

Can public sector pay rises cause inflation?

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Inflation is the consequence of rising real prices of good and services relative to the value of the goods and services provided. In other words, if the price of what we buy goes up by 10% but what we buy is unchanged then we have 10% inflation.

We are suffering inflation now. It is widely recognised that there have been three reasons for this inflation.

The first was supply chain disruption following the Covid lockdowns that created shortages in the supply of some products, from gas to semi-conductors. With some people having savings from the Covid period and a desire to spend them this caused some selective short term price hikes in late 2021. This influence on prices has now gone.

Then there was the war in Ukraine. It was believed that this would create supply shortages for oil, gas, essential foodstuffs and fertiliser. As a result the financial commodity markets massively increased the cost of these products. As it turned out there were no such shortages. There need have been no such price rises, but those who made them liked the profits and by no means all those prices have fallen back as yet, especially in consumer markets.

Third, there is Brexit, which has made some foodstuffs much harder to import into the UK even though there are no actual shortages, and this has increased prices.

What has not caused inflation are quantitative easing, excess government spending or wage increases. In fact, government spending compared to need is too low and wages in general are well behind inflation.

So, the causes of inflation have nothing to do with pay.

This, though leads to the question 'who gains from inflation?' After all, if prices rise by 10% and wages by only 6%, who gets the rest?

Some, very obviously, covers increased costs. That's a fact. But those costs have only

increased by 10% on average. So, any employer who has managed to increase prices by 10% has covered their non-wage cost increases pound for pound, but if they have only paid a 6% pay rise they have increased their profit by roughly 4% of their payroll cost. In other words, it is certain that right now profits are being made by keeping pay rises down.

What that means though is that part of the inflation we are suffering is the result of a profit spiral.

At the same time there is a downward wage spiral.

But none of this affects the NHS, or teachers, or many other public servants because there is no charge for the services they supply. So their pay increases cannot directly fuel inflation.

They could only indirectly fuel inflation. But that would only be true if public sector employees got above average pay rises that pushed pay claims in the private sector upward.

That is not what is happening. Public sector pay deals that have been agreed are lower than private sector deals, on average. So there is no spillover from public sector pay deals into private sector pay.

So, in other words, nothing about likely public sector pay deals is going to impact inflation.

That's not surprising. That's because inflation is going to tumble this year come what may, although prices will still go up. That's because inflation measures relative and not actual prices. Now we are more than a year after the start of war in Ukraine the price shock it created will automatically work through the inflation calculations this year meaning that they will be very much smaller. 3% inflation is possible by the year end. Next year it may well go negative and prices might fall, although not by very much. That is going to happen because the arithmetic makes that outcome nigh on inevitable, unless there is another worldwide shock like another war.

So, not only can public sector pay not increase inflation, inflation will fall whatever happens to public sector pay. Those are as close to facts as can be said of any economic forecast.

The government's claim that it cannot afford public sector pay rises because they are inflationary is in that case a lie. It is not possible to make that claim. But they do. And that is why the public sector workers seeking to both be fairly paid and to secure the future of our public services deserve our support.