' applies). To provide an accurate picture, we have to look at the level of job involved and extend the comparison beyond salary to look at the package as a whole. Studies by Hay Group based on job content and type and looking at all elements of remuneration which can be valued, show:

- Public sector salaries are broadly competitive with the private sector up to experienced professional/middle manager level. However, public sector organisations offer better benefits for these jobs; in particular, index-linked final salary pensions are far more valuable than the lower cost defined contribution arrangements which now dominate the rest of the economy. So at these levels, the public sector often pays more in total.
- For more senior jobs, the value of public sector pensions is more than offset by the value in the private sector of annual bonuses, car and health benefits and long term incentives. There are exceptions, but above middle management it is more common for private sector remuneration packages to be worth more.

All this tells us is that different parts of the economy have different pay patterns and traditions. But all the fuss about *how much* public sector employees are paid has distracted attention from *how* they are paid.

There are two main concerns. First, the large scale public sector pay systems are still based on automatic incremental progression, in addition to a so-called cost of living increase.

> "All the fuss about *how much* public sector employees are paid has distracted attention from *how* they are paid."

This makes it impossible to freeze pay in difficult times, as the private sector can. It also means that all statements about annual range increases – such as the one per cent cap mentioned in the pre-budget report – significantly understate what is actually happening to earnings.

Secondly, the pension commitments of the public sector cannot be supported for much longer, either financially or politically. The various funded and unfunded schemes will have to be reformed to bring the cost down and the entitlements closer to the rest of the market.

Both these things – incremental pay rises and final salary pensions – create a large, rising and inflexible cost over which public service executive management teams have no control. There have been major pay system changes in the past decade in the NHS, local government and universities but increments and pensions have been left unreformed.

So the real issue about pay in the public sector is not the amount of salary, bonus and so on. It is that it is inflexible, and bears no relationship to the performance of the service concerned or to affordability.

Myth two

Nobody in the public sector should be paid more than the Prime Minister

Salary comparisons between senior public servants and the Prime Minister have become increasingly common. The Conservative opposition has promised scrutiny of all public sector pay above this level and the Government has announced procedures for reviewing all salaries over £150,000.

The Prime Minister's official salary is £198,661, from a combination of his pay as an MP and his salary as head of government in the UK, but he only accepts £142,500. He also has two pension schemes (one for each of his roles), use of two houses and chauffeur driven cars while in the post and access to extensive earnings opportunities afterwards – though these additional factors are seldom mentioned. The Prime Minister's salary is subject to review by the Senior Salaries Review Body, and it is worth noting that increases have not kept pace with the wider market – the basic salaries of chief executives in major companies have risen twice as fast in the last twenty years.

So is the comparison between the Prime Minister's salary and others in the public sector relevant? Pay levels relate to the market for the job concerned; in particular they are designed to recruit, retain and motivate people with the necessary talent. The public sector itself comprises multiple pay systems and markets, including the following.

- The senior civil service, where a high proportion of jobs are filled from within the ranks of career civil servants. For this reason, the salaries are not as high as in public service jobs where there is open market recruitment. However, the pay of externally recruited senior civil servants is over 20 per cent higher than that of internal appointees.
- Local government, where top jobs are filled by open selection from across the country (though generally from among those experienced in the sector).
- Various arms-length public bodies and corporations, where top jobs are filled from open recruitment across multiple sectors, sometimes internationally. The highest paid jobs are the most specialised or those in organisations with the greatest commercial freedom.

These career routes, skills and activities have a limited amount in common with each other, and lead to differences in remuneration. They have nothing in common with the route to Prime Minister, which is based on a political career and a constrained recruitment pool. It would only make sense to compare the salaries for top jobs in the public sector with the Prime Minister if they were operating in the same market. They are not and the comparison is irrelevant.

All the attention, for example to local authority chief executives on £220,000 or more, may lead to some changes in policy. It remains to be seen whether cutting the offer to, say £180,000 would reduce the number and capability of applicants.

However, the debate so far has ignored the critical issues of performance and value. Whether a senior public official gets less or more than the Prime Minister, we have to make sure they are worth the money – and that their performance continues to justify the salary. Yet in many public service organisations, performance management disciplines at top level are weak; there are lots of targets, yet there is little agreement on the definition of good and excellent performance.

Politicians, the media and the public should be less worried about unhelpful comparisons and more concerned with ensuring we get real performance in return for our money.

“Whether a senior public official gets less or more than the Prime Minister, we have to make sure they are worth the money – and that their performance continues to justify the salary.”

Myth three

Measuring and managing performance is difficult in the public sector

There has always been a feeling that measurement in public services is hard, because they lack simple summative measures like profit or share performance. Although government agencies, hospitals and local councils now all have a wide range of targets, the sheer number of initiatives and 'priorities' has made it difficult for people to gain a clear view of how their organisation is performing.

These are fair points – it is not easy to cut through the hundreds of targets and measures in a complex public organisation. However, it is by no means impossible. The ingredients in a successful approach to performance management include the following.

- A clear and common understanding about what the organisation exists to achieve and its priorities (expressed in medium terms and annual plans). These priorities may overlap with those set centrally, e.g. by a sponsor government department, but it is vital that those in the governance structure and the executive team establish their own picture.
- A similarly clear and agreed view about how the organisation will work – its culture, values and operating model.
- An understanding of what constitutes standard, effective performance for the whole organisation (running a safe and financially secure hospital, meeting audit guidelines etc) and what stretching achievements are intended on top. The same distinction between core and stretch performance can be used at team and individual level.
- Agreement among post holders at all levels about their respective roles and accountabilities.

