The Hutton review is unlikely to solve the “wicked” problem of executive pay in the public sector

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In a time of fiscal austerity in government, the pay levels for senior civil servants have come under increasing scrutiny. **Sandy Pepper** *finds that despite the public’s seeming opposition to high pay in the public sector, there are no easy fixes, and that some of the recommendations in Will Hutton’s review may actually have the opposite outcome to what is intended.*

Problems, according to Rittel and Webster in an obscure but incredibly insightful article published in *Policy Sciences* in 1973, are either “tame” or “wicked”. A tame problem, on the one hand, is capable of a technical solution, for example by finding an expert with the necessary knowledge. A wicked problem, on the other hand, is not. Wicked problems are non-standard and context dependent. They are, in the words of Keith Grint, “open to better or worse developments, but not right or wrong solutions”.

Will Hutton’s review of fair pay in the public sector (not to be confused with Lord Hutton’s report on public sector pensions) recognises that executive pay is a wicked problem. He therefore rightly rejects technical solutions such as the 20 to 1 maximum pay multiple proposed by the Government after the last election. Pay caps generally don’t work. They don’t take account of the diverse nature of public sector organisations, some employing only highly skilled technical staff and others with large numbers of unskilled or semi-skilled workers: fixed multiples applied in such circumstances risk producing bizarre results.

Pay caps quickly become pay targets, leading to averaging up of total reward. Perverse incentives are created, such as outsourcing certain activities solely to remove lower paid staff from the payroll. Instead the Hutton review proposes a complex set of measures, including a focus on fairness (“due desert” in Hutton’s rather old fashioned terminology), greater transparency (for example through “fair pay reports”), and incorporating “earn-back” provisions into the employment contracts of public servants to prevent salaries from being paid in full in the event of underperformance. Hutton advocates a “fair pay code” as part of an attempt to force labour markets to take account of societal norms of what constitutes fair pay.

All of this is very worthy, and probably directionally correct, but nevertheless unlikely to succeed by itself. The first problem is that the pay of senior executives behaves in much the same way as the price of luxury or “Veblen” goods (after Thorstein Veblen’s *The Theory of the Leisure Classes*), where demand goes up if prices rise and down if prices fall. Evidence shows that enhancing the level of disclosure of senior executive reward leads to an increase in average executive pay levels, as lower paid executives use newly available data to negotiate pay rises.

This is precisely what happened in the 1990s when detailed disclosure of company directors’ pay was enforced by legislation in the United Kingdom. The second problem is that fairness is incredibly difficult to institutionalise in a formal or informal way. Economists struggle to conceptualise fairness: efficiency (which is to economics what justice is to law or health is to medicine) is hard enough to define. It is even harder to see how the concept of fairness can be readily incorporated into the economic calculus. Edward Zajac’s *Political Economy of Fairness* (1996) provides an examination of the issues.

Will Hutton deserves credit for recognising the wickedness of the problem of executive pay, for avoiding simplistic solutions, and for trying to work towards the deep issues that lie at the heart of the problem. But there is more work to be done.