LEAN, NOT MEAN

HOW SMALL GOVERNMENT WORKS

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SUMMARY

Which type of government gives its citizens the best public services, the best standard of living and the most equitable outcomes? Big government? Or lean government?

This pamphlet examines the performance of 10 OECD member countries over the last two decades in 20 different fields. Five of these countries are classified as having "leaner" governments (Canada, Ireland, New Zealand, Spain and the US); and five are classified as having "larger" governments" (France, Germany, Italy, Portugal and the UK).

The results are striking:

- Leaner governments reduced their tax take and other receipts, expressed as a proportion of GDP, by an average of 6.5 percentage points over the last two decades while larger governments grew their tax and other receipts by an average of 4.8%. Spending for the leaner governments averaged 37% of GDP for the leaner governments compared to 49% for larger governments.
- Per capita income was 12% higher in leaner government countries in 2003 than it was in larger government countries.
- Real GDP grew faster in lean government countries than it did in countries with larger governments (between 1997 and 2005, it grew at an average rate of 4.1% in the first group compared to 1.9% in the second).
- Leaner governments expanded their spending on public services at a faster rate than larger governments (the average growth rate in public spending for leaner governments went up from 2.4% a year (1980-1990) to 4.3% (2000-05) while it fell over the same period for larger governments from 2.6% to 2.2%).
- In terms of the UN's Human Development Index (which is based on estimates of life expectancy, education and standard of living), countries with leaner governments score higher on average than those with larger governments.

- Life expectancy and mortality rates are very similar for both groups.
- Total health spending is higher in countries with leaner governments than it is in countries with larger governments. In 2002, the first group of countries spent an average of 9.5% of GDP on health compared to 9.2% in the second group.
- Leaner governments spent slightly more on education than larger governments. In 2002, leaner governments spent an average of 5.5% of GDP on education compared to 5.4% in the second group.
- Leaner government economies have created more jobs in the last decade than larger government economies (the employment growth rate in the first group averaged 2.5% a year between 1993 and 2005 compared to just 0.8% a year in the second group). Youth unemployment has dropped in larger countries to just 12.9% whereas in larger government economies it has grown to 16.5%.
- Both groups spent similar amounts on income support to people of working age; larger government economies were more generous to pensioners (spending an average of 11.7% of GDP on pensions compared to 7.3% by leaner government economies).
- Reductions in government expenditure by leaner governments have not widened the gap between rich and poor in those countries.
- Both groups of countries give similar amounts in foreign aid. However, in terms of imports from developing countries, leaner government economies imported far more from developing countries than larger government economies (7.1% of GNI compared to 4.2%), thereby helping to stimulate developing country econmomies.
- There is little difference (just 0.1 kg) in the average CO_2 emission levels per dollar of GDP between the two groups.
- Domestic savings grew in leaner government countries between 1990 and 2003 (from 21% of GDP to 25%) but fell in larger government countries (from 21% to 19% over the same period).
- Leaner government economies attracted far more foreign direct investment than larger government economies. It more than doubled in the first group (from 2.0% of GDP in 1990 to 4.9% in 2003), while it fell from 1.8% to 1.2% over the same period for the second group.
- Leaner government economies have higher exports and imports. They are more likely therefore to be able to respond to the pressures of globalisation that the more protection-minded economies of the larger government group.
- Leaner government economies have less rigid employment practices and are generally rated to be more friendly to business than larger government economies.
- Leaner government economies have also seen a growth in private sector productivity. This reached an average of 1.9% over the last decade. This is now nearly twice the rate of that in larger government economies (where it has fallen to an average of 1.1% a year).
- All data come from the published reports of international organisations such as the OECD, IMF, World Bank, United Nations and the WTO.

CHAPTER ONE
INTRODUCTION

Which type of government gives its citizens the best services, the best standard of living and the most equitable outcomes? Big governments? Or leaner governments?

The advocates of big governments claim that the prosperity of a nation and the welfare of its people cannot be left to the mercy of unrestrained market forces. Democratic elections give governments a mandate and a duty to implement plans and programmes set out in their party manifestos. They need adequate resources to execute them. They also need a coherent social philosophy to guide their actions. So say the supporters of the European "social model".

Big government, they claim, has the broad perspective to take decisions in the national interest. Only they have the capacity to ensure that all citizens have access to basic public services such as education and health care. Only they can redistribute income to the poor, aged and disadvantaged to ensure a just and fair society.

Moreover, once voters are accustomed to a high level of government expenditure and public services that are free at the point of delivery, lean government can appear threatening. Politicians might worry that potential supporters fear cuts to their own benefits and entitlements, fear a reduction in investment in public services and may be uncomfortable with the idea of giving tax cuts to the already well-off.

Yet the simple question remains. Does big government work?

For the evidence suggests that big governments lack business acumen. They have little familiarity with consumers' needs in the myriad fields in which advanced economies are engaged. They fail to allocate resources as perceptively as do market participants. And lacking commercial motivations or competitive pressures, their record in managing government operations is poor.

And big governments discourage enterprise and initiative by grabbing too large a share of the rewards, and by tying entrepreneurs up in too much red tape. They set too many rules affecting social behaviour in areas best left to the discretion of individuals and families.

And the idea that only big governments can deliver good health and education outcomes is based on an unduly static approach to fiscal policy. For reduced tax rates and lower overall tax burdens do not necessarily mean less government revenue. If tax cuts stimulate entrepreneurship, higher investment, harder work, and faster productivity growth, more resources will be made available in the future to spend on key public services than would otherwise be the case. And more income will be retained by households and businesses to spend in ways they know best, thus generating further growth.

It is therefore a mistake to think of lower taxes as dividends that can only be paid out to stake holders if other policies bear fruit. The countervailing evidence is strong: several governments have slimmed down their operations (in relative terms), and still modernised both their private economies and their social services. Gains accrued to all segments of the community. Economic performance has generally improved, and social welfare enhanced. In contrast, countries whose governments have expanded their direct interventions in the economy and society, and have controlled a larger share of total resources, have done less well on the whole.

This pamphlet examines the performance of ten OECD member countries over the last two decades. The countries selected have similar socio-economic characteristics and income levels. But their governments have pursued different approaches to the role of the state. Half of the countries (Canada, Ireland, New Zealand, Spain and the United States) lowered tax burdens and reduced the relative size of the state, as measured by the share of government receipts and expenditure in GDP. This group is labelled "leaner governments". The other half (France, Germany, Italy, Portugal and the UK) have increased state intervention in recent years, resulting in rising government spending/GDP ratios from already relatively high levels. They are called "larger governments".

The data come from published reports of international organisations, such as the OECD, IMF, World Bank, United Nations and the WTO. The periods and years shown in the tables vary from indicator to indicator. They are determined by the practices of the source organisations cited, and the availability of data. Chapters 2 to 13 chart trends in key areas. Chapters 14 to 20 examine some of the forces and factors that have influenced the outcomes. The focus throughout is on long-term trends, which even out cyclical and random fluctuations.

CHAPTER TWO
TRENDS IN THE SIZE OF GOVERNMENT

Table 1 overleaf shows the level of government receipts and outlays expressed as a percentage of GDP in 2005. For countries with leaner governments, the table indicates the extent of the drop in the government's share from the highest level reached during the last two decades. For countries with larger governments, it records the increase in their share from the lowest points during the same period.

The two groups exhibit strikingly different behaviour. Leaner governments reduced their tax and other receipts by an average of 6.5 percentage points, down to 37.1% of GDP in 2005. And they borrowed less in recent years. So their total outlays fell by 12.3 points from peak levels on average, reaching a balance with receipts. New Zealand's government undertook the most drastic slimming regime. Its receipts fell by 12.7 points, and its spending by 18.5 points. The US government kept the most consistently lean shape. Its receipts and outlays remained well below the 40% mark during the whole of the period. But in 2005 it was still able to cut spending by 2.6 points from its highest level.

Larger governments were substantially greedier in their appetites for revenue, and more lavish in their spending. Their receipts rose by an average 4.8 points from their lowest levels, reaching 45.1% of GDP – a full eight points above their leaner rivals.

