



EUROPEAN CENTRAL BANK

# **Fit for the future? Towards a lean and efficient public sector**

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# I. Introduction

## Central bank perspective on fiscal policy:

- Budgetary consolidation and fiscal stance (short-term)
- Sustainability of public finances (long-term)

## Independent central banks at arms length from “politics” of public spending, but:

- Public sector performance and efficiency matter
- Relevant for economic growth and fiscal sustainability

## Today:

- Broader reflections on role and size of public sector

## 2. The core objectives of government (I)

### Adam Smith: The Wealth of Nations

- State should be responsible for:

*“erecting and maintaining those public works, which, though they may be in the highest degree advantageous to a great society, are...of such a nature, that the profit could never repay the expense to any individual or small number of individuals”*

### Basic Public Goods with limited scope

- Rule of law (public administration, police, judiciary)
- Basic infrastructure (roads, railways)
- Defence
- Education
- Basic social safety net and healthcare

### 3. The rise of government expenditure

<b>General government expenditure (% of GDP)</b>			
	1913	1960	1990
France	17.0	34.6	48.8
Germany	14.8	32.4	44.1
Italy	17.1	30.1	52.4
Japan	8.3	17.5	31.3
United Kingdom	12.7	32.2	38.5
United States	7.5	27.0	36.0

*Sources: European Commission, Tanzi & Schuknecht (2000)*

## 4. The core objectives of government (2)

### Post-war enthusiasm for state intervention

#### Musgrave: objectives of fiscal policy:

- Allocation
- Stabilisation
- Redistribution

#### Hayek, Buchanan: criticised “big” government

- Framework of rules for markets, incentives, opportunities

#### Consensus view?

- Need to focus on core objectives and achieve them in an efficient manner.

## 5. Cross country differences in public spending

<b>General government expenditure in 2005 (% of GDP)</b>			
France	53.7	Sweden	56.0
Belgium	52.2	Denmark	52.5
Finland	49.9	United Kingdom	44.0
Austria	49.8	Norway	42.9
Italy	48.1	New Zealand	40.6
Portugal	47.8	Japan	39.5
Germany	46.8	Canada	39.3
Greece	46.8	Australia	34.9
<b>Euro area</b>	<b>47.6</b>	United States	34.8
Netherlands	45.4	Korea	28.1
Luxembourg	43.2		
Spain	38.2		
Ireland	34.1		

*Sources: European Commission if available, otherwise OECD*

## 6. How effective is public spending? (I)

Spending can come to be seen as an end in itself (e.g. election pledges)

Need to distinguish between “means” and “ends”

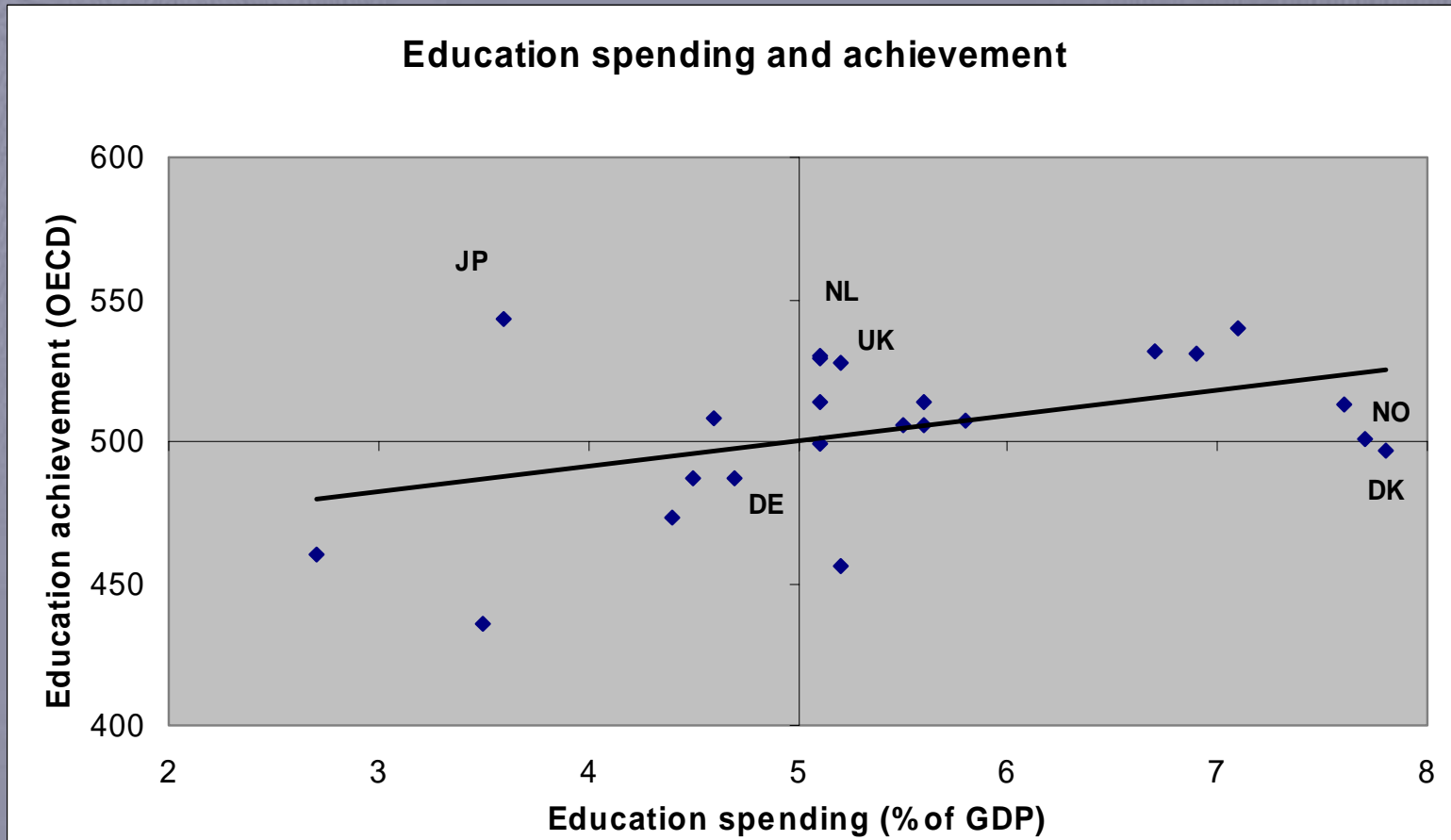
Growing interest in “quality” and “effectiveness” of public spending:

