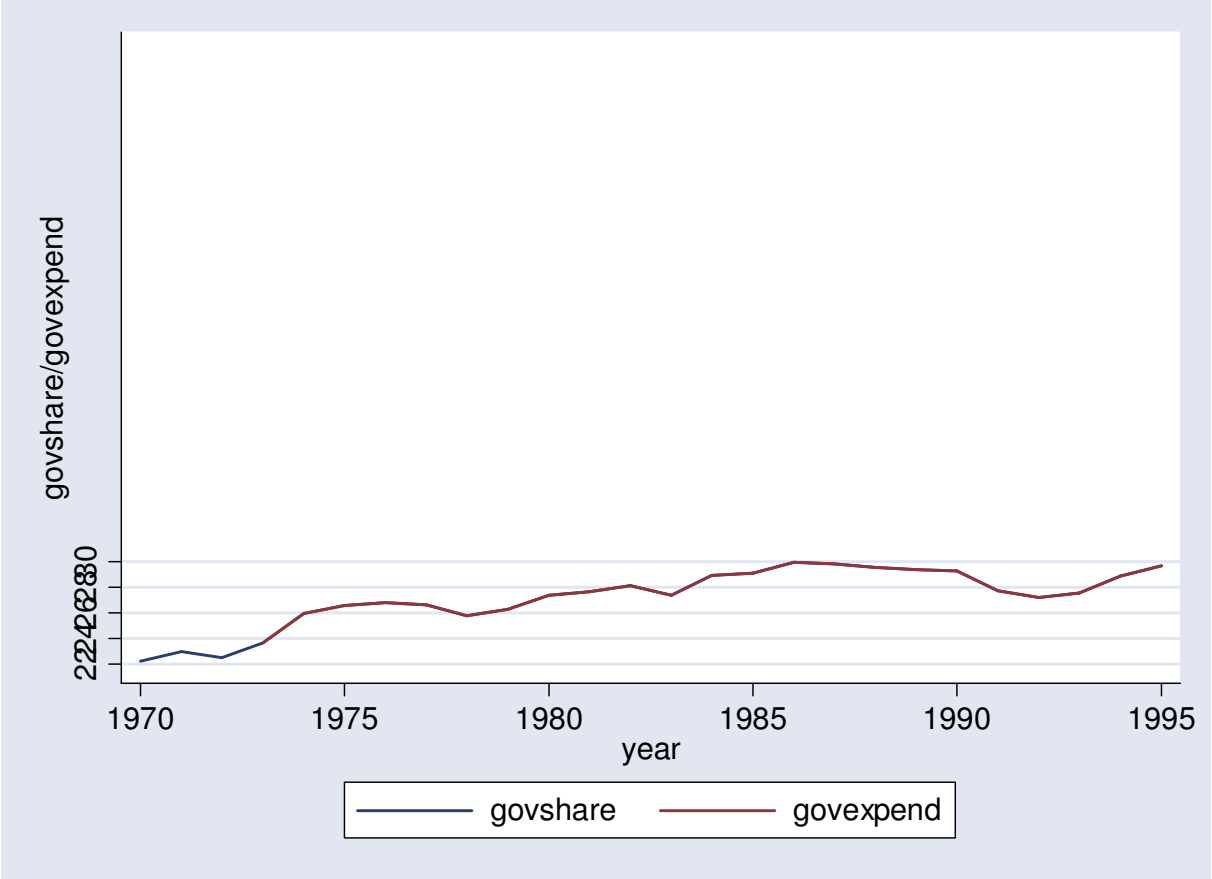


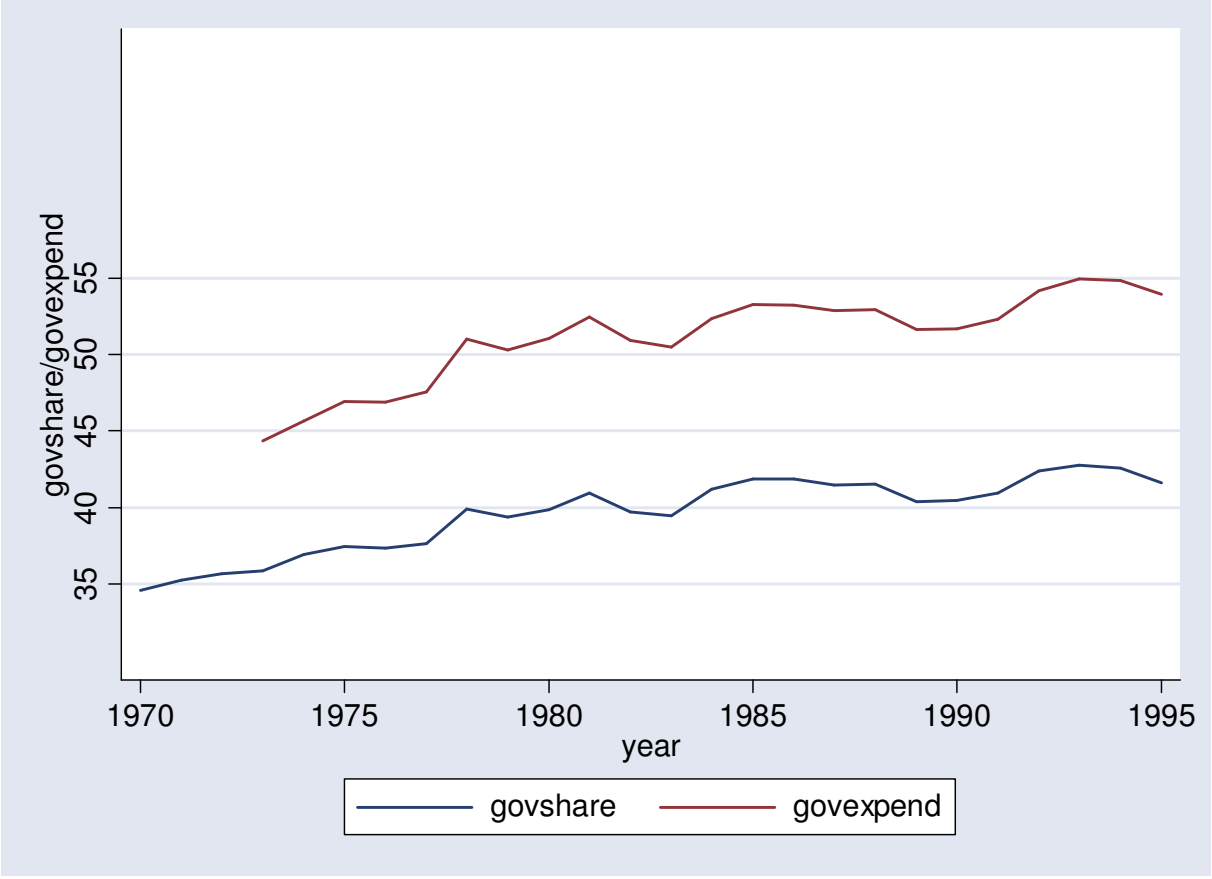
**16**

## **Government Spending**

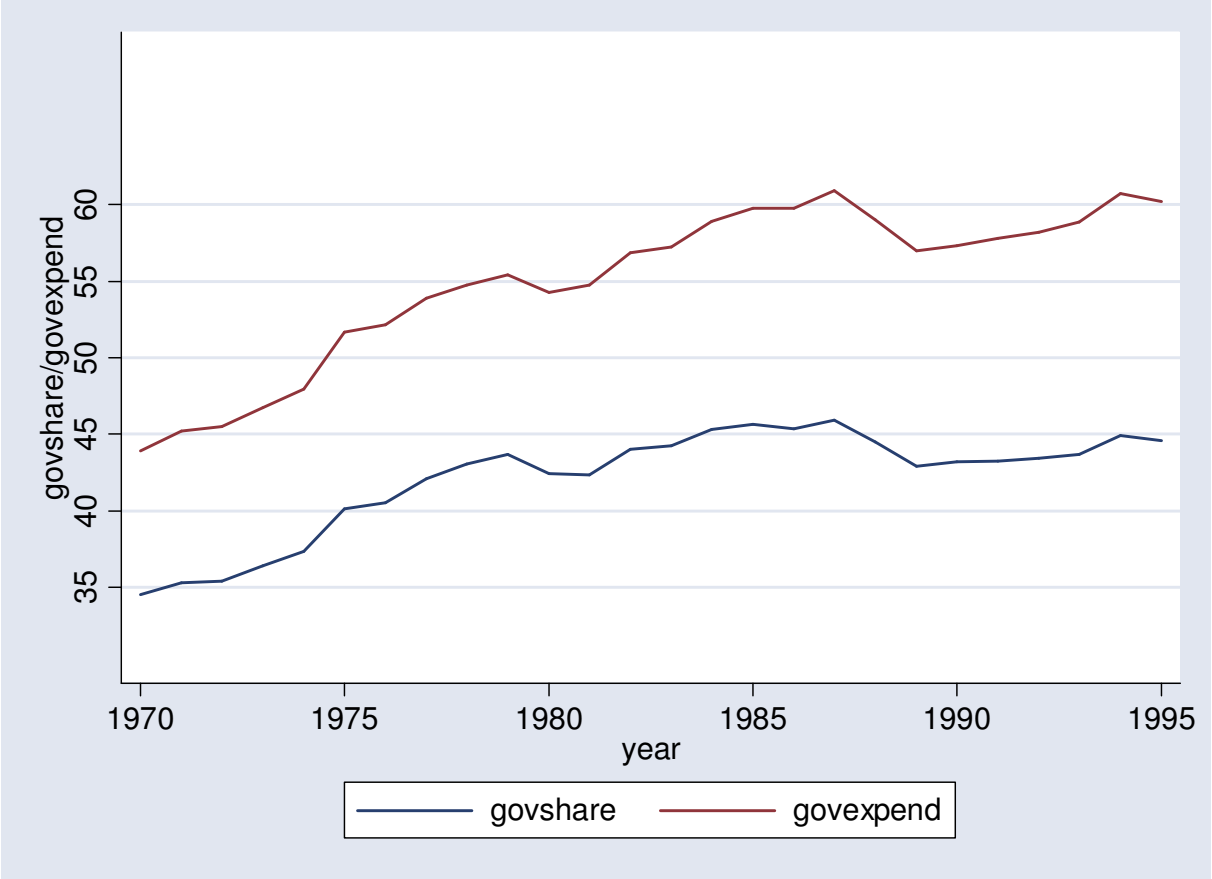