Spending soared by an average of 5.5 points, accounting for not far short of half (48.9%) of total national income on average in 2005. This was 11.8 percentage points above the leaner group average.

TABLE 1. GOVERNMENT RECEIPTS AND OUTLAYS AS A PERCENTAGE OF GDP

	GENERAL GOVERNMENT RECEIPTS			GENERAL GOVERNMENT OUTLAYS		
	% of GDP		Change	% of GDP		Change
LEANER GOVERNMENTS	**Highest**	**2005**	**% points**	**Highest**	**2005**	**% points**
Canada	44.5	40.5	– 4.0	53.3	39.3	– 14.0
Ireland	44.2	34.5	– 9.7	52.0	35.2	– 16.8
New Zealand	51.0	38.3	– 12.7	53.6	35.1	– 18.5
Spain	42.4	40.6	– 1.8	49.4	40.1	– 9.3
US	35.8	31.8	– 4.0	38.5	35.9	– 2.6
Average	**43.6**	**37.1**	**– 6.5**	**49.4**	**37.1**	**– 12.3**
LARGER GOVERNMENTS	**% of GDP**		**Change**	**% of GDP**		**Change**
	Lowest	**2005**	**% points**	**Lowest**	**2005**	**% points**
France	48.8	51.5	+2.7	50.4	54.5	+ 4.1
Germany	42.5	43.6	+ 1.1	44.0	47.1	+ 3.1
Italy	39.1	45.0	+ 5.9	46.9	49.5	+ 2.6
Portugal	32.8	43.8	+ 11.0	38.5	49.1	+ 10.6
UK	38.1	41.6	+ 3.5	37.5	44.5	+ 7.0
Average	**40.3**	**45.1**	**+ 4.8**	**43.5**	**48.9**	**+ 5.5**

Source: OECD, *Economic Outlook No.*77, 2005 Annex tables 25 and 26.

Note: The term "general government" covers all central, regional and local government activities and institutions in each country. Government receipts include all taxes, social security payments and non-tax revenue such as licence fees. Government outlays cover all forms of spending (for current operations and capital investment) on public services and benefit programmes. They include the cost of providing services in-kind (such as education, health, justice and defence) as well as cash transfers to citizens (for example, pensions and out-of-work benefits) and to firms (subsidies). Outlays are financed by tax and other receipts, supplemented in most cases by government borrowing. The figures for group averages are simple (non-weighted) averages for the members of each group.

The Portuguese government put on the most weight, adding 11 points since 1985. Spending by the United Kingdom government went up by 7.0 points from the lowest point since 1985, taking 44.5% of GDP in 2005. This was not far short of those well-known big spenders – Germany (47.1%), and Italy (49.5%).

CHAPTER THREE
INCOME LEVELS

Table 2 shows that average per capita income was 12% higher in countries with leaner governments than in those with larger, expanding governments in 2003, the latest year for which comparative data are available. This gap has emerged over the last two decades, as a result of faster economic growth in the first group.

TABLE 2. GROSS NATIONAL INCOME IN PPP DOLLARS, 2003

LEANER GOVERNMENTS	PPP GROSS NATIONAL INCOME $ billions	PPP GROSS NATIONAL INCOME PER CAPITA $
Canada	950	30,040
Ireland	123	30,910
New Zealand	86	21,350
Spain	910	22,150
US	10,978	37,750
Average	**2,609**	**28,440**
LARGER GOVERNMENTS		
France	1,652	27,640
Germany	2,279	27,610
Italy	1,546	26,830
Portugal	428	17,710
UK	1,643	27,690
Average	**1,510**	**25,496**

Source: World Bank, *World Development Indicators*, 2005, table 1.1.

Note: Data expressed in PPP dollars take account of differences in domestic prices for goods and services and so give a more realistic picture of income levels than unadjusted estimates.

CHAPTER FOUR

KEY GROWTH INDICATORS

As a group, growth in the economies with leaner governments easily outpaced those with larger governments in three key areas.

GDP

Table 3 shows that real GDP (measured in constant prices) grew at an average annual rate of 4.1% over the last nine years in the first group, up from 3.2% over the previous decade. The average growth rate for the second group dropped to 1.9% from 2.6%. Ireland was the star performer. Its economic growth surged to 7.0% annually since 1997, topping an already high average rate of 5.2% from 1987 to 1996. France and the UK improved their growth performance slightly, but fell short of all those in the first group.

REAL HOUSEHOLD CONSUMPTION EXPENDITURE

Real household consumption expenditure, a key indicator of living standards, rose by 3.6% annually on average in the first group from 1990 to 2003, compared with 2.8% a decade earlier. The reverse trend occurred in the countries whose governments grabbed a larger share of the cake. Their household consumption growth rate slowed to 2.1% from 2.8%. There are significant variations within the groups: average growth rate for the first group was boosted by a particularly strong surge in Ireland, and to a lesser extent in New Zealand. Consumption growth slowed in both Canada and the US. Nevertheless, since 1990 US households have enjoyed a rise in consumption more than twice as fast as their French, German and Italian counterparts.

TABLE 3. GROWTH OF GDP, HOUSEHOLD CONSUMPTION AND PUBLIC SERVICES

	GDP Average annual growth rate (%)		HOUSEHOLD CONSUMPTION Average annual growth rate (%)		PUBLIC SERVICES Average annual growth rate (%)	
LEANER GOVERNMENTS	**1987-96**	**1997-05**	**1980-90**	**1990-03**	**1980-90**	**2000-05**
Canada	2.2	3.5	3.1	2.8	2.4	3.3
Ireland	5.2	7.0	2.2	5.6	0.1	6.4
New Zealand	2.8	3.0	2.1	3.2	1.7	3.4
Spain	2.9	3.7	2.6	2.6	5.0	6.0
US	2.9	3.3	3.9	3.7	2.8	2.5
Average	**3.2**	**4.1**	**2.8**	**3.6**	**2.4**	**4.3**
LARGER GOVERNMENTS						
France	1.9	2.2	2.2	1.6	2.7	2.8
Germany	2.6	1.3	2.3	1.5	1.4	0.7
Italy	1.9	1.4	2.9	1.6	2.9	1.8
Portugal	4.0	1.9	2.5	2.8	5.0	2.4
UK	2.4	2.8	4.0	3.1	0.9	3.2
Average	**2.6**	**1.9**	**2.8**	**2.1**	**2.6**	**2.2**

Sources: IMF, *World Economic Outlook*, September 2005, Appendix table 2; World Bank, *World Economic Indicators* ,2005, table 4.10; and OECD, *Economic Outlook No. 77*, 2005, Annex table 4.

Note: The data for Public Services cover what is technically called "government consumption". This includes spending on personnel, materials and other current inputs used in public services. It excludes capital investment and monetary transfers in the form of cash benefits.

PUBLIC SERVICES

The most surprising finding to some observers is what has happened to public services. In the leaner government group, the growth in spending on public services accelerated to an average annual rate of 4.3% in 2000-2005, up from 2.4% in 1980-90. This suggests that an increased share of national income left in private hands stimulated greater efficiency and faster growth in the private sector, thus boosting individual and corporate tax revenues despite lower rates.

The growth in spending on the public services went up from an average of 2.4% (1980-90) to 4.3% a year (2000-05) in the leaner group. Over the same period, it fell from 2.6% to 2.2% in the larger government group.

The most striking change occurred in Ireland, where the corporate tax rate was reduced to 12.5%. This fiscal incentive encouraged a surge of investment, which in turn expanded the tax base rapidly. Thus the Irish government was able to increase spending on its public services at a 6.4% average annual rate over the last six years, compared with just 0.1% during the 1980s.

In contrast, the expansion of public services slowed in the second group from a 2.6% annual rate during the 1980s to 2.2% since 2000. But the UK appears to have bucked this trend, with a recorded 3.2% average rate over the last six years, up from just 0.9% in the 1980s. This latter figure was kept low as a deliberate strategy. The then Conservative Government aimed to make more efficient use of existing resources employed in public services, by reducing the number of hospital beds for example, and by raising the rate of patient turnover by shortening the period of post-operative treatment.