Inputs (spending) → Outputs (performance)

Does more spending lead to better performance?

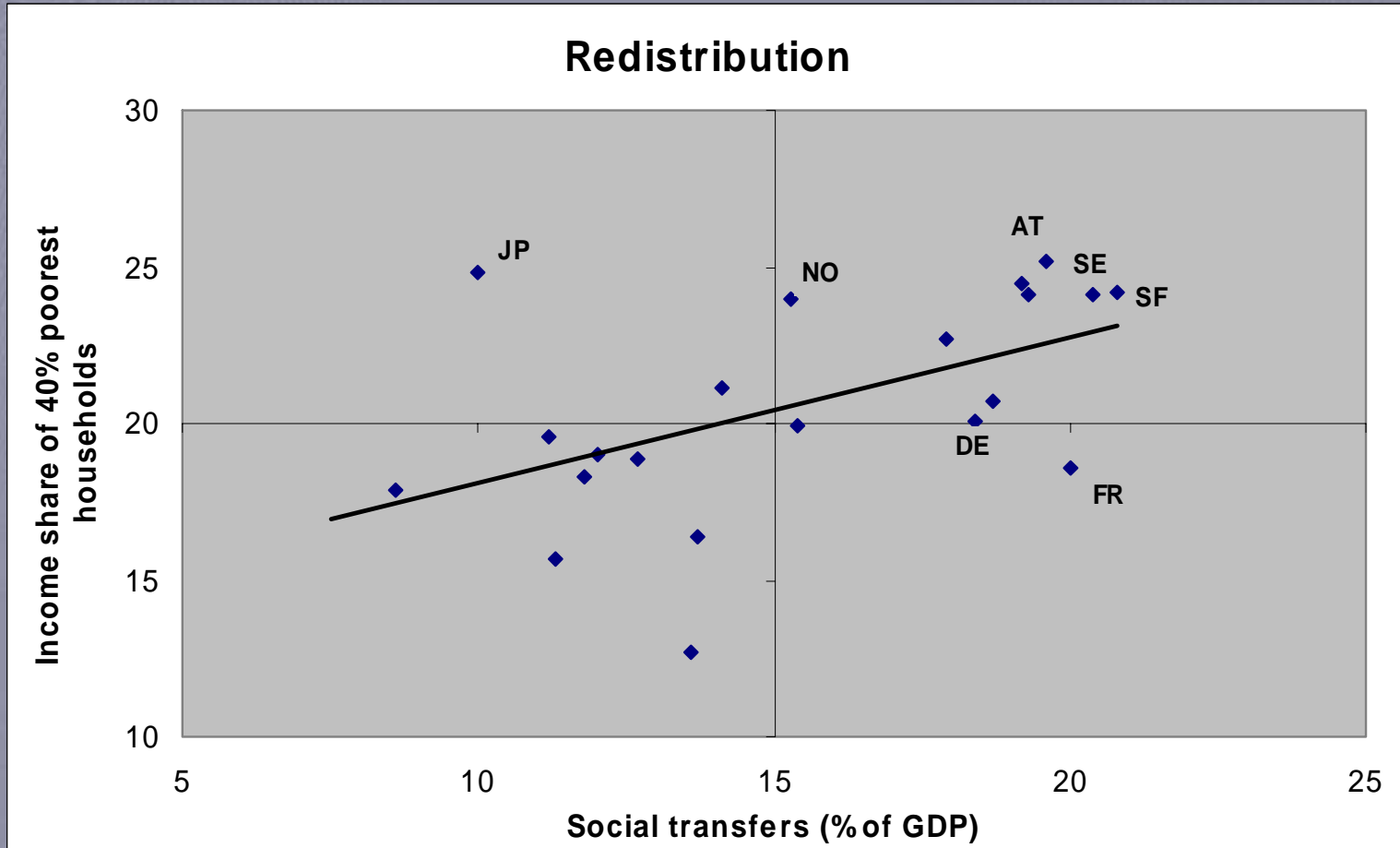
- Not always
- Can “get more for less”

