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Why Government Grows (and Grows) in a Democracy

ALLAN H. MELTZER & SCOTT F. RICHARD

DEMOCRATIC government continues in relatively few countries, and mainly in the market economies of the world. Yet even in the United States, with a long history of coexistence between market freedom and political freedom, state intervention in the market has grown, and the size of government has grown. Growth of government is not a simple transfer of power from one group to another. Well-functioning markets disperse power; growth of government concentrates power.

No single, absolute measure summarizes the multi-dimensional term, "size of government." We have developed two measures of relative size. One compares the growth of government employment to the growth of the total labor force. The other compares the growth of tax payments to the growth of economic activity. The two measures show that the government has grown faster than the private sector throughout most of American history and give complementary evidence about the rates of growth.

Tax collections of the Federal government have increased at a compound annual rate of 6.4 percent since 1792. Subtracting the compound average annual rate of price change, to adjust for inflation, the average annual rate of growth of taxes has been 5.5 percent, in real terms. At this rate, the real size of taxes doubles about every 13 years.

We do not have reliable measures of private output dating from 1792, but we can infer that it has grown more slowly than taxes. For output or income to have grown at the same annual rate as real tax payments, 5.5 percent in real terms for 182 years, real output (GNP) in 1792 would have to have been about $80 million (in 1974 purchasing power). Per-capita GNP in 1792 would have been $20.00, much too low a number. We can be confident, therefore, that the average growth rate of government tax collections has been larger than that of real output for nearly two centuries.

The 5.5-percent annual growth rate of real tax collections has not been uniform throughout the period (as shown in the table on the next page). From 1792 to 1901, the average growth rate of real Federal tax collections (Federal taxes adjusted for inflation) was

Compound Annual Rates of Growth of Government and Other Selected Measures[1]

Period	Taxes (Current Dollars) Federal	Taxes (Current Dollars) Total	Prices	Employment Federal Government	Employment Total Government	Real Gross National Product	Total Labor Force
1792-1974	6.40%	—[4]	0.9%[6]	—	—	—	—
1792-1821	4.87	—	0.3[6]	—	—	—	—
1821-1901	4.73	—	–0.3[6]	4.53%	—	—	—
1901-1974	9.54	8.08%[5]	2.69[7]	3.39	3.46%[8]	3.17%	1.62%[8]
1901-1929	7.12[3]	7.29[3]	2.62[7] (1.96[6])	3.21[3]	3.43[3]	3.20	2.06[3]
1929-1951[2]	13.70	9.59	2.42[7] (2.94[6])	6.88	3.40	2.92	1.26
1951-1974	6.81	7.58	3.03[7]	0.74	3.56	3.37	1.57

[1] Sources: For the period 1792-1929, *Historical Statistics of the United States*, Series Y241, p. 710 (1821-1929 only), Series Y254, p. 711 and Y384, p. 722; for the period 1929-1974, *Economic Report of the President* (February 1975), pp. 282, 328, 252, and 305; GNP deflator for the period 1901-1929 from *Long-Term Economic Growth*, pp. 200-201; Wholesale Price Index for the period 1792-1890 from *Historical Statistics*, Series E1, pp. 114-115; for the period 1890-1951, Series E13, pp. 115-116; Employment and Real GNP for the period 1901-1929, *Long Term Economic Growth*, pp. 166, 182, 236; for the period 1929-1974, *Economic Report of the President*.

[2] From *Economic Report of the President*.

[3] From *Historical Statistics*.

[4] Statistics for some years are not available.

[5] The starting year is 1902.

[6] Wholesale price index.

[7] GNP deflator.

[8] The starting year is 1899.

about 4.75 percent, compounded annually. The comparable average growth rate for the 20th century has been nearly 7 percent. This century has included a period of acceleration, from 1929 to 1951, followed by deceleration, from 1951 to 1974.