New Labour has chosen to inject substantial new resources at the tax payers' expense. However, doubts have been raised about the accuracy of these figures, which are obtained by converting expenditure in current prices into "real" values using price indexes for inputs. It has been suggested that more of the increase in current spending has been absorbed by higher salaries and other costs than indicated by the Office for National Statistics estimates submitted to international organisations.

CHAPTER FIVE

COMPOSITE HUMAN DEVELOPMENT INDICATORS

Each year the United Nations publishes a collection of human development indicators, which provide a global assessment of country achievements in different areas of human development. The findings are summarised in a Human Development Index (HDI) index. The HDI is a composite index that measures the average achievements in a country in three basic dimensions of human development: a long and healthy life, as measured by life expectancy at birth; knowledge, as measured by the adult literacy rate and the combined gross enrolment rate for primary, secondary and tertiary schools; and a decent standard of living, as measured by GDP per capita in purchasing power parity (PPP) US dollars.

While the concept of human development is much broader than any single composite index can measure, the HDI offers a powerful alternative to income as a summary measure of human well-being. It is also an important tool for monitoring long-term trends in human development. The HDI is calculated at five year intervals using consistent methodology.

Table 4 shows the UN estimates for the years 2003 and 1985 for the ten countries included in this study. All have achieved significant improvement in their human development standards. The HDI index rose to an average of 0.940 for leaner governments, 0.011 points higher for the larger. Out of 178 countries covered by the UN index, the leaner government group members were all classed among the top 21, with an average ranking of 13. The average ranking for the larger government group was 19.

TABLE 4. HUMAN DEVELOPMENT INDICES AND RANKINGS

	HUMAN DEVELOPMENT INDEX		HDI GLOBAL RANKING	
LEANER GOVERNMENTS	**2003**	**1985**	**2003**	**1985**
Canada	0.949	0.909	5	1
Ireland	0.946	0.845	8	21
New Zealand	0.933	0.868	19	= 15
Spain	0.928	0.868	21	=15
US	0.944	0.901	10	2
Average	**0.940**	**0.878**	13	11
LARGER GOVERNMENTS				
France	0.936	0.881	16	9
Germany	0.930	0.869	20	14
Italy	0.934	0.866	18	17
Portugal	0.904	0.826	27	24
UK	0.939	0.863	15	19
Average	**0.929**	**0.861**	**19**	**17**

Source: United Nations, *Human Development Report*, 2005, tables 1, 2 and 10.

Canada had the best all-round performance of the 10 countries in 2003. It was ranked fifth in the world, but has been overtaken by Norway, Iceland Australia and Luxembourg over the last two decades. Ireland has experienced the most substantial rise, jumping thirteen places in the rankings. The US has slipped back eight places, France seven and Germany six. But the UK has climbed four places.

The UN's evidence rejects the proposition that improvement in well-being requires governments to commandeer an ever-larger share of national income.

To sum up, there is relatively little difference between the two groups in their human development results. But the findings clearly reject the proposition that improvement in human well-being requires governments to commandeer an ever larger share of national income.

CHAPTER SIX
LIFE EXPECTANCY AND MORTALITY

Table 5 shows that the average citizens of all ten countries can now expect to live a few more years longer than their counterparts did a quarter of a century ago. Since 1970-75, average life expectancy at birth has increased by 6.6 years in the leaner government group. This rise is slightly less than in the larger government category. The two groups now have identical average levels of 78.7 years. The probability of surviving to age 65 is also very similar – around the 90% mark.

In richer countries, the relative size of government is not a critical determinant of average life spans or mortality rates.

Both groups have had considerable success in reducing child mortality rates, down to just 5 to 6 deaths per 1,000 live births. And maternal mortality rates are now very low – in the range of 4 to 17 per 100,000 live births.

The relative size of government is clearly not a critical determinant of average life spans or mortality rates in richer countries.

TABLE 5. SELECTED INDICATORS OF LIFE EXPECTANCY AND MORTALITY

	LIFE EXPECTANCY AT BIRTH (years)		UNDER-FIVE MORTALITY RATE (per 1,000 live births)		MATERNAL MORTALITY RATE (per 100,000 live births)	PROBABILITY AT BIRTH OF SURVIVING TO AGE 65 (% of cohort) 2000-05	
LEANER GOVERNMENTS	**2000-05**	**1970-75**	**2003**	**1970**	**2000**	**Female**	**Male**
Canada	79.9	73.2	6	23	6	90.7	85.0
Ireland	77.7	71.3	6	27	5	89.7	83.1
New Zealand	79.0	71.7	6	20	7	89.1	84.1
Spain	79.5	72.9	4	34	4	92.8	82.1
US	77.3	71.5	8	26	17	86.7	79.1
Average	**78.7**	**72.1**	**6**	**26**	**8**	**89.8**	**82.7**
LARGER GOVERNMENTS							
France	79.4	72.4	5	24	17	91.2	80.9
Germany	78.7	71.0	5	26	8	90.5	82.3
Italy	80.0	72.1	4	33	5	92.2	84.6
Portugal	77.2	68.0	5	62	5	90.2	79.8
UK	78.3	72.0	6	23	13	89.4	83.6
Average	**78.7**	**71.1**	**5**	**34**	**10**	**90.7**	**82.2**

Source: United Nations, *Human Development Report*, 2005, table 10.

CHAPTER SEVEN

HEALTH

Leaner governments spent an average of 6.2% of GDP on health in 2002, 0.9 percentage points less than their ideological rivals. But their populations benefited from higher total allocations (9.5% of GDP versus 9.2%), because private funding of health care by individuals and enterprises was significantly higher on average (3.3%). Table 6 shows that this was one and a half times the amount put aside for private programmes in the second group. These figures may underestimate private health spending because they often exclude individual co-payments set through government regulations.

The US topped the list for total health spending with 14.6%. Because of its large private health care sector (8.0% of GDP), taxpayer-funded programmes (6.6% of GDP) could be concentrated on the most vulnerable segments of the population (particularly lower-income pensioners). The UK had the second lowest total health funding ratio (7.7%), just above Spain's.

The number of physicians per 1,000 people went up in all but one country (Canada) from 1990 to 2004. The second group has a slightly higher ratio on average (3.6 versus 3.1). But the US witnessed the most rapid rise, to 5.5 from 2.4. The UK is bottom of the list with just 1.7.

The number of hospital beds per 100,000 people has fallen in all ten countries, with the lowest point being reached in the US (3.6). This general trend reflects a consensus on the need to use capital and manpower in health services more efficiently.

TABLE 6. HEALTH EXPENDITURE, AND NUMBER OF PHYSICIANS & HOSPITAL BEDS

LEANER GOVERNMENTS	HEALTH EXPENDITURE (% of GDP, 2002) Total	Public	PHYSICIANS (per 1,000 people) 2004	1990	HOSPITAL BEDS (per 1,000 people) latest year	1990
Canada	9.6	6.7	2.1	2.1	3.9	6.3
Ireland	7.3	5.5	2.4	1.6	9.7	10.5
New Zealand	8.5	6.6	2.2	1.9	6.2	8.5
Spain	7.6	5.4	3.2	2.3	4.1	4.3
US	14.6	6.6	5.5	2.4	3.6	4.9
Average	**9.5**	**6.2**	**3.1**	**2.1**	**3.9**	**6.9**
LARGER GOVERNMENTS						
France	9.7	7.4	3.3	2.6	8.2	9.7
Germany	10.9	8.6	3.6	3.1	9.1	10.4
Italy	8.5	6.4	6.1	4.7	4.9	7.2
Portugal	9.3	6.6	3.2	2.8	4.0	4.6
UK	7.7	6.4	1.7	1.4	4.1	5.9
Average	**9.2**	**7.1**	**3.6**	**2.9**	**6.1**	**7.6**

Source: World Bank, *World Development Indicators*, 2005, table 2.14.

CHAPTER EIGHT

EDUCATION

Table 7 shows that leaner governments spent slightly more on education (5.5% of GDP) than larger governments (5.4%) in 2002, with Spain leading the way (6.7%).They also encouraged greater private funding. So their total outlays on education were 0.7 percentage points higher on average (see table 7).

