The Growth of Government Revisited

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Governments have grown faster than the private sector in all countries where governments are chosen by the votes of the citizens in competitive elections with complete, or near universal, suffrage. This finding has been documented in many studies and for different time periods. Although the finding is sometimes questioned, I accept it as a fact and ask four questions. First, is the growing size of government a recent phenomenon? Second, is growth in the relative size of government increasing or decreasing? Third, why does government grow faster than the private sector? Fourth, what could or should be done to slow the growth of government or, possibly, reduce the relative size of government.

RECENT GROWTH IN PERSPECTIVE

Meltzer and Richard (1978) used two measures of the relative size of government in the United States. One is the amount of taxes paid to the central government, and to all levels of government, relative to GNP; the other is the number of government employees relative to the labor force. They found that real tax revenues of the Federal government increased at a 5.5% rate from 1792 to 1974. Since the 5.5% rate of increase far exceeds any plausible rate of growth of real GNP, they concluded that the share of output...
taken in taxes increased faster than real output throughout U.S. history.\textsuperscript{1} Employment by government at all levels rose at a 3.5\% rate from 1901 to 1974 and in the sub-periods considered. The rate of increase of government employment is approximately twice the growth rate of the labor force for the period as a whole. These data supported the tax data in showing an increase in the relative size of government. There was no clear evidence that the growth of government had slowed. The growth of government employment relative to the labor force was approximately the same for 1951-1974 as for 1901-1974, but the rate of increase in taxes showed some evidence of slower growth relative to GNP in the later period.\textsuperscript{2}

Extending the series on tax revenues of all levels of government and GNP to 1985 suggests that in the U.S. the growth of government has slowed. For 1974 to 1985, total tax collections (in current dollars) and nominal GNP rose at approximately the same average rate, 9.1\%, while total government spending rose at a 10\% annual rate. Adjusting for differences in the pricing of government services and total output does not change the inference. The rate of growth of government relative to GNP has slowed. Data on labor force and government employment strengthen the conclusion. From 1974 to 1985, the labor force rose on average 1.9\% per year; government employment rose 1.3\% a year. Government employment as a share of the civilian labor force appears to have reached a peak in 1978. Table 1 shows some of these data.

Evidence of recent growth, or decline, in the relative size of government is not limited to the United States. Data for Germany show that the ratio of government spending to GNP rose at a compound average annual rate of 1.5 to

\textsuperscript{1}They note that real output per capita would have been $20 (in 1974 prices) in 1792 if real output had grown at the same rate as tax payments for the period. This is much too low. Further, their table shows that real Federal tax payment rose at 4.8\% rate in the 19th century. This is much above the growth of real output.

\textsuperscript{2}Data are from Meltzer and Richard (1978, p. 112). The annual average rate of growth of real tax payments falls from 5.4\% to 4.6\% while the rate of growth of real GNP rises from 3.2\% to 3.4\% for the periods 1951-74 and 1901-74.
## Table 1

### Compound Annual Rates of Growth of Government and Other Measures

<table>
<thead>
<tr>
<th>Period</th>
<th>Taxes (Current Dollars)</th>
<th>Taxes (Constant Dollars)</th>
<th>Real GNP</th>
<th>Total Government</th>
<th>Labor Force</th>
</tr>
</thead>
<tbody>
<tr>
<td>1901-74a</td>
<td>8.1</td>
<td>5.4</td>
<td>3.2</td>
<td>3.5</td>
<td>1.6</td>
</tr>
<tr>
<td>1951-74a</td>
<td>7.6</td>
<td>4.6</td>
<td>3.4</td>
<td>3.6</td>
<td>1.6</td>
</tr>
<tr>
<td>1974-85b</td>
<td>9.1</td>
<td>2.0c</td>
<td>2.5</td>
<td>1.3</td>
<td>1.9</td>
</tr>
<tr>
<td>1980-85b</td>
<td>7.8</td>
<td>2.0c</td>
<td>2.3</td>
<td>0.1</td>
<td>1.5</td>
</tr>
</tbody>
</table>