- 1. Patterns of Government Spending**
- 2. Theories of the Increase in Government Spending**



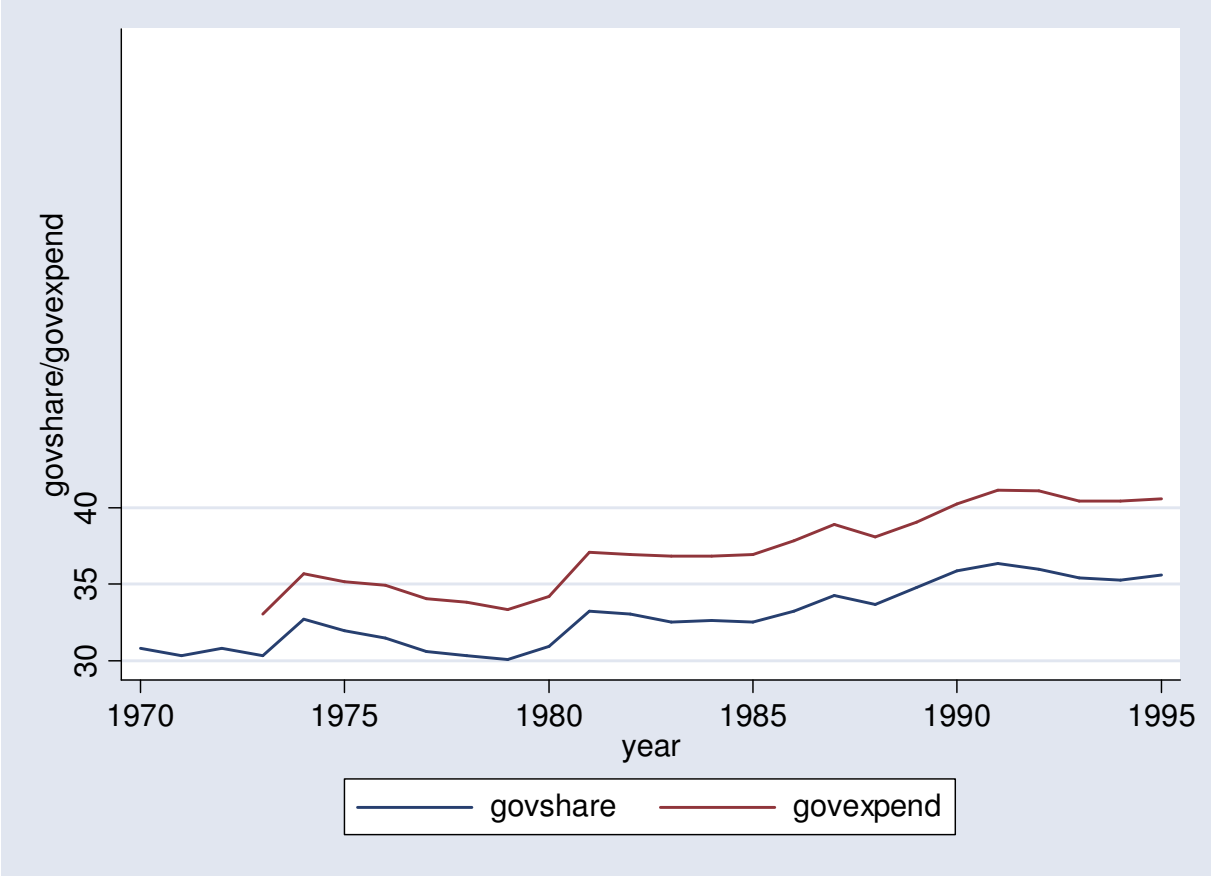
**Australia**



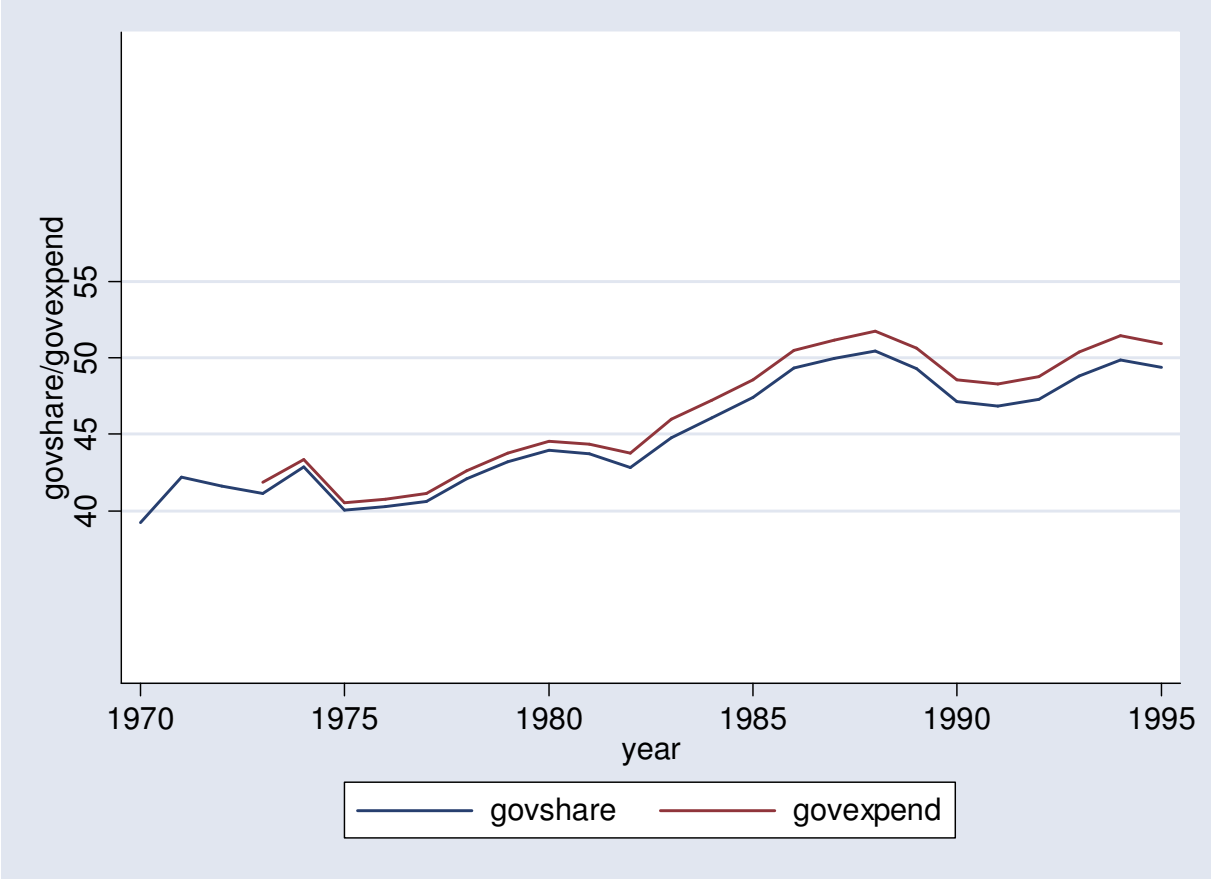