In 2002, leaner governments spent more on education than larger governments, and had a higher enrolment rate in tertiary education.

These additional resources helped to raise tertiary enrolment rates. An average of 64% of the relevant age group was enrolled in higher education institutions in the first group in 2002/03, compared with 55% in the second. The US easily led the rankings with 81%. Ireland, though still bottom of the group with 50%, is catching up rapidly. Its ratio was just 31% in 1990/91. Competing successfully in the global market requires a wider spread, and more intensive development, of high-level skills and knowledge bases.

At the level of development reached by these industrialised countries, expanding advanced education and training programmes should be a more important priority than reducing pupil to teacher ratios in primary schools. The slightly lower ratios at the primary level achieved by larger governments are unlikely to have a significant impact on their countries' performance in the economic or social spheres in the future.

TABLE 7. EDUCATION INPUTS AND TERTIARY ENROLLMENT RATES

	EDUCATION EXPENDITURE (% of GDP)			PRIMARY PUPIL-TEACHER RATIO	TERTIARY ENROLMENT RATE
	Public	Private	Total	Pupils/teacher	(% of relevant age group)
LEANER GOVERNMENTS	**2002**	**2002**	**2002**	**2002/03**	**2002/03**
Canada	5.2	1.3	6.5	17	58
Ireland	5.7	0.3	6.0	19	50
New Zealand	5.5	n.a.	n.a.	18	74
Spain	6.7	0.6	7.3	14	59
US	4.5	2.3	6.8	15	81
Average	**5.5**	**1.1**	**6.7**	**17**	**64**
LARGER GOVERNMENTS					
France	5.6	0.4	6.0	19	54
Germany	4.6	1.0	5.6	14	49
Italy	5.8	0.4	6.2	11	53
Portugal	5.8	0.1	5.9	11	53
UK	5.3	0.8	6.1	17	64
Average	**5.4**	**0.5**	**5.9**	**14**	**55**

Source: UN, *Human Development Report*, 2005 table11; OECD Indicators, *Education at a Glance*, 2004; World Bank, *World Development Indicators*. 2005, tables 2.10 2.11.

CHAPTER NINE
EMPLOYMENT

Table 8 shows that leaner government economies have created more jobs over the last decade. Their average ratio of total employment to the population of working age climbed to 70.1% in 2005, an increase of 8.5 percentage points from the 1993-95 level and 3.2 points higher than the larger governments' average in 2005. The two groups had identical average levels 10 to 12 years ago.

New Zealand makes the fullest use of its labour resources. Three quarters of its 15 to 65 year olds were in jobs in 2005. Italy lags well behind. 42.8% of its working age population was economically inactive last year.

The economies of leaner governments generated much faster growth of employment. Their rate of job creation averaged 2.5% annually from 1993 to 2005. This was two and a half times faster than over the previous decade, and more than three times the average rate of the second group since 1992. Ireland and Spain posted particularly strong employment growth rates, admittedly starting from low employment/population ratios.

TABLE 8. EMPLOYMENT AND UNEMPLOYMENT: RATIOS AND RATES

	EMPLOYMENT RATIO Average %		EMPLOYMENT GROWTH RATE Average annual %		UNEMPLOYMENT RATE % of labour force		
LEANER GOVERNMENTS	**1993-1995**	**2005**	**1983-1992**	**1993-2005**	**1987-1996**	**1997-2005**	**2005**
Canada	65.7	73.8	1.6	1.9	9.5	7.5	6.8
Ireland	53.8	68.2	0.4	3.9	14.5	5.3	4.2
New Zealand	74.9	75.0	0.0	2.4	7.5	5.4	4.0
Spain	47.2	62.8	1.3	3.1	20.0	13.0	9.1
US	66.4	70.8	1.8	1.4	6.1	5.0	5.2
Average	**61.6**	**70.1**	**1.0**	**2.5**	**11.5**	**7.2**	**5.9**
LARGER GOVERNMENTS							
France	59.7	62.7	0.3	1.0	10.4	9.8	9.8
Germany	63.9	70.4	3.9	0.3	7.3	8.9	9.5
Italy	54.9	57.2	0.2	0.7	11.3	9.7	8.1
Portugal	63.5	71.8	1.4	0.8	5.8	5.7	7.4
UK	65.9	72.2	0.7	1.0	8.5	5.5	4.7
Average	**61.6**	**66.9**	**1.3**	**0.8**	**8.7**	**7.9**	**7.9**

Sources: OECD, *Economic Outlook No.* 77, 2005 Annex tables 20, 21; IMF, *World Economic Outlook*, September 2005, Statistical Appendix table 4.

Both groups have reduced their unemployment rates (measured by the percentage of the labour force seeking work but unable to find jobs). But the first group has done so more rapidly, and to a lower point. The average rate in leaner government economies dropped to 7.2% over the 1997-2005 period, from 11.5% during 1987-1996, and fell further to 5.9% in 2005. Ireland, which has reduced its overall government spending ratio the most over the last two decades, has also been most effective in tackling unemployment. Its unemployment rate has dropped to 4.2% in 2005, from a 14.5% average rate during the 1887-1996 period.

The larger government group realised only slight long-term reductions in unemployment levels – a fall of just 0.8 percentage points in their average rates over two decades. And only Italy and the UK have recorded further progress in recent years.

THE EFFECTIVE LABOUR MARKET PROGRAMMES OF LEAN GOVERNMENTS

There is no correlation between the level of government expenditure on labour market programmes – such as training, placement services, and employment incentives to employers – and national performance in the employment field. Table 9 shows that the second group spent on average 2.29% of their GDP on such programmes in 2003/04, compared with 1.47% by the first. Yet their incidence of both long-term and youth unemployment is now substantially higher. Moreover, apart from Italy, the situation has worsened since 1990 in this group on both counts.

TABLE 9. GOVERNMENT SPENDING ON LABOUR MARKET PROGRAMMES, LONG-TERM AND YOUTH UNEMPLOYMENT RATES

	GOVERNMENT EXPENDITURE ON LABOUR MARKET PROGRAMMES	LONG-TERM UNEMPLOYMENT (12 months and over)		YOUTH UNEMPLOYMENT RATE	
	% of GDP	% of total unemployment		15-24 years	
LEANER GOVERNMENTS	**2003/04**	**1990**	**2004**	**1990**	**2004**
Canada	1.14	7.3	9.5	12.4	13.4
Ireland	2.09	66.0	34.3	17.7	8.1
New Zealand	1.32	21.8	11.7	14.1	9.3
Spain	2.27	54.0	37.7	30.2	22.0
US	0.53	5.5	12.7	11.2	11.8
Average	**1.47**	**30.9**	**21.2**	**17.1**	**12.9**
LARGER GOVERNMENTS					
France	2.85	38.1	41.6	19.8	21.3
Germany	3.46	46.8	51.8	4.5	11.7
Italy	n.a.	69.8	51.8	31.5	23.5
Portugal	1.95	44.9	49.7	9.6	15.3
UK	0.89	34.4	43.2	10.1	10.9
Average	**2.29**	**46.8**	**47.6**	**15.1**	**16.5**

Source: OECD Employment Outlook 2005, tables C, H and G.

Average long-term and youth unemployment rates have dropped where governments have become leaner.

In contrast, average long-term and youth unemployment rates have dropped where governments have become leaner. Clearly, the performance of the whole economy is a more important determinant of employment and unemployment levels than the extent of government intervention in the labour market.

CHAPTER TEN
SOCIAL SUPPORT

Social support is defined by the OECD as the provision, by both public and private institutions, of benefits and financial contributions to households whose circumstances adversely affect their welfare. Much of this support takes the form of social expenditures, which comprises cash benefits and direct "in-kind" provision of goods and services. They are usually targeted at low-income households but also to children, the elderly, and persons who are disabled, sick or unemployed.

Table 10 below gives the latest data for two types of cash benefits:

(i) income support to the working age population, and

(ii) pensions for the aged and survivors.

