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# The Scottish Public Sector: Does Size Matter?

An investigation of the link between post devolution growth in public spending and Scottish economic performance

Based on Hume Occasional Paper No 69

by

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## Key questions

- Why did we carry out this research?
- What is the size of the UK/Scottish public sector?
- How can the size of the public sector influence the economy?
- What did we find for Scotland?
- Does this mean public spending should be cut?
- What should happen in future?

## Why did we carry out this research?

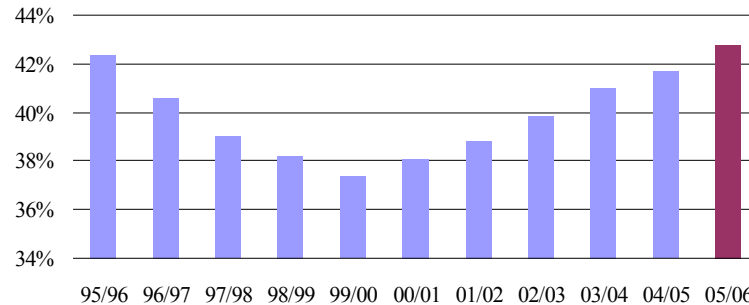
- UK wide debate on public spending, specifically applied to Scotland

<p>The Scottish Executive needs to cut public sector employment and reduce public spending. (Bill Jamieson, 2005)</p>	<p>'... the tabloid scare stories about a burgeoning state running out of control is not borne out by this data.' (Alf Young, 2006)</p>
<p>"... it should be an objective of the Scottish Executive to reverse the process of crowding out market sector activity which its policies have aggravated significantly." (Sir Donald MacKay &amp; David Bell, 2006)</p>	<p>Recent criticisms of the public sector have tended to resort to old and largely discredited arguments about 'crowding out' which do not reflect the more complex ways that public spending interacts with business activity. (Cumbers and Birch, 2006)</p>

- Objective and impartial, based on existing evidence
- Moving beyond polarised views of 'good or bad'
- Raising questions for consideration for future policy

# What is the size of the UK/Scottish public sector?

- Not one accepted measure of size of public sector
- Unprecedented spending growth in the UK



[Government spending as a share of the UK economy (% of GDP)]

	Outturn 2004-05	Plans 2005-06	% change
Northern Ireland	£8,216	£9,084	11%
<b>Scotland</b>	<b>£7,597</b>	<b>£8,265</b>	9%
Wales	£7,248	£7,666	6%
London	£7,530	£8,037	7%
North East	£7,167	£7,689	7%
North West	£6,930	£7,368	6%
<b>UK</b>	<b>£6,563</b>	<b>£7,000</b>	7%
England	£6,361	£6,762	6%

- Scottish data limitations
- Indications are that the public sector is relatively bigger in Scotland than in the rest of the UK
- Public sector expansion from a higher base

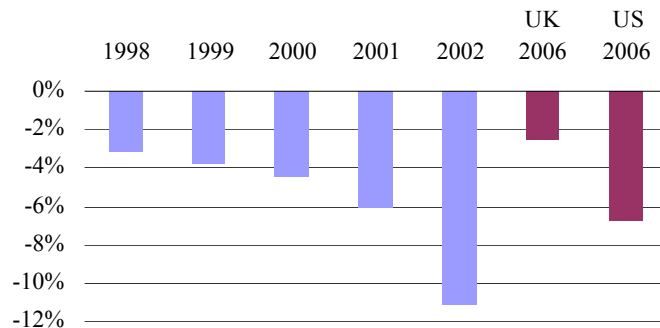
## How can the size of the public sector influence the economy?

- Technically known as ‘crowding out’
- Two key types of crowding out mechanisms:
  - Linked to government deficits → higher interest rates lead to lower private sector investment or higher taxes reduce economic activity
  - Government using up limited resources → these resources (labour, capital) are not available to the private sector
- Difficult to prove or disprove empirically – not a simple relationship

*“The results of the analysis tentatively support the hypothesis that the size of government has a detrimental impact on growth.” (OECD, 2004)*

## What do we find for Scotland? Fiscal position

- Scottish fiscal deficit (i.e. spending > revenue) persistent over time
  - With no oil revenue = 12.9% of Scottish GDP (2002-03)
  - With all oil revenue = 6.2% of Scottish GDP (2002-03)
- Higher than UK deficit = 3.7% of UK GDP over same period
- BUT: deficit financed through UK transfers → no crowding out
- Will have an impact on balance of trade if there is no additional production of goods and services in Scotland



Scottish balance of trade  
as a share of GDP

## What do we find for Scotland? Resources

- Capacity constraints can lead to resource crowding out
- Can result in unsustainable wage/price increases
- Some indication that this is happening in the construction sector
- Labour market impacts – at the higher end of the labour market:
  - Productivity gap is highest for Scotland at the high end
  - Scotland has a higher public sector wage premium
  - Almost half of Scottish graduates go into the public sector

Table 11: Graduates gaining permanent UK employment by industry of employer and level of qualification obtained: 1999-00 to 2004-05

Industry of employer	Agriculture and Related Industries (%)	Manufacturing and Construction (%)	Retail and Leisure (%)	Transport and Communication (%)	Finance and Business Services (%)	Public Administration (%)	Education (%)	Health, Social and Community Work (%)
Total								
1999-00	1	15	11	4	25	8	11	24
2000-01	1	13	13	3	24	9	11	27
2001-02	1	12	18	3	23	9	6	31
2002-03	1	10	18	3	21	9	5	36
2003-04	1	10	17	3	23	9	5	32
2004-05	1	10	15	2	23	9	5	34