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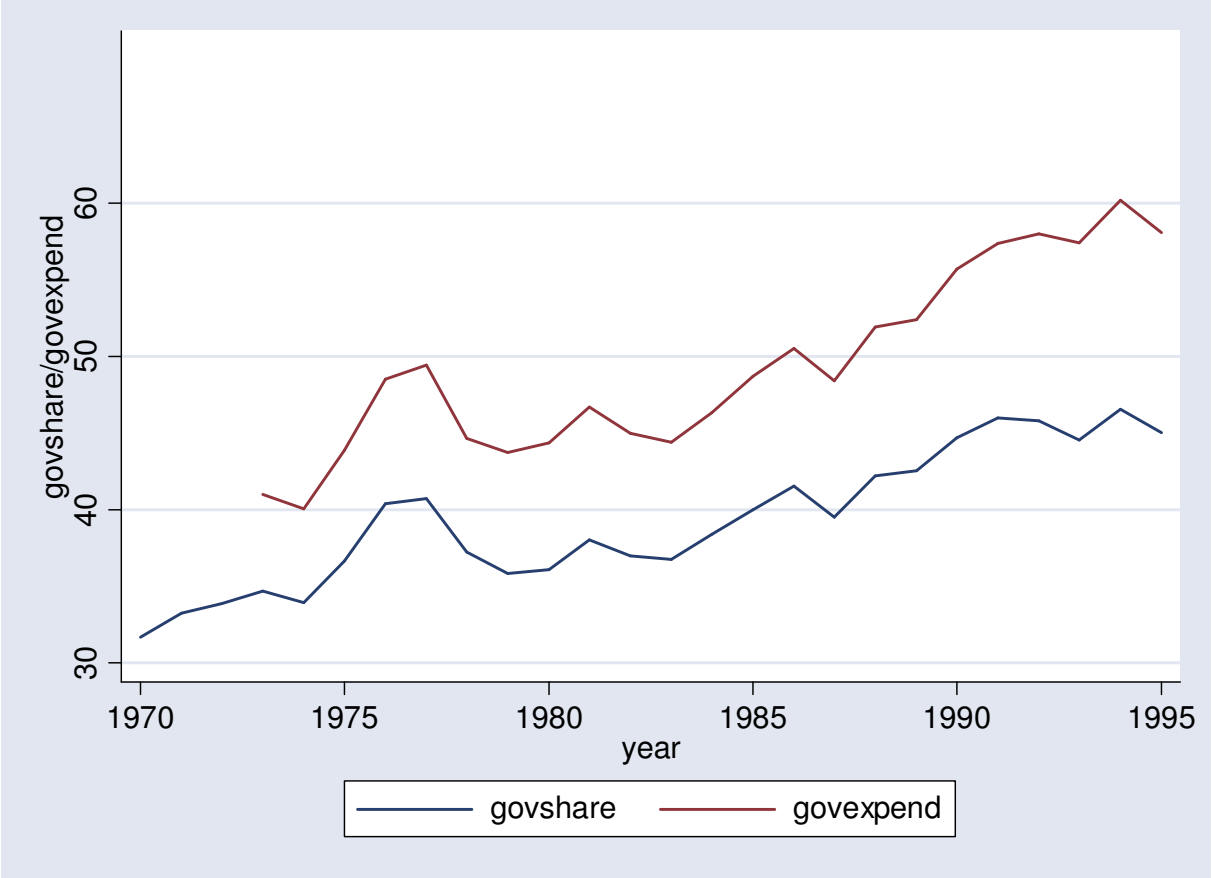
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