FINANCE COMMITTEE

Tuesday 2 November 2004

Session 2

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FINANCE COMMITTEE
27th Meeting 2004, Session 2

CONVENER

*Des McNulty (Clydebank and Milngavie) (Lab)

DEPUTY CONVENER

*Alasdair Morgan (South of Scotland) (SNP)

COMMITTEE MEMBERS

*Ms Wendy Alexander (Paisley North) (Lab)
*Mr Ted Brocklebank (Mid Scotland and Fife) (Con)
*Mr Frank McAveety (Glasgow Shettleston) (Lab)
*Jim Mather (Highlands and Islands) (SNP)
*Dr Elaine Murray (Dumfries) (Lab)
*Jeremy Purvis (Tweeddale, Ettrick and Lauderdale) (LD)
*John Swinburne (Central Scotland) (SSCUP)

COMMITTEE SUBSTITUTES

Gordon Jackson (Glasgow Govan) (Lab)
David Mundell (South of Scotland) (Con)
Alex Neil (Central Scotland) (SNP)
Iain Smith (North East Fife) (LD)

*attended

THE FOLLOWING ALSO ATTENDED:

Professor Arthur Midwinter (Adviser)

THE FOLLOWING GAVE EVIDENCE:

Professor David Bell (University of Stirling)
Professor Irvine Lapsley (University of Edinburgh)

CLERK TO THE COMMITTEE

Susan Duffy

SENIOR ASSISTANT CLERK

Terry Shevlin

ASSISTANT CLERK

Emma Berry

LOCATION

Committee Room 1

Scottish Parliament

Finance Committee

Tuesday 2 November 2004

[THE CONVENER *opened the meeting at 10:02*]

Interests

The Convener (Des McNulty): I welcome members, the press and the public to the 27th meeting of the Finance Committee in 2004. I remind members to switch off all pagers and mobile phones. No apologies have been received and we are all present.

Since the previous meeting, Kate Maclean has resigned from the committee because of pressure of work from two other committees. We are pleased to welcome Frank McAveety as her replacement. I place on record the committee's thanks to Kate for her work on the Finance Committee, if that is agreeable.

Members *indicated agreement*.

The Convener: Under agenda item 1, I ask our new member, Frank McAveety, to declare any relevant interests.

Mr Frank McAveety (Glasgow Shettleston) (Lab): As far as I understand it, I have no relevant interests in relation to the Finance Committee. I refer members to my entry in the register of members' interests.

The Convener: Thank you, Frank, and welcome on board the Finance Committee.

Budget Process 2005-06

10:03

The Convener: We should have had a heavier agenda today because the original plan was for Tom McCabe to appear before us. However, because he is relatively new in post, he will appear before us next week to deal with budget matters and end-year flexibility.

Under agenda item 2, we will take evidence from Professor David Bell, who is professor of economics at the University of Stirling, and Professor Irvine Lapsley, who is professor of accounting and director of the institute of public sector accounting research at the University of Edinburgh. I welcome both professors to the committee. We have received and circulated copies of your submissions. I suggest that we take brief opening statements from you and I will then allow members to ask questions. I do not know whether you have tossed a coin to see which one of you will go first, but it looks like Professor Bell is the front runner.

Professor David Bell (University of Stirling): The submission that I sent to the committee last week was wide ranging, but I will address myself more precisely to the budget this morning. I will make three or so points to back up what I wrote in my submission.

The first point concerns public sector productivity. The budget increases the amount to be spent in different parts of the public sector, but applying the same percentage increase in resource to different programmes can lead to widely varying outcomes. The reason for that is that levels of productivity vary considerably across the public sector. Much of what is produced by the public sector is not traded on any markets so we do not necessarily have a way to value it. How do we value the outcome of a drugs rehabilitation scheme as compared with the impact of a day care centre for the elderly? Many activities are valued, but they are not included in the national accounts. For example, reassurance to a cancer sufferer, which might be of great value, is not included in the national accounts as a measure of output. However, we can measure activity. We have to distinguish between activity and productivity in the public sector. We can be actively doing things, but those things do not necessarily produce the kind of outputs that the community and society at large want.

In the past few years we have seen rates of inflation vary widely in different parts of the public sector. The committee will be particularly aware of the problems of inflation in the health sector and the impact that that has had on the budget, in that a large amount of resource has been added to the health sector, although it is not yet clear how much additional output has resulted from that additional resource. Therefore, the publication in the draft budget of so-called real figures for different level 2 activities can be a little misleading because different rates of inflation apply in different parts of the public sector. The rates are currently produced by the application to all the programmes of a gross domestic product deflator from the Treasury. The Executive is aware of that and two things have been happening: the so-called Atkinson review of public sector productivity; and the efficient government review. The Finance Committee has a role in ensuring that the agendas of both those reviews are pursued vigorously.

My second point, which I raised in my submission, concerns crowding out. The Scottish departmental expenditure limit grew by 6.2 per cent in real terms between 2002-03 and 2004-05 and is expected to grow by a further 3.4 per cent between 2005-06 and 2007-08. That is well in excess of the rate of growth in the private sector in Scotland, which raises the question of the extent to which private sector activity might be being crowded out by the public sector. If economic growth is the Scottish Executive's key objective, some attention must be paid to the possibility that private sector activity is being crowded out. Some activity in the public sector represents hidden supply constraints, of which water is a good example.

I mention as an aside that discussions around fiscal autonomy have focused almost entirely on tax-raising powers. Among the key powers that are available in other countries to provinces, states and regions, such as the Länder in Germany, are the power to borrow and the power to save—mostly the power to borrow. Scotland has no opportunity to save, in the sense that if there was a strong belief that the levels of activity in the public sector were growing so fast that the economy could not accommodate them, there is no way in which that can be smoothed out by holding back some resource over a period of time.