Contrary to what might be expected, two leaner governments (Canada and New Zealand) were the most generous providers of cash benefits to working age households, allocating 8.7% and 6.7% of their GDP in this way respectively. Their munificence brought their group average to 5.1% in 2001 compared with 4.8% for larger governments.

Public pension provision absorbed nearly twice as high a proportion of national income in the second group than the first. Private providers supplement public pensions to the greatest extent in Canada, the US and UK. Italian pensioners and survivors receive the largest share of the national cake.

However, these figures exclude pension receipts from savings and investments made by individuals from their own resources during their working lifetimes. This source is particularly important in the US.

TABLE 10. INCOME TRANSFERS AND PENSION PAYMENTS FROM PUBLIC AND PRIVATE SOURCES

	INCOME SUPPORT* TO THE WORKING AGE POPULATION % of GDP (2001)			PENSIONS (OLD AGE AND SURVIVORS) % of GDP (2001)		
LEANER GOVERNMENTS	**Public**	**Private**	**Total**	**Public**	**Private**	**Total**
Canada	8.7	0.0	8.7	5.3	3.4	8.7
Ireland	4.4	0.0	4.4	3.2	0.0	3.2
New Zealand	6.7	0.0	6.7	4.9	0.0	4.9
Spain	4.1	0.0	4.1	8.7	0.0	8.7
US	1.8	0.4	2.2	6.1	4.7	10.8
Average	**5.1**	**0.1**	**5.2**	**5.6**	**1.6**	**7.3**
LARGER GOVERNMENTS						
France	6.0	0.3	6.3	11.9	0.2	12.1
Germany	4.5	1.4	5.9	11.2	0.6	11.8
Italy	3.3	n.a.	3.3	13.8	n.a.	13.8
Portugal	4.2	0.4	4.6	9.1	0.2	9.3
UK	5.9	0.8	6.7	8.3	3.0	11.3
Average	**4.8**	**0.4**	**5.4**	**10.9**	**1.0**	**11.7**

Source: OECD, *Society at a Glance: Social Indicators 2005*, Tables EQ5.1 and EQ6.2
* including incapacity benefits.

EXPENDITURE ON SOCIAL SERVICES

Table 11 presents the latest data on social services provided in-kind, except health. Once again, the Canadian and New Zealand governments are the most active in these fields among the first group, rivalling the support provided by the German and Italian governments. However the figures for private provision are understated, because they do not take into account the vast array of voluntary services provided by non-governmental organisations in most countries.

TABLE 11. PUBLIC AND PRIVATE EXPENDITURE ON IN-KIND SOCIAL SERVICES

	ALL SOCIAL SERVICES EXCEPT HEALTH, 2001		
LEANER GOVERNMENTS	**Public % of GDP**	**Private % of GDP**	**Total % of GDP**
Canada	2.7	0.0	2.7
Ireland	0.6	n.a.	0.6
New Zealand	2.6	n.a.	2.6
Spain	0.6	n.a.	0.6
US	0.5	0.0	0.5
Average	**1.4**	**0.0**	**1.4**
LARGER GOVERNMENTS			
France	2.0	0.3	2.3
Germany	2.6	0.1	2.7
Italy	2.4	1.4	3.8
Portugal	1.0	0.1	1.1
UK	1.2	0.4	1.6
Average	**1.8**	**0.5**	**2.3**

Source: OECD, *Society at a Glance: Social Indicators 2005*, tables EQ5.1 and EQ6.2

CHAPTER ELEVEN
INCOME DISTRIBUTION

Table 12 shows that reductions in government expenditure in relative terms have not widened the gap between rich and poor in the leaner government group. On the contrary, the share of the poorest 20% of households in total income or consumption has increased significantly in all members of the group since the 1980s. Their average percentage (6.7%) in recent years is almost on a par with the average (6.8%) for governments that spend a far higher percentage of national income.

Similarly, there is little difference between the group scores for a commonly used inequality measure. In the latest years for which data are available, the average level of income/consumption of the richest 20% of households was 6.5 times that of the poorest 20% in the first group, compared with 5.7 times in the second group.

Moreover, these figures probably exaggerate the degree of inequality. While they take account of household receipts of cash benefits from the government, they exclude the cost of benefits in-kind, such as health and education services and subsidised housing. Nor do they include gifts and services in kind provided free of charge to the poor and disadvantaged by non-governmental organisations and private charities. *The Economist* (25 February 2006) cites estimates of philanthropic giving amounting to 1.8% of GDP in the US, compared with just 0.1% in Germany and Italy from 1995-2002.

TABLE 12. SHARES OF INCOME OR CONSUMPTION OF DIFFERENT HOUSEHOLD GROUPS, AND A MEASURE OF INEQUALITY

	% SHARE OF TOTAL INCOME OR CONSUMPTION Latest Year		% SHARE OF TOTAL INCOME OR CONSUMPTION 1980s		INEQUALITY MEASURE Richest 20% to poorest 20%	
LEANER GOVERNMENTS	**Poorest 20%**	**Richest 20%**	**Poorest 20%**	**Richest 20%**	**Latest year**	**1980s**
Canada	7.0	40.4	5.7	40.2	5.8	7.1
Ireland	7.1	43.3	6.7	42.9	6.1	6.4
New Zealand	6.4	43.8	5.1	44.7	6.8	6.6
Spain	7.5	40.3	6.9	40.0	5.4	5.8
US	5.4	45.8	4.7	41.9	8.4	8.9
Average	**6.7**	**42.7**	**5.8**	**41.9**	**6.4**	**7.2**
LARGER GOVERNMENTS						
France	7.2	40.2	6.3	40.8	5.6	6.5
Germany	8.5	36.9	6.8	38.7	4.3	6.1
Italy	6.5	42.0	6.8	41.0	6.5	6.0
Portugal	5.8	45.9	7.3	43.4	4.7	5.9
UK	6.1	44.0	5.8	39.5	7.2	6.8
Average	**6.8**	**41.8**	**6.6**	**40.7**	**5.7**	**6.3**

Sources: UN, *Human Development Report*, 2005, table 15; and World Bank, *World Development Report*, 1990, Table 30.

The UK National Statistics Office publishes an annual report that incorporates estimates for benefits in-kind received by different income groups from the UK government. The data show that benefits in-kind provided by public programmes make the distribution of final income substantially more equal. In 2003, the ratio between the final incomes of the richest and poorest quintiles was reduced to 3.7:1, compared with 7.2:1 recorded in the above UN statistics.

CHAPTER TWELVE

SUPPORT FOR POORER COUNTRIES

Governments and taxpayers of rich countries are not just concerned about the welfare of their own people. They have become increasingly aware of the often distressingly low living standards in poor countries. Their compassion and strategic self-interests combine to make support for poor countries an important component of their policies.

Political debate on foreign aid is often confined to official development assistance (ODA). The term covers grants and loans made by the governments of richer countries to finance economic and social development projects and programmes in poorer countries. Table 13 shows that the US is the biggest ODA provider in dollars. But it is the least generous when measured by the proportion (0.15%) of national income it devoted to ODA in 2003. Nevertheless, the group averages are similar – 0.25% of GNI in the first group against 0.28% in the second. The UK was ranked third highest among the ten countries, with 0.34%.

However, the impact of this aid on the recipient countries is uncertain. Countries that have received large volumes of ODA in relation to their own GDP (in the 20% to 50% range) for long periods have often performed poorly. While economies that have grown rapidly, and reduced poverty levels substantially (such as China and Korea), have done so with low ODA/GDP ratios. Much of this aid has been siphoned off by corrupt politicians, bureaucrats, suppliers and contractors. And the public institutions generally made responsible for executing aid projects have often lacked the motivation and/or the expertise to use the resources efficiently. Yet these subsidised programmes often pre-empt the opportunities for private investment in the wide range of sectors covered by ODA projects.

