

## **OME Reward in the Public Sector: research seminar 10 July 2015**

### **Present for at least part:**

*RB Economist members:* Anna Vignoles (NHSPRB), David Blackaby (NHSPRB), Ken Clark (STRB), Ken Mayhew (AFPRB), Kevin Lee (DDRB).

*Presenters:* Jonathan Cribb (IFS), Phil Murphy (Swansea University), Peter Dolton (University of Sussex), Ian Walker (Lancaster University), Carol Propper (Imperial College), Alex Bryson (NIESR).

*External attendees:* Chiara Rosazza-Bondibene (NIESR), Josef Janovsky (DfE), Alison Hardaker (DH), Lorna Weaver (NHSE), Robert Woods (HMT), John Appleton (HMT), Esther Browning (HMT), Alberto Nunez-Elvira (Lancaster University).

*OME:* Martin Williams, Jenny Eastabrook, Mark Franks, Ffiona Hesketh, Margaret McEvoy, Stuart Sarson, Nicola Allison, Anthony Craggs, Dawn Camus, Neil Higginbottom, Gary Mills, Grant Whitfield, Tony Wilkins.

### **Session 1: Comparing public and private sector reward and mobility**

**Jonathan Cribb of the Institute for Fiscal Studies presented on ‘Public sector pay and pensions’.** In this he described regression estimates over time of the public-private sector pay differential after taking account of the differing personal characteristics (including age, education and experience) of employees in the two sectors. He went on to describe estimation of the differential when pension benefits were additionally included. Next, **Phil Murphy of Swansea University presented on ‘Is public sector pay advantage explained by differences in work quality?’.** In this he provided evidence about differences between the private and public sectors in intrinsic work quality, e.g. the skill requirement, autonomy at work, work intensity and perceptions of job insecurity. He showed that these differences alone could ‘explain’ a great deal of the variation in average pay between private and public sectors.

Open discussion then covered the following topics:

- The challenges in developing a robust counterfactual when comparing public and private sectors, given many occupations tend to be dominated by one sector or the other.
- The potential for the LFS to misclassify public and private sector occupations and the extent to which contracting out of public sector services may lead to differential measurement error over time.
- The impact of career average pensions on the incentives to seek promotion.
- The value to the individual and impact of incentives from defined benefit schemes resulting from reduced perceived or actual risk, over and above the expected returns.
- The extent to which firm size may account for sectorial differences in pay levels and pension provision.
- Whether it is less attractive to work in certain geographical areas (e.g. deprived areas) and whether the attractiveness of working in certain occupational sectors had changed differentially over time.

**Peter Dolton from the University of Sussex then presented on ‘Total reward in the public and private sectors’.** In this he described work to provide the most comprehensive measure of Total Reward to date by including earnings, pension accruals, working hours, unemployment risk and non-pay benefits (paid holidays, employer-provided training and health insurance) throughout an employee’s working life and into retirement. He also mentioned plans under a new ESRC project to examine Total Reward in certain occupations, e.g. nurses, teachers, managers, scientists, in which there was both a public and private sector employment possibility. After this, **Jonathan Cribb from the Institute for Fiscal Studies presented on ‘Mobility between the public and private sectors’.** In this he explored, among other things, the extent to which recent planned reductions to the public sector workforce had resulted in movements of public sector workers into the private sector or net outflows to non-employment. Given the Government is expected to make further cuts to public sector employment, he sought to understand whether these cuts could also be delivered without a big increase in net outflows to non-employment.

Open discussion then covered the following topics:

- Whether contracting out of certain functions from the public sector was significantly driving the results; the evidence suggested not.
- The intention to take account of the changing retirement age, which could be important especially where changes to pension tax meant it may no longer be advantageous to keep working.
- Whether the simple 'adding up' approach and the discount rates used overvalued Total Reward.
- Previous work by the Institute for Fiscal Studies suggested the labour supply of nurses was more responsive to pay in London than in other regions.

**Remarks summarising the morning (first session) included:**

- Public sector pay policy is likely to result in a large negative pay premium for some groups of public sector workers, particularly more educated workers and those at the top end of the income distribution.
- If pensions and total reward are considered that would imply less of a problem. However it's unlikely that individuals take account of pension as much as they might, either due to information failure or possibly very high discount rates. We cannot therefore rely on pensions to counter the negative impact of four further years of pay restraint on some occupations in the public sector.
- Some occupations are likely to be particularly at risk (high skill, high education) but also some regions, i.e. London and the South East.
- Leaving pensions aside, women's public sector pay advantage is greater than for men so it should still be possible to attract women to public sector jobs, although this will again be harder at the top end of the income distribution.
- Given relatively good public sector pensions, it remains a crucial part of any recruitment strategy to promote the total reward concept.
- Total reward calculations imply potentially large redistributions across generations.

