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Chapter 2

Explaining the Growth of Government: International Perspectives*

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1. The Issue

Government activity as measured by conventional indicators such as the share of public expenditure or taxes in GNP has dramatically risen in all industrialized countries of the west since World War II. The task is to explain the differences observable between countries. There are different ways to measure government activity. Lybeck (1986, ch. 3) gives a useful survey of 13 different modes of measurement. However, even this list is incomplete in at least two respects:

(a) The *regulatory* activities of the government are not taken into account. This part of government is particulary difficult to measure, but should nevertheless not be disregarded. It will be argued in this paper that there are systematic shifts between types of government activities, resulting in increases and decreases of public expenditures and taxes compensated by changes in regulatory activities.

(b) Public expenditures relate to the input side of government activities; what is desirable for many purposes is the *output* side, or the *effects* of government activity. For example, has government activity increased or decreased human welfare? As is well known by now, no social welfare function exists with which it would be possible to evaluate these effects in the aggregate, and neither are there prices reflecting the consumer's marginal utility.

The only way to deal with this second problem is to use various direct (e.g. surveys) and indirect (revealed preferences, e.g. in voting) methods (see Pommerehne (1987)). The theoretical and practical problems of measuring government output activity are of special importance in the case of international organizations which constitute an additional governmental actor to be taken into account in an international perspective. However, the activity of such an organization is uniformly measured by their budget or their number of employees, i.e. by inputs. At least for some international organizations it is doubtful whether their activity increases or decreases world welfare.

In the context of explaining the growth of government in an international setting, seven perspectives are relevant:

a. Comparisons of the determinants of government growth between individual countries:
   (1) non-institutional;
   (2) institutional specifications.
b. Interactions between basic units as a cause for government growth:
   (3) nations as units;
   (4) sectors as units.
c. Supranational units as a cause for government growth:
   (5) political integration;
   (6) international organizations.
d. Additive aggregations of causes (7).

These perspectives will now be discussed in turn.

2. Seven Perspectives

2.1. Non-Institutional Comparisons Between Individual Countries

According to this approach, the differences in government growth between countries are attributed to a common set of factors describing demand and supply elements. The purpose is to find out whether some of these factors exert a statistically significant influence in many or all countries studied. If so, the corresponding determinant may be considered to have an influence on the growth of government.

This approach makes a comparison between countries easy. It (implicitly) assumes, however, that the underlying politico-economic structure of the various countries is either identical (or at least similar), or that institutional differences do not matter. The representative democracy with government elected and depending on parliament, and the market-type economies with similar sectoral compositions, may be sufficiently similar to warrant that approach. It is not acceptable, however, if the countries under study have institutional differences (not taken into account in the common set of factors) producing different rates of government growth.

The common set approach has been undertaken by Lybeck (1986, ch. 5). He assumes that the maximum of the demand and the supply side is dominating. His results are mixed; it is difficult to deduce any coherent

picture. Another common approach is the permanent income model, which is analyzed and rejected by Borooah in this volume.

2.2. Specifications of Institutional Differences Between Individual Countries

In this approach the particular institutional characteristics of each country are specified as precisely as possible, and the differences between countries are accentuated. For instance, for France the "double" executive of the president and the *premier ministre* would be explicitly modelled; for Germany the bicameral parliament and the special role of the minister of finance; for the United Kingdom the variable election dates and the non-proportional parliamentary election system; for Switzerland the direct referendum; and for Finland the requisite qualified majority for tax increases.

A particular institutional setting being unique to a country, it is not strictly possible to test whether it is really the underlying "cause" for the growth of government in a particular country. A test is possible for elements of the institutional set-up which exist in a sufficient number of countries. In that case this approach merges with (1), although the strong emphasis on an extensive and careful analysis of the institutional details still makes this approach different in practical work.

2.3. Interactions Between Countries

The growth of government may be the result of the interrelationship between individual nations. The following types of interaction may produce this outcome:

(i) *economic interdependence.* An example would be that a recession in country A leads to a recession in country B, which in turn leads to a rise in public expenditure in B. (This effect is taken into account in adequately modelled interdependent country studies.)

(ii) *political interdependence.* An example would be government leaders who (are able to) increase the government share of GDP because another government has also done so.

(iii) *politico-economic interdependence.* An important example is political business cycles affecting other countries. A cumulation of election dates may produce a stronger overall cycle if each government disregards the cycle produced by the other countries due to the time lag involved. On the other hand, widely distributed election dates may dampen the overall cycle because a government may benefit from the election cycle brought about by the government of another country.

Somewhat surprisingly, the interdependencies (ii) and (iii) have not received much attention in politico-economic modelling.

2.4. Interactions Between Sectors

The actors driving the process of ever-increasing government activity may be considered as interest groups organized along economic sectors, especially by lagging ones such as agriculture, steel or textiles. These sectors cross national boundaries. The agricultural lobby, for instance, which is able to effect continuously rising government transfers to its benefit, is active in industrialized western countries.

According to this (extreme) approach, the country-specific size and development of government solely depends on the share of the corresponding sectors in the economy (pure structural effect).

2.5. Political Integration

Supranational institutions designed to liberalize internal trade (such as the European Community) may create new processes leading to rising government activity (for more details see Frey and Buhofer (1986)).