Sources:
- a Meltzer and Richard (1978, p. 112)
- b Economic Report of the President (February 1986) pp. 288, 299, 344, 253, 256. If the armed forces are included in the labor force, the growth rate is 2.0.
- c 2.9 and 3.4 if spending is used instead of taxes.
1.7% per year from 1881 to 1979. This is very close to the long-term growth in a comparable measure of the size of government for the U.S. \((5.4/3.2 = 1.7)\) in 1901-74, as shown in Table 1. Growth in the relative size of government appears to have slowed during the Hitler period, then increased in the 1960s and early 1970s. Since the middle or late 1970s, growth in the size of government has slowed and possibly reversed direction. The change in government spending relative to GDP or GNP is more marked for Germany than for the U.S.\(^5\) Table 2 shows the data for Germany.

Two propositions are suggested by the German and U.S. data. First, increases in the government spending or taxes relative to output are not of recent origin. Growth of this measure of the size of government has persisted for most of the century or longer. Second, there is some evidence that the size of government has reached a peak in these countries. The peak may be temporary, but it is apparent in several of the measures in Tables 1 and 2.

Meltzer and Richard (1978, 1981) suggest that the spread of the franchise contributes to the size of government by increasing the number of voters with relatively low income or wealth. These voters choose higher taxes on upper income groups and more spending for income redistribution. On their argument, the growth of government reflects the workings of the political process with near universal suffrage in fact or in prospect. If this view is correct, the size of government should have increased in many countries in the latter part of the 19th century as the franchise spread down the income distribution. Table 3 presents data from a sample of countries for the years prior to World War I.

In each of the five countries, government spending rose relative to output, on average. Except for Norway, the growth rates of the ratio of government spending to output are noticeably lower than for the U.S. and

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3 The difference arises as a result of differences between the OECD and EEC measures especially the replacement of net national product by GDP in the denominator. See the footnotes to Table 2.

4 This calls attention to the difference between government influence and government size and, thus, to ambiguity in measures of the size of government. We return to this problem below.

5 For the U.S., real government spending has grown 1.2 times real GNP for 1974-85 and 1.5 times real GNP for 1980-85. See the footnotes to Table 1.
### Table 1

<table>
<thead>
<tr>
<th>Period</th>
<th>Growth Rate</th>
<th>Period</th>
<th>Growth Rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>1881-1979</td>
<td>1.7</td>
<td>1881-1913</td>
<td>1.8</td>
</tr>
<tr>
<td>1881-1913</td>
<td>1.8</td>
<td>1913-1925</td>
<td>2.0</td>
</tr>
<tr>
<td>1913-1925</td>
<td>2.0</td>
<td>1930-1938</td>
<td>1.3</td>
</tr>
<tr>
<td>1930-1938</td>
<td>1.3</td>
<td>1960-1979</td>
<td>2.2</td>
</tr>
<tr>
<td>1960-1979</td>
<td>2.2</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

*a Tullio (1986, p. 42). The difference in measures of long-term growth is mainly the result of different denominators in the two series. Tullio uses OECD data for 1960-79 with net national product in the denominator. EEC data has GDP in the denominator.

*b European Economy 29, July 1986, p. 164.
Table 3

Growth of Government in Selected Countries
Compound Annual Rates in Percenta

<table>
<thead>
<tr>
<th>Country and Period</th>
<th>Government Spending</th>
<th>Outputb</th>
<th>Ratio</th>
</tr>
</thead>
<tbody>
<tr>
<td>Denmark 1870-1912</td>
<td>3.2</td>
<td>3.0</td>
<td>0.2</td>
</tr>
<tr>
<td>Italy 1862-1913</td>
<td>2.4</td>
<td>2.0</td>
<td>0.4</td>
</tr>
<tr>
<td>Norway 1865-1913</td>
<td>4.2</td>
<td>2.8</td>
<td>1.4</td>
</tr>
<tr>
<td>Sweden 1881-1913</td>
<td>3.7</td>
<td>3.3</td>
<td>0.4</td>
</tr>
<tr>
<td>U.K. 1870-1913</td>
<td>2.4</td>
<td>2.0</td>
<td>0.4</td>
</tr>
</tbody>
</table>

b GNP, GDP or NNP.
Germany, but all countries show increases in the size of government for the period prior to World War I.