The greater growth of the Federal government in this century reflects the changing distribution of activities among Federal, state, and local governments. The increase in total taxes to all levels of government, adjusted for inflation, has been 5.39 percent per annum (8.08 percent minus 2.69 percent) in this century, about the same rate of growth as that of Federal taxes during the entire history of the republic. In the last 25 years, the average growth rate of total real taxes has fallen to 4.55 percent (7.58 percent minus 3.03 percent). If we correct for the effects of inflation on the purchasing power of money and the effect of unanticipated inflation on the value of government bonds, as we should, the real tax burden may actually have increased in recent years, but we have avoided these complicated, though appropriate adjustments.

Real GNP rose at an average rate of 3.17 percent during this century while total real taxes increased 5.39 percent, so real taxes rose 1.7 times as fast as real output. During the years 1929-1951, which include the Depression, the New Deal, and World War II, the growth rate of total taxes paid to government, in dollars of constant purchasing power, rose to 7.17 percent (9.59 percent minus 2.42 percent). The average growth rate of output declined to 2.92 percent per annum, so government grew 2.4 times as fast as the private sector in that period. For the most recent quarter-century, the ratio of the growth of taxes to that of real output has fallen to 1.3.

The data in the table comparing the growth of government employment to that of the total labor force tell a very similar story. From 1821, the compound annual rate of growth for the Federal bureaucracy has been 4.5 percent. For this century, employment at all levels of government rose at a slightly lower rate, 3.5 percent. However, at this rate, the public sector grew more than twice as fast as the total labor force.

Two conclusions merit attention. First, both of these crude and not entirely accurate measures of the growth of government point to the same conclusion: Whether measured by tax share or employment share, the government has grown from 75 percent to 100 percent faster than the private sector during much of our history. Second, the relative share of government in the labor force is about half the share of output taken by government (as measured by the tax burden) for each period. At the turn of the century, when government employment was 4 percent of the total labor force, the tax share was 8 percent of output. In 1929, respective figures were 6 percent and 11 percent; in 1974, 15 percent and 32 percent.

If we extrapolate from the most recent rates of growth for the government sector and for output in the table, we can estimate the future tax burden and share of government in the labor force. By the year 2000, the government will take about 45 percent of GNP

in taxes and employ about 25 percent of the labor force. In another 100 years, the government will take everything, all of GNP, in taxes. Although the government then will employ about 50 percent of the labor force, everyone in effect will "work" for the government.

Whether or not the government is "big" or "small" now, it will certainly be "big" in the future. If a majority believes that efficiency or freedom is sustained only if there is some private output and employment, there will be a growing consensus that government is "too big." Sometime in the future, the government will pass the point at which more voters regard the government as too large rather than too small—if not in the next 50 years, then in the next 75 years. Before the government takes all of the output in taxes and removes all incentive to work and save, a majority should favor reducing the growth of government.

THE present size of government is not the result of a few chance events. The relative growth of the public sector over two centuries has gone on too long and at too high a rate to be treated as a temporary phenomenon resulting from the New Deal, the Fair Deal, the Great Society, 19th-century populism, the income-tax amendment, the Vietnam war, or any other single event or program. Moreover, the growth of government has not been limited to the United States; any valid explanation must account for a similar trend in many other countries.

A currently popular explanation identifies the cold war and the threat of military confrontation as a reason for government growth. This argument was recently made by Arthur Schlesinger Jr. in *The Imperial Presidency*, although it can be found earlier in the radical press, and it is loosely connected with the Marxist notion that military spending is required for prosperity in the capitalist system. But this view cannot account for growth extending over two centuries or for increasing government size, power, and influence in most of Western Europe, where there are few signs of resurgent militarism. It is true that government grows in war time; it is not true that government requires a war to grow.

Moreover, Schlesinger's explanation lacks predictive power: Government continued to grow after military spending declined following Vietnam. A new super agency was recently created to concentrate control of energy and energy prices. New agencies (for consumer protection and education) and new powers for old agencies seem more likely than substantial deregulation.