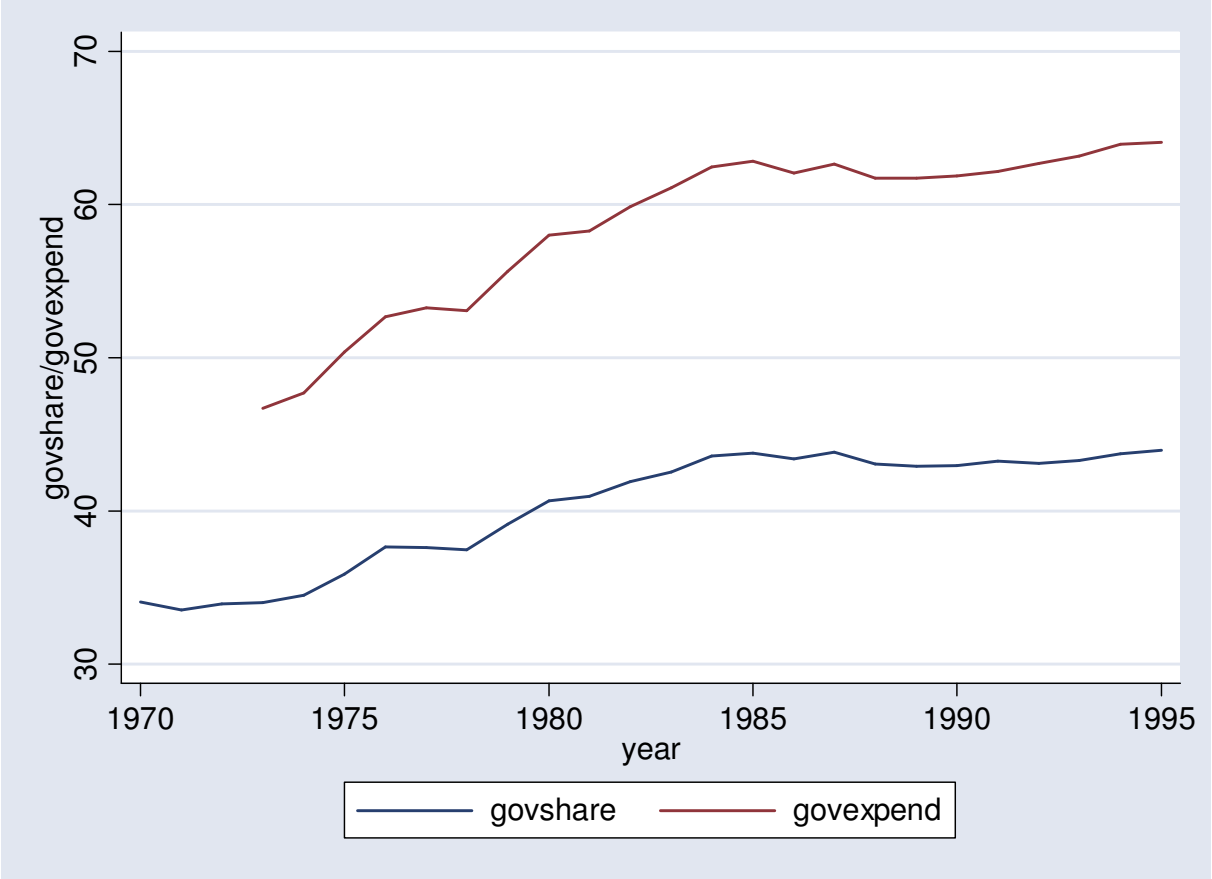
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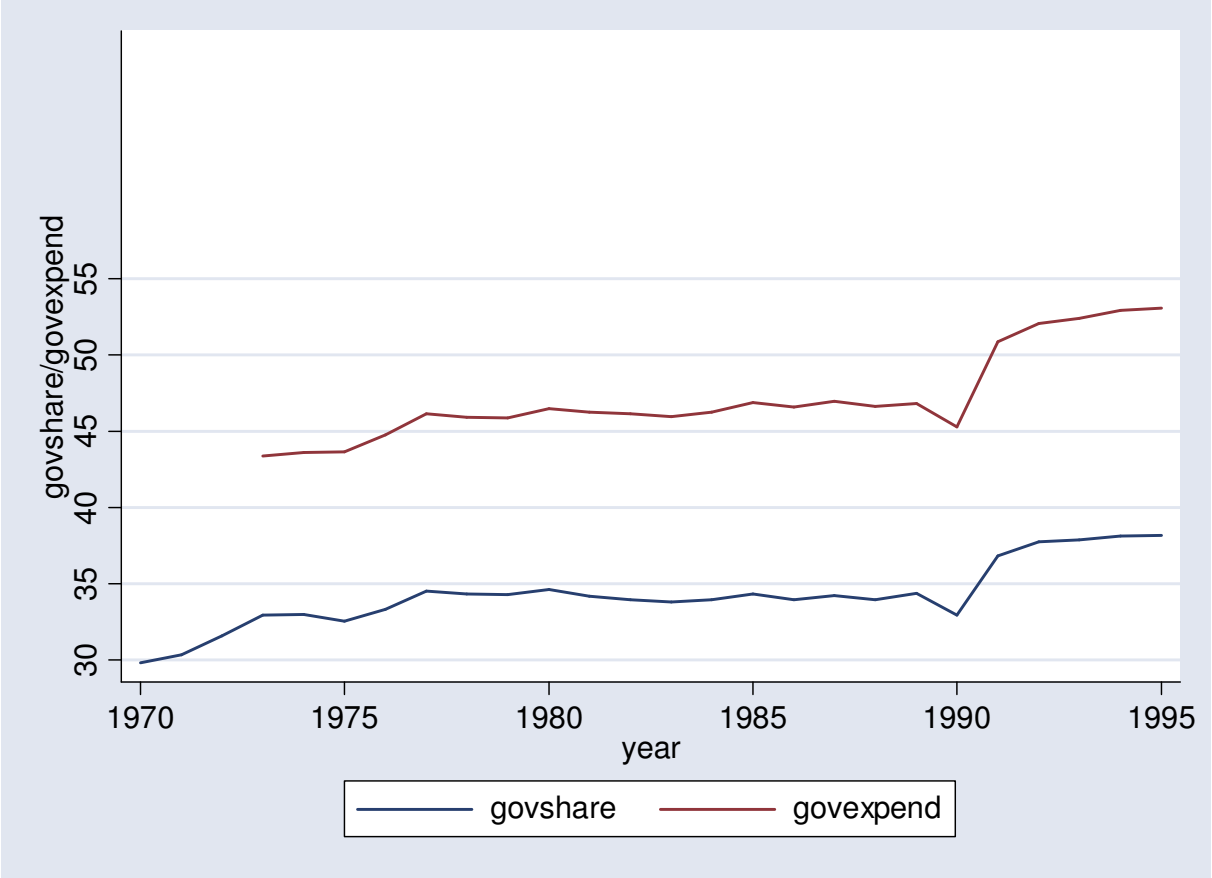
**Denmark**



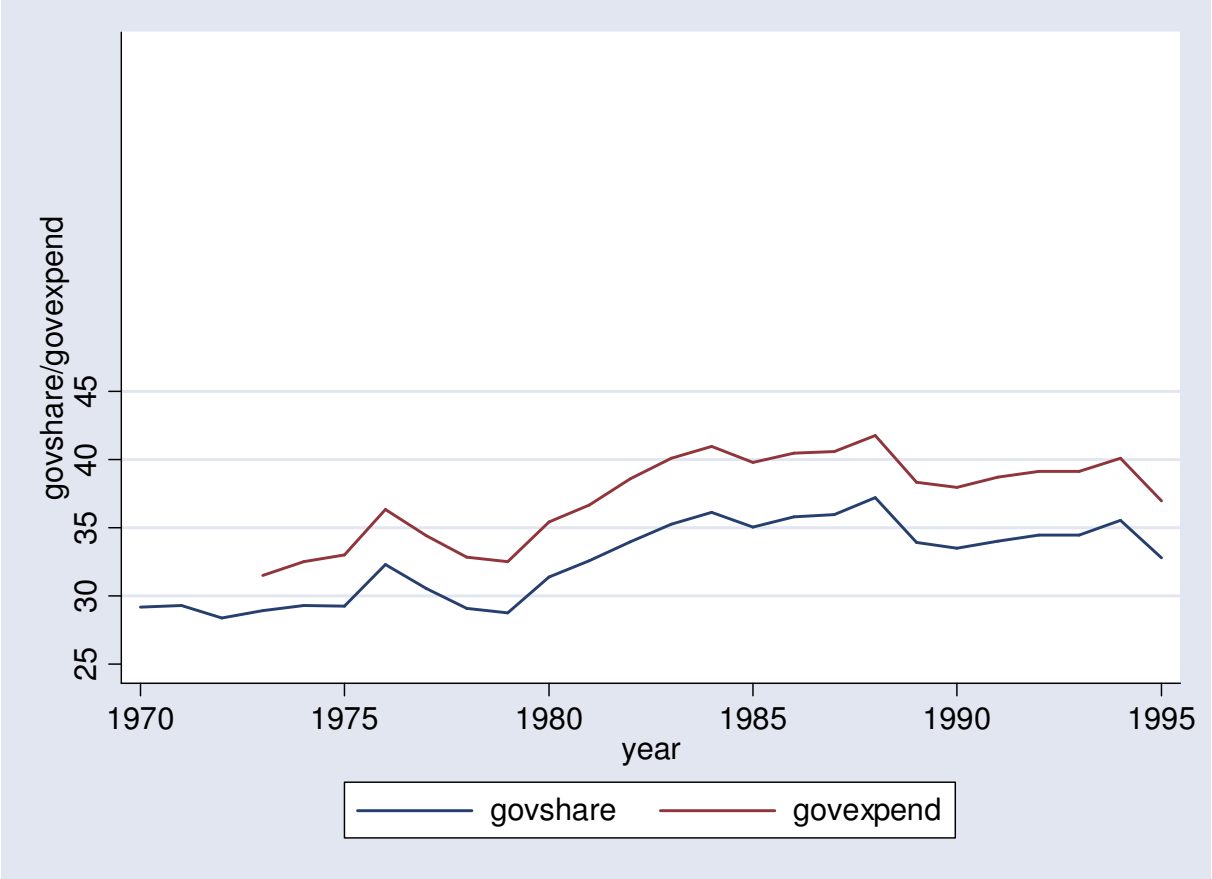