I will make a final point that I did not make in my submission. In some of the papers that Arthur Midwinter has produced for the committee, he refers to the problems of the local government settlement. There will apparently be a considerable slowdown in aggregate external finance going to local government over the next three years. In real terms, AEF will grow at 0.6 per cent per year. Another way of putting it is that, in real terms, there will be an increase of £128 million over the next three years in AEF going to local government.

As some members may know, I was involved in the range and capacity review, which examined future costs of funding care for the elderly over the next 15 years or so. That study essentially parcelled up all the costs of caring for the elderly into components from the private sector, the health service and, most important, local government. Our estimate in the range and capacity review was that the cost to local authorities between 2004 and 2009—one year later than the end of the budget period—would be, in real terms, an increase of £163 million. In effect, local authorities would be required to make the increase in spending that we predicted to accommodate demographic change, and the cost of increasing care for the elderly well exceeds the total real increase that is apparently in the current budget. That point was not in my submission, but when I looked at the figures subsequently it struck me that that issue is worth raising.

The Convener: I know that the committee is looking to address community care and efficient government later this year. There is perhaps an immediate issue for the committee and then some longer-term issues.

Before I invite Irvine Lapsley to speak, I welcome a delegation from the National Assembly of Quebec, headed by Mr William Cusano, who is the Vice-President of the Assembly. I thank them for coming along and welcome them to the committee.

Professor Irvine Lapsley (University of Edinburgh): This is the first time that I have been in the building and I must say that it is not only very different, but most impressive.

I have three sets of comments that I want to draw to the attention of the committee in its deliberations at stage 2 of the budget process: on format of the budget; on priorities; and on targets.

The budget is a huge document—I have downloaded all the documentation and am carrying a large bundle of documents around. In a sense, it has to be a large document because there is so much in it, but there must be a way of getting the information in a form that is accessible to people other than those like me who are comfortable wading through such documents. That remains a burning issue in relation to finance and the budget document. However, some healthy additions have been made to the document. There are two annexes, the first of which shows the responses of the Executive to subject committee reports. That is to be welcomed as it shows that there is a healthy dialogue between the Parliament and the Executive. The other annex is on revisions to targets, which again shows the responsiveness of the Executive. That annex is also a welcome addition. However, it is sometimes hard to follow through the detail, which sub-programmes get lost in. We have moved forward on the format, but there is still progress to be made.

10:15

On priorities, in my submission to the committee I consider a couple of budget heads in the draft budget and track through their priorities. The first point that strikes me is the number of priorities. For example, 57 priorities come within the budgetary head of the Justice Department. That raises the question whether we can prioritise the priorities. The committee might wish to reflect on that issue.

Another issue is how the priorities relate to one another and to whatever overarching theme drives individual departments. There is also the matter of how those priorities are ranked and what urgency is attached to them.

In justice, for example, there are many useful, acceptable and sound priorities, but the question is whether there are too many for them to be real priorities. Similarly, there are 78 strategic priorities for expenditure in health, which is rather a lot to my mind. There are attempts to link strategic priorities to objectives. The first 11 strategic priorities relate clearly to the primary objective of improving access to health care. That is excellent—it is what we want. It is an articulation of objectives and strategic priorities, but such an approach is not always taken. There is an issue about how strategic priorities that relate to cross-cutting themes relate to the first 11 strategic priorities. I suggest that it is not entirely obvious how those additional 26 priorities relate to the first 11 priorities.

When one delves further into that part of the draft budget, one finds a further, distinct set of 12 national priorities, which are clearly labelled as not being targets and are separate from targets. Again, that raises an issue of prioritisation. We accumulate further priorities as we go along through that part of the draft budget.

I am not suggesting that there is anything wrong with any of the specific strategic priorities but, cumulatively, there is a real possibility of swamping and getting lost in the detail. Most important, there is a need to have an overarching articulation of how the various priorities relate to one another, to the mission of the individual department and to cross-cutting themes.

I remind the committee of comments that I made on targets in my evidence at stage 1 of its discussion of the budget. The idea of linking specific targets to the levels of resources devoted to them and to the actual or expected outcome is probably the most difficult thing—well, perhaps it is not the most difficult thing, but it is certainly one of the most challenging things—that public service managers have to do. That difficulty should be recognised from the outset, and rapidly changing targets can make the process even more difficult. We should, in any consideration of the process, note that the whole science of performance reporting is still at a developmental stage. I can see improvements year on year in what is happening, so it is important that what I say is not seen as being too critical. Improvements are being made and this is about continuing to move forward.

I will look at the two budget heads that I have targeted: justice and health. On justice, there are clear objectives and a small and probably meaningful number of targets, but it is hard to relate them to expenditure. The relationship between objectives, targets and strategic priorities is not clear—it is not evident to me. The health objectives are clear, logical and understandable and they relate to objectives set, but there is still a difficulty with the articulation of high-level objectives with operational targets and strategic priorities. There is a general issue here: the success in reducing the number of targets might be outweighed by the emergence of a proliferation of strategic priorities—I end on that point.

The Convener: Thank you. I will make two comments before inviting members to ask questions. First, as Professor Lapsley indicated, there has been considerable progress during the past three or four years on the quality of information in the budget documents and the clarity with which that information is presented. A significant dialogue has taken place and we have seen considerable improvements.

