

# **Government guidance note on progressing local pay**

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9 October 2003

# GOVERNMENT GUIDANCE NOTE ON PROGRESSING LOCAL PAY

This guidance note details the Government's local pay policy and its rationale. It outlines the objectives of the policy and other considerations necessary in implementation.

## Context

**1.1** In his Budget statement, the Chancellor of the Exchequer announced that the Government would be giving increased emphasis to the regional and local elements of public service pay. The Chancellor reiterated the importance of this agenda in his statement on 9 June on the Five Tests in relation to UK membership of the European Single Currency. In particular, the Government is seeking within existing national bargaining frameworks to increase the amount of regional and local pay flexibility and variability across the public service labour market, primarily through amending the remits of key public service departments and agencies.

**1.2** Flexibility in pay is an essential element of the UK economy's ability to achieve high growth and high employment, and thereby to perform at world-class standards. Flexibility is also critical to help improve the delivery of public services, and to ensure we have the right people with the right skills. The evidence suggests, however, that the degree of regional and local flexibility of public service pay is less than in the private sector, and that there is significant room within the existing national bargaining frameworks to increase the extent to which differentiated pay is used, the levels of differentiation across the public service and the links between pay setting and local labour markets.

**1.3** Given the overriding importance of improving public services, it is essential that the public service starts making steps to develop or further develop pay systems that focus on local labour markets and incorporate the local and regional responsiveness needed to achieve this objective. This is expected to be an evolutionary process – public service organisations building on their current arrangements when the next opportunity arises to amend or review their pay arrangements. For example, some organisations have multi year pay deals and may not be able to implement anything for a couple of years. For some this may involve considering what information they need to start collecting on local recruitment and retention and the local labour market in order to initiate a local pay arrangement, while for others the task will be focused on whether their current local pay arrangements can be extended or improved.

**1.4** There are a number of avenues where this policy will be taken forward:

- The terms of reference or remit letters of the Pay Review Bodies (PRBs) have been modified to require them to have regard to regional/local labour markets and their effects on recruitment and retention.
- Correspondingly, departments responsible for workforces covered by PRBs will need to provide robust evidence on local and regional recruitment and retention issues and make clear to PRBs how they expect pay to reflect these different markets.

**1.5** It is important that the move towards greater flexibility and responsiveness occurs throughout the public service and not just for PRB groups. Therefore, except

where there has been an explicit agreement that circumstances make more locally responsive pay systems inappropriate, the Government will be looking for strategies to be formulated in respect of all groups:

**1.6** The Government will be looking for local pay considerations to be incorporated into future revisions of all pay and workforce strategies, according to the six monthly review timeframe determined by the Pay and Workforce Coordination Group, and considered within the context of their relocation plans under the Lyons Review.

**1.7** For the civil service there will also be an expectation for local pay to be included in 2004 remits process (or future processes in the instance of multi-year pay deals) and the Pay Guidance issued at the end of this year will include further detail.

### Objectives of local pay

**1.8** Flexible and responsive local pay systems within national frameworks make an essential contribution to vigorous and balanced growth across the UK.

**1.9** Other key objectives of local pay are to:

- improve public service delivery by recruiting and retaining necessary staff; and
- ensure value for money;
- ensure fairness.

#### Flexibility and balanced growth

Locally-varied pay which responds to local labour markets is good for the economic development of all parts of the UK – not just specific locations or areas. The public service accounts for around a fifth of the economy. It has a pronounced effect on whether the private sector is able to operate efficiently, and thereby on the economy's productivity and its ability to withstand economic shocks. Barriers that obstruct staff and their skills from moving to where they are most needed impose rigidities in the wider economy, which restrict the potential for economic growth and employment throughout the UK.

#### Service delivery

The ability to recruit and retain staff in every location is crucial to high quality public services. Staff shortages, resulting from an inability to recruit and retain staff with the requisite skills in the right numbers in specific locations, are currently concentrated in certain areas, mainly, but not exclusively, in parts of London and the South East. Shortages may be disguised by recruiting staff of weaker quality, by over grading, inappropriate use of agency staff, high turnover and high overtime, all of which can have clear and adverse impact on service to the public. A stronger local and regional element to pay is one important tool to address these issues. However, we also recognise that this is only a part of the answer –public bodies must also consider other factors (such as equipping the leadership with the necessary skills to manage change, and the need to ensure staff feel valued and respected for their work) if they are to have a workforce equipped to meet consumers expectations of their services.

#### Value for money

Like any employer, public service employers need to avoid excessive paybills beyond what is needed to recruit and retain staff with the right skills, what is affordable within budgets and reflective of broader labour market conditions. But there is wide variation in market wages by location, driven by difference in living costs and other factors. For example, in general there is evidence of relatively higher market wages in London and much of the South East, compared to most of the rest of the country, as well as

considerable variability within London and the South East. For some sectors there are also certain ‘hotspots’ of recruitment and retention difficulty spread throughout the UK. Not taking into account such variations would lead to inefficient allocation of resources and poor value for money.