**Finland**



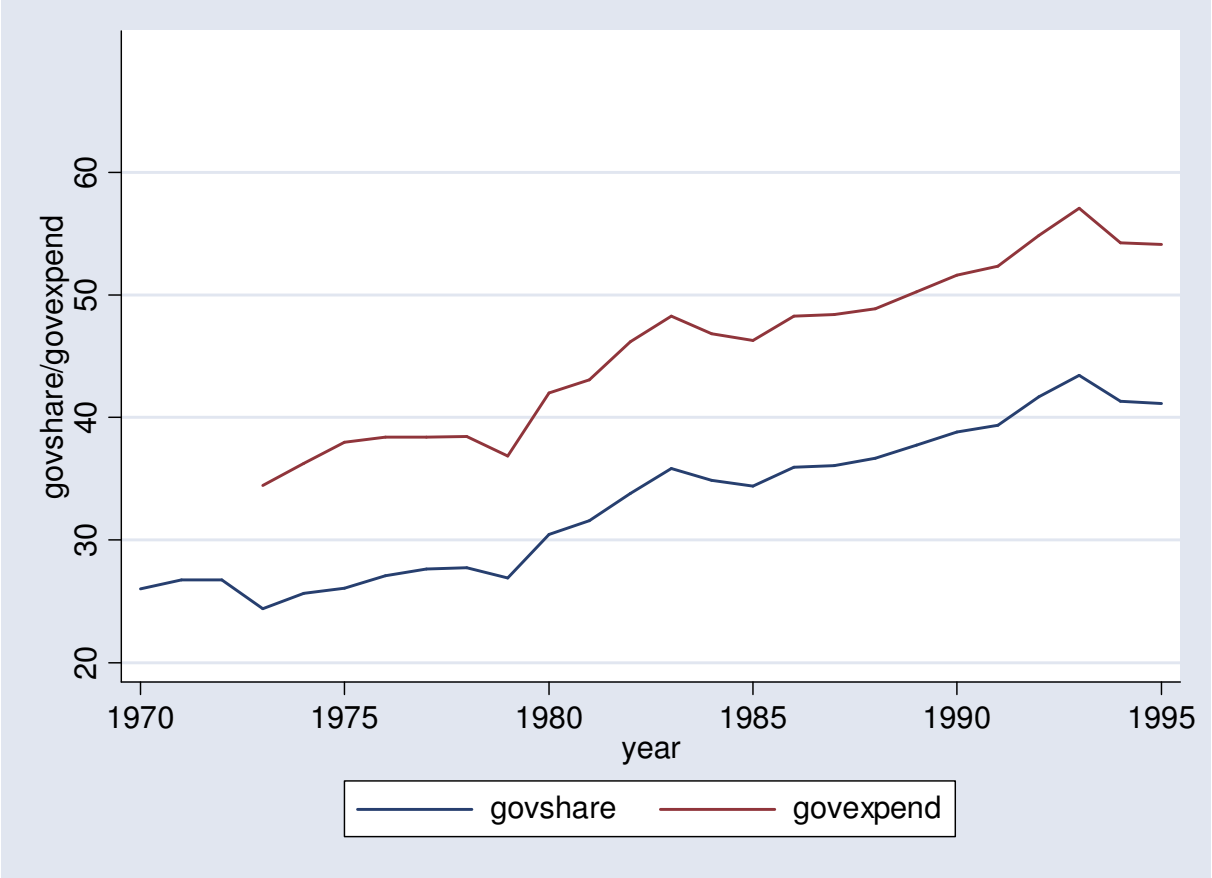
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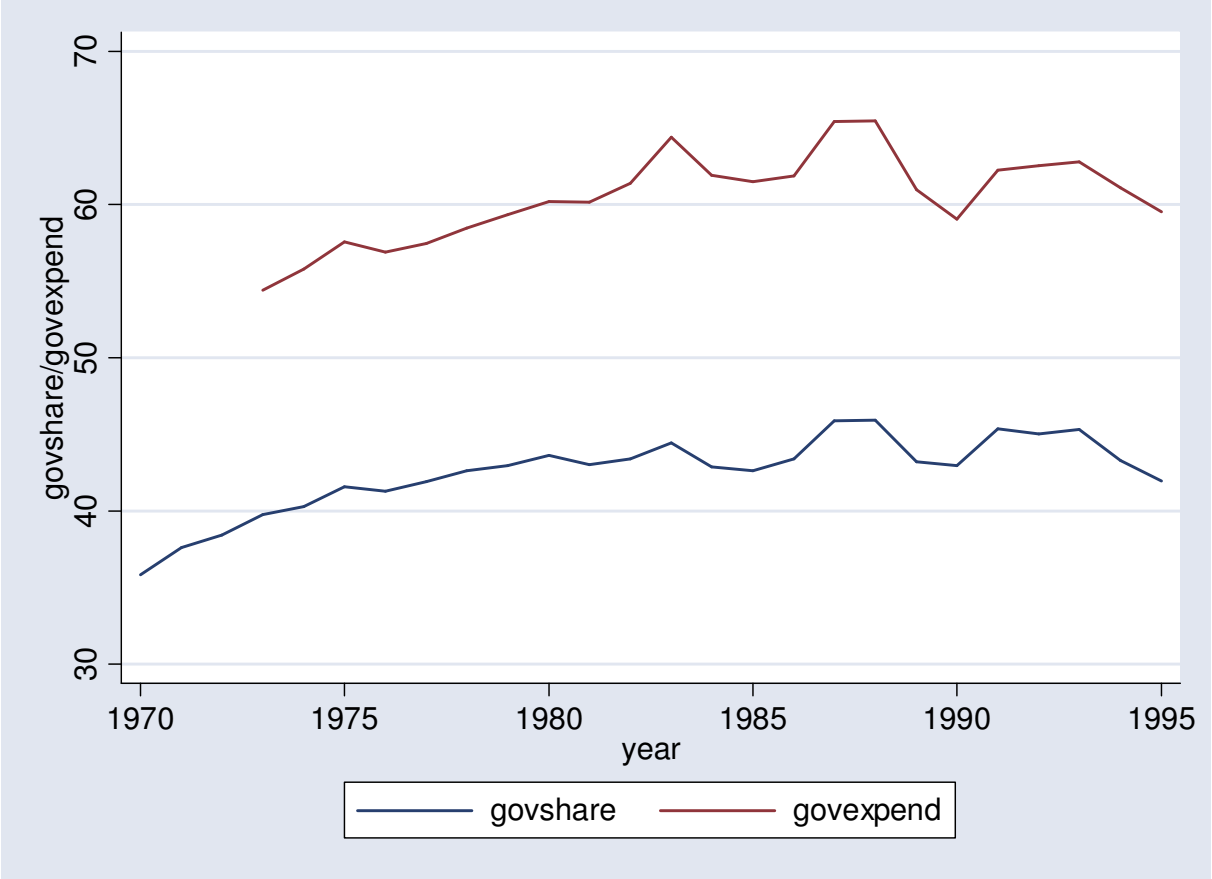