Secondly, there might be limits to what we can achieve in terms of, if you like, the perfect management document for Scotland. Some of the issues that we are dealing with are so large and complex that it might not be possible to devise a document to present crisply and concisely priorities and targets in the same way that one would for a company or even a university. That said, what Professor Lapsley said about priorities is right. There probably are too many priorities, but there is a political issue that we, collectively, have to face up to: we all recognise that if a priority that affects a particular interest group is dropped, that becomes a political story and the source of much agitation. If we do not mention the homeless, or any other particular client group, that is taken to be a de-prioritisation of that interest.

To some extent, we have to find a language that separates strategic priorities—Professor Lapsley is quite right to say that they should cover a relatively limited number of things—and the range of tasks that a Government department is expected to accomplish. That involves our trying to find the right language and context in relation to what the strategic priorities are, what the targets are and what tasks need to be managed as part of dealing with a department.

Professor Lapsley: I readily concur with your observation that significant progress has been made, but I would also say that there is a constituency that is intimidated by the volume of detail. We should keep in our thoughts the need to make the documents accessible to those people so that they can understand what is going on and take part in an informed debate.

I entirely take your point that the perfect document will probably never arrive, which is fair comment, and we must bear in mind the improvements that have been made. One of the suggestions that I made is that it might be useful for ministers who are responsible for budget heads to state what they regard as the priorities for their areas, and for that to be made explicit in the document. In effect, we would then achieve a kind of ranking. That does not mean that other areas are unimportant—I take your point about the publicity that might arise around saying that something is no longer a priority—but my suggestion might be a way to cross the bridge and reduce the number of priorities.

The Convener: The suggestion that we should ask ministers to state their priorities is useful. However, to pursue it a bit further, should that statement be on a general set of priorities? Alternatively, should it be a statement on a time-specific set of priorities and deal with how a minister is going to make changes or reallocate within their budgetary scope during a fixed period of time, such as the period of the spending review?

Professor Lapsley: The second would be preferable. It would be useful to have a set of priorities that explicitly addresses cross-cutting issues and joined-up government and how that is being achieved. It is difficult to track and monitor that, but it would be useful to have something explicit from the minister who is responsible—that would sharpen up thinking in the department about what the minister expects of colleagues and what the department is about.

Alasdair Morgan (South of Scotland) (SNP): I will make two points, both of which arise from what Professor Bell said. He talked about the crowding out of private sector growth by public sector growth, but I am not clear about where he includes water in his remarks, or on which side he puts it. Given that a significant amount of capital investment is done through public-private partnerships and the private finance initiative, certainly in education and health, is the underlying pressure on those sectors even starker than might be suggested by comparing the figures for the public and private sectors?

Professor Bell: I am not sure that the means by which capital projects are funded is a particular issue in that respect. What I am thinking about is the pressure on resources in general, particularly labour.

Alasdair Morgan: The point that I am trying to make is that if we simply look at the expenditure figures, say "The public sector is X and the private sector is Y" and try to use that as a measure of the pressure, the pressure on the public sector will be understated to some extent.

Professor Bell: Yes, that would be true to a certain degree, but I do not think that that is the determining factor. We are moving to a situation in which the public sector is gradually taking over a larger and larger share of economic activity in Scotland. The PPP schemes are part of that, but it does not seem to me that they are a vastly important part of the overall change. It is just part of the process during the past five years whereby we have had public sector growth of 6 per cent and 3.5 per cent against, probably, an overall rate of economic growth of between 2 and 2.5 per cent. It is clear that in Scotland the public sector is expanding and, in relative terms, the private sector is shrinking.

Alasdair Morgan: My second question relates to that point. The witnesses talked about the differential rates of expenditure, both between departments and compared with the overall rate of expenditure. For example, the rate of expenditure on the health service is much higher than ordinary inflation. Is any research available into the extent to which Government expenditure has caused inflation to be higher in such sectors because of the pressures to which we referred in the previous question? In other words, by spending more on health are we increasing the inflation that affects the health service?

Professor Bell: I do not know whether there is any direct research into that, but it is clear that wage inflation in the public sector has increased quite rapidly in the past three or four years. In a sense, that might be a response to pressures to hire and to meet new contracts that are being placed as demands by the public sector.

10:30

John Swinburne (Central Scotland) (SSCUP): Do you agree that because the public sector addresses public need whereas the private sector is ruled by the profit motive, it is difficult to judge one against the other? They come from different angles. One sector addresses public and social need whereas the other addresses the boardroom and the profits that can be pushed its way.

Professor Lapsley mentioned the scatter-gun approach to targets and priorities. That is clever political speak, because with a good scatter-gun approach, the Executive is bound to get 20 per cent right. Possibly "scatter-gun" is the wrong term; it should be "blunderbuss", because the failure rate is probably 70 to 80 per cent.

Professor Bell: The public and private sectors produce different outcomes. It is much easier to measure outcomes in the private sector and it is extremely difficult to measure what the public sector produces—the Atkinson review is trying to measure that. Even if that is understood, having the ability to measure is yet another step.

As I said, what the public sector produces may be greatly valued, but it is not included in any measure of national output. For example, the reassurance that a doctor gives a cancer patient is extremely valuable, but nowhere in the national accounts will that be found.

It is also true that the public and private sectors are interdependent. That is not just because the private sector funds activity in the public sector. Many public sector activities are necessary for the private sector to operate efficiently—education is probably the most important of those activities. Your general point about the differences between the public and private sectors is well taken.

Professor Lapsley: I will make an observation on the relationship between the two sectors. Many people would agree with John Swinburne's perspective on public need versus private sector profit. However, the reality is that determining the efficiency of the public sector is a major objective and challenge for the Scottish economy. Doing that is a challenge not only for Scotland but for every economy and especially for economies that are of our size.