AN explanation with more substance and greater appeal was offered by Joseph Schumpeter in *Capitalism, Socialism, and Democracy*. Schumpeter, like Marx, argued that capitalism would not survive; unlike Marx, he thought capitalism would be brought to an end by its successes, not its failures. One achievement of capitalism stressed by Schumpeter is material success: Capitalism produces goods more efficiently than other systems. Another success is the

extension of freedom, which is more likely to thrive under capitalism than under other systems. Schumpeter went on to argue that such successes threaten the very set of institutions and social arrangements on which capitalism rests. The church, the bourgeois family, the dynastic ambitions of the capitalists, and the respect for privacy in private and public affairs—each of these institutions and arrangements is criticized, attacked, and weakly defended. Gradually, the old institutions are replaced by state agencies or institutions supported by public funds.

To Schumpeter's argument, we would add the observation that as more business is done with the state, relationships develop between government agencies and corporations. Within the business sector, groups develop that see their interests joined to those of the political bureaucracy. Although businessmen may for a time retain the rhetoric of hostility to "government," a growing number find reason to support the expansion of agencies and programs relevant to their interests.

A few corporations defend the market system publicly; most grumble silently, if at all. (Their shareholders did not intend to join a crusade by buying stock, and public-relations directors are sensitive to the difficulties that may arise from criticizing the government.) The corporations that lead the charge against "big government" bear a larger share of the cost than of any prospective gain. It is much less costly to cooperate—to work with, and even for, the regulatory agencies rather than to oppose them. By cooperating, the regulations can be made less onerous. There may even be a chance to squeeze out some small competitors, or to keep out potential entrants. The regulated thus become the regulators or the clients of the regulators. (A former senior official of the government, now a senior official of a respected firm, once remarked that one of the great advantages Europeans had in the 1960's was that the leaders of government and business could sit down together at lunch to decide what needed to be done—without going through a legislative process and without public scrutiny. Likewise, all the talk in business and government circles a few years ago about "Japan, Incorporated" revealed a belief that cooperation was the key to Japan's high rate of growth.)

Many of Schumpeter's arguments are appealing because many of his predictions have come true. Accurate forecasting is not so common in social science that we can cavalierly dismiss the theoretical argument from which the predictions arise. Yet Schumpeter's main premise now seems incorrect. If it is true that capitalism will be brought to an end by its successes, its breakdown and the consequent growth of government should be faster in rich nations than in poor. But this clearly is not the case. Most poor nations never accepted capitalism or even the market system. The fact that Hong Kong, Taiwan, Singapore, Japan, and Brazil have increased real income much more in the last 10 to 20 years than Sri Lanka, Egypt, or Syria has not raised demands for less regulation, smaller bu-

reaucracies, less government control or influence, or smaller government. Moreover, in the United States, contrary to Schumpeter's premise, the government, on average, has grown faster than the private sector since the beginning of the republic.

A third explanation is that the growth of the state is fostered by the competition for votes and by the distribution of income. Elected officeholders and office seekers look for issues that attract and maintain a winning coalition. In their search for votes, candidates propose many more programs than they enact. Each member of the electorate compares the benefits he expects to receive from expanded government programs to the costs he expects to pay. Voters choose candidates who promise to act in their interest and reelect those who do.

With nearly universal suffrage, the median voter has less income than the average earner. The voter with an income below the median can gain if incomes above the average are taxed, and the benefits are distributed to himself and others.

Large government thus results from the difference between the distribution of votes and the distribution of income. Government grows when the franchise is extended to include more voters below the median income or when the growth of income provides revenues for increased redistribution. It is not necessary that everyone vote or that each voter fully perceive the effect of his vote on society. A voter need only choose the candidate who promises net benefits; majority rule does the rest.

The problem with such an argument is that it fails to explain why redistribution has not been greater or why government did not grow faster, sooner. Once there is universal suffrage, there is nothing to stop or slow redistribution; the poor could have confiscated and redistributed all the wealth long ago. Some costs have clearly been ignored in this argument.