The following three factors tend to increase the share of public expenditures in GDP:

(i) *Pure integration effect.* Provided the integration does not diminish the influence of protective pressure groups, they will make sure that the loss of protection suffered by the elimination of internal tariffs is compensated by subsidies (usually provided by the government or the commission of the economic community); the growth in transfers pushes up the shares of public expenditures.

(ii) *Increased influence of pressure groups.* Due to the rise in transaction costs coupled with an increasing size of the political unit, the well organized protective producer groups are able to gain power relative to the even weaker consumers. This tends to increase transfers and public expenditures.

(iii) *Increased influence of political suppliers.* In the European Community, the voters and tax payers have very little direct influence on the policies undertaken at this level. The political suppliers, in particular the national bureaucrats and the Eurocrats gain in power, which tends to push up public expenditure.

These propositions may be empirically tested. For each country, an "integration dummy" can be constructed. It may be either 1 (member of EC) or 0 (non-member), or it may gradually increase (e.g. 0, 1/4, 1/2, 3/4, 1) to take formal or informal degrees of integration into account.

In country studies on the growth of government, little attention has been payed to *regulations*, partly because of the difficulty of measurement. When internal trade-liberalizing economic communities are considered, regulations in the form of trade restrictions (tariff/non-tariff barriers) become central. In order to capture the role of government in the economy, it is necessary to deal with these regulations. In the political economy of protectionism considerable theoretical and empirical work has been undertaken on which one may draw. Surveys are provided by Anderson and Baldwin (1981), Magee (1984), Frey (1984) and Baldwin (1985).

The behaviour of an economic community can be analyzed by assuming that the commission (government) pursues its own utility (which is mainly derived from the extension of the community's activities) subject to the constraints imposed by national governments (the need to be reappointed as national delegate to the commission) and by the interest groups. It may be deduced that the protectionism advocated both by the interest groups and the national politicians leads to a shift from internal tariffs to subsidies and non-tariff barriers. In terms of government activity, transfer expenditures and regulations increase, while revenues (from tariffs) decrease.

2.6. International Organizations

Public institutions above the level of individual nations are part of the *government* structure and should therefore be taken into account when analyzing the growth of government in an international perspective.[1] The first international organizations were founded around 1820, but only since World War II has their number rapidly grown. Today, there are more than 300 governmental international organizations of very different size and composition.

International organizations have with few exceptions been measured from the input side, i.e. one considers the development of the budget or the employment. Contrary to what one would believe, it is practically impossible to get reliable series on the budget, especially for the UN. The situation is somewhat better for employment. The average yearly growth rates of the number of employees since the foundation of the respective international organization are (Blanc (1984)):

OECD	2.0 %
ILO	3.0 %
IAEO	4.5 %
UN	4.7 %
EC	9.5 %
World Bank	11.0 %

While the resource cost of international organizations is still quite small (compared to the appropriate GDP level), some of the growth rates suggest that this cost is rapidly increasing. To my knowledge, no consistent figures exist concerning the regulatory activities of international organizations.

The output or the effect of international organizations on human (economic) welfare is even more difficult to analyze theoretically and empirically, than is the case for national governments. Some of the measures for evaluation make little sense, because these organizations are far removed from the decisions of individual voters/taxpayers.

2.7. Additive Aggregation of Causes

Following this approach, the share of public expenditure or taxes relative to GDP aggregated over a number of countries may be regressed on the common set of demand and supply factors identified for the individual countries. This perspective implicitly assumes that the interaction between the countries and the supranational units discussed in subsections 2.3 - 2.6 can be disregarded, as they do not produce any additional effects beyond those included in an isolated analysis of national governments. This approach is problematic because there exists no decision-making unit at this level. The interrelationship between the set of factors and the changes in government activity observed must be looked upon as a pure reflection of the decisions taken at the national level.

The additive approach has been pursued by Lybeck (1986, ch. 5) for the aggregate (pooled cross-section and time-series data) of twelve OECD countries. The estimation results are not the same as those for individual countries. For example, the degree of unionization turns out to be of no importance in explaining total government expenditure, though in the estimates for various countries it proved to be statistically significant. The reverse holds for unemployment which is of great importance in the aggregate, but of no importance in the country estimates. This suggests that the interactions alluded to may play such a role that they should not be disregarded. Lybeck (1986, p. 106) mentions himself the

...clear indication that the model may be correctly specified for each of the individual countries and yet the same model is *not* applicable to the aggregate of the countries.

3. Evaluation

The discussion suggests the following propositions:

(a) The "extreme" perspectives (1) of non-institutional country comparisons and (7) of additive aggregation have been sufficiently explored, with mixed results. At least with existing data, there does not seem to be much ground to be gained by pursuing these approaches further.

(b) Perspectives (2) of an institutional comparison between countries and (3) of the various kinds of interactions between nations should not meet with any grave problems, except requiring a large amount of empirical work.

(c) To successfully pursue perspectives (4) of the interaction between sectors, (5) of political integration, and (6) of international organizations requires new theoretical insights as well as data which so far have not been consistently collected. These perspectives provide a real challenge to politico-economic modelling.

NOTES

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1. There have only bee a few attempts to do so within public choice: Olson and Zeckhauser (1966), Tollison and Willett (1976), Dreyer and Schotter (1980), Sandler (1980), Fratianni and Pattison (1982), Vaubel (1986), Frey and Schneider (1986).

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