The business of determining what efficiency, transformation and delivery of service are is difficult and incredibly complex. If it were simple and straightforward, it would have been resolved years ago. Much of that is due to interconnections, not only at an organisational level but at a societal level, and how things fit together in lifestyle terms. That is difficult to crack, but it is worth the focus and the effort. I suggest that the committee should look hard at strategic priorities, targets or whatever language is used to deliver on public services. That is a major objective.

Dr Elaine Murray (Dumfries) (Lab): I will return to Professor Bell's concern that public sector activity is crowding out the private sector. What are the budgetary allocation alternatives for the Executive? As you say, no power to save exists. I do not suppose that anybody would suggest that some money should be given back to Westminster and not spent on the public sector. Even if we spent money on priorities for the private sector, such as infrastructure, the crowding-out effect would remain on labour, as you said. What else could the Minister for Finance and Public Service Reform do to reduce the concern about crowding out the private sector?

Professor Bell: There is virtually no alternative in the present framework. The allocation is determined by the Barnett formula and that is what the Executive has to spend over the next three years. Some end-year flexibility exists.

Dr Murray: Do you suggest a reduction in the business rate? Is that the only alternative?

Professor Bell: The fiscal instruments are not tremendously powerful. They would still be overpowered by Westminster's largesse.

Dr Murray: That is a concern to address to the United Kingdom Government. I suppose that reducing the income tax rate is an alternative to reducing the business rate.

Professor Bell: The Scotland Act 1998 does not view taxation reduction favourably.

Dr Murray: We have the power to reduce the income tax rate.

Jeremy Purvis (Tweeddale, Ettrick and Lauderdale) (LD): What about council tax?

Dr Murray: An attempt to reduce the council tax rate would mean additional public sector spending on local authorities, which would decide whether to reduce the rate. I presume that we do not have control over that rate. Do you agree that the alternatives are limited?

Professor Bell: I agree that they are limited at the moment.

Professor Lapsley: We should not understate the importance of having an infrastructure that is attractive to foreign investment. As for what can be done, the cross-fertilisation of ideas from the private sector to the public sector is an option. That fits with thinking about a new vitality in the management of public services and with the idea of partnerships between the private and public sectors. All that offers opportunities or possibilities for private sector developments. Perhaps they are not of the order of budget restructuring, but possibilities exist. Education opportunities also exist to help employers with labour supply gaps.

The Convener: It could be argued that much public sector investment represents private sector orders. We heard from the construction industry recently about the scale of water spending and its impact on that industry.

Jim Mather (Highlands and Islands) (SNP): Economic growth and its position as top priority have been mentioned, but growth does not just happen; it is a function of competitiveness and sheer hard work. What in the budget document will improve Scottish competitiveness? In particular, is there any sign of a step change in the pattern? If so, what is it?

Professor Bell: I see no particular step change in the way in which budgets are being allocated that signals a new initiative that relates to economic growth. As Irvine Lapsley said, targets are immensely complex. The Executive has said that it does not want to associate a growth target with the budget documents. I understand that, because economic growth is affected by world and United Kingdom events and the causes of growth are still contested to an extent. Solutions that work in some cultures may not work as well in other cultures.

The budget shows an increasing focus on further and higher education, which fits into the view that we should concentrate on skills and on improving our human capital. I do not expect a step change in the immediate future, because the investments are essentially long term. I will add to what Irvine Lapsley said. Not only do many targets exist, but the targets will probably operate over different lifespans. An indeterminate time span seems to be associated with economic growth.

It might happen soon. The Irish may have been very surprised when suddenly they got on to the crest of a wave, but they did not find a magic formula that we can apply. We could copy some of their best practice, but it does not necessarily follow that we would have the same outcomes.

The Convener: There is a danger that we are establishing a pattern of both witnesses responding to the same question. There should be one response to each question.

Mr McAveety: Perhaps by the end of my time as a member of the committee I will know the difference between a priority and a target. You may be able to elucidate that distinction for us.

I want to raise two critical issues. Earlier, a point was made about crowding out. At the moment, are certain sectors of private sector activity more likely than others to be crowded out by public sector expenditure? I am intrigued to find out whether that is the case. Such information could help us to tackle problems with sustainable employment.

My second question relates to the issue of aggregate external finance for the community care line. You raised the issue of free personal care and questioned the rigorousness of the assessments that were made when that was debated. You asked how it related to AEF for local government and whether other aspects of the Executive's budget might have to deal with the issue if it develops as you have suggested. There seems to be a disparity.

Professor Bell: I have no direct evidence on the question of impact on the private sector, but we know that in certain industries infrastructure cannot be put in place as rapidly as we would like. We have an aging society and increasingly we are realising that to provide for that demographic change a large number of people will need to be involved in health care and caring more generally. Under present funding arrangements, that will largely be public sector activity. I wonder about the career choices that people are making. If there are more career paths available in the public sector now, will that influence in the long run the way in which our economy develops? I would like to see research into that question.

I spoke about care for the elderly, but I was not referring to free personal care in particular. Most local authority spending on care for the elderly does not relate to free personal care for the group that did not receive it previously but now does. The analysis that was done to generate the estimates for real resource requirements over the next 15 years was fairly carefully put together by the Executive and followed the methodologies that were used by the Royal Commission on Long Term Care for the Elderly. It assumed that there would be a 2 per cent real increase in the costs of care. We were allowing for supply pressures to bid up the costs of caring for the elderly. Over the period from 2004 to 2009, the necessary increase in resource that we predicted for local authorities to provide care in the way in which it is provided at the moment appears to exceed the increase that is available in aggregate external finance to local authorities. One component of that will be free personal care, but it is not the main component. Both the figures to which I refer are measured in real terms.