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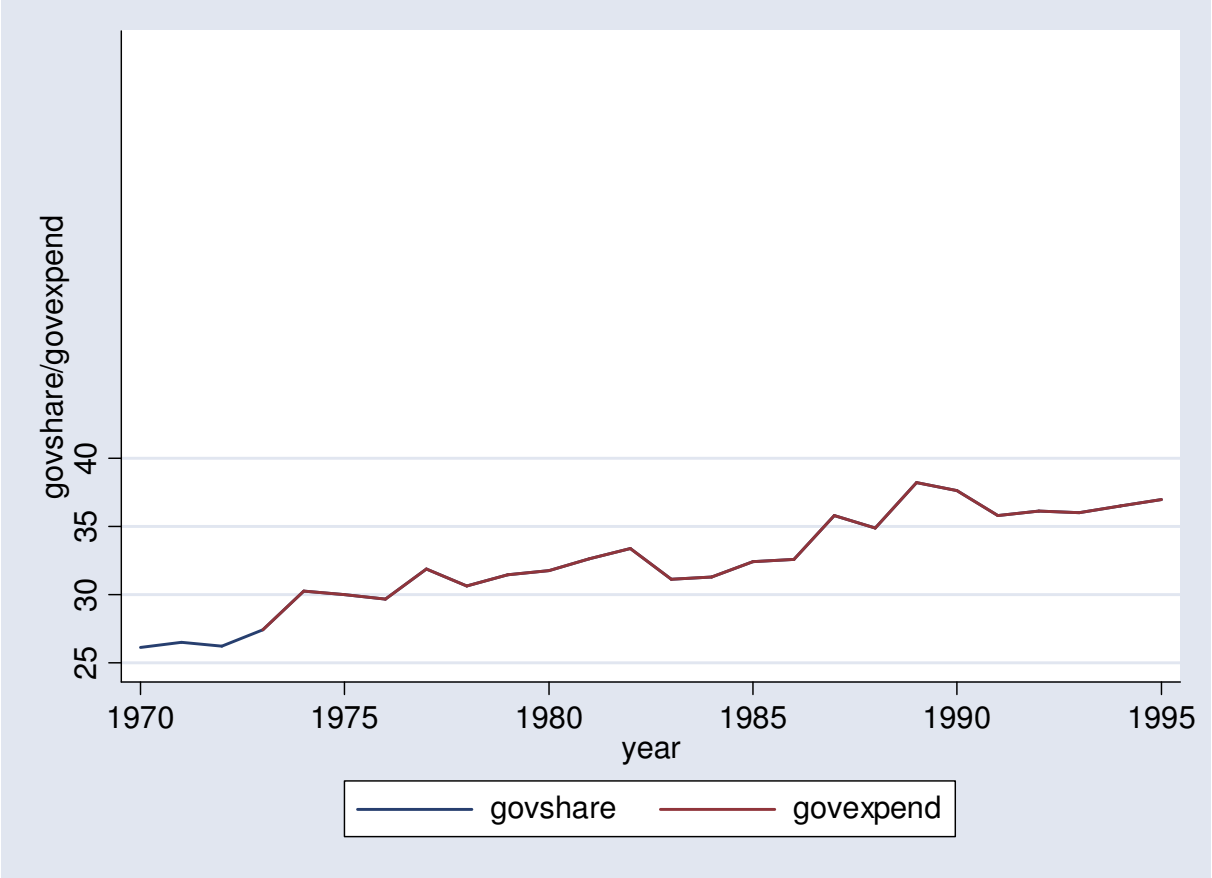
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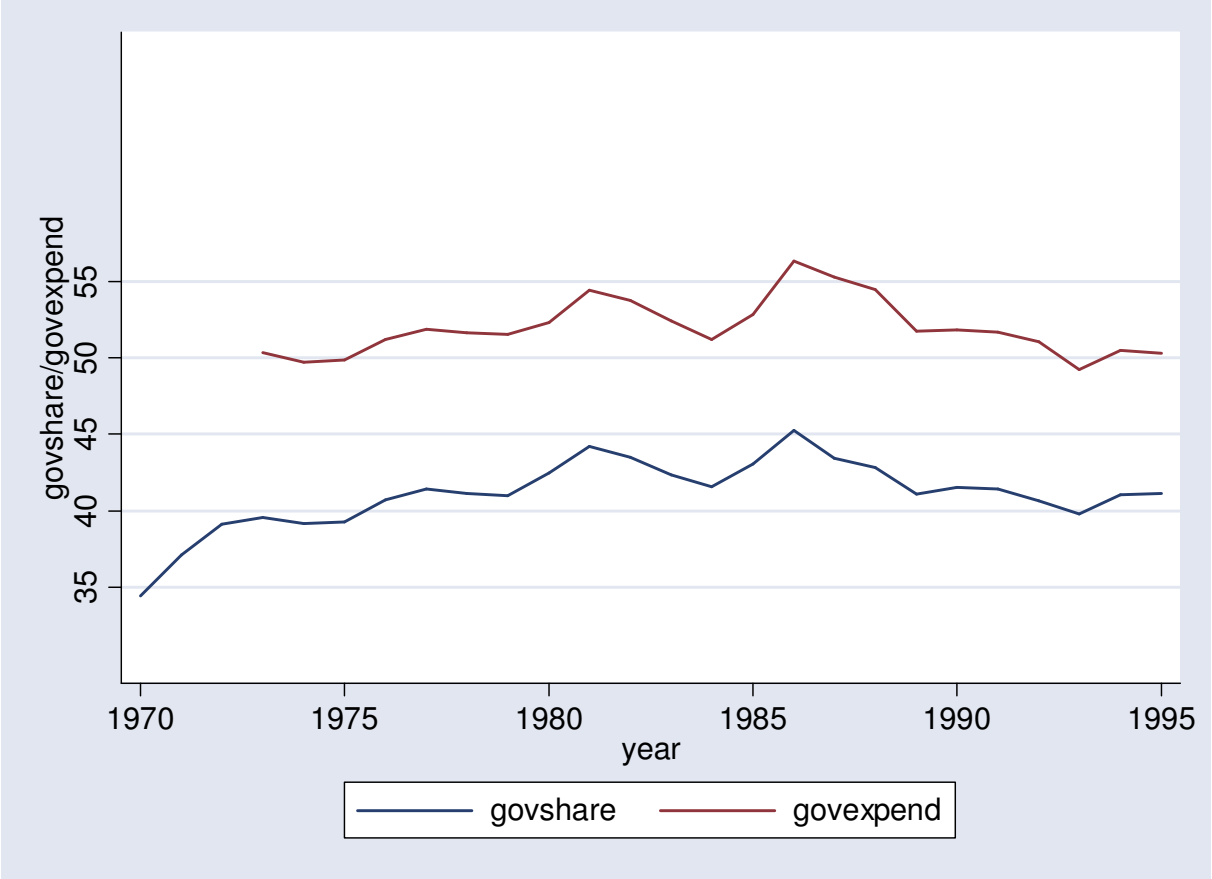