## **Session 2: Topics on public sector labour market and pay**

**Ian Walker from Lancaster University presented on ‘Changes in the labour supply of doctors in the UK 1994-2014’.** In this he described initial investigation of doctor numbers, hours of work, contract type, age and gender using pooled cross-sectional data from the Labour Force Survey. He said that the Royal College of General Practitioners predicted a shortage of GPs, and estimated – given current propensities to opt for a hospital career or one in general practice – a 14% rise in medical school entrants could be needed to avert the shortfall.

Open discussion then covered the following topics:

- The study might usefully establish which types of vacancies tended to be filled first, e.g. between GPs and hospital doctors, in order to establish a rank order of preference.
- Recent changes in NHS organisation altered proportions opting for certain career choices, e.g. whether to become a self-employed or salaried GP, or a hospital consultant.
- The study could also look at curricula of the medical schools which doctors had attended to assess possible influence over subsequent medical career options taken.
- How decisions were taken over the number of training places available and the influence of high costs of provision and the British Medical Association.
- Whether individual doctor data could usefully be aggregated to Local Authority level in order to facilitate assessment of doctor effectiveness.
- Whether there were other useful data sources beyond the LFS.

**Carol Propper of Imperial College Business School presented on ‘Pay regulation in health and education’.** In this she assessed whether national pay setting in the public sector could result in lower public sector staff quality in some high cost areas, leading to poorer outcomes in public sector service provision. She advocated moving to a system which would enable schools and hospitals to have pay flexibility without large transaction costs. Finally, **Alex Bryson from the National Institute of Economic and Social Research (NIESR) presented on**

**‘Performance Pay in the Public Sector’**. He defined performance pay, economic theory proposing its use, evaluated its relative incidence in public and private sectors, and described the current paucity of evidence on the effectiveness of its use in the UK public sector. He went on to describe different ways in which performance pay could be used in the public sector.

Open discussion then covered the following topics:

- Coastal towns now appeared to have more teaching quality issues than London; perhaps DfE might consider targeted action as they had previously done in the capital.
- The School Teacher Review Body (STRB) had recently recommended pay reforms in the teaching profession, including greater autonomy over pay flexibility which could be used to address geographic recruitment and retention issues; evidence on the effectiveness of this was not yet available.
- Poorer performing *hospitals* tended to be in the commuter belt close to the M25 motorway: high cost areas where hospitals lacked the kudos of the large London hospitals.
- The success of performance pay is related to the production function of the organisation and the degree of co-operation between different types of labour. Private sector experience on this could help reveal which parts of the public sector might benefit from performance pay.
- Whether differentiation of reward could affect individuals and the collective workforce differently.
- Whether effectiveness of an incentive scheme might be reduced by ‘observability’ factors, e.g. the enhanced performance of senior staff could be less observable than for more junior staff.
- The Quality and Outcomes Framework (QOF) in general medical services was considered to have achieved little initially, both because of the timing of its roll-out and due to thresholds having been set too low.
- Should performance pay be tied to more aggregate performance, e.g. at the level of the Chief Executive Officer, particularly where it is complex to monitor inputs and ability?

- Implementation of performance pay might be facilitated by technological advances which have reduced the cost of monitoring workers.
- Increasing the incidence of performance pay in the public sector would continue to be hampered by the constrained pay world and the difficulty of divvying up only a very small additional sum of money.
- While the UK might be prepared to shed some *workers*, it was unlikely to allow whole public sector organisations to fail, unlike experience in the US.

**Remarks summarising the afternoon (second session) included:**

- The NHS Pay Review Body (NHSPRB) was about to submit a report about 7-day working in the NHS which was likely to have implications for the numbers of doctors in training.
- While the Conservative manifesto appeared to rule out local pay, Review Bodies would need to examine high cost areas, such as London and the South East to assess the need for additional payments, together with consideration of possible cliff-edge effects.
- Given Review Bodies had been encouraged to ensure increments were no longer automatic, based solely on time served, the session on performance pay and how to introduce it had been an important one.
- Pension reform must not be ‘a race to the bottom’: public sector employees should genuinely be supported after retirement. The private sector did not always get things right - notably the gender pay gap - so it was not necessarily the best role model in every case.

**Concluding comments:**

- It was clear from the morning session that the nature of reward has changed in the public sector over time, and the afternoon made it clear that some issues had remained pertinent, such as regional differentials and, performance pay.
- A fascinating and challenging environment lies ahead for the Review Bodies: some policy aims, while legitimate in their own terms, do not necessarily lead to the same pay policy conclusions.

- Given that the events of the last five years could not have been predicted, despite the announcement in the budget, considerable uncertainty remains as to how the public sector labour market is likely to evolve over the next five years too.
- Thanks to: the organisers and particularly Margaret McEvoy; the speakers for their excellent presentations; and the audience for their insightful comments during Q&A sessions.