10:45

Ms Wendy Alexander (Paisley North) (Lab): Both papers that we are discussing this morning focus on the size of the public sector in Scotland and, to a lesser extent, its efficiency. I want to focus on the efficiency side of the argument because, as the papers point out, it is questionable to what extent we can affect the size of the public sector.

The efficiency of the public sector is an issue that has risen up the agenda both in the UK as a whole and in Scotland. The UK budget document committed the Government to making externally auditable efficiency savings of 2.5 per cent each year for the whole spending review period. The spending review document that was published in England in July contained the fascinating statement that the devolved Administrations had agreed to match those annual efficiency savings. The implication was that the Scottish spending review document would contain a commitment to making £1.9 billion of savings over the period of the spending review, which is equivalent to 2.5 per cent every year.

In fact, I understand that the 2.5 per cent target that the English spending review document said would apply in Scotland applies only to a component of the administration budget. We are applying the target to less than 1 per cent of the Scottish budget and not to the other 99 per cent. For 99 per cent of the budget, we appear to be aiming for £500 million of savings. We also do not have the departmental details that the English document provided.

Why are we applying the target to only 1 per cent of the budget and not to the other 99 per cent? Why is the figure for savings £500 million, rather than £1.9 billion? Given that there is a further document on efficient government to come from the Executive, would you consider providing in due course a supplementary paper on the issue? Although the size of the public sector may not be within our control, efficient government is. It was believed that the devolved Administrations had given a commitment to match the savings that were proposed by the UK Government and that those savings would be externally verifiable and auditable. That does not appear to be the case.

The Convener: It may be easier for the witnesses to answer the question in a couple of weeks' time, when the Executive produces its document on efficient government.

Professor Lapsley: This is one area in which we could have a target, rather than a strategic priority. We could quantify savings and say what the measurement is. However, I would not use the term "efficiency". People often speak of efficiency gains, but in fact we are dealing with cost savings. Anyone can trim the budget, if they wish. However, it is very difficult to determine the impact of such trimming. At that point, we enter uncertain territory. That is why it is helpful for policies, objectives, targets and priorities to be articulated. It is difficult to achieve that across the board. Ultimately, it is an issue for negotiation by the Executive, but it is doable if there is the will to impose savings across the board.

Ms Alexander: How can we reconcile the UK spending review document that says that the devolved Administrations have agreed to match the proposed annual efficiency savings with the document that is before us today?

Professor Lapsley: I have not examined the UK document, so I cannot comment on that point.

Jeremy Purvis: It would be interesting to see the first draft of the Treasury document. I do not know whether Wendy Alexander is able to confirm that that sought to bind the Scottish Executive to UK commitments, before it was realised that the Treasury did not have that power. It is right that we should have our own debate, which will be joined next week.

I return to the issues of productivity and crowding out. A large number of questions have been asked about those issues. I am struck by the fact that in many of the debates that we have had about economic growth, the Scandinavian model has been cited. Growth rates in Scandinavian countries have outstripped those in Scotland and the UK. Historically, France spends a higher proportion of its GDP on public services than Scotland spends, but productivity in the French private sector is considerably higher. In the Scandinavian countries, too, traditionally a much higher proportion of GDP has been spent in the public sector. Why has there been no significant crowding out of the private sector in those countries?

Professor Bell: The French example is interesting. If productivity is measured on a per hour basis, the results for France are quite a lot higher than those for the UK. However, of course, the French work only 35 hours per week and they are desperately backtracking on that commitment because the country's record on growth during the past few years has been much poorer than that of the UK.

The Scandinavian model is interesting, because it is clear that there is a social compact whereby it is agreed that the state will occupy a much larger proportion of the economy than is the case in the UK. For example, much greater provision of child care by the state enables women to go out to work and makes the economy more effective and efficient. In effect, there has been a bit of indicative planning, which has worked well in that culture. However, we come from the Anglo-American model of the economy. I am not saying that the Scandinavian model necessarily would not work in this country, but historically in the United States of America and other, similar Western economies, such as the UK, the private sector has been the main driver of economic growth.

Jeremy Purvis: It is fair to say that our economy is predominantly based on very small businesses—I think that 99 per cent of all businesses have fewer than 200 employees. Given the structure of the economy, we can perhaps understand why there are lower levels of private sector investment, because it is harder for an economy that is predominantly based on self-employment or very small businesses to invest in, for example, research and development. This is a cliché, but the mobile telephone companies in Scandinavia have considerably outstripped us on R and D spend. Could it be argued that we are moving towards the compact that you described? Since 1999, although productivity continues to decline—"The Framework for Economic Development in Scotland" shows the same rate of decline from 1996 to 1999 as there was from 1999 to 2002—the economy seems to be unaffected by the decline in productivity. I cannot understand that. Are we witnessing a gradual, structural change in Scotland and a move away from the Anglo-American model towards a different kind of compact?

Professor Lapsley: When we talk about a compact and about doing things differently, we must think carefully about what we mean by the public sector. If we mean a standstill public sector, I foresee difficulties for the Scottish economy. However, it is a different story if we mean a revitalised, transformed public sector. That is the main factor that we can consider, given the current regime. Mention was made of how we secure economic growth and get into the economy, but the reality is that we do not have the fiscal powers to do so. Much of the success of the Celtic tiger economy was due to the tax structure in Ireland, which helped to achieve sustained growth, but that is beyond the scope of the Scottish Parliament.

There are real, structural imbalances in the Scandinavian economies. What is Finland? The Nokia economy? There is an issue about small countries trading in a global economy and we are fortunate if a big, successful entity comes along—we have such entities in the Scottish economy. However, the crucial matter of interest for the committee and the Parliament, on which you should focus hard, is the revitalisation of the public sector of the economy.