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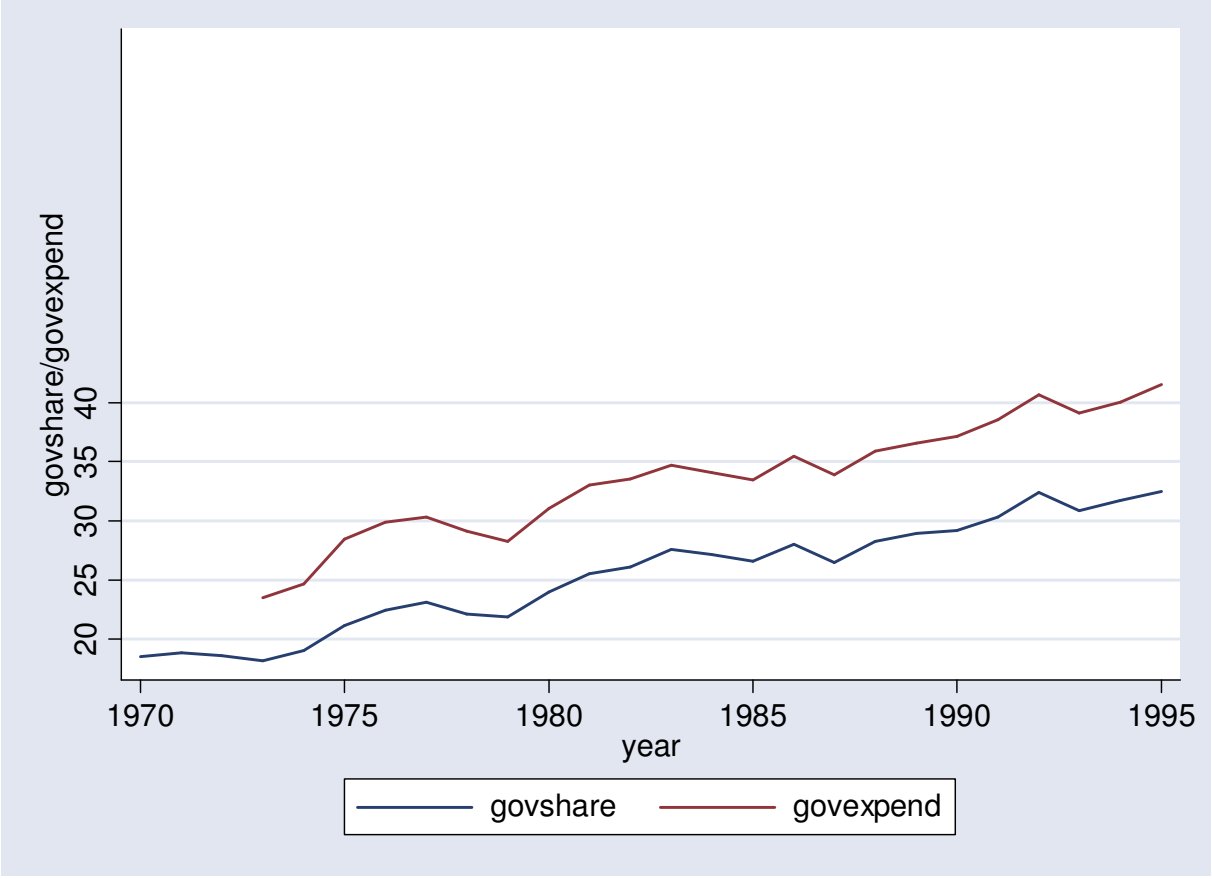
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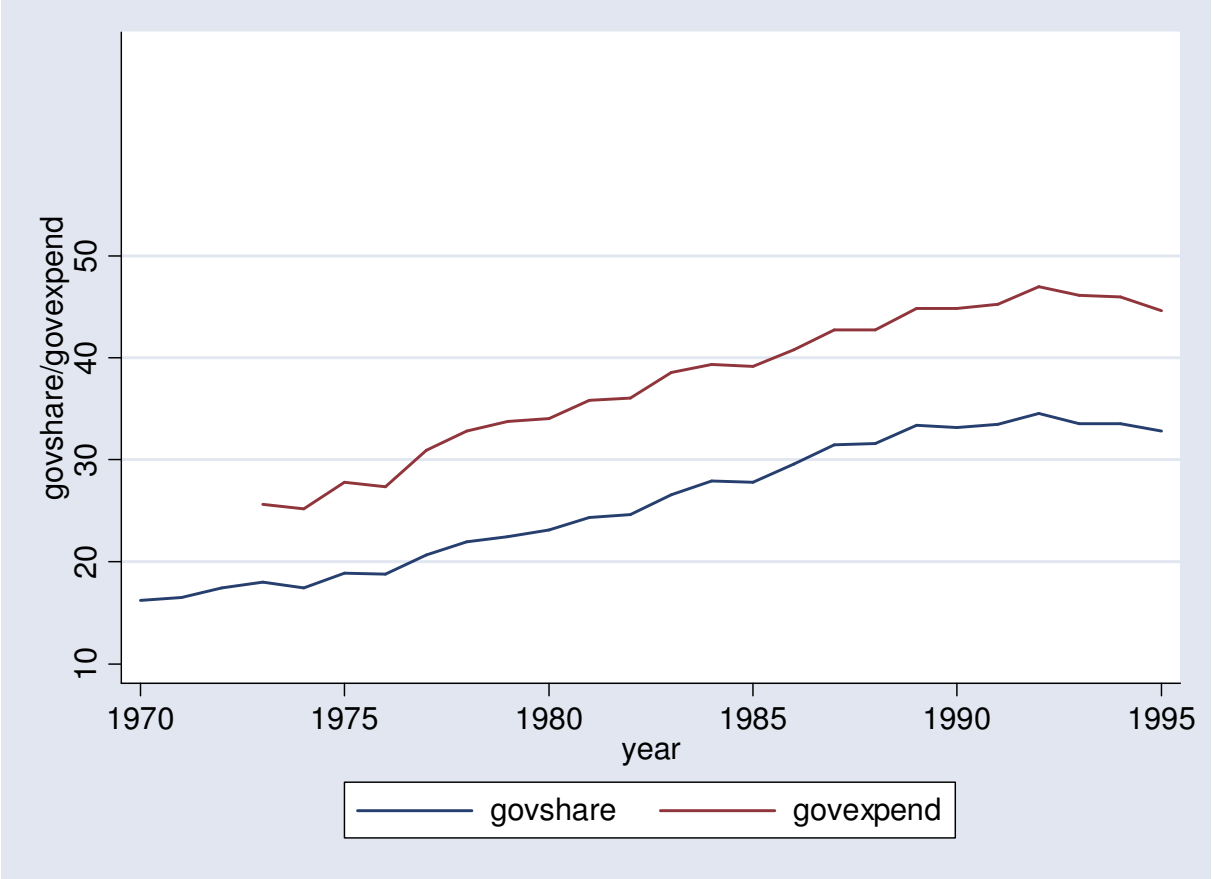