TABLE 13: AID AND TRADE FLOWS AND FOREIGN WORKERS' REMITTANCES

LEANER GOVERNMENTS	NET OFFICIAL DEVELOPMENT ASSISTANCE DISBURSED 2003 US$, bn	%of GNI	GOODS IMPORTS FROM DEVELOPING COUNTRIES 2003 US$, bn	%of GNI	WORKERS' OUTWARDS REMITTANCES 2000 US$, bn	%of GDP
Canada	2.0	0.24	46.0	5.9	2.7	0.4
Ireland	0.5	0.39	8.8	8.1	0.1	0.1
New Zealand	0.2	0.23	5.7	9.2	0.1	0.2
Spain	2.0	0.23	45.0	6.4	1.3	0.2
US	16.3	0.15	641.8	5.8	26.8	0.3
Average		**0.25**		**7.1**		**0.2**
LARGER GOVERNMENTS						
France	7.2	0.41	64.3	4.2	2.7	0.2
Germany	6.8	0.28	98.2	4.7	3.2	0.1
Italy	2.4	0.17	55.5	4.5	0.5	0.04
Portugal	0.3	0.22	5.9	2.9	0.2	0.1
UK	6.3	0.34	79.5	4.7	1.3	0.1
Average		**0.28**		**4.2**		**0.1**

Sources: UN, *Human Development Report*, 2005, table 17, 18; World Bank, *World Development Indicators*, 2005, table 1.1; and A Harrison, *Working Abroad – the benefits flowing from nationals working in other economies*, OECD, 2004, annex table 7.

Aid donors need to look at support for poor countries from a wider perspective. Much larger volumes of financial assistance are transferred through trade mechanisms. The value of imports of goods made in developing countries averaged 7.1% of the importers' GDP in the first group, and 4.2% in the second in 2003. The payments made for these imports constitute a direct reward to the producers and service providers for their efforts, skills and enterprise. Jobs are created in the exporters' industries and in the whole supply chain from primary producers, through suppliers of diverse inputs and components, to transport and trading enterprises. And the higher prices usually prevailing in rich country markets (compared with their own domestic markets) boost exporters' incomes further.

MIGRATION

Table 14 shows that in leaner government countries, the value of remittances by foreign workers to their families remaining in the home countries was not far short of the level of ODA on average. It was also double the remittances percentage for the larger government group. As well as the direct cash benefit to the recipient countries, temporary migration allows migrants to develop their capacities in more sophisticated working environments. Thus they acquire skills that can promote more rapid development in their own countries when they return.

Modernising governments have been more willing to accept migrants. The migration stock, that is the number of people born in a country other than that in which they currently live, rose to an average of 12.9% of their total populations in 2000, up from 9.8% in 1990. In the larger government group, the migrant proportion increased slowly to just 6.3% in 2000. These figures include migrants from other higher-income countries, and those who may have become permanent migrants and accepted naturalisation.

Table 14 also shows that remittances from migrants supplement the incomes of family members remaining in developing regions by significant amounts. Latin American and Caribbean countries gained the most, receiving $14 billion in 2000 from the US alone. Flows to Asia from economies with leaner governments were more than four times those from countries with larger governments. The latter group accounted for a higher proportion of remittances to Africa, reflecting their ties with former colonies. But the much lower level of flows from the UK, compared with France and Spain, is surprising.

TABLE 14. REMITTANCES BY REGION

LEANER GOVERNMENTS	REMITTANCES TO AFRICA $millions, 2000	REMITTANCES TO ASIA $millions, 2000	REMITTANCES TO LATIN AMERICA & CARIBBEAN $millions, 2000
Canada	n.a.	838	188
Ireland	n.a.	n.a.	n.a.
New Zealand	n.a.	25	n.a.
Spain	387	105	296
US	681	7,085	14,056
LARGER GOVERNMENTS			
France	1,352	248	n.a.
Germany	n.a.	1,195	n.a.
Italy	173	119	19
Portugal	85	3	24
UK	107	339	50

Sources: A Harrison, *Working Abroad – the benefits flowing from nationals working in other economies*, OECD, 2004.

CHAPTER THIRTEEN
THE ENVIRONMENT

Governments and citizens have become more aware of, and concerned by, the impact of their activities on the environment, and the possible long term effects on future generations. Environmental activists sometimes argue that larger, more interventionist governments care more about, and are more effective in tackling, environmental problems.

The evidence is not so clear cut. Table 15 shows that carbon dioxide emissions (green house gases) have generally risen more slowly than incomes in rich countries, and that there is relatively little difference (just 0.1 kg) in the average emission levels per dollar of GDP between the two groups. Major oil producing nations tend to be much more profligate in what they discharge into the atmosphere. In relation to income, the emissions of Russia, Saudi Arabia and Venezuela were three times the average levels of the leaner government group at the turn of the century.

Moreover, gas emissions are partially taken up (sequestered) from the atmosphere by so-called “sinks”. Through photosynthesis, trees and plants incorporate the carbon from $C0_2$ and exhale oxygen. This fact is recognised in the Kyoto Protocol on climate change, although precise measurements of the magnitude of the effect are lacking. But it is known that a single tree can absorb many tons of carbon dioxide, and a growing, healthy forest can absorb thousands of tons. Afforestation (planting new forests on previously unforested land) and reforestation (planting tress on land that was deforested in the past) contribute significantly to the absorption of green house gases. Their contribution should be taken into account when judging a country’s overall environmental record.

TABLE 15. TRENDS IN CARBON DIOXIDE EMISSIONS AND "SINKS"

	CARBON DIOXIDE EMISSIONS kg. per ppp$ of GDP		C02 SINKS: FOREST AREA 1000 sq. km	FOREST AREA Average annual increase 1990-00	
LEANER GOVERNMENTS	**1990**	**2000**	**2000**	**sq.km**	**%**
Canada	0.7	0.5	2,446	0	0.0
Ireland	0.6	0.4	7	50	4.9
New Zealand	0.4	0.4	79	390	0.5
Spain	0.3	0.3	144	860	0.6
US	0.7	0.6	2,246	3,880	0.2
Average	**0.5**	**0.4**	**984**	**1,036**	**1.2**
LARGER GOVERNMENTS					
France	0.3	0.2	153	616	0.4
Germany	0.5	0.4	107	0	0.0
Italy	0.3	0.3	100	295	0.3
Portugal	0.3	0.3	37	570	1.7
UK	0.5	0.4	28	170	0.6
Average	**0.4**	**0.3**	**85**	**330**	**0.6**

Source: World Bank, *World Development Indicators*, 2005, tables 3.4 and 3.8

The existing forest area of the leaner government group is 11 times that of the larger government group, and the former expanded its forests twice as fast as the latter from 1990 to 2000. Of course, the large land masses of Canada and the US facilitate forestry expansion. But credit should also be given to private forestry, house builders and pulp and paper manufacturers in responding to market signals in eco-positive ways.

CHAPTER FOURTEEN
SAVINGS, INVESTMENT & BANK CREDIT

Many factors have contributed to the generally superior performance of "leaner government" economies. Higher levels of savings, investment and bank credit have played leading roles.

People and enterprises are able and encouraged to save and invest when lower taxes leave more money in the tills of businesses, and in the pockets of workers and consumers. When domestic savings are high, banks accumulate more deposits to convert into loans. When enterprise is fostered, profitable investment opportunities expand and the credit-worthiness of borrowers is enhanced. Private enterprise is the main driving force behind economic and social progress in market economies.

Table 16 shows that gross domestic savings jumped to 25% of GDP in the leaner government group in 2003, from 21% in 1990. But the average ratio dropped to 19% from 21% in countries where the government's appetite has increased. However, the patterns are not entirely consistent. Domestic savings ratios have fallen to especially low points in the UK (13%) and the US (14%). But in the latter country, domestic savings were supplemented by substantial inflows of foreign savings. So its gross capital formation (investment) has expanded at the high annual rate of 6.2% since 1990.

From 1990-2003, the average annual investment growth rate (5.8%) for the leaner government group was two and a half times faster than the rate (2.3%) of the larger government group. In the UK, the growth of investment has slowed significantly since 1990 compared with the 1980s.

