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making business sense

The UK's public sector productivity shortfall is costing taxpayers £58.4 billion a year – in other words, not far short of half our income tax is paying for public sector inefficiency

In a little noticed revision slipped out on 14 August, the Office for National Statistics let on that the **public sector's productivity performance had been even worse than earlier admitted, with a decline of 3.4% from 1997 to 2007.**

At the same time productivity in the market sector rose by 27.9% so **had productivity in the public sector moved in line with that in the market sector, productivity would have been 32.4% higher.** On the other hand, although pay in the public sector has recently risen much faster than in the private sector, over the whole period from 1997 to 2007 pay in the public sector rose by slightly less. So in looking at the cost of public expenditure it is probably fairer to use the unit labour cost comparison which shows public sector costs rising by 30.5% relative to the market sector.

This productivity calculation does not of course apply to all public spending. It would be unreasonable to apply it to transfers, although there is an argument that many of these transfers are poorly targeted at the very minimum. Equally it would be wrong to apply it to capital expenditure. The paper on the subject <http://www.statistics.gov.uk/articles/nojournal/TotalPublicServiceFinalv5.pdf> makes it clear that the productivity calculation applies to General Government Final Consumption Expenditure (plus that part of further education dealing with under-19s).

This spending amounts to about £250 billion a year. So **had costs risen in line with the market sector, this would have cost £58.4 billion less.**

This cost simply relates to the falling behind in public sector productivity since 1997. Arguably public sector productivity was lower than it should have been even then – evidence from the Chartered Institute of Personnel Development shows sickness absence in the public sector running about 1½ times the rate in the private sector. As a former Chief Economist for IBM UK I am very aware that even in 1997 the level of automation in the public sector was well behind the curve, leading to excess cost. And this calculation does not take account of the increasing costs of public sector pensions or other equivalent costs.

The £58.4 billion excess cost is roughly equal to the entire yield forecast for VAT this year (partly at 15%) or to 42% of all income tax receipts.

Hard pressed taxpayers will not take too kindly to finding out that not too far short of half of the income tax that they pay is simply to cover the cost of the increased inefficiency of the public sector that has occurred since 1997.

The increasing inefficiency of public sector spending is one of the reasons why taxpayers in the UK feel that despite much higher taxes, they do not seem to have been rewarded with a commensurate improvement in public services. It also gives some confidence that it may well be possible to make substantial cuts in UK public spending without too great an impact on the levels of services.

Douglas McWilliams *chief executive*
centre for economics and business research ltd
dmcwilliams@cebr.com 0207 324 2845

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