**Fairness** As a minimum, pay systems should not discriminate by age, gender, sexual orientation, religion or belief, disability or ethnicity, and should be in accordance with legislation. It is critical that pay decisions are made on an objective and evidence based case.

**1.10** These objectives provide clear criteria for assessing the adequacy of local pay strategies. Public service organisations may want to consider them against these headings. In addition, of course, proposals need to be practicable and to have regard of the ease of implementation, given the capability of the institutions concerned.

## Policy

Within existing national bargaining frameworks the policy is to increase the amount of regional and local pay flexibility and variability across the public service labour market, primarily through amending the remits of key public service departments and agencies.

**1.11** There are a number of situations that Public service organisations may face where they will need to consider local variations in pay. This may include, for example:

- specific recruitment and retention problems in deprived areas where cost of living is relatively low but a premium is required to attract the necessary skills to deliver services;
- instances where recruitment is difficult as the private sector is the preferred employer or there is direct competition from other parts of the public service; or
- where there is currently too high a premium relative to the rest of the labour market, so vacancy rates and turnover are low and resources are not allocated efficiently.

**1.12** Implementation of local pay policies means building on existing pay structures to allow for more differentiation and variation of pay to meet local needs. There are a number of models of local pay, some of which already operate to some extent within the public service and we could encourage their continued development. The Annex provides examples of the use of local pay differential from the public and private sectors.

**1.13** In the multitude of circumstances in which the public service operates, it is abundantly clear that no single system of local pay would be desirable or necessary. A one-size-fits-all solution is therefore ruled out. Nevertheless the current paper sets out some considerations to bear in mind in taking forward local pay arrangements. In many cases, productive dialogues are already underway.

## Policy implementation: national bargaining

**1.14** Meeting the objectives for local pay is likely to be best achieved through national bargaining arrangements<sup>1</sup>, rather than devolving responsibility for bargaining down to the local level. In particular, building regional and local flexibility within national arrangements is more likely to be better at delivering flexibility with value for money and avoiding unnecessary costs. The starting point is therefore the current national pay bargaining and other pay setting arrangements. The following outlines the key arguments and why the preference is for maintaining current bargaining arrangement rather than increasing devolution of bargaining.

**1.15** At the extreme, local pay in theory could mean devolving all responsibility for setting pay and conditions and pay arrangements to the local bodies delivering the frontline services: for example, individual schools, particular NHS Trusts, individual Police forces. Since frontline managers would be making the key decisions, they could be made with very detailed knowledge of the circumstances in which those services were being delivered.

**1.16** In practice, however, extremely devolved arrangements are not desirable. There are risks of workers being treated differently for no good reason other than subjective variations in judgement or local affordability. There could be dangers of leap-frogging and parts of the public service competing harmfully against each other for the best staff. The administration and bargaining costs of a large number of separate units each inventing their own pay and conditions systems, and engaging in manifold separate bargaining sessions, would be substantial. Such costs tie up management capacity and would not be available for improved public services.

**1.17** It is also important to be clear that by national bargaining the Government does not mean a move to highly centralised bargaining. Such arrangements cannot provide the necessary flexibility to meet public service organisations' needs, including providing sufficient flexibility to meet service delivery requirements.

**1.18** The most productive way forward is likely to be building on the existing national bargaining arrangements and to take an evolutionary approach to greater regional and local flexibility.

**1.19** Accordingly, as the Government has made clear, national pay bargaining will remain – such as national bargaining within the civil service, health, education and so on. The task is then to build local and regional flexibilities - “local positioning” - into the national pay arrangements. Local positioning is itself, of course, by no means new and a number of public service pay systems already incorporate such features, as outlined in the Annex.

**1.20** Making progress, therefore, in many cases will mean increased attention to such existing features, ensuring that they are consistent with improved flexibility and are effective in supporting local service delivery, rather than embarking upon a completely new direction.

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<sup>1</sup> In this context, the term national bargaining is used as shorthand for organization-wide pay arrangements, systems or frameworks. The Government intention is not to change such arrangements but to ensure that local pay considerations are incorporated into them.