## 7. How effective is public spending (2)

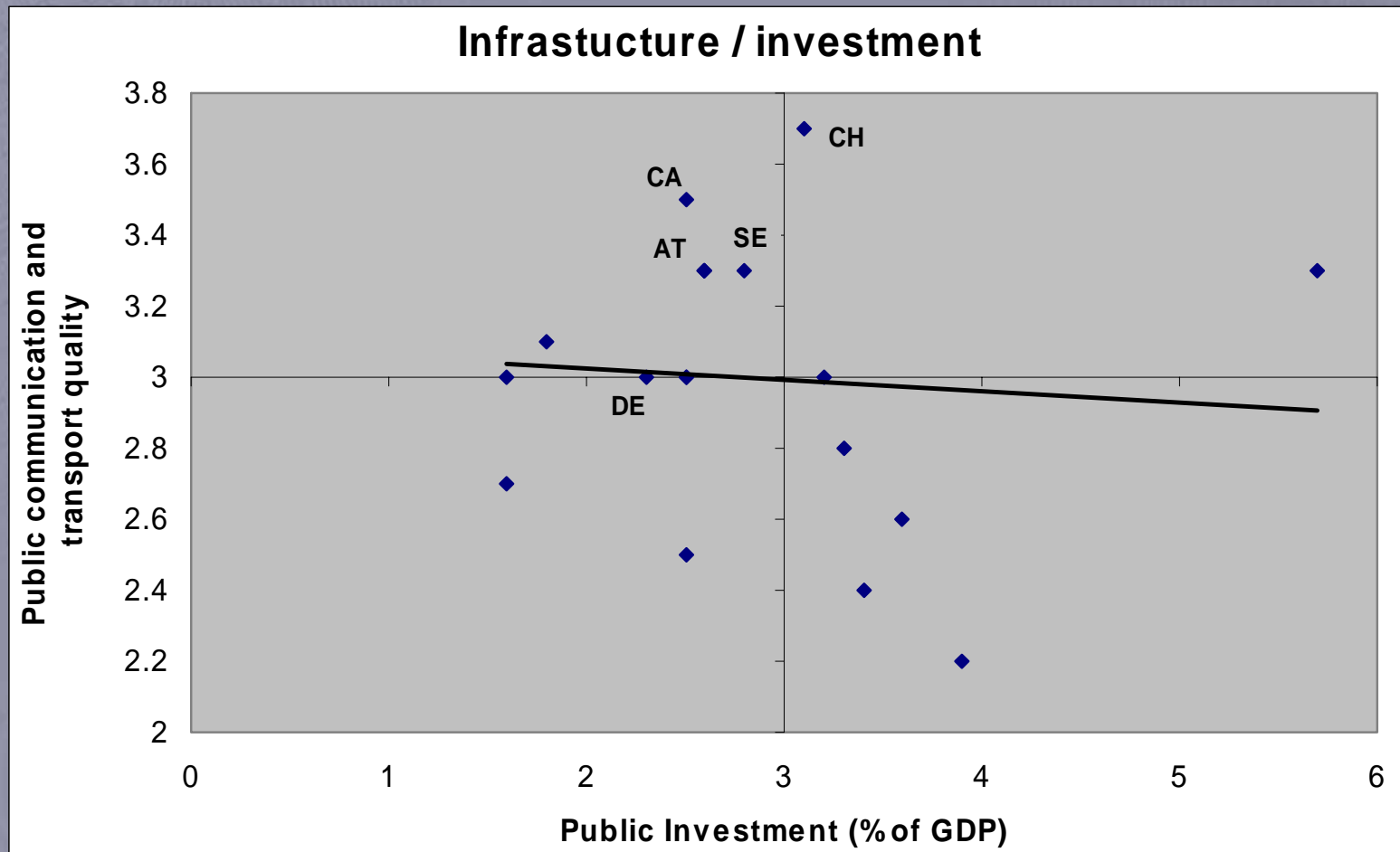




## 8. How effective is public spending? (3)



## 9. How large does government need to be ? (I)



## 10. How large does government need to be? (2)

<b>Objective / spending category</b>	<b>Efficient performers</b>	<b>Spending (% GDP)</b>
Education	JP, NL, UK	≈ 5%
Other goods and services	JP, NZ, CH	≈ 10%
Infrastructure / investment	AT, CA, CH, SE	2-3%
Redistribution / transfers	JP, NO	10-15%
<b>Total primary spending</b>		<b>≈ 30%</b>
Interest payments		2-3%
<b>Total expenditure</b>		<b>30-35%</b>

## II. Concluding remarks

- Public sector should use resources efficiently
- Spending ratio of 30-35% of GDP should be enough to attain core objectives (leaving room to adapt to change)
- Case for reform is too compelling to be missed