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making business sense

Had the public sector pay bill risen in the last two years in line with the private sector bill, taxes could be £11 billion lower

The official figures for the public sector pay bill (estimated by multiplying the average earnings index for the public sector by the employment numbers) show the public sector pay bill up by 12.5% in the two years to September 2009. This seemed unexpectedly high so we have looked carefully to see if the figures are distorted. It turns out that they are by the inclusion of Lloyds Bank and RBS employees. To get an accurate idea of what has been happening on a like for like basis the number of public sector employees in September 2009 needs to be adjusted down by 220,000, which brings the public sector pay bill increase down to 8.4%.

Meanwhile, the private sector pay bill (again adjusted to take out the distortion from the reclassification of Lloyds and RBS), which essentially creates the tax base to finance the public sector, has risen by only 1.8% over the same period.

Driving the rising relative cost of public sector employment are two factors. Employment in the public sector has been rising while that in the private sector has been declining. But in addition, public sector pay rose 3.9% in the year to September 2008 versus a private sector rise of 3.0% and by 2.9% in the year to September 2009 versus a private sector rise of 0.9%.

There is plenty of scope for legitimate argument over the right speed at which fiscal consolidation in the UK should take place, though a serious currency crisis could take this argument out of the hands of the economists.

But with income tax thresholds frozen in April, income tax rates set to rise in April 2010, employers' and employees' national insurance contribution rates set to rise in April 2011 and with above inflation rises in council tax projected, an excessive public sector pay bill cannot now be justified on Keynesian grounds. Any justification for the scale of the increase in public sector pay bills has to be based on a view that it makes sense to take resources away from the private sector to give to the public sector.

Had the public sector pay bill risen in line with the private sector pay bill over the past two years, £11 billion would have been saved in public spending, which would have made the entire rise in income tax and national insurance contributions in 2010 and 2011 unnecessary.

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