## Policy implementation: other key considerations

**1.21** In addition to building on national bargaining frameworks, there are key considerations to be taken in determining the design of local pay arrangements:

- determining the number of differentiations to be applied. In principle, there is a spectrum of possibilities below national level from regional differentiation at the coarsest level to individual service provider units at the opposite end of the scale. The choice will need to depend on the circumstances, including the stage of implementation of local pay and the quality of information available to make decisions. Simplicity and practicability will tend to argue for a small number of differentiations that could be defined by localities or perhaps by defining all localities to be part of one or more zones covering the country as a whole according to the cost of living and/or labour market characteristics. On the other hand, increasing the number of gradations for pay purposes may allow for more tailoring to local circumstances.
- whether the areas for which pay might be locally differentiated should be defined by reference to “natural geography” or to specifically defined areas. Again, there are advantages and disadvantages in both directions. Natural geography areas are robust and incontestable – a place is either clearly in London or a particular region or area or it is not. On the other hand, areas that correspond to particular labour market conditions and circumstances may not naturally relate to a natural geography area. Whichever choices are made as to the basic area units for local positioning, decisions as to the local variations in pay which are made need to be evidence-based.
- whether consolidated or non-consolidated locality payments are preferable. It would be useful for departments to consider the extent to which flexibility is required to move staff around different locations, and therefore whether consolidated or non-consolidated allowances would be most appropriate.

## Policy implementation: information and data required to make pay decisions

**1.22** A crucial concomitant of a successful local pay strategy is having in place mechanisms to generate the labour market intelligence and other information that can inform decisions about local pay variations. In some cases, such information sources already exist. But where they do not, or where they need strengthening, organisations should consider how best to achieve this.

**1.23** Even where information sources are adequate, a robust pay system is likely to be one that demonstrates a high degree of transparency.

**1.24** Public service organisations need to ensure that clear and objective criteria and information are used so that local pay variations are well based. In particular, it is most important in relation to equal pay that public service organisations base their local pay decisions on cogent evidence, which they should retain. Organisations should also record their reasons for the decisions taken so that, if necessary, they can demonstrate to an Employment Tribunal that pay differentials exist for reasons which are not tainted by discrimination on grounds of sex, race etc. Furthermore, basing local pay on objective information will also enable organisations to test from time to time whether local variations are still needed.

**1.25** These examples suggest information on local labour market conditions and recruitment and retention is critical to support local pay considerations. Such information would include:

- vacancy rates and recruitment difficulties and their composition (i.e. locality, skill base, specific grades);
- assessment of whether quality of staff appointed varies by location or whether grades are being used differentially in order to match pay to market conditions;
- wider labour market indicators such as unemployment rates and regional price indices;
- retention problems, whether they can be attributed to specific areas and whether they are related to pay or other factors such as work tasks, culture or leadership;
- whether the current package of benefits offered by the organisation is sufficient or excessive, and the degree to which non-pay factors can influence staff turnover rates;
- the staffing profile (such as age, gender, and ethnicity) and whether this addresses diversity requirements of the organisation;
- exit interview information on reasons for leaving and next destinations; and
- information from staff surveys on perceptions of reward adequacy in different locations.

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## SUMMARY

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**2.1** The key objectives of local pay policy are to:

- contribute to vigorous and balanced growth across the UK, with a particular focus on ensuring well functioning labour markets;
- achieve improvements to service delivery through enabling the recruitment and retention of the right staff, especially in areas with particular difficulties such as London and the South East;
- ensure value for money is achieved within existing budgets and to maintain affordability; and
- achieve greater fairness, and ensure objective and evidence-based decisions on pay.

**2.2** There is significant room to increase the extent to which differentiated pay is used and the levels of differentiation across the whole public service. Local pay arrangements should be:

- firmly constructed and based around the objectives outlined above – using these as criteria for assessing the adequacy of the local pay strategy;
- based on existing national bargaining frameworks for pay and conditions;
- built on the needs of the department and existing pay structures (i.e. not one-size-fits-all but adapted to specific business requirements);
- focused on addressing recruitment and retention and the local labour market, and where pay as opposed to non-pay measures, such as working conditions and levels of bureaucracy, can make a difference;
- focused on and assisting with the development of efficient and effective labour markets;
- developed by using transparent, objective and evidence based information.

**2.3** Public service organisations will be expected to update their pay and workforce strategies over the coming months to reflect their local pay plans – and to reflect changes through relevant pay decision processes, whether this be evidence to Pay Review Bodies or civil service remits in 2004, for example.

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## ANNEX: EXAMPLES OF LOCAL PAY FROM THE PUBLIC AND PRIVATE SECTORS

### Public service examples

#### *Health service: Agenda for Change: Local Supplements and Premia Model*

The recent Agenda for Change agreement in the NHS covers more than one million non-medical staff, from nurses and other health professionals through administrators to porters and cleaning staff. The unions have agreed that testing of the new pay system in 12 early implementer sites can begin with an effective date of 1 June 2003. From 2003-04 to 2005-06 the package will give a 10% pay increase to all staff plus an average 5.9% from the reform package in the longer run.

Under Agenda for Change staff will be placed in one of eight pay bands on the basis of their knowledge, responsibility, skills and the effort needed for the job, rather than on the basis of the current job title. Their pay will increase in annual steps as now, except that there will be two “gateways” where progression will depend on the demonstration of the applied knowledge and skills needed for that job.

NHS productivity should be improved both by the focus on a better skilled workforce working in new ways, and by breaking down barriers between different roles - nurses doing some of the tasks traditionally reserved for doctors, and support staff in turn taking on some of the nurses' tasks.

#### *Local elements of Agenda for Change*

Agenda For Change harmonises and simplifies the system of London allowances and cost of living supplements:

- Harmonised ‘high cost area’ supplements will replace London allowances and cost of living supplements for Inner London, Outer London and Fringe. All non-medical staff working in inner London will receive a 20% supplement to their salary (minimum £3097 to a maximum of £5161). Staff working in outer London will receive a 15% supplement (minimum £2581 and maximum £3613). Staff in the Fringe zone will be entitled to a 5% supplement. All these are 2003/04 rates and will be uprated by 3.225% in 2004/05 and again in 2005/06. This system could, in principle, be applied to other areas in future.
- For staff working outside London, cost of living supplements will be converted into long-term recruitment and retention premia.
- There will be flexibility to introduce recruitment and retention premia, either short-term or long-term, for any location or specialism that is undergoing particular recruitment and retention difficulties. The premia can be initiated either by the Pay Review Body or the new Pay Negotiating Council, or by the affected Trusts.

### *Prisons Service Local Allowance Banding Model*

As an adjunct to national awards the Prisons Service has for several years operated Local Allowance Payments (LAP) for establishments experiencing recruitment and retention problems.

The system of LAP is currently under review in order to better meet the particular needs of each establishment and to ensure resources are well targeted. Until most recently LAP has been awarded in four bands, the current range being from £1,100 to £3,800 per annum.

Under a new system being considered for this year, establishments would no longer be paid in bands, but rather via a continuous award scale.

Under the proposed scheme, establishments would be required to submit application forms in order to explain recruitment and retention difficulties. The analysis would begin by considering whether non-pay initiatives would assist to resolve recruitment and retention difficulties or whether there are other operational issues that may warrant a local allowance. Finally, eligible establishments would be assessed through a quantitative model that determines the exact amount of LAP to be awarded. The model focuses on factors such as the main impacts on the cost of living and local labour market competition to determine the award levels.

### *Local Authorities Local Grading And Banding Model*

Under a voluntary grouping of most local authorities, annual uplifts are agreed nationally, but with flexibility at the local level to address recruitment and retention or other issues.

National pay negotiations determine percentage pay increases at a national level, which is applied to a national pay spine that consists of points from 4 to 49. Each point corresponds to a salary figure. The national agreement also determines key national level conditions of work, such as hours of work, leave, and a maternity scheme.

Local authorities then create their own individual grading/band structure and can position jobs anywhere on the national scale, where they think appropriate, such as in response to recruitment pressures. Some national conditions of work can also be modified locally in agreement with the unions, including premium payments for overtime and weekend working, training and development and leave for child care and dependents.

## Private sector examples

### *Boots The Chemists Zone Model*

Under a new pay structure previous allowances for outer, inner and central London zones were removed and each of the 1,404 stores was placed into one of four pay zones: zone 1 (provincial), zone 2 (typically premium city locations outside of London), zone 3 (typically outer London and the South East) and zone 4 (typically central London). This zonal structure was designed to allow the flexibility to address varying labour market pressures between and within regions. Stores can be moved into a higher zone if recruitment and retention pressures require it, but any such upgrading is strictly controlled by the company.

Differentials between the zones are based on a calculation of the median rate paid by the company's main competitors in the different locations. Zone 2 rates have been set 10 per cent higher than zone 1, zone 3 rates are 16 per cent higher and zone 4 are 35 per cent higher.

### *Tesco Pay Band Model*

Tesco operates a national pay structure for its retail staff across the country with four higher pay bands in areas with higher costs and/or areas with recruitment and retention problems. The structure was introduced in 1999 and it replaced the previous two-tiered system based on provincial and London rates. Bands 1 and 2 correspond to the previous provincial rate. Band 3 incorporates provisional locations, such as Oxford and Swindon, where the company was experiencing recruitment and retention problems and also areas of London, like Woodford Green and Romford, where it was felt there was no need to pay the full London rate. Band 4 equated to the former London rate and also covered 'hot spots', such as Reading and Gatwick, where it was felt that band 3 rates would not be high enough. Band 5 covers stores primarily located in the centre of London.

Source: *Pay Differentiation Practice in UK Organisations*: Incomes Data Services Ltd, November 2002