

This is a non-technical background paper for a talk to be given by Andrew Oswald at the House of Commons on March 21, 2002.

March 2002

London's Public-Sector Workers Need to be Paid 50 % More Than Those in the North

Andrew Oswald

Andrew Oswald is professor of economics at Warwick University.

The Cabinet meeting room should have a large sign hung on the wall: *we cannot force people to take public-sector jobs in the South-East.*

The latest figures for teacher and other public vacancies make unpleasant reading. What is particularly striking is their regional pattern. It is the South-East that cannot recruit. In London, teacher vacancy rates are more than five times those in Yorkshire and Humberside. This is inefficient and unjust: we are badly letting down the children of the south of England.

To an economist, the right policy is obvious. It is time to have much larger regional weighting in public servants' pay packets. More public cash has to be allocated to areas that are driving distance from Big Ben.

Competition is the reason. In the private sector, there is enormous variation in pay across regions. This is because conditions, especially in the local cost of living, vary a lot from one part of the country to another. However, because the public sector does not allow enough spatial variation in its wage rates, it cannot compete properly for staff in the high-wage places. In London, things are now acute.

But exactly how much more should public-sector workers earn in the expensive parts of the country? The right approach is to match the pay differentials, area by area, in the private sector. This does not mean matching the salary levels; it means matching the percentage differentials between the different regions. So if private-sector workers earn 29% more in an expensive region like Surrey than in a cheap one like Humberside, then so should public-sector workers.

When a proper statistical analysis is done, here is what is found, for a worker with standardised qualifications, from one region to another. These figures draw on a sample of 200,000 randomly sampled private-sector workers across the country.

In Central and Inner London, private-sector workers earn 54% more than in Tyne and Wear

Outer London workers earn 24% more than those in Tyne and Wear

Rest-of- the-South-East workers earn 13% more than those in Tyne and Wear.

The full table is as follows:

Estimated Regional Wage Relativities for a Standardised Worker

**[These are for Private Sector employees. All Figures are Relative to Tyne and Wear as the Base]
Using private sector LFS data for 1996-2001**

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

*Note: All estimates are relative to Tyne and Wear wage levels
Source: Work by David Blanchflower, Andrew Oswald, and NERA.*

Yet to the relief of Northern local authorities, the government looks like it may head in the opposite direction. Ignoring the 1990s advice of a giant year-long independent inquiry headed by Professor Robert Elliott of Aberdeen University, it last year released a Green Paper on local government finance that wants to move away from the valuable mechanism – known in the jargon as the Area Cost Adjustment (ACA) – that is used to help compensate those local authorities who are in the expensive south-east. An inquiry is now re-starting. Only a few dozen people in England understand the fine details of these ACA formulae. Anyone within 2 hours' driving distance of Parliament, however, can see that our nation needs to divert far more resources to southern local authorities. The government should be modifying the Area Cost Adjustment to favour the south more strongly.

The rationale for having a regional weighting is straightforward. In places where private sector wages are high, extra money has to be found for teachers' salaries and other local authority costs. Otherwise it will not be possible to compete – in other words to attract staff of the right quality into education.

In considering how to determine local authority budgets, it is thus essential to be guided by private sector wage differentials across regions. Market forces there have operated to compensate employees by just the right amount for the inherent differences, in house prices and congestion and the quality of the environment and other factors, across different parts of the country. Schools have to be given the money to recruit staff in their own area, not somewhere else. Individuals make career choices across the complete set of alternatives open to them. Hence the labour market for teachers can never be insulated from the labour markets for other jobs: education staff must be attracted to teaching and then retained.

The figures for vacancies show that government funding needs urgently to be made more sensitive to the different costs of living in Docklands, Dundee and Derby. Whether they are in cheap or expensive areas, public servants have to have houses. But tinkering with housing allowances is just running away from the issue: regional compensation should be directly into the pay packet.

The government has to face four ideas.

- i. **Pay determines the quality of a workforce.** If society wants talent in our schools, society must stump up.
- ii. **The pattern of public-sector wages across regions should be set to be the same as in the private sector.** If the banks in region X pay secretaries thirty per cent more, so must the schools in region X. The same argument goes for teachers and other professionals. Otherwise schools in the expensive places will end up with vacancies, high turnover of staff, and workers of lower morale than in the cheaper areas of the country.
- iii. **The variation in relative private sector pay across regions needs to be worked out by statisticians, and that should be used to say how big the regional pay weightings are for public sector workers like teachers.**
- iv. **How to do all this was explained in the Elliott Report.**

Many people will prefer not to listen to commonsense, but the truth is that southern public-sector workers need a huge pay rise relative to those in the north.