Table 4 compares data for some major countries in recent years using some common measures of the size of government. There is no evidence of slower growth in the ratio of government spending or transfer payments to output in France and Italy. Britain shows modest declines in the growth rates of spending and transfers but, in the U.K. budget, asset sales are subtracted from budget outlays, so the decline in total spending may be illusory. There is no evidence of a slower rate of increase for the European Community (EEC 8), as a group. Government in most countries continues to grow. For many countries, the rate of growth remains high relative to the growth rate in the 1960s.

There are many reasons for not treating the data too literally. Short-period growth rates are affected by recessions or booms and by the introduction of new programs. Changes in the age composition of the population and other demographic factors change eligibility and participation in existing programs without affecting the long-period share of resources transferred or allocated by governments. Further, the term "size of government" has many possible meanings. Governments provide public goods, including defense and infrastructure, that increase private wealth and welfare. Governments also transfer resources using procedures that often seem inefficient. One measure, ideal for welfare analysis, is to compute the excess burdens imposed by government programs less the excess burdens reduced by government programs. Measures of this kind must be adjusted in some way to recognize the political process. Countries have voting rules that permit a majority to reallocate resources to themselves. Reallocation that would be unthinkable in a world of near unanimity may be optimal, at least for the majority, in an economy where preferences can be expressed in the polling place as well as in the market place.

A problem in using spending to measure the size of government is that governments spend for different purposes. Public spending for defense and police protection are classic examples of public goods. For the U.S. in recent years, and for many countries in wartime, growth of spending includes greatly increased spending for defense. On the other hand, in many countries that seek to reduce government spending, relatively large reductions are made in spending for infrastructure. Highways, hospitals, jails, schools and other
<table>
<thead>
<tr>
<th>Country</th>
<th>General Government as a Percent of GDP</th>
<th>Transfer Payments as a Percent of GDP</th>
</tr>
</thead>
<tbody>
<tr>
<td>France</td>
<td>1.2</td>
<td>2.0</td>
</tr>
<tr>
<td>Germany</td>
<td>1.7</td>
<td>1.4</td>
</tr>
<tr>
<td>Italy</td>
<td>1.3</td>
<td>3.6</td>
</tr>
<tr>
<td>U.K.</td>
<td>1.2</td>
<td>1.3</td>
</tr>
<tr>
<td>E.E.C.8</td>
<td>1.2</td>
<td>2.0</td>
</tr>
<tr>
<td>U.S.</td>
<td>1.6</td>
<td>0.8</td>
</tr>
</tbody>
</table>


b GNP for the U.S.
public buildings are postponed, and spending for maintenance may be reduced. Reductions of this kind are often postponements, not permanent reductions, and have short but not long-term effects on measures of the size of government or its rate of growth.

Government may be powerful yet tax or spend only a small share of resources. Regulation and prohibition are alternatives to spending or transfers. These alternatives are no more likely, and often less likely, to encourage efficiency and allocative freedom. Measures of the size of government that use budget data or government employment fail to capture the resulting loss of efficiency and freedom if government spending and regulation change at different rates.

Comparisons of the size of government in different countries face additional problems. Most health care in the United States is paid for by private insurance. The arrangements are not entirely voluntary; often all employees are covered and are required to contribute. Such programs have some of the features of government programs. Pension programs, also, differ in the degree to which they are public and private, voluntary or mandatory in different countries.

Despite the difficulties and ambiguities in any particular measure of the size of government, a rising share of spending allocated by government, taxes paid to government or employment in the government sector has effects on resource allocation. More resources are allocated in response to political rather than market signals. Governments often have shorter horizons, typically allocate relatively more to consumption than to investment, frequently price services at less than marginal cost, and in these and other ways, reduce efficiency and market freedom. Indeed, a principal aim of modern governments is to change the distribution of income by putting less weight on market freedom and efficiency as criteria for policy and giving greater weight to the redistribution of resources, wealth and income.

