PERSPECTIVE

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Declining Government Productivity: another tax on the economy

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The level of government spending, the public sector's role in the economy and the government's productivity record are worrying. The first and most obvious concern is that general government spending on goods and services has been growing so much faster than GDP.[1] This has led to a substantial structural budget deficit at a time when, after 14 consecutive years of growth, the budget ought to be in surplus. Measured in cash terms, general government spending on goods and services rose 67% between 1997 and 2004, compared with an increase in GDP of 43%.

General government sector spending has increased by 67% since 1997, compared to a real-terms increase of 23% – indicating that inflation has risen far quicker than in the economy as a whole.

A second concern relates to the real value or benefit that has been generated by such rapid government spending. Since 1997 the real (inflation adjusted) increase in general government spending has been 23%, compared with a 21% increase in GDP. The gap between the general government cash increase of 67% and the real increase of 23% indicates that inflation has risen far quicker in the general government sector than in the economy as a whole. As a result, far too little of the huge increase in expenditure over the past seven years has fed through to an improvement in the real level of goods and services being provided by government.

This is linked to the Government's poor productivity record. The most up to date numbers available, published by the ONS in March 2005, show employment in general government rose by 12% from the second quarter of 1997 through to the first quarter of 2004.[2] Over the same period, whole-economy employment rose by 7%.

This has had two consequences. Firstly, the 553,000 increase in general government employment over this period has contributed significantly to a tightening in the labour market, at a time when many private-sector employers have been reporting labour shortages. In addition, fast growth in public sector wages and earnings (4.3% in the year to the fourth quarter of 2003 and 4.7% in the year to the fourth quarter of 2004) has almost certainly begun to put upward pressure on private sector labour costs.

Secondly, it is important to identify the degree to which recent increases in employment are contributing to improved output of government goods and services. Indeed, it is important to identify the productivity record of general government as a whole. Although there is no precise measure of general government output, the ONS has produced a series that it believes to be a good approximation.

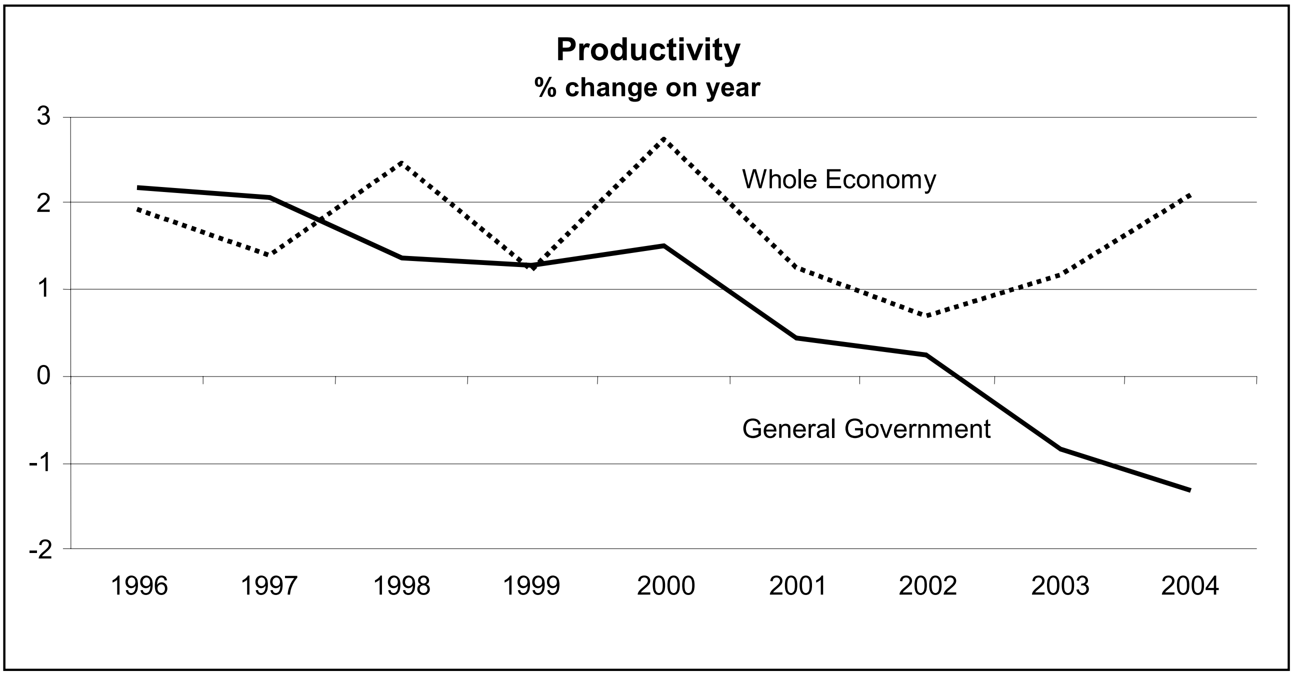
Analysing this data series in conjunction with employment data reveals a significant deterioration in the productivity record of general government. The chart below shows how its productivity is currently declining. The shocking nature of recent figures is all the more marked when related to the economy as a whole. While whole-economy productivity rose 1.2% in 2003 and 2.1% in 2004, general government productivity fell by 0.8% in 2003 and was 1.3% down year on year in the first quarter of 2004. These estimates are based on the numbers of people employed. Recalculation on the basis of full-time equivalents, the productivity track record of general government looks even worse, with a decline of 1.0% in 2003 and of 1.6% in the year to the first quarter of 2004.

These figures are deplorable – particularly for a services-based economy in which labour has become an increasingly scarce and valuable resource. They are indicative of deteriorating efficiency in the public sector and can have but one implication: that rising public sector employment is inhibiting growth in national income within the economy as a whole. In effect, if the additional numbers employed in the public sector been used in the private sector, then per capita income growth would have been higher. In this sense, low public sector productivity can be regarded as another hidden 'tax' on the private sector.

REFERENCES

1 "General government spending" is the total of central and local government spending. Similarly, "general government employment" is the total of central and local government employment.

2 ONS, *Productivity First Release 4th Quarter 2004*, March 2005. Note that before 1999, only second quarter estimates of public sector employment are available.



Note: General government productivity estimates between 1996 and 1999 use Q2 data. For 2004, the general government estimate is for Q1.

Source: ONS

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ISBN 1 903219 96 5

Printed by the Centre for Policy Studies, 57 Tufton Street, London SW1P 3QL