Individuals work, save, and invest in market economies to receive after-tax benefits. High tax rates reduce incentives, thereby making untaxed leisure more attractive than labor, and current consumption more attractive than investment. Welfare payments, food stamps, and other types of redistribution discourage the least skilled from working. The smaller labor force and lower investment reduce current and future income.

Lower income is part of the cost society pays for redistribution. Everyone shares in the cost—those who gain most from redistribution and those who pay a disproportionate share of the taxes. Voters previously on the margin become net losers, when they must pay more in future income and in current and future taxes than the additional benefits are worth to them.

The reduction in future income need not be absolute, and voters need not recognize instantly that they bear the cost of redistribution. In fact, voters often complain about the taxes they pay, but continue to vote for candidates who favor new or expanded govern-

ment programs. But periodic dissatisfaction with high taxes and sluggish growth, and support for tax cuts to increase incentives to work and save, will slow income redistribution and limit, but not end, the growth of government.

Periodic talk of a taxpayers' revolt will not stop government growth; talk is cheap when its marginal product is small. Taxpayers do not "revolt" in Western countries because, despite the rhetoric, a majority perceives net benefits from redistribution and votes for it.

Revolt is more common in less developed countries in Africa, Asia, or Latin America, where the "rich" often have (or had) a larger share of income and a smaller share of the votes than in more developed countries. If one political group does not redistribute income during its term in office, another will attract votes and take its place. Even if many voters recognize that high taxes on current income increase current consumption at the expense of investment and future income, the competition for votes makes it difficult for politicians to avoid promising to seek redistribution. Dictatorship, often with the support or under the control of the military, is a common way of ending this open competition for votes.

GOVERNMENT continues to grow because there is a decisive difference between the political process and the market process. The market produces a distribution of income that is less equal than the distribution of votes. Consequently, those with the lowest income use the political process to increase their income. Politicians have an incentive to attract voters with incomes near the median by offering benefits that impose a net cost on those with incomes above the median. The redistributive programs offered vary from place to place and time to time, as the composition of the electorate changes. But as long as the disincentive to work, save, and invest does not lower future income enough to turn the expected gain into a loss, support for redistribution will continue.

In most Western countries, property or status requirements for voting have been abolished during the last hundred years. Extension of the franchise is always in the interest of voters with incomes below the median because the spread of the franchise increases the number and proportion of voters who favor redistribution. As the franchise spreads downward through the income distribution, the proportion of votes going to candidates who promise redistribution increases. Progressive taxes increase the gain to the majority by taking a larger fraction of income from voters with incomes above the median to pay for programs like health care, which is available to everyone, or housing allowances, which go mainly to voters with incomes below the median. But if high taxes reduce incentives greatly, income is lowered, the size of net benefits from redistribution declines, and there is an increase in the number of voters favoring lower tax rates and smaller government.

This description of the political process as a rational process, in which voters compare benefits and costs, differs from many current

explanations that place responsibility on the bureaucracy or on a coalition of career bureaucrats and elected officials. In such accounts, the bureaucracy plays the role monopoly or advertising play in vulgar explanations of the market process. Supposedly, the public is consistently misled in the market place into buying products they do not want, and in the voting booth into voting for candidates who promise to reduce taxes, but instead work to increase them. Somehow the public never anticipates the growth of bureaucracy and the cost of programs and never learns that the costs of redistribution must be paid.

We have offered a different explanation. Though we are convinced that government is too large and too powerful, we do not believe that government has accidentally grown faster than the private sector throughout most of our history. Nor do we believe that a majority of voters can be convinced to reduce the size of government unless each of them can be convinced that it is in his interest and worth his individual vote to do so.

The size of government is often treated as a moral question or an emotional issue. Men grow passionate, and properly so, when they believe that freedom is threatened. Although large government poses a threat to many of our freedoms, government grows in every society where the majority remains free to express its will.