The data in this section suggest that there is some process at work that has the effect of increasing the share of resources allocated by government. The process is widespread. It occurs in all developed countries. It has continued, at different rates, for a century or more in those countries for which we have data. Reversals are rare, but they are not impossible; there is some evidence that Germany has reduced the size of government, at least for the present.
WHY DO GOVERNMENTS GROW?

The ubiquitous increase in the size of government during most of this century, and before, permits us to dismiss explanations that rely on features found in a single country or a small group. The size or growth rate of government in federal systems like Canada, Germany and the United States is not noticeably different from growth in countries with national systems—France, Italy, Sweden or Japan. Although particular constitutional provisions such as the referendum on tax changes in Switzerland may limit the size of government or its rate of increase, written constitutions generally have not been more restrictive than unwritten constitutions in controlling the size of government.

General explanations of the size or growth of government are not hard to find. There are now several comprehensive surveys of these explanations, for example Larkey, Stolp and Winer (1981). Many of the explanations fall into one of two classes of hypothesis distinguished by their emphasis on demand or supply side explanations.

Supply side explanations posit some group or force that makes government larger than the size implied by the collective choice of free individuals operating under existing voting rules. Bureaucrats, interest groups, Congressional committees and others are used to explain why the government is larger or more powerful than citizens prefer. Many of these explanations appeal, in one way or another, to the cost of organizing opposition, the public goods aspect of imposing restrictions, the diffusion of costs over large groups and the concentration of benefits on a small group of beneficiaries.

Without doubt, these costs are real. The problem with explanations that give a prominent rate to these costs as a reason for the growth of government is that governments do not grow at a uniform rate. The role of bureaucrats, interest groups or other supply-side forces must operate with different strength at different times. Explanations based on supply side forces must show why the costs of organizing change from time to time or why it is easier to diffuse costs and concentrate benefits at some times but not at others.

The beginnings of an explanation along these lines has been offered in Olson (1982). According to Olson, interest groups organize and accumulate power as society develops. In countries that have suffered a major defeat,
experienced a revolution or a major change in institutional structure, interest groups are weak and less able to impose external diseconomies on society. This argument has some attractive features, but it does not explain the growth of spending under Bismark, or in nineteenth century United States, or the early postwar growth of spending in Germany or the recent decline in spending relative to GNP in Germany, the U.K. and the U.S. Nor can it explain the great differences in welfare spending among states in the U.S. According to data for a recent year, the District of Columbia spends 2½ times the national average on welfare per capita while Arizona spends less than 40% of the national average. Surely it is not the fact that Arizona is a newer state that explains relatively low rates of spending on welfare and above average rates on spending on education. Utah and Indiana have patterns similar to Arizona while, to no one's surprise, New York, Massachusetts and California have a pattern more like Washington D.C. than like Arizona, Indiana or Utah.

Table 4 above compares France, Germany, Italy, the U.K. and the U.S. for different periods. The growth of government in the U.K. and the U.S. slowed in the late 1970s or early 1980s. In Germany, the growth of government changed from the highest rate among the countries shown in Table 4 to a decline. In France and Italy, the growth rate of government increased in the early eighties.

Can these changes be explained entirely by supply-side mechanisms? Did taxpayers recently become easier to fool in France and Italy but harder to fool in the U.K. and U.S.? Can arguments based on fiscal illusion or diffused costs and concentrated benefits explain the decline in the relative size of the German government? Did the bureaucrats lose their power? Did the cost of organizing taxpayers fall?

I believe the answer to the first four questions is no, to the last question a qualified yes. Taxpayers are voters, and voters in different countries have sent different messages in recent years. In the U.S., the U.K. and Germany, the voters elected government that, in one way or another, promised to slow the growth of government or reverse that growth. In France, the Mitterand government came to power promising more income and wealth redistribution. In Italy, a Socialist became prime minister for the first time.

There is often a large gap between pre-election rhetoric and performance in office. Nevertheless, the voters who chose Reagan, Thatcher and Mitterand
were almost certainly aware of the kind of choice being made. There were no large costs of acquiring information about the direction of change advocated by these candidates, although specific details were not usually given. And, while many voters got more or less change than they anticipated, allowing for deficiencies in the data, changes appear to have been made in the directions advocated by the candidates.