## Are there any other impacts on the economy?

- Overall impact will also depend on:
  - What the expenditure is on (productive expenditure?)
  - Efficiency of public spending
- Long term investments required to provide framework for private sector growth
- Safety of the public sector option – dampening entrepreneurial spirit and activity?
- Long term dependence of the economy on public sector activity and ongoing transfers

## Does this mean public spending should be cut?

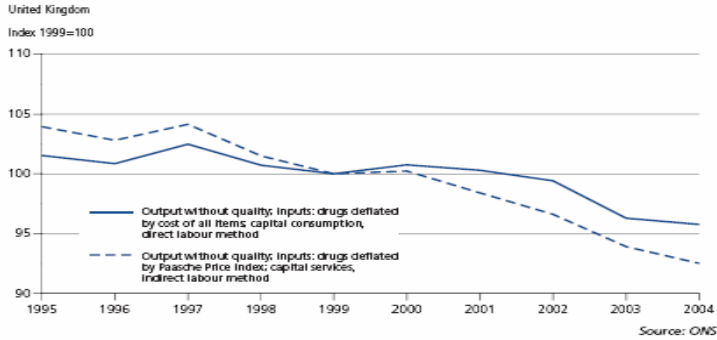
- Depends on what objectives are pursued
- Size of public sector has an impact – but it is one of many factors
- No free lunch – trade-offs are important
- If biggest priority is economic growth, bigger focus needed on productive investment
- Spending environment will become much tighter → difficult to maintain focus on productive investment
- Efficiency is critical but little agreement on measurement

# Productivity

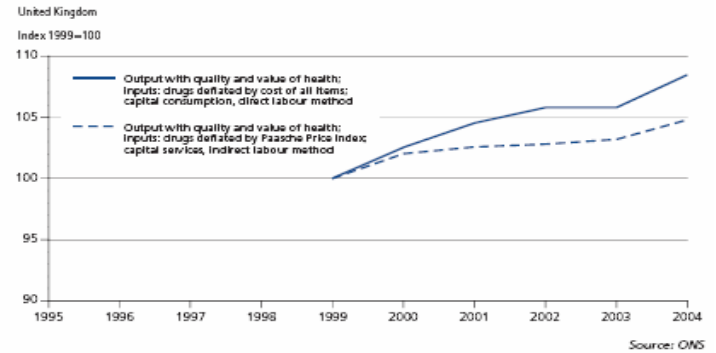
# Adjusted Productivity

Health

**Figure 1:**  
NHS productivity, excluding quality change for NHS output, 1995 to 2004

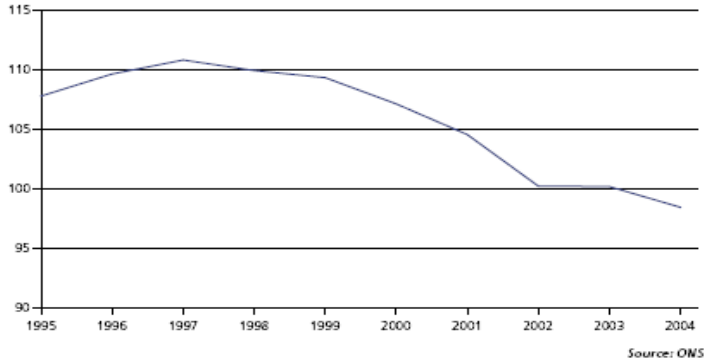


**Figure 3.**  
NHS productivity including quality change in NHS output and allowance for increasing value of health, 1999 to 2004

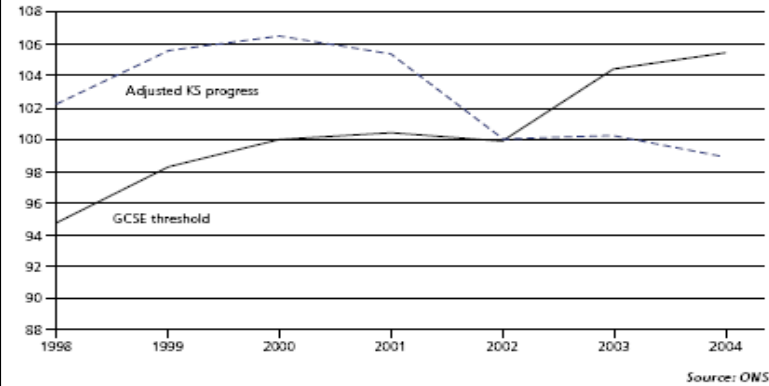


Education

**Figure 1.3**  
Education productivity measure 1995 to 2004



**Figure 1.5**  
Earnings adjusted measures of productivity 1998-2004



## A view from 'Yes, Minister' on these statistics?

Sir Humphrey: Minister, you said you wanted the administration figures reduced, didn't you?

Jim Hacker: Yes.

Sir Humphrey: So we reduced the figures.

Jim Hacker: But only the figures, not the number of administrators.

Sir Humphrey: Well of course not.

Jim Hacker: Well that is not what I meant.

Sir Humphrey: Well really Minister, one is not a mind-reader, is one? You said reduce the figures, so we reduced the figures.



BBC 'Yes, Minister'

Sir Humphrey: The government figures will be incomplete!

Jim Hacker: So?

Sir Humphrey: They will be a nonsense!

Jim Hacker: I thought the government figures were always a nonsense.

Bernard Woolley: Yes, but I think Sir Humphrey wants them to be a complete nonsense, Minister.

## What should happen in future?

- Efficiency/productivity of public spending needs more investigation
- Size of the public sector has an impact on the economy but this does not mean that there should be cuts
- It matters what the public sector spends money on → productive investment to enable private growth
- Long term development plans like Irish NDP can help to lock in investment



*“... a policy idea everyone could agree with.”*

*(Peter Jones, Scotsman)*