TABLE 16. DOMESTIC SAVINGS, GROSS CAPITAL FORMATION AND DOMESTIC CREDIT TO THE PRIVATE SECTOR

	GROSS DOMESTIC SAVINGS % of GDP		GROSS CAPITAL FORMATION Average annual growth rate (%)		DOMESTIC CREDIT TO PRIVATE SECTOR % of GDP	
LEANER GOVERNMENTS	**1990**	**2003**	**1980-1990**	**1990-2003**	**1990**	**2003**
Canada	21	25	5.1	4.5	76	81
Ireland	26	41	-0.6	9.5	48	118
New Zealand	20	23	2.9	5.2	76	119
Spain	23	24	5.9	3.5	80	119
US	16	14	4.0	6.2	148	239
Average	**21**	**25**	**3.5**	**5.8**	**86**	**135**
LARGER GOVERNMENTS						
France	22	21	3.3	2.0	96	90
Germany	24	22	1.6	0.5	91	117
Italy	22	20	2.9	-0.2	56	86
Portugal	21	18	3.1	5.0	49	148
UK	18	13	6.4	4.3	115	148
Average	**21**	**19**	**3.5**	**2.3**	**81**	**118**

Source: World Bank, *World Development Indicators*, 2005 tables 4.9, 4.10, and 5.1.

Bank credit to the private sector has soared in the first group. The level of credit outstanding averaged 135% of GDP in 2003, up by 49 percentage points since 1990 and 17 points higher than in the second group. The highest ratio was reached in the US at 239% of GDP, considerably above the two countries with the second highest levels – UK and Portugal at 148%.

CHAPTER FIFTEEN
MONETARY STABILITY

New Labour has often boasted about its success in achieving monetary stability since it took office in 1997. This, it implies, was a unique achievement among advanced economies, and that the UK had a far worse record than its competitors under his predecessors.

Table 17 contradicts these claims. It shows that economy-wide inflation, measured by the GDP deflator, has fallen in all the selected countries except Ireland since 1996, and that five countries have experienced a lower average rate since 1996 than the UK. Furthermore, the UK's overall inflation rate from 1987 to 1996 was below that of Portugal, Spain and Italy. It was also below the average during this period for the current members of the larger government group.

More importantly, the evidence suggests that countries can have too much of a good thing. Sharply reduced inflation does not always coincide with improved economic performance or enhanced social welfare. Germany and France have brought their average annual rates down to 0.6% and 1.3% respectively over the last decade, yet as shown in Table 3, have fallen well short of the average rates of growth of GDP, household consumption and public services realised by the leaner government group. A decline in unit labour costs kept their manufactured products competitive in export markets, but a slow growth of labour earnings depressed domestic demand. However, they avoided the deflationary forces experienced by Japan, where a 1.0% average annual drop in the GDP deflator from 1997 to 2005 resulted in an average annual expansion of real GDP of just 1.1% over the last decade. This was the slowest growth among OECD members.

TABLE 17. TRENDS IN INFLATION, HOURLY EARNINGS AND UNIT LABOUR COSTS

	INFLATION GDP deflator Annual % change		HOURLY EARNINGS* Annual % change		UNIT LABOUR COSTS* Annual % change	
LEANER GOVERNMENTS	**1987-1996**	**1997-2005**	**1987-1996**	**1997-2005**	**1987-1996**	**1997-2005**
Canada	2.7	2.0	3.8	3.2	1.5	0.1
Ireland	2.9	4.4	n.a.	n.a.	n.a.	n.a.
New Zealand	3.5	2.2	n.a.	n.a.	n.a.	n.a.
Spain	5.6	3.4	6.6	3.7	3.6	2.1
US	2.8	2.0	3.4	5.2	0.5	0.8
Average	**3.5**	**2.8**	**4.6**	**4.0**	**1.9**	**1.0**
LARGER GOVERNMENTS						
France	2.3	1.3	4.0	2.5	0.1	– 1.1
Germany	3.7	0.6	5.8	2.3	2.4	– 0.9
Italy	5.7	2.4	6.8	2.6	3.9	2.2
Portugal	8.5	3.3	n.a.	n.a.	n.a.	n.a.
UK	4.7	2.3	6.8	3.8	3.3	0.4
Average	**5.0**	**2.0**	**5.9**	**2.4**	**2.4**	**0.1**

Source: IMF, *World Economic Outlook*, September 2005, Statistical Appendix tables 8 and 9.
* in manufacturing.

CHAPTER SIXTEEN

FDI AND TOTAL CAPITAL STOCK

Foreign direct investment (FDI) boosts economic performance and contributes to social goals in various ways. It usually embodies modern technology, brings with it advanced management techniques, and provides easier access to global market networks and distribution channels. It also allows domestic producers to take advantage of the brand loyalties of consumers around the world. These factors help to raise productivity and employee earnings faster. Furthermore, initial wage levels and working conditions in foreign-owned enterprises are often superior to those in indigenous firms.

Table 18 shows that the inward flow of FDI, expressed as a percentage of the host country's GDP, more than doubled in the first group from 1990 to 2003, reaching 4.9%. However, Ireland was responsible for much of this upsurge. The second group's average fell to 1.2% from 1.8%, largely due to sharp drops in the inflows, in percentage terms, into the UK and Portugal.

By 2003, the inward stock of FDI in the first group was valued at 51.2% of GDP, double the average level in the second. Once again, it should be pointed out that the gap between the average figures for the two groups is exaggerated by the high level attained in Ireland.

The growth of the total capital stock, financed from domestic and foreign sources, has accelerated since 1993 in the first group. It rose at an average annual rate of 3.3%, compared with 3.0% over the previous decade. The average rate dropped to 2.7% from 3.9% where governments grabbed a larger chunk of resources.

TABLE 18. TRENDS IN FDI AND CAPITAL STOCK

LEANER GOVERNMENTS	FOREIGN DIRECT INVESTMENT % of GDP 1990	2003	FOREIGN DIRECT INVESTMENT Inward stock % of GDP 1990	2003	TOTAL CAPITAL STOCK Average annual growth (%) 1983-1992	1993-2005
Canada	1.3	0.7	19.6	30.5	2.7	2.5
Ireland	1.3	17.3	88.9	126.3	2.4	4.5
New Zealand	4.0	3.1	18.2	51.5	2.9	3.2
Spain	2.7	3.0	12.8	34.9	4.0	3.6
US	0.8	0.4	6.9	12.6	2.9	2.9
Average	**2.0**	**4.9**	**29.3**	**51.2**	**3.0**	**3.3**
LARGER GOVERNMENTS						
France	1.1	2.7	7.1	26.5	4.3	3.1
Germany	0.2	0.5	6.6	12.9	4.4	1.6
Italy	0.6	1.1	5.4	13.1	3.3	2.4
Portugal	3.7	0.7	14.8	39.0	n.a.	n.a.
UK	3.4	1.2	20.6	36.3	3.6	3.6
Average	**1.8**	**1.2**	**10.9**	**25.6**	**3.9**	**2.7**

Sources: World Bank, *World Development Indicators*, 2005 table 5.1; UN, *World Investment Report*, 2005 table B.3; and OECD, *Economic Outlook No. 77*, 2005, Annex table 21.

CHAPTER SEVENTEEN
R&D AND HIGH TECHNOLOGY

Table 19 sheds light on the technological base of countries – the level of expenditure on Research and Development (R&D), the availability of skilled human resources and the level of high technology exports.

R&D expenditure, as a percentage of GDP, was a little higher in the larger government group on average. But it had fewer researchers in R&D in relation to population. And it appears to have been marginally less effective in translating its research into competitive products. High technology exports accounted for 16% of total exports of manufactured goods in the second group on average, compared with 19% in the first. Britain's percentage was third highest, behind Ireland and the US.