This line of argument should not be confused with the argument that conservatives parties reduce the size or growth of government and interventionist or socialist parties increase size and growth. This is not the general rule. One of the facts to be explained in a discussion of the size or growth of government is that so-called conservative parties typically complain about bureaucracy, tax rates, social spending and the like when out of office but do little to change the growth of government when in office. Observation of many countries suggests that there is little difference in the growth of spending under different political parties. Table 5 uses the U.S. as an example by comparing the average growth rate of spending, adjusted for inflation, under Republican and Democratic presidents during this century. Data are for government at all levels.\(^6\)

The weighted averages for non-defense spending show comparable growth under both parties. The highest and lowest rates of increase occur under Democrats. If defense spending is included, spending rises more under Democrats than under Republicans. This is largely a result of the very slow growth of military spending in the Eisenhower administration, 1952-60, and the relatively high growth rate of military spending during World War II and the changed military role accepted by the U.S. after that war.\(^7\)

A demand-side explanation of the data in Tables 4 and 5 is that voters choose the size of government they prefer by electing to office people who promise, and deliver, programs to redistribute income. Voters are rational. They recognize that government spending must be paid for by taxes. Since

\(^6\)Averages are weighted by the number of years in each R or D regime. There are 41 D years and 42 R years in aggregate.

\(^7\)The growth of real non-defense spending for the non-war Roosevelt administrations, 1932-40, is 4.83% per year. That administration would rank sixth instead of seventh if we excluded the years 1940-52.
Table 5

Growth Rates of Real Government Spending in the United States 1902-85 Ranked by Party of the President\(^a\)
(Compound annual rates of change in percent)

<table>
<thead>
<tr>
<th>Period</th>
<th>Party</th>
<th>Total Spending</th>
<th>Total Spending</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td>Less Defense</td>
<td></td>
</tr>
<tr>
<td>1960-68</td>
<td>D</td>
<td>7.28</td>
<td>6.06</td>
</tr>
<tr>
<td>1913-22</td>
<td>D</td>
<td>6.47</td>
<td>6.67</td>
</tr>
<tr>
<td>1952-60</td>
<td>R</td>
<td>5.74</td>
<td>2.30</td>
</tr>
<tr>
<td>1922-32</td>
<td>R</td>
<td>5.36</td>
<td>4.97</td>
</tr>
<tr>
<td>1968-76</td>
<td>R</td>
<td>5.30</td>
<td>3.18</td>
</tr>
<tr>
<td>1902-13</td>
<td>R</td>
<td>4.37</td>
<td>4.15</td>
</tr>
<tr>
<td>1932-52</td>
<td>D</td>
<td>3.54</td>
<td>6.53</td>
</tr>
<tr>
<td>1980-85</td>
<td>R</td>
<td>3.14</td>
<td>3.79</td>
</tr>
<tr>
<td>1976-80</td>
<td>D</td>
<td>2.68</td>
<td>2.72</td>
</tr>
</tbody>
</table>

Annual Weighted Average
- D: 4.83
- R: 4.90


Source gives data for early years at discrete points that do not correspond exactly to election years.

D = Democrat, R = Republican.
taxes distort incentives to save, invest and work, the social cost of government programs is paid by reductions in the level of output. Voters are aware that there is a cost. They trade future income for current income when they vote for redistribution. The trade-off occurs in many ways. By taxing investment or the returns to investment in productive capital, by taxing producers with relatively high marginal productivity at relatively high marginal tax rates and by leaving debt to future generations, the current generation of voters discourages investment, encourages leisure and reduces the size of the capital stock. In these and other ways, the current generation of voters imposes excess burdens on society—departures from the optimal taxation, investment, saving, labor and leisure decisions that would arise in a society with near unanimity.

Meltzer and Richard (1981, 1983) show that the principal forces driving these decisions are the level of income earned by the median or decisive voter—the voter at the mid-point of the voters' income distribution—and the ratio of mean to median income. The share of income redistributed, and the size of government, increase with the level of income and with the difference between mean income and the income of the median or decisive voter. By implication the growth rate of income increases with the growth of median income and a rising spread between mean and median income.