Technical table based on our study of 200,000 workers:

Table of How Private Sector Pay Varies Across Parts of the Country for a Standardised Worker
Weekly wage equation calculations – private sector (Labour Force Survey data)

| | 1 | 2 | 3 | 4 | 5 | 6 | 7 |
|-----------------------|--------------|--------------|--------------|--------------|--------------|--------------|--------------|
| Rest of North East | -.045 (2.56) | -.043 (2.98) | -.044 (3.04) | -.032 (2.34) | -.034 (2.62) | -.022 (2.27) | -.014 (1.49) |
| South Yorkshire | -.054 (2.76) | -.054 (3.35) | -.053 (3.29) | -.034 (2.24) | -.039 (2.73) | -.037 (3.46) | -.029 (2.78) |
| West Yorkshire | .067 (3.91) | .085 (6.00) | .095 (6.77) | .082 (6.12) | .069 (5.44) | .042 (4.42) | .039 (4.27) |
| Rest Yorks Humberside | -.058 (3.19) | -.045 (3.04) | -.045 (3.06) | -.041 (2.94) | -.026 (1.95) | -.027 (2.76) | -.023 (2.43) |
| East Midlands | .022 (1.37) | .036 (2.73) | .040 (3.05) | .050 (4.08) | .045 (3.84) | .018 (2.09) | .016 (1.93) |
| East Anglia | .049 (2.89) | .066 (4.69) | .067 (4.80) | .059 (4.51) | .071 (5.62) | .034 (3.63) | .043 (4.81) |
| Central London | .904 (53.19) | .837 (59.69) | .873 (62.10) | .684 (51.28) | .634 (49.46) | .504 (52.46) | .486 (52.7) |
| Inner London | .483 (26.01) | .450 (29.33) | .506 (32.79) | .397 (27.24) | .421 (30.31) | .319 (30.64) | .324 (32.4) |
| Outer London | .269 (16.50) | .286 (21.26) | .323 (23.91) | .270 (21.19) | .280 (23.06) | .211 (23.24) | .218 (24.9) |
| Rest of South East | .166 (11.27) | .200 (16.42) | .205 (16.90) | .161 (14.08) | .169 (15.56) | .124 (15.24) | .124 (15.9) |
| South West | -.010 (0.65) | .028 (2.19) | .029 (2.30) | .004 (0.30) | .018 (1.57) | .009 (1.01) | .019 (2.28) |
| West Midlands | .143 (8.67) | .117 (8.59) | .136 (9.98) | .136 (10.62) | .102 (8.29) | .049 (5.31) | .053 (5.99) |
| Rest of West Midlands | -.012 (0.75) | .015 (1.13) | .018 (1.35) | .025 (1.91) | .023 (1.92) | -.008 (0.90) | -.006 (0.71) |
| Greater Manchester | .094 (5.49) | .104 (7.40) | .111 (7.92) | .091 (6.90) | .083 (6.62) | .044 (4.66) | .036 (4.02) |
| Merseyside | -.034 (1.65) | -.001 (0.05) | -.001 (0.08) | -.011 (0.70) | .009 (0.62) | -.014 (1.28) | .007 (0.68) |
| Rest of North West | .057 (3.35) | .060 (4.26) | .061 (4.40) | .038 (2.90) | .030 (2.38) | -.001 (0.16) | .010 (1.13) |
| Wales | -.020 (1.16) | -.005 (0.42) | -.005 (0.38) | .005 (0.35) | .003 (0.23) | -.027 (2.89) | -.017 (1.87) |
| Median regression | No | No | No | No | No | No | Yes |
| Personal controls | No | Yes | Yes | Yes | Yes | Yes | Yes |
| Ethnic controls | No | No | Yes | Yes | Yes | Yes | Yes |
| Qualifications | No | No | No | Yes | Yes | Yes | Yes |

| | | | | | | | |
|---|--------|--------|--------|--------|--------|--------|--------|
| Work controls | No | No | No | No | Yes | Yes | Yes |
| 2 digit industry | No | No | No | No | No | Yes | Yes |
| Adjusted R ² / Pseudo R ² | .0551 | .3565 | .3611 | .4329 | .4872 | .7057 | .5007 |
| N | 191997 | 191997 | 191979 | 191880 | 191828 | 190917 | 190917 |
| F | 510.0 | 4254.9 | 2931.7 | 1903.6 | 1441.0 | 4223.3 | |

Notes: Source is Blanchflower, Oswald, NERA

Log of weekly pay. Estimates are all in relation to the excluded category of Tyne & Wear.

Source: Labour Force Surveys, 1996-2001.

All equations also include 5 year-dummies.

1. Column 1 is the simplest calculation. It ignores all the factors that mould pay except for one, namely, the region. These, therefore, are raw wage differentials area-by-area. They do not do a like-for-like comparison.
2. Column 2 assumes that two other things influence pay. One is a person's age and the other is their gender. Thus the numbers next to the region names in Column 2 measure how pay varies across these areas after we factor out (or 'hold constant' in the jargon) age and gender.
3. Column 3 extends this list of possible influences to include ethnic background. It factors out from the wage equation a set of nine measures for a person's race and four measures of where they were born.
4. Column 4 allows for a long set of (forty) different levels of qualification, as well as all the earlier factors. This is a particularly important step in allowing a correct comparison of people between one region and another.
5. Column 5 allows for the number of hours the employee spends working, and the length of the person's job tenure in the workplace. It also allows for which industry the person is employed in (grouping the country into approximately a dozen industries).
6. Column 6 allows for the number of hours the employee spends working, and the length of the person's job tenure in the workplace. It also allows for which industry the person is employed within (grouping the country into approximately sixty different industries).
7. Column 7 uses median regression methods. The median regression finds the line that minimizes the sum of absolute residuals rather than the squares of the residuals as in Ordinary Least Squares, which we use to derive the other results.