

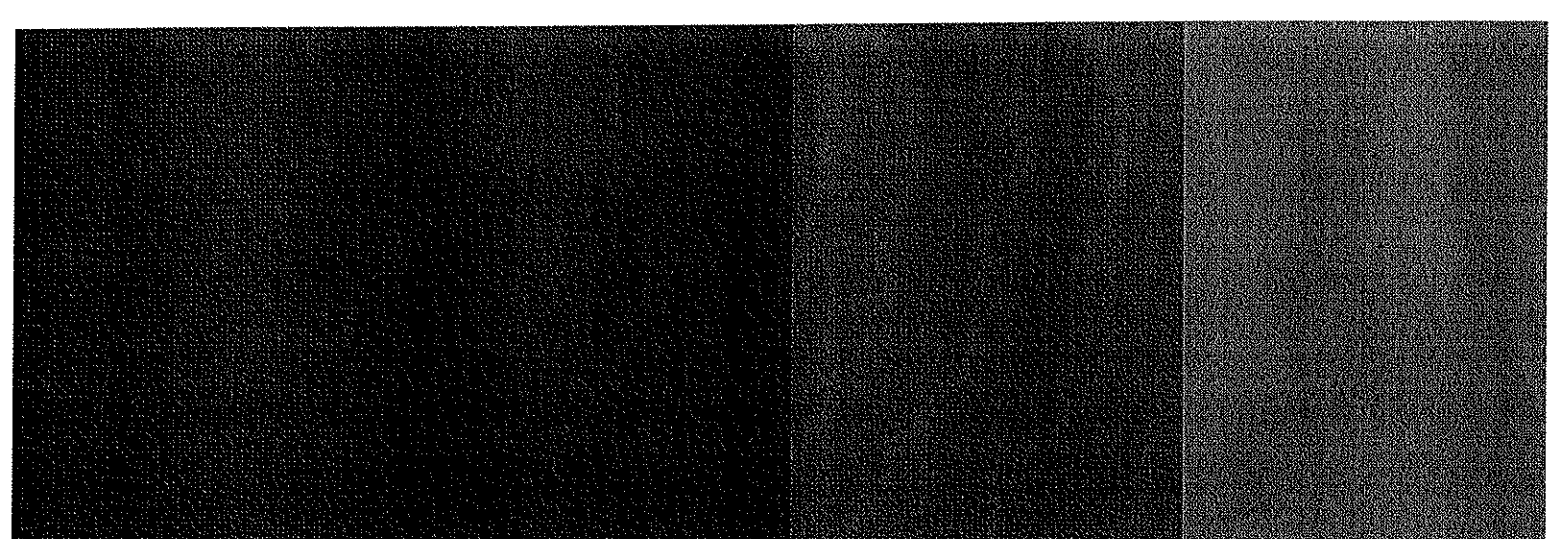
Hutton Review of

Fair Pay

**Hutton Review of Fair Pay
in the public sector:**

Final Report

March 2011



Executive summary

High quality public services require high calibre leaders to deliver them, especially in difficult fiscal conditions. A key challenge for Government is to maintain and improve the standard of public service leadership as the structures of public service delivery are reformed. Vital to this will be to ensure that public service leaders are adequately and fairly rewarded for their contributions, and that the public service ethos – that sense of mission and public duty that motivates many to work delivering public services – is maintained. This requires that a delicate balance be struck. If senior public servants are inadequately rewarded, it will be ever more difficult to attract and retain individuals of the calibre required. At the same time taxpayers are right to demand value for money from public resources, and an assurance that their money is not being wasted on excessive executive salaries. Without that assurance, trust in public services cannot be maintained.

Yet public understanding of both senior public service roles, and senior public service pay, is often very poor. A quarter of the public believe that public sector executives are currently paid more than their counterparts in private businesses, while in fact executive pay in large listed companies far outstrips that in even the largest and most complex of public bodies. The public also often have limited knowledge of what senior public servants actually do, so are not in a position to judge what level of reward is fair for these roles. Meanwhile the absence of a consistent framework of senior pay principles denies citizens reassurance that rewards are fairly matched to responsibilities and performance, and leaves a gap in which mistrust of public servants can grow.