Jeremy Purvis: I acknowledge what you said, but would it be easier to divide public sector spend into two different categories? The first category is the investment or the capital programme that the public sector commissions and spends—the committee looks forward to receiving a single publication that outlines the capital programme, as it carried out much work on that during the past year. Whether the spend comes through the PPP route, Scottish Water Solutions Ltd or new railway projects, it is spend. Obviously, the private sector procures for that capital, which provides the stimulus. The second category relates to how efficiently the public sector is reducing the productivity gap by providing a healthier work force that has more transferable skills and a higher education system that does its job. I have outlined two quite different functions of the public sector.

I have a difficulty with including the capital programme in the debate that we have had about public sector efficiency and the outcomes that we want. It is easy to consider the global sum and say that we are spending too much in Scotland, but there is a more sophisticated argument to be had, first about the capital programme—it could be argued that we have not been spending enough on the capital programme—and secondly, about how we spend the remainder of the capital programme. The committee's advisers tell us that we have limited flexibility to change the situation, but the issue is not the global sum; it is how that is managed.

Professor Bell: I go along with that. It is extremely important to ensure that the capital spend is utilised efficiently to provide infrastructure and encourage the inward investment in Scotland that we seek, as Irvine Lapsley said. It is also important that we regard education as an investment and that we keep track of how effective that investment is. We should not only consult educationists to ascertain the effectiveness of education spending in Scotland but consider the impact and success of Scottish-educated individuals in the labour market.

Mr Ted Brocklebank (Mid Scotland and Fife) (Con): The question that I was going to ask might already have been answered; we have had two or three goes at it. Like other members, I was impressed with and challenged by the phrase "the crowding out of the private sector". The perceived wisdom of most witnesses who have given evidence to the committee—whether they were economists or whatever—is that public sector increases should not be viewed as undesirable per se. We have been told that somehow the private sector should be able to look after itself and that businessmen and entrepreneurs should have the skills to overcome disadvantages that are placed in their way.

I have always found that argument difficult to understand, because it seems to me that, if the public sector continues to grow in percentage terms, the private sector will automatically diminish in percentage terms. That appears to be happening. We recognise that there is stagnation and a lack of business start-ups in the Scottish economy and I have always considered that that situation reflects the fact that the public sector is becoming too large and stifling. Is that what the witnesses mean when they talk about the private sector being crowded out? Given that we do not have fiscal autonomy and real powers to change how we raise money, as Professor Lapsley said, how can we start to cope with the problem?

Professor Bell: It would be possible to have a private sector that was diminishing in terms of, for example, the number of employees but that was still tremendously efficient, growing in productivity and acting as the engine of growth for the Scottish economy. I do not rule out such a possibility. However, statistics show that, during the past eight or so years, growth in the public sector has been much larger than growth in the private sector, so there has been no such surge in private sector activity.

I am interested in another phrase that is commonly used by economists: "rent seeking". That means that people will go to wherever they can find a relatively easy existence. What worries me a little about the expansion of the public sector is that, if it is not accompanied by efficiency checks and constant attempts to improve productivity, the sector becomes an area of rent seeking, so that people making their career choices opt for public sector occupations. We may not necessarily see the impact of that for 20 or 30 years, but I have a slight concern about that and I would love to see some research done on it.

11:00

Mr Brocklebank: People like me—I do not want to be overtly political—have a major concern about that. Given that the largest employers in most regions of Scotland are the local authorities, it might be argued that there is a built-in desire to keep on increasing the number of public sector jobs, because people will continue to vote for that kind of existence rather than going out and trying to make something in the cold climate outside.

Professor Bell: That is for politicians to determine, I think.

The Convener: I would like us to be specific. In a sense, you have inferred that the relative growth of the public sector and the relatively slower growth of the private sector might be associated with crowding out. Is there solid research evidence to highlight by what mechanisms that might actually be happening and the extent of it? You referred to firms having difficulty getting labour and to the driving up of labour costs in the private sector. The compensating argument might be that, as I have mentioned, public sector growth in construction could be leading to orders that stimulate private sector growth. The issue is obviously complicated. What research is there on it?

Professor Bell: There is not enough, but I and a colleague in Aberdeen have done some work for the Economic and Social Research Council's devolution programme, which looks at wage differentials and, in particular, at the comparison between public sector wages and private sector wages. There is something called the public sector premium. That means that people with the same set of characteristics—40-year-old males, for example, or 25-year-old females—will earn somewhat more in the public sector than they do in the private sector. That premium is larger in Scotland than it is down south and that is the kind of evidence that makes me a little worried that there is some element of rent seeking in Scotland, which could be made worse by continued rapid growth in public sector expenditure in Scotland.

The Convener: Arthur Midwinter's point would be that he is not an economist, so if we wish to pursue those issues perhaps he could draw on advice from David Bell and Irvine Lapsley.

I would like to ask another specific question. You referred in your opening statement to £128 million of real growth. Was that over one year or three years?

Professor Bell: Was I talking about the AEF?

Professor Arthur Midwinter (Adviser): Yes.

Professor Bell: It was over three years.

The Convener: There are obviously questions about how much that growth really is. That is the sort of money that would fund the teachers' settlement.

Professor Bell: It is a real increase, but it is deflated using the Treasury's deflator, which is probably bumbling along at quite a low rate. A settlement in almost any local government wage-bargaining group will blow a big hole in that total.

The Convener: I would like to ask another factual question, this time about the concessionary fares figure that you give in table 2 of your paper. That seems to be a huge increase. I do not know whether it is more in your area or in Irvine Lapsley's, but do you have any comment on the scale of that volume increase? The policy has been decided to extend concessionary fares, but is the costing that has been put against that reasonable?