The demand-side model implies that, once the growth of output is perceived to slow permanently, votes for increased redistribution decline. Voters are more attracted by promises of increased growth and rising incomes than by promises of more redistribution. The slower growth in Germany, the U.K. and the U.S. in the 1970s, and the slower growth of income in France, following the changes introduced by the Mitterand government, encouraged policies that deemphasized redistribution and encouraged growth.

Arguments about incentives are not new. They were made by Adam Smith and perhaps before. Arguments about redistribution, offered under calls for social justice, equity and fairness, are about as old. What must be explained is that voters shift, at the margin, from those who call for increased

8These arguments apply strictly to consumption spending. Governments may invest profitably, but investment spending is a small fraction of government spending and profitable investment smaller still in the United States and much of western Europe.
efficiency and more incentives to those who call for more redistribution.

The demand-side explanation attributes the size of government to the rational choice of voters. The increase in the size of government in this century is seen as the result of the spread of the franchise down the income distribution, the increase in the income of the decisive voter and shifts in the relation of mean to median income. This explanation does not deny that supply-side effects of interest groups, bureaucrats and others affect the composition of spending. The discretionary authority of bureaucrats, the pressures of interest groups and the like may affect the types of goods received and the form redistribution takes. The well-known problems of controlling agents, the costs of acquiring information, the concentration of benefits on small groups are more relevant for specific programs than for the aggregate. A demand side explanation need not deny that there are gains from organizing pressure groups. At issue is whether these gains affect the aggregate or its composition.

The demand-side explanation helps to account for one of the most common features of the political process. Large numbers of voters complain about the costs of government, yet they re-elect the politicians who vote for spending and taxes. Conservative parties in office do little to reduce the size of government or its rate of growth. Another large number of voters have the opposite complaint. They vote for candidates and parties that promise more redistribution and more spending. From their perspective, government is too small, redistribution is too meager and the growth of government is too slow.

The explanation of these observations given by the decisive voter hypothesis is that both parties strive to satisfy marginal voters who are close to indifference between the two parties or two candidates in an election. Those whose incomes are above the income of the decisive voter would like lower taxes and spending, but they cannot find a candidate who can permanently reduce the size of government and be re-elected. Those with incomes below the income of the decisive voter would like faster growth but cannot achieve it.

WHAT CAN BE DONE?

The decisive voter hypothesis does not imply that the size or growth of
government cannot be limited. The choices that voters make depend on the voting rule and other institutional arrangements. To reduce the size or growth of government, these arrangements must be changed.

Switzerland has a smaller size of government and lower tax rates than its neighbors. The principal reason, I believe, is that the Swiss constitution permits voters to reject tax and spending legislation by referendum. A majority of the cantons with relatively small share of the total population can defeat tax bills. A majority of the population or of the voters is not sufficient to raise tax rates and spending. A super-majority—more than 50% of the votes—is required.

There are many proposals for changes that require super majorities to increase spending and taxes and that use super majorities to limit the size of government. A constitutional amendment to limit the growth of government spending to the growth of output is one example. A requirement that the budget be passed by 60% vote, or a 2/3 vote, limits the power of a simple majority to raise taxes and spending.

If the size of government is determined by the actions of rational voters, why would these voters choose to limit their ability to vote for tax and spending increases? One reason is that there may be an externality under existing arrangements. For example, many voters may vote for candidates favoring more spending on programs that are of direct benefit to the voter knowing that others do the same. A spending limitation amendment to the constitution is, then, a rule under which everyone agrees to limit spending in the aggregate by accepting a rule constraining his own demands.

No country has, as yet, adopted a limitation of this kind. None has followed Switzerland by permitting referendums on spending. Many states have adopted tax limitation amendments, state balanced budget rules and other restrictions on the fiscal authority of the legislature. None has adopted a spending limitation amendment. And states like California, where initiative and referendum are used for many purposes, do not prevent their legislature from voting budgets with rates of spending per capita that are above the national average.

These facts are far from conclusive. Nevertheless it is difficult to find in them a strong message from the voters in favor of spending limitation or smaller government.