TABLE 19. TECHNOLOGY INDICATORS

	R&D EXPENDITURE 1996-2003 % of GDP	RESEARCHERS IN R&D 1996-2002 Per million people	HIGH-TECHNOLOGY EXPORTS 2003 $ billions	% of manuf. exports
LEANER GOVERNMENTS				
Canada	1.91	3,487	23.1	14
Ireland	1.13	2,315	27.6	34
New Zealand	1.16	2,593	0.5	10
Spain	1.03	2,036	8.9	7
US	2.66	4,526	160.2	31
Average	**1.58**	**2,991**		**19**
LARGER GOVERNMENTS				
France	2.26	3,134	56.3	19
Germany	2.53	3,222	102.9	16
Italy	1.11	1,156	20.0	8
Portugal	0.93	1,745	2.3	9
UK	1.88	2,691	64.5	26
Average	**1.74**	**2,390**		**16**

Source: World Bank, *World Development Indicators*, 2005, table 5.12.

Note: R&D expenditures include both capital and current costs (annual wages, salaries and associated costs of researchers, technicians, and supporting staff and non capital purchases of materials, supplies, and R&D equipment).

CHAPTER EIGHTEEN
TRADE PERFORMANCE

The dynamism and resilience of a nation's economy, and the speed at which incomes are raised and the welfare of their citizens enhanced, depend increasingly on whether government policies promote exports.

Table 20 shows that leaner governments have proved to be more effective. Exports of goods and services rose to an average of 41% of GDP in this group in 2003, up from 27% in 1990. Ireland and Canada were the star performers. Exports were valued at 94% and 42% of their GDP respectively in 2003. Larger government economies could only reach an export share averaging 28% in 2003, just three percentage points above their 1990 level. The US was the only member of the first group that failed to lift the contribution of exports to its GDP.

The value of merchandise exports grew at an average annual rate of 7.4% from 1990-2002 in the first group. This was almost twice as fast as in the second group. Ireland has maintained an export growth rate averaging nearly 13% annually since 1980. It is noteworthy that the government's share of the cake shrank during most of this period.

Table 20 also reports changes in import penetration ratios from 1990 to 2005. The higher average import penetration ratio (28.7%) in the first group, compared with the second (25.6%) in 2005, may indicate that their economies are more open to trade. This is likely to prove a better response to the opportunities created by globalisation than the generally more protectionist-minded large government group.

TABLE 20. EXPORTS AND IMPORT PENETRATION

	EXPORTS OF GOODS AND SERVICES % of GDP		MERCHANDISE EXPORTS Average annual % growth in value		IMPORT PENETRATION*	
LEANER GOVERNMENTS	**1990**	**2003**	**1980-1990**	**1990-2002**	**1990**	**2005**
Canada	26	42	6.8	7.2	21.6	29.0
Ireland	57	94	12.8	12.9	33.9	45.4
New Zealand	27	32	6.2	3.4	19.5	27.4
Spain	16	28	10.8	7.5	15.1	27.4
US	10	10	5.7	5.8	7.9	14.1
Average	**27**	**41**	**8.5**	**7.4**	**19.6**	**28.7**
LARGER GOVERNMENTS						
France	21	26	7.5	3.6	15.9	23.2
Germany	25	36	9.2	3.8	19.3	25.4
Italy	20	25	8.7	3.9	17.4	22.1
Portugal	33	30	15.1	4.4	22.8	33.2
UK	24	25	5.9	4.3	17.0	24.1
Average	25	28	9.3	4.0	18.5	25.6

Sources: World Bank, *World Development Indicators*, 2005 tables 4.4, 4.9; OECD Economic Outlook No. 77, 2005 Annex table 54.

Note: Import penetration data for the US is not strictly comparable with that for EU countries as the latter data include trade between EU countries.

* Goods and services imports as a percentage of total final expenditure in constant prices.

CHAPTER NINETEEN

THE BUSINESS CLIMATE

Economic and social progress is also affected by the overall business climate, including the extent of government intervention through regulatory controls and bureaucratic procedures.

Table 21 reports the findings of the World Bank for three indicators. It takes slightly less time (in days) to start a business in the first group, but its group average is inflated by the very drawn out procedures required in Spain.

A bigger difference exists on the rigidity of employment index. This measures the difficulty of hiring and firing workers. On a scale of 0 (less rigid) to 100 (more rigid), the leaner government group scored an average of 22, with three members rated under 10. Employment laws and procedures were considerably more rigid in the larger government group, scoring an average of 49 and as high as 68 in France. The UK was given a rating of 20, reflecting the greater flexibility of its labour markets following the reforms of the 1980s.

Leaner governments also impose fewer procedures to enforce contracts, 18 against 21 on average.

TABLE 21. THE RELATIVE WEIGHT OF GOVERNMENT CONTROLS & PROCEDURES

LEANER GOVERNMENTS	STARTING A BUSINESS Time required in days 2004	RIGIDITY OF EMPLOYMENT Index, 1-100 2005	ENFORCING CONTRACTS Number of procedures 2005
Canada	3	4	17
Ireland	24	29	16
New Zealand	12	7	19
Spain	108	69	23
US	5	3	17
Average	**30**	**22**	**18**
LARGER GOVERNMENTS			
France	8	68	21
Germany	45	49	26
Italy	13	50	18
Portugal	78	58	24
UK	18	20	14
Average	**32**	**49**	**21**

Source: World Bank, *World Development Indicators*, 2005, tables 5.1, 5.3.

CHAPTER TWENTY
PRIVATE SECTOR PERFORMANCE

Governments which have become more lean have also seen a growth in private sector productivity (Spain is the only exception to this rule). Table 22 shows that over the past decade, labour productivity has grown at an average 1.9% annual rate in the leaner group, well above the average of 1.1% where the relative size of governments has increased. Business sector productivity has been particularly buoyant in Ireland and the US. But its growth rate has dropped sharply in France, Italy and the UK over the last decade.

Private non-residential investment has surged in the first group since 1997, averaging 6.4% annually in real terms. This was more than double the average for the second group, despite the UK's strong performance.

Dynamic private sectors have boosted stock market confidence, and increased the supply of equity capital. Stock market capitalisation expressed as a percentage of GDP, has increased in both groups but at a faster pace in the first.

TABLE 22. GROWTH OF PRODUCTIVITY AND INVESTMENT IN THE PRIVATE SECTOR, AND STOCK MARKET CAPITALISATION

	LABOUR PRODUCTIVITY IN THE BUSINESS SECTOR Average annual growth %		PRIVATE NON-RESIDENTIAL INVESTMENT Average annual growth %		STOCK MARKET CAPITALISATION % of GDP	
LEANER GOVERNMENTS	**1978-1987**	**1996-2005**	**1980-1990**	**1996-2005**	**1990**	**2003**
Canada	0.8	1.3	3.6	5.6	42.1	104.4
Ireland	3.2	3.8	2.3	9.2	n.a.	55.3
New Zealand	1.1	1.3	4.9	6.1	20.3	41.5
Spain	2.7	0.8	4.8	5.3	21.8	86.6
US	1.1	2.5	3.2	6.0	53.2	130.3
Average	**1.8**	**1.9**	**3.8**	**6.4**	**34.4**	**83.6**
LARGER GOVERNMENTS						
France	2.5	1.2	4.2	3.5	25.8	77.1
Germany	1.1	0.9	1.7	0.8	21.2	44.9
Italy	2.1	0.4	2.4	2.1	13.5	41.9
Portugal	1.7	1.2	n.a.	n.a.	12.9	39.4
UK	2.6	1.8	5.2	5.5	85.8	134.4
Average	**2.0**	**1.1**	**3.4**	**3.0**	**31.8**	**67.5**

Sources: OECD, *Economic Outlook No.* 77, 2005, Annex tables 6, 12; and World Bank, *World Development Indicators*, 2005, table 5.

CHAPTER TWENTY ONE

CONCLUSION

It may be surprising, even counter-intuitive, to find that countries with leaner governments spend more on health and education than those with larger governments (and have been growing that expenditure at a faster rate), that they have a better standard of living, better employment records and similar spending on income support.

The great majority of individuals do not, of course, study OECD, IMF, World Bank, UN and WTO reports. And the great majority of individuals have no reason to believe these surprising and counter-intuitive truths, particularly when policy-makers are uncomfortable in propounding them.

But the data presented here should give policy-makers some confidence in arguing their case. It may be difficult to persuade people that "less" really is "more". But it would still be right. For leaner governments clearly benefit their citizens more than the narrow illusory benefits offered by larger governments.