Even if all these tests are met – which is often not the case – every organisation has to face significant barriers of capability and culture. For example, how good are line managers at setting clear performance plans and monitoring progress against them? The feedback on this point from surveys is not encouraging. Are managers willing to give clear feedback about individual performance and to identify and communicate poor, good and excellent performance alike? The signs are that public sector managers can be poor at feedback and some public service organisations are culturally opposed to differentiating performance.

So it is hard work to manage performance well, but it is worth the effort. And, the alternatives – not managing performance or managing it badly – can only cause trouble.

> *"The signs are that public sector managers can be poor at feedback and some public service organisations are culturally opposed to differentiating performance."*

"There is a belief that bonuses – and performance related pay of all kinds – simply do not fit the culture. However, predominant cultures can change over time and schemes can become accepted."

Myth four

Bonuses don't work in the public sector

Bonuses are smaller and less common in the public than the private sector and there is a long tradition of concern about bonuses in public services. Recent publicity about payments in investment banks has led to greater comment on public sector bonuses (even though in practice they have little in common with City practices).

If we set the recent politics on one side, the opposition to bonuses tends to concentrate on four arguments.

- It is said that bonuses do not motivate (and sometimes that the amount of money needed to make a difference would be too high for the public sector to afford). However, this assumes that motivating people through money is the aim. In fact, many bonus and incentive schemes are far more subtle in intent. Their aims are to help communicate the priorities of the organisation to the individual and – as a matter of propriety and value for money – to ensure that the remuneration relates to performance. The communication point is particularly important because, during low inflation and a recession, salary awards provide little opportunity to acknowledge performance differences. A bonus can provide clearer recognition of excellence than an extra one per cent on salary.
- There is concern about the cost of bonuses, the assumption being that the money involved could have been saved, or spent on essential services. However, in some cases public sector bonuses have been introduced in lieu of salary increases which would otherwise have been higher. This has actually *saved* money because bonuses do not trigger pension contributions. If the choice is between delivering a competitive level of remuneration through salary and bonus or through salary alone, the former is both more flexible and more cost effective.
- Some public sector managers feel that bonuses emphasise individual achievement and undermine collective effort. This is more a reaction to the way they have been used in the public sector than to their inherent characteristics. The NHS, for example, was subject to a forced distribution of performance ratings and individualised performance payments for senior managers in the 1990s and many of those covered by the scheme have been hostile to bonuses ever since. However, bonus schemes can easily emphasise teamworking or recognise collective achievement.
- There is a belief that bonuses – and performance related pay of all kinds – simply do not fit the culture. However, predominant cultures can change over time and schemes can become accepted. And in some cases, the opposition is to new proposals without people acknowledging what is already done. University culture often seems to be hostile to bonuses, yet many institutions have applied them to professors for years; medics would express opposition to performance pay, but they already have it in the form of clinical excellence awards.

So: many arguments against bonuses are misleading or weak; and bonus schemes have the potential to provide a flexible and cost effective form of reward, which communicates performance priorities. Many schemes are poorly designed and they need frequent review to ensure they can deliver the intended benefits. However, we know from an extensive Hay Group and IES study of team rewards in the NHS that properly designed and managed bonus schemes can make a big impact even in the most apparently unwelcoming environments.

There is a risk now that too many commentators and public sector leaders are almost unthinkingly opposed to bonuses. This might dilute still further the relationship between pay and performance in the public sector, when in fact it should be strengthened. The risk is already visible in the NHS, where many top salaries are supposedly set based on market rate and little use is made of bonus payments. The approach is exemplified by the remuneration report from one of the country's largest foundation trusts, which states: "No element of the executive…directors' remuneration is performance related".

It is only sensible to relate rewards to performance. The alternative is to pay people the same whether or not they perform – which is not even common sense, let alone good use of public money.

Myth five

Disclosure of executive salaries in the public sector causes trouble

There has for some time been a duty on many public sector bodies to disclose executive remuneration in their annual report. Until recently, the exception was local authorities, but they have now been brought under new rules following a commitment in the pre-budget report. They know this will lead to some difficult publicity and will be aware of the debate caused every year by the figures from some public bodies.

It has to be said that the new arrangements for councils are long overdue. Every organisation which is wholly or mainly funded by the taxpayer should provide a clear and comprehensible annual report and accounts, including disclosure of the total remuneration costs and the individual package elements for each of the top executives. The only surprise is that this has not been seen as essential before.

However, the approach is still rather grudging and the expectation is that public sector organisations will explain the minimum possible. Few if any have seen the potential for taking the initiative and managing the story themselves (rather than allowing critics and the media to make the running). The present high level of scrutiny provides an opportunity for local authorities and others to take four steps.

- *Policy:* Review and clarify the remuneration policy affecting the chief executive and senior posts. This should specify how remuneration should be set, how it is composed and why.
- *Process:* Ensure there is a sound structure of remuneration governance and there are good processes for review, both annually and for new appointments.
- *Performance:* Tie remuneration clearly and explicitly to the performance of the organisation and – where appropriate the individual and/or team. The measures of success should relate as closely as possible to service performance as it affects the users of the service and the wider community. Therefore it should be possible for stakeholders (including members of the public) to recognise them.
- *Publication:* Tell the remuneration story on your own terms. Explain the policy, the governance process and the relationship to performance, so that readers see not only what people are paid but why.

Public sector organisations which deal properly with these four 'P's will be in a far stronger position on top pay than those who don't.

> "Few if any have seen the **potential** for taking the initiative and managing the story **themselves**."

Contact information

PETER SMITH
Director of public sector consulting

t 0207 856 7178
f 0207 856 7101
e peter.smith@haygroup.com
w www.haygroup.co.uk