The UK therefore needs a framework for fairness in senior public service pay. This framework should be based on the principle of fairness as **due desert**: reward should be proportional to the weight of each role and each individual's performance; should be set according to a fair process; and should recognise that organisations' success derives from the collective efforts of the whole workforce. This fairness framework will ensure that senior pay in public services is fair and seen to be fair, and will preserve the ability of public services to recruit talented individuals while reassuring the public that their tax money is not being unfairly creamed off by 'fat cat' public sector executives. This report presents the Fair Pay Review's conclusions, and sets out twelve recommendations to the Government that together form the framework for fairness.

The framework for fairness in senior public service pay: summary of recommendations

1 Using pay multiples to track executive pay against that of all employees

The Government should not cap pay across public services, but should require that from 2011-12 all public service organisations publish their top to median pay multiples each year to allow the public to hold them to account.

2 Informing the public debate through annual Fair Pay Reports

To support citizen accountability, the Government should commission the Senior Salaries Review Body to publish annual Fair Pay Reports, starting from 2011-12. These reports should set out trends in pay multiples across public services, highlight year-on-year changes and identify organisations that fail to produce meaningful, specific and verifiable explanations for their pay multiples and for changes.

3 Re-calibrating the pay of Non-Departmental Public Body chief executives

To address particular concerns that the pay of Non-Departmental Public Body chief executives has become detached from the responsibilities of their roles, the Government should by December 2011 establish a series of pay benchmarks for NDPB chief executives, following advice from the Senior Salaries Review Body.

4 From disclosure to explanation: ensuring complete transparency over executive roles and remuneration

To enable citizens to understand executive remuneration and the nature of executive responsibilities, from 2011-12 the Government should require that all organisations delivering public services disclose in precise numbers the full remuneration of all executives, alongside an explanation of the responsibilities of each role and of how executives' pay reflects individual performance.

5 Enabling citizen analysis of executive pay

From 2011-12, the Government should require public organisations to submit executive pay data through an online template, and make this data available on data.gov.uk, to allow citizens to access and analyse this data and thus have the information required to hold public service organisations to account.

6 Abandoning arbitrary benchmarks for public service pay

Once this framework of recommendations is in place, the Government should refrain from using the pay of the Prime Minister or other politicians as a benchmark for the remuneration of senior public servants, whose pay should reflect their due desert and be proportional to the weight of their roles and their performance.

7 Preventing rewards for failure through earn-back pay for senior public servants

To allow pay to vary down as well as up with performance, all public service executives should have an element of their basic pay that needs to be earned back each year through meeting pre-agreed objectives.

The Government should by July 2011 bring forward proposals for Senior Civil Service pay to include an element of base pay at risk, and should encourage the application of earn-back pay to other organisations delivering public services. This earn-back should be conditional upon meeting pre-agreed objectives; excellent performers who go beyond their objectives should be eligible for additional pay.

8 Extending earn-back pay to high performing middle managers

To identify and reward high fliers, once earn-back pay has been implemented at the most senior levels, Government departments and other public service organisations should consider offering this pay structure to middle managers on an opt-in basis.

9 Sharing the rewards of greater productivity

To prevent executives monopolising the rewards of productivity increases, and allow all employees who have contributed to share the benefits, government departments should identify ways of offering gainsharing schemes linked to achievement of the efficiency aspects of their business plans. The Government should also explore options for gainsharing schemes across public services more widely.

10 Opening up opportunities for future generations of public service leaders

To increase the supply of candidates for top positions and reinforce public service management as a career, the Government should facilitate greater opportunities for managers to move across different public services. By the end of 2011 the Government should establish a single online portal for advertisements and applications for public service management roles, and work with major public service employers to establish a passport scheme for middle and senior managers across public services. It should also drive and prioritise ongoing collaboration between public sector graduate recruitment and development programmes.

11 A Fair Pay Code

To embed fairness principles and ensure fair process in executive remuneration, all public service organisations should adopt the Fair Pay Code proposed by this Review. Government departments should by July 2011 bring forward proposals for the application of this Code to all bodies and sectors in which they have an interest.

12 Tracking pay multiples across the economy

To make tracking pay multiples normal practice across the economy, as part of its commitment to improve corporate reporting, the Government should require listed companies to publish top to median pay multiples in their annual reporting from January 2012.

The full text of the Fair Pay Review's recommendations is set out at Annex A. The full text of the proposed Fair Pay Code is set out at Annex B.

