

Economic View: All that effort goes to waste

By Robert Chote

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When politicians claim they can finance tax cuts or provide extra resources for public services by cracking down on waste and bureaucracy, voters should start counting the spoons. History shows that savings are much easier to promise than to deliver.

But the Government and opposition alike are now under pressure to get a bigger bang for the public spending buck. On the government side, the Treasury said in December's pre-Budget Report that the 2004 spending review - which will set departmental budgets to 2007-08 - will "lock in the step change in funding for key public services delivered in previous spending reviews". In other words, the rise in current government spending since 1999, from around 37 to 40 per cent of national income, has run its course.

With polls suggesting voters think public services are in worse shape than when Labour came to power, the Government will have to show it can make the current pot of money go further. The political imperative will be even greater as taxes increase over the next five years to meet Gordon Brown's fiscal rules and pay for the rise in spending we have already seen.

The task facing the Conservatives is tougher still. Unless they abandon Mr Brown's rules, they will need to explain convincingly how they can cut public spending as a share of national income if they are to hold out the prospect of lower taxes than under Labour. All the more so if they want to do more than merely avoid some of the increase the Government has already pencilled in.

Hence the search by both parties for savings. For the Government, much hangs on the Gershon Review, announced in last year's Budget. Its initial findings suggest the Treasury will look closely at procurement, back office functions (such as finance and human resource management) and the management of transactions between the public and private sectors (such as tax and benefit payments).

Meanwhile, the Conservatives have asked a task force led by company doctor David James to identify possible economies. As evidence that there are savings to be made, they cite - ironically, given their views on the euro - an interesting study published by the European Central Bank that compares public sector efficiency in 23 industrialised countries.*

The study pulls together different indicators of public sector performance. Some measure growth, unemployment, inflation and the share of total incomes received by the poorest 40 per cent of the population. Others try to capture the quality of public services and administration, including life expectancy, school enrolment, quality of transport infrastructure and perceptions of corruption.

The various measures are then combined in a single index of public sector performance. In 2000, the UK had an above-average score for education, average scores for public administration and infrastructure, but below-average scores for health, income distribution, economic stability and economic performance. Its performance overall was 9 per cent below average, a little worse than in 1990. Top performers were Luxembourg, Japan, Norway, Austria and the Netherlands, each at least 10 per cent above average.

To assess the efficiency of the public sector in each country, performance in 2000 is compared with the average level of general government spending in the 1990s - thereby taking into account the likely lag between spending and performance. In the UK, the Government spent just over 40 per cent of national income in the 1990s, compared with an average for industrialised countries of more than 46 per cent.

It is obvious from looking at the charts that, in some cases, one country is more efficient than another, because it is delivering at least the same performance while spending less money. The countries that are clearly most efficient are the US, Japan and Luxembourg. Public spending in the US is 16 per cent lower than in the UK, yet public sector performance is higher. On this basis the Conservatives conclude from the study that at least £70bn of public spending in the UK is wasted.

Now one might have numerous quibbles with this sort of analysis, most of which the authors concede. You might object to the way public sector performance has been measured. For example, life expectancy does not depend only on the quality of publicly provided healthcare, but also on factors such as diet.

You might also object to the weights given to each component. Of particular importance is the weight given to income distribution. The main difference between big spenders and small spenders is the size of their welfare payments, not the amount they spend on things like health and education. The study finds that if you modestly alter the weight given to income distribution in the overall performance measure, the efficiency calculations are little changed. But this may underplay differences in the relative importance that countries place on efficiency and equality. This may matter quite a bit if preferences differ between the country under examination and the particular exemplar of efficiency to which it is compared.

Even if you ignore such caveats, it is worth noting that while the UK public sector lags behind those of the most efficient countries, it actually delivers better value for money than the majority - especially in Europe. Performance may be below average, but public spending is even further below average. The lesson both parties should heed is that while there is doubtless waste in the public sector, eliminating it is easier said than done.

The study can be found at: www.ecb.int/pub/wp/ecbwp242.pdf

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