Funding the Future

Pay rises for teachers and the NHS will pay for themsel...

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I published this video this morning. In it, I argue that while the government will agonise over the cost of paying NHS workers and teachers the above-inflation pay rises that have been recommended for them, doing so is absurd. Once tax is taken into account, a large part of any payment due heads straight back to the government quite quickly. So why does no politician ever talk about that?

https://youtu.be/BWbm1RZtXT8?si=AeDWUpRnRgXaIYkF

The audio version of this video is here:

https://www.podbean.com/player-v2/?i=5irje-16810e5-pb&from=pb6admin&share=1&download=1&rtl=0&fonts=Arial&skin=c73a3a&font-color=&logo_link=episode_page&btn-skin=ff6d00

The transcript is:

There is going to be a lot of discussion in the next week or so about whether the government is going to give a 5. 5 per cent pay increase to people who work in the NHS and education. We know that the pay boards for both sectors have recommended this increase, and it's right that they have, because without such an increase, which is, of course, above the current inflation rate, those who work in these sectors will not see their wages catch up with the losses that they suffered during the period of inflation that we had in 2021/22.

So why is there going to be a lot of discussion? Well, because Rachel Reeves is going to say, "There's no money left. We can't afford this."

There will be hang ringing. There will be agonising. And there will be claims that any such pay increase will have to be associated with an increase in productivity in the NHS and schools, which, let's be honest, is pretty unlikely to be delivered.

Why? Because if you demand an increase in productivity of a teacher, what you actually do is provide less education to each child, and that isn't an outcome that society wants any more than we want a nurse looking after more people.

So, let's look at this from a different perspective.

How much is this really going to cost the government? And I want to use a few numbers here. Let's suppose that the pay increase would cost £100 in total. That's it. Now, obviously that's unrealistic, but you can multiply that figure by any sum you like, and that will still work through in the same way as the example I'm going to use.

And let's assume that the payment being made will be given to people who are on basic rate income tax and who pay National Insurance on all their earnings, which is pretty fair, because almost everybody working in education in the NHS will be in that situation on their existing earnings. Some might be higher rate, but let's not worry about that.

We'll also ignore the consequences for pensions, but they would actually make the calculations that follow more favourable for the government.

And we will ignore the fact that there is no corporation tax paid, so that doesn't have to be taken into account in this calculation, but it would in a private sector one.

Now, that £100 is going to have to cover not just the pay increase, but the employer's national insurance that will be paid on that pay increase. So, in other words, £100 actually covers the pay plus National Insurance at 13. 8%, which National Insurance is at present. That will mean that the actual pay increase is £87.87 and £12.13 of employers' National Insurance will be paid. Add those two figures together and they come to that £100. But we've got our first contribution back to the government as a result. £12.13 of employers' National Insurance is going to be paid by NHS trusts, by school trusts, by local authorities, or whoever else is supplying NHS care and education.

Then the person who gets the pay increase, that's a teacher, that's an NHS worker, whatever they might be doing, is going to pay PAYE on what they get. How much will they pay? We've said they're a basic rate taxpayer, so they'll pay 20%. £17.57 of income tax, in other words, plus they'll pay employee's National Insurance, which right now is at 8%, so that's £7.02 on the £87.87 of extra pay they'll get.

Add those two together and £24.59 of the pay increase is going to be heading back to the government.

But then, that means they'll have a net pay increase out of that £100 of just £63.28 in their pocket. You can already see that a figure of over £36 has been paid back to the

government.

But now there's another factor to take into account. When they get their pay increase, the person will spend it. And they'll pay VAT. on what they spend money on. Now VAT does vary in rate. I fully admit if they pay all their increase on rent, there won't be any VAT on it. If they buy an expensive car, there will be more than VAT to pay. There'll be car taxes and other things as well. But let's assume VAT at 20%. That's the standard rate. And it's one-sixth of everything we spend if VAT at that rate is applied. The actual amount we pay includes the 20%. Therefore, we have to divide the spend by six to work out what the VAT included in it is.

And that means in that £63.28 of extra pay, £10.54 of VAT could be paid over on top of the PAYE and employer's national insurance already paid.

That means £12.13 of employers' National Insurance, plus £24.59 of total PAYE, plus £10.54 of VAT will now be being passed over to the government as a consequence of the person in the NHS or education getting their £100 pay rise. Net result? A total of £47.26 will be passed over to the government as a consequence of paying the pay increase, or almost half of it because just £52.74 is left to move into the rest of the economy as a result of them having spent their pay increase.

But now let's just think about what happens to that £52.74. If £47.26 was paid on the money that was passed to the NHS employee, then let's presume that near enough, 47.26 per cent of the money that is now passed to someone else to buy services as a consequence of the spending by that person in the NHS or the education service will also give rise to a tax return. So, 47.26 per cent of that sum now paid over by the person working for the NHS or in education will become a further tax payment to the government. How much does that become? Well, that is £24.92, leaving a net benefit after that of just £27.82 to be passed on to the third round of this iterative process.

On that third round, £13.15 of tax will be paid. And let's stop there.

There's just £14.67 now left over, but of course we could repeat the process several times more with ever smaller sums of money going back to the government.

What you will have realised by now is that when we add up all these figures then in total £85.33 is being paid in tax, out of £100 that it cost to give a pay rise.

And it doesn't take very long for all those processes to take place, maybe months at most.

My point is a simple one. This pay rise very largely pays for itself.

And when we consider that having happier employments in the NHS and in education is likely to result in a better quality of service and therefore healthier outcomes for people or better education outcomes for our children, then we actually see a further benefit,

not least in the case of the NHS, because more people might be able to get back to work and productivity will rise.

In other words, it's entirely possible that the amount of gain to the government from giving a pay rise to keep NHS employees happy in their work will more than pay for itself in terms of extra tax paid, let alone anything else.

So, what is the government agonising about when it comes to these pay rises? I wish I knew. If only they understood this process, which is called the multiplier effect, then they would get their economic thinking right about pay rises and realise that within reason, they pay for themselves. It really is time that they did.

Thanks to commentator Andrew here, who made me think of doing this video.