Professor Bell: I do not know about that. However, I am conscious that a lot of the programmes shown in the table that I produced are relatively small, so it is not difficult to apportion large increases to those budget heads. Some of those increases are specific to the kind of targets that we have been discussing, although I do not think that concessionary fares are a direct target. I am sorry, but I do not know whether the numbers are plausible or not.

Jim Mather: I want to return to a point that was made earlier about the absence of magic formulae. There is no magic formula. The key things that I am picking up today are the public sector premium, the lack of a level playing field between us and the rest of the United Kingdom, the lack of a step change in the budget's effect on Scottish competitiveness, the lack of top-level targets, the absence of tax powers, borrowing powers and saving powers, and more crowding out. Does that suggest to you that what we have got just now is not a magic formula?

Professor Lapsley: That is an interesting question. There are different ways of looking at that question and, indeed, of asking it. As I see it, the whole issue of fiscal autonomy underlies a lot of that. I would also say that, although the idea of crowding out is interesting, there are anomalies around it. You find, for example, certain local areas where entrepreneurs or private entities might be expected to seek profit to provide a service, but sometimes they do not enter the market because there is not sufficient profit there and the public sector ends up picking up the pieces because the service is necessary. That is true of services for the elderly in areas where there is structural imbalance, which is a wider question than the split that we have observed.

On the question about where we sit and whether we have got things right, I see improvements. I have said from the beginning that the whole process has improved. It is imperfect and I have made further suggestions on improvement, but I see a progression. There are difficult questions about the whole business of setting targets and getting them to relate to priorities in a way that is absolutely foolproof. We have not arrived there, but I do not think that that is in any way a criticism of the process. It has more to do with the intrinsic difficulty of the task.

Jim Mather: There is a growing body of opinion in favour of top-level targets and a target for economic growth. Where do you gentlemen stand on that issue?

Professor Lapsley: My view on the economic growth question is that I understand the Executive's position. However, there are so many factors, because we sit in a global economy, and so many levers that are entirely beyond the control of the Executive that it would be hard to quantify a meaningful specific target. I sympathise with the aim of going for growth, but I recognise the difficulties of quantifying it specifically. It is a priority rather than a target.

Jim Mather: Would it be reasonable for the Scottish people to expect Holyrood ministers to sit down with Westminster ministers to produce a target for Scotland?

Professor Lapsley: That is an interesting observation.

Dr Murray: I have two points to make. First, I return to the issue of the public and private sectors. "Rent seeking" is not an expression that I have heard before and I am not sure that I quite understand where it comes from. Concern is being expressed about the public sector seeming to be a more comfortable place for people looking for employment, but that has been true in the past as well. After the second world war, there were periods—I certainly recall this from when I was young—when the public sector was an attractive place to work. Has any research been done on the effects that that had on the economy? Are there things that we can learn from analysis of other periods when there has been significant public sector growth as opposed to private sector growth?

Professor Lapsley: A lot of research on the public sector has concluded that it is not a comfortable place to work. Indeed, it is very testing and challenging.

Dr Murray: My second point is on a completely different subject and concerns the level 3 spending plans, which I thought were very useful. However, Jeremy Purvis and I were a bit confused about whether the first line, on the health spend, is numerically correct or whether a number has been missed out.

Professor Bell: I am sorry; I do not have the document in front of me. However, for some of the spending plans, it was not possible to calculate the percentage changes.

Dr Murray: It is only a minor point, but the health and community care spend appears to increase from £6 billion to £67 billion in the course of a year. I am not so sure that that figure is correct.

Professor Midwinter: A comma seems to be in the wrong place.

Dr Murray: Yes. However, irrespective of that, it appears that the document contains a lot of information about inputs. We have been talking about presenting the budget in such a way that we can learn about strategic priorities. However, it seems that much of the data are already included in the budget document. Are you suggesting that the document should be structured differently to ensure that the data on inputs are accumulated under the headings of priorities and then related to outputs? Perhaps that would mean reporting the information differently in order to indicate whether the Executive was spending according to its priorities.

Professor Lapsley: It is a question of balancing the document's different elements and, indeed, of articulating the overarching and secondary elements of the process. When I read the document, I am not clear about the overarching priorities and how the objectives feed through to the targets without—to use David Bell's expression—crowding out what is actually happening. The problem is that we have almost a surfeit of information instead of having much more focused information. However, I do not want to be overly critical, because the document certainly represents a move forward on earlier documents. Perhaps people would make much more sense of the document if it set out ministers' priorities and then cascaded those down into fewer objectives and targets.

There are also some problems with aggregation, with overlaps within some of the budget heads making it hard to see the overall picture. However, such suggestions are all about trying to make the document more accessible. My aspiration is for a very simple document that anyone in Scotland could pick up and make some sense of.

The Convener: The Executive used to produce a summary budget document. I do not know whether you ever saw a copy of it.

Professor Lapsley: Yes, I remember the early days. That document got lost somewhere. I suppose that these things happen.

The Convener: Perhaps the committee could consider whether reinstating the summary budget document would deal with some of the accessibility issues that Professor Lapsley has raised.

Jeremy Purvis: I wonder whether we could have some supplementary work on David Bell's appendix paper. Even if a figure has been placed erroneously, I am still not able to match the figures in that paper with those in the budget document. Perhaps we could discuss that matter further.

Alasdair Morgan: I think that those figures should at least bear some relation to those in the budget document.

Professor Bell: I very tediously extracted each of the level 3 tables from a hugely long document and put them into a spreadsheet.