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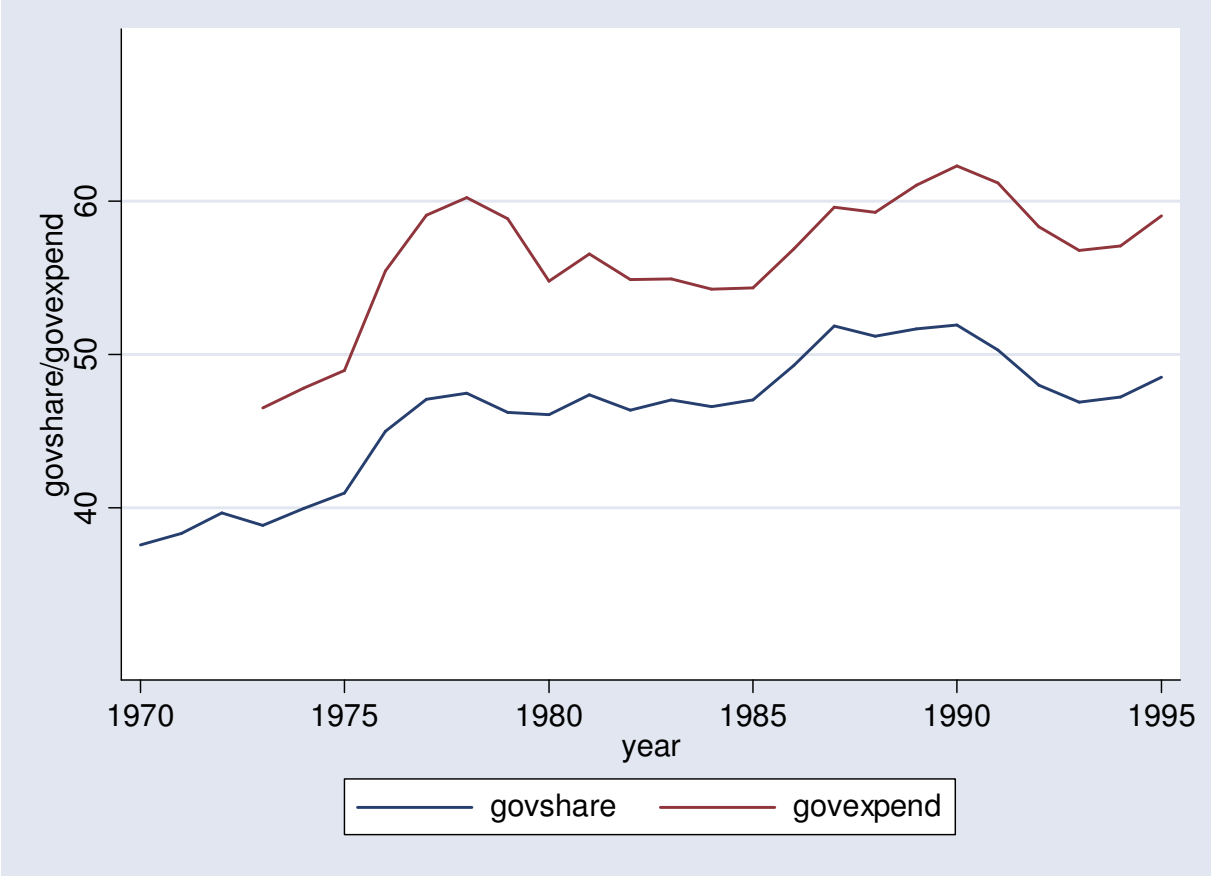
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