

in brief...

Can pay regulation kill?

John Van Reenen and colleagues present evidence on the impact of regulating the labour market for nurses on the performance of hospitals in England.

Nurses' pay in England is set centrally with little local variation. This means that hospitals in high cost areas like London and the South East struggle to recruit and retain staff. As a consequence, our research finds that they treat fewer patients and have lower quality outcomes – for example, much higher fatality rates among patients admitted with emergency heart attacks.

These effects are not trivial: the results suggest that a 10% increase in the gap between the wages paid to NHS nurses and those paid to women working in the private sector locally raises the fatality rate among people admitted with a heart attack by about 5%.

Centralised pay setting happens in many public sector labour markets like health, teaching and the police. People often worry about the minimum wage pricing people out of jobs. But when pay in a sector is set to be almost the same across the country, it effectively imposes a maximum wage on people living in parts of the South

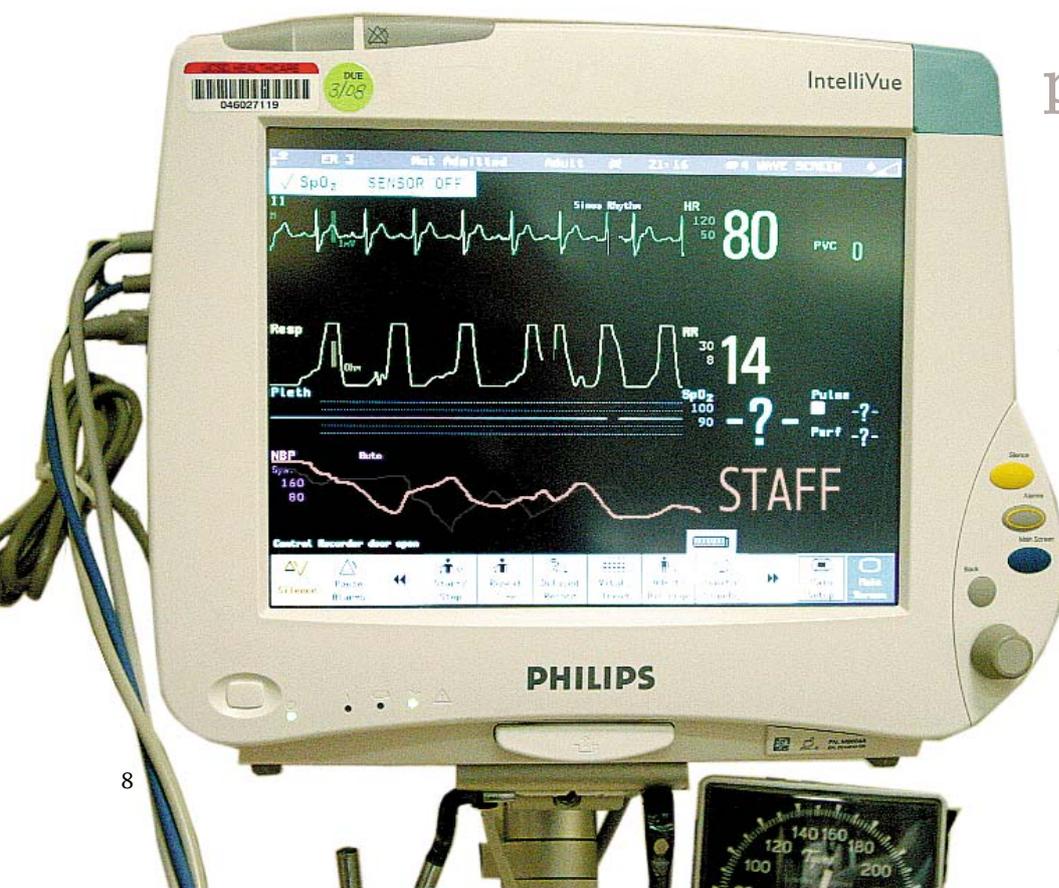
East where wages outside the public sector are pushed up by the tightness of the labour market.

Nowhere is centralised pay setting more important than in the NHS. More than a quarter of a million nurses in England have their pay set by a single pay review body. The process allows some local flexibility, but in practice the gap between the wages paid to a nurse in Newcastle and one in London is small compared with the pay gap between women in those areas who are not nurses.

The research looks at how centralised pay setting for nurses in the NHS affects hospital performance by tracking changes in the outside wage and changes in performance in over 100 English hospital trusts over a six-year period.

Common sense would suggest that hospitals located in places where outside opportunities are better are going to struggle to recruit, retain and motivate staff. This is

Centralised pay setting for nurses means that hospitals in high cost areas struggle to recruit and retain staff



exactly what the study finds: in areas like London where the outside labour market is strong – where the wages of nurses are lowest compared with their non-nurse counterparts – nurse vacancy rates are higher and fewer qualified nurses work in the NHS.

But these recruitment difficulties are not confined to the human resources department. More worryingly, they feed into a lower quality of service provision and poorer outcomes for patients. Hospitals in areas where the outside labour market is strong have lower volumes of activity relative to their staffing levels. They also have higher fatality rates among patients who are admitted with emergency heart attacks. A 10% increase in the outside wage means a 5% increase in death rates from heart attacks.

None of these effects are present in firms operating in the private sector. Nor do they seem to arise because hospitals in high cost areas face greater financial problems or have patients who are sicker – in fact, patients in many high external wage areas generally have better health than those in low external wage areas.

One key problem is that hospitals that find it difficult to recruit permanent staff rely more on temporary agency staff. These nurses can be paid at a higher rate to get around the pay regulation. But they often tend to have less experience and training, and will not know the hospital as well as someone on a permanent contract.

The maps in Figure 1 show the link between outside wages and use of temporary agency nurses who are less

experienced in working in the hospital. In the first map, the areas with the highest outside wages are marked in red and those with the lowest outside wages are marked in blue: it is clear that the large cities and the South East have higher outside wages. The second map shows the intensity of use of agency nurses, and the spatial distribution is very similar to that of the first map: where outside wages are high, use of agency nurses is high.

The study uses data from 1995 to 2002 and there have been some relaxations in the rules since then with more recruitment bonuses and cost of living allowances. But it is still the case that public sector workers are taking a much bigger effective pay cut compared with similarly skilled workers in lower cost areas.

The lessons can be used throughout the public sector. Instead of across the board pay increases, the right thing to do is to allow wages in the high cost areas of the South to increase at a much faster rate than the low cost areas of the North. This should be done in schools and police departments as well as hospitals. Only then will the death premium of London be properly tackled.

This article summarises ‘Can Pay Regulation Kill? Panel Data Evidence on the Effect of Labour Markets on Hospital Performance’ by Emma Hall, Carol Propper and John Van Reenen, CEP Discussion Paper No. 843 (<http://cep.lse.ac.uk/pubs/download/dp0843.pdf>).

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Figure 1:
Outside wages and the use of agency nurses