Jeremy Purvis: In table 5.03 in the budget document, the total level 3 spend on health boards comes to £7.9 billion for 2004-05. In your paper, the figure is £6.3 billion.

Professor Bell: Is that real or nominal?

The Convener: Perhaps we should reconcile that offline. Do you have another question, Jeremy?

11:15

Jeremy Purvis: My second question is to both witnesses. In all our debates on this matter, I have made the same point. You have provided a table on growth and decline in spending, but how can we communicate where decline has been experienced? Decline in spending is often, if not always, equated with a reduction in the importance that the Executive gives to a certain priority or with the fact that the Executive is no longer politically committed to an issue. For example, if the justice policy is a success, fewer people go to jail and costs go down. Moreover, if spending in an area such as public health increased, demand on the health service might decrease. That does not mean that any less importance has been placed on health as a priority; in fact, the reverse might be the case. My difficulty is that the budget document does not come with that kind of context, whereas a document such as the partnership agreement sets out the political priorities. How could budget documents indicate that spending has been decreased in certain areas because a policy has been a success?

Professor Bell: That has to be laid out very clearly. The table on growth and decline in my paper should come with a huge health warning for exactly the reasons that you have highlighted. When some things are achieved, they become less of a political priority and spending on them decreases. Similarly, if a certain policy is successful, there might be less of a requirement for finance. As I have said, such matters have to be laid out in the document.

However, if we tried to do that with level 3 detail, the document would be twice the size of the one that we already have. As Irvine Lapsley has pointed out, we must find some way of focusing on key areas where we can show the success of a certain policy, its impact on outcomes and any subsequent change to resources. A document that was twice the length would be interesting for anoraks, but we really need a summary document.

The Convener: Perhaps I can help Jeremy Purvis with his figures. In the budget document, there is a footnote-indicating numeral at the end of the figures in the columns for the plans for 2005-06, 2006-07 and 2007-08, which in David Bell's paper has resulted in the figure for health spend in 2005-06 being £67 billion instead of £6.7 billion.

Professor Midwinter: That is a lot of crowding out, convener.

Jeremy Purvis: Regardless of whether we are anoraks, the debate is skewed. Budget holders in Government will not try to reduce their call on the Finance and Central Services Department if they produce tables that show only pluses or minuses, because press coverage will immediately equate that information with policies that are or are not successful. As a result, budget holders will always take an almost instinctive "I need to grow my budget" approach.

Professor Lapsley: That is an accurate statement. Perhaps the solution is to identify expenditure programmes that have a specific objective, which might be to change levels of expenditure or to do things differently. The question is how we capture data and express them differently to ensure that we do not have to deal with the noise of a single sum that says, "This is expenditure." We need to be able to distinguish between programmes that have different objectives and that are trying to do things differently. Such an approach would be challenging, but it would address the matter. Indeed, it might lead to a more rational debate, take the issue away from anoraks and give it to a more receptive audience.

John Swinburne: Growing the economy is obviously one of the major factors in your analysis of the budget document. Did you find that any investment in research and development was made through incentivising the private sector or funding the public sector?

Professor Bell: In the public sector a lot of money for research and development—probably the bulk—is determined by competition. The person most likely to succeed in a biotechnology programme in the public sector is the one who can convince his or her peers that they can produce the best research. That is highly competitive. The office of science and technology has increased its budget rapidly for the period of the next spending review; that money filters down to the research councils. Scotland will benefit from that if the scientists in the universities can compete effectively with scientists in other UK universities for what will be a much larger pot. That funding is not covered by the Barnett formula but comes in because the science base in Scotland can compete effectively for an increasing public resource for science, technology and research.

The Convener: No other member has indicated that they have questions, so I thank the witnesses for their evidence.

I remind members that we will be taking evidence on the spending review and draft budget from the Minister for Finance and Public Service Reform at next week's meeting. Looking at the table from Professor Bell, I think that there are perhaps two or three areas where expenditure is rising significantly, such as concessionary fares and higher education. The witnesses also highlighted issues relating to the cost of care of the elderly and how it will be dealt with in different budgets. I wonder whether we might ask the Scottish Parliament information centre for further information on those three budget areas so that, in questioning the minister, we can focus on specific strands. Do members want to highlight any other strands?

Ms Alexander: We should ask what the position is in the spending review document on efficiency. I realise that some things come later, but getting clarity on the commitments in the Scottish spending review document and the UK spending review document might be valuable.

The Convener: I thought that we were going to split up the spending review and efficiency issues. We have the minister coming along the week after next to deal with efficient government.

Professor Midwinter: Wendy Alexander is asking about the kind of financial assumptions that are built into the budget—as opposed to the management of the efficiency plan—which it would be useful to hear about next week.

Ms Alexander: Exactly. I am interested in the raw budget numbers.

Professor Midwinter: We know that they have been fed into the local government budget already; it would be useful to have them teased out.

The Convener: If we can get a briefing on that issue as well as on the others that I mentioned, that would be helpful.

Jeremy Purvis: This follows on from one of the witnesses' final comments. If we are considering areas of significant growth, I wonder whether SPICe would be able to cover the areas of decline and the reasons for it—I am sure that there are good reasons. If we are looking for areas of substantial growth, it would be fair to look for areas where budgets either have been cut or are no longer required.

The Convener: There might be difficulties in turning around as much information as that in a few days. We will take the point on board and see what we can do.

I remind members that, as well as having the minister next week—and, subsequently, to give evidence on efficient government—we have our external meeting in Cupar on Monday 15 November. Members have had information circulated on the workshops. If they want to raise issues with the clerks, they should do so as quickly as possible.

Meeting closed at 11:24.

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