The case for fair pay in a reformed public sector

Fair pay should be understood as pay that reflects due desert: **fair pay must be both proportional to each individual's contribution and set according to a fair process.** Fairness is more than simple equality, individuals should face the consequences of their choices and efforts, but not be rewarded or punished for brute luck or circumstances beyond their control.

Fair pay is essential to high quality, well managed public services. Public services are vital co-creators of wealth and well-being, and have direct and important consequences for the lives of citizens. Public trust in public services requires that public service pay is fair and seen to be fair, and that public services stand up to high standards of scrutiny.

There are genuine concerns about executive pay in public services, as discussed in the Fair Pay Review Interim Report. These include top pay pulling away from bottom pay in many areas; a patchwork

quilt of governance arrangements; inadequate transparency; insufficient competition in executive labour markets; and the risk of senior pay inflation where institutions are granted autonomy over pay. Taxpayers are right to demand value for money from public resources, and assurance that their money is not being wasted on excessive executive salaries.

Yet the public overestimates how much public sector executives are paid. The sharp increase in executive pay over the last decade, and the wider trend of growing income inequality, has been largely a private sector phenomenon.

The UK must take care to avoid making the public sector a fundamentally unattractive place for those with talent and drive. Management roles in public services are becoming more complex and risky, making the need for talent greater than ever. Meanwhile elements of the wider public sector reward package are being cut back. If the wider value of public service is diminished, the talented and motivated will only be willing to work in public services to the extent that they are paid what they can make elsewhere.

A delicate balance must be struck between defending the attractiveness of public service careers while ensuring taxpayers can be confident that public money is being wisely used. A framework for senior pay is required that is understood by both citizens and public servants to be fair, and to guarantee that public servants' pay is duly deserved for contributions that citizens value.

Pay multiples, transparency and public accountability

The Fair Pay Review was asked to consider the case for a fixed limit on pay dispersion in the public sector, and a ban on managers earning more than 20 times the pay of the lowest paid person in their organisation. A single limit on pay dispersion would however be unfair, hitting some organisations more than others, and could create perverse incentives and even become a target for executives earning less. At present, a 20 to 1 maximum multiple would impact as few as 70 senior managers.

Rather than complying with a cap, organisations delivering public services should track, publish and explain their pay multiples over time. The most appropriate metric for pay dispersion is the multiple of chief executive to median earnings. This will ensure public service organisations are accountable for the relationship between the pay of their executives and the wider workforce.

To aid citizen scrutiny of organisations' pay multiples, the Government should commission the Senior Salaries Review Body to publish annual Fair Pay Reports, setting out pay multiples across public services, highlighting year-on-year changes and identifying organisations that fail to produce specific and verifiable explanations for their multiples and for any changes. If in the light of these reports the Government judges that pay multiples have increased without adequate justification, it should consider intervening directly to restrict executive pay.

Given the inconsistencies in their executive pay, the Government should establish a system of benchmarks for executive pay in Non-Departmental Public Bodies on the advice of the Senior Salaries Review Body in parallel with requiring them to public pay multiples year on year.

To ensure complete transparency over executive pay, and to aid greater public understanding of senior roles and their remuneration, all organisations delivering public services should disclose full details of executive remuneration, together with an explanation of how executive pay relates to the weight of roles and individuals' performance. The Government should establish an online system for comprehensive disclosure of pay data in a consistent, re-usable format to allow citizens and third-party organisations to collate and analyse these data.

Greater transparency, disclosure and explanation will allow a more rational and informed debate on senior public service pay, and enable citizens to hold public service organisations to account. This will remove the need for simplistic benchmarks, such as the pay of the Prime Minister.

Ensuring pay reflects performance

Understanding fairness in terms of due desert inevitably implies that pay should vary according to individuals' performance. Despite well-rehearsed objections to performance pay in the public sector, there are compelling reasons why performance pay for senior staff should not be abandoned in the face of public criticism of bonuses, or because of difficulties of implementation. An outright rejection of performance pay implies that there should be no financial reward to differentiate the good from the poor performer.

The public demands consequences for failure as well as rewards for success, and behavioural studies suggest that individuals are more powerfully influenced by the prospect of losses than of gains. There therefore needs to be a better balance between rewards and penalties in performance pay schemes. The Government should give serious consideration to reconfiguring performance pay systems for senior managers to include an element of 'earn-back' pay. This system would see executives required to meet pre-agreed performance objectives in order to earn back an element of their basic pay that had been placed at risk. Only if objectives were met would executives receive their full basic pay, and only if objectives are clearly exceeded can additional awards be made.

The public sector may be missing out on high calibre individuals because it does not offer sufficient opportunities and incentives to perform. Public sector organisations may not do a satisfactory job of spotting and developing future senior managers at the mid-career stage. If employees were not eligible for additional performance pay unless they also signed up to earn-back, this could prove a useful way of helping to attract and identify strong performers.

It should be possible to design team-based incentives that reconcile the importance of due desert with the reality that outcomes are collectively produced by the whole of an organisation's workforce. In this context, gainsharing – the sharing of the rewards from productivity gains and resultant savings among all the staff that contributed to them – is an option that should feature more often.

Strengthening the talent pipeline

The ability to attract, retain and develop high calibre employees is a vital prerequisite of strong and innovative public services. Action is needed to support and expand the 'pipeline' of talent that supplies public service organisations.

There are four key priorities in this area. The talent pool from which executives are recruited should be broadened, to minimise the risk of constrained supply putting upward pressure on senior pay. Managers should be supported at all stages of their development, to maximise the opportunities for managers to progress and build varied careers within public service. Broader career paths should be encouraged to produce the cross-sectoral skills vital for public service reform to succeed. And the profile of public service leadership should be raised to reinforce the value and ethos of public service and help the public sector to compete for the best.

A cultural shift is needed among recruiters, who should be encouraged to be more open to talent across public services, and given the infrastructure to allow them to look more widely when filling top positions. An online recruitment portal for the advertisement of management roles across public services would help achieve this. There would also be benefit in a 'passport' scheme that helped open up movement across different areas of public services, as well as to and from the private sector. This would not just help ensure adequate competition for top jobs to restrain unnecessary pay inflation, but would also help to match public servants' desire for greater opportunity and progression with the need to develop people capable of leading public services in a time of institutional reform and disaggregation.

Attention also needs to be given to the leaders of the future. Given the influence of factors such as career prospects and job security on attracting graduate recruits, there are risks to the quality of the

public service workforce if these factors are diminished, especially in a time of spending restraint. **Greater collaboration between graduate schemes can help ensure graduates see a career in public services as having varied career prospects. It should also help graduate recruits to develop the cross-sectoral experience and genuine generalist skills that leaders of the future will need.**

A Fair Pay Code

Independent pay-determination is vital for fairness, particularly where pay can vary with performance. Employees must perceive that pay-setting processes are fair, and be assured this they are free from arbitrary influences such as political interference. Taxpayers must also be confident that decisions about pay and performance are robust and protected against undue managerial influence.

Pay governance practices currently vary significantly across public services. Such variation is not necessarily a problem, but to reassure the public **a consistent framework of pay principles should be established.**

The Senior Salaries Review Body has produced a draft Code of Practice on senior pay. This has much to recommend it, but does not include fairness among its principles. Building upon this work, **this Review has therefore produced a Fair Pay Code, to be adopted by all organisations delivering public services on a 'comply or explain' basis.**

This new Code includes provisions on proportionality in executive pay, the use of variable pay and enhanced disclosure of executive pay in line with the recommendations of this Report. It also requires improved independent pay-determination processes.

To ensure that decisions on executive pay take account of the whole workforce context, and that executive pay decisions are justifiable to all employees, **organisations delivering public services should include an employee representative in the membership of their remuneration committees.**

There are risks in a 'comply or explain' approach; hence the importance of supporting good governance with the potential for tougher regulatory intervention, through a 'pyramid' of gradually escalating sanctions.

Fair Pay as a Social Norm

The principle set out in this Review, that pay should reflect due desert, set within a fair process, applies more widely than just to the issue of differentials between top pay and the pay of the rest. It is unfair that anyone should be rewarded or penalised for the brute luck of having been born male or female, or into any given ethnic or socio-economic background.

The revolution in executive remuneration is part of a wider trend of increasing pay dispersion. Some of this will have been fair and deserved, but some attributable to brute luck and economic rent. There is growing concern that increasing executive pay is not justified, and that it has detrimental results for organisations and for society at large.

The pay norms that are accepted where public meets private will affect the ability of public sector organisations to recruit and retain. Hence **it is important that the Fair Pay Code and as far as possible the other recommendations of this Review are extended into the public services industry.**

The framework of tracking multiples, of transparency and explanation, of earn-back, of escalating intervention, and of widening the talent pool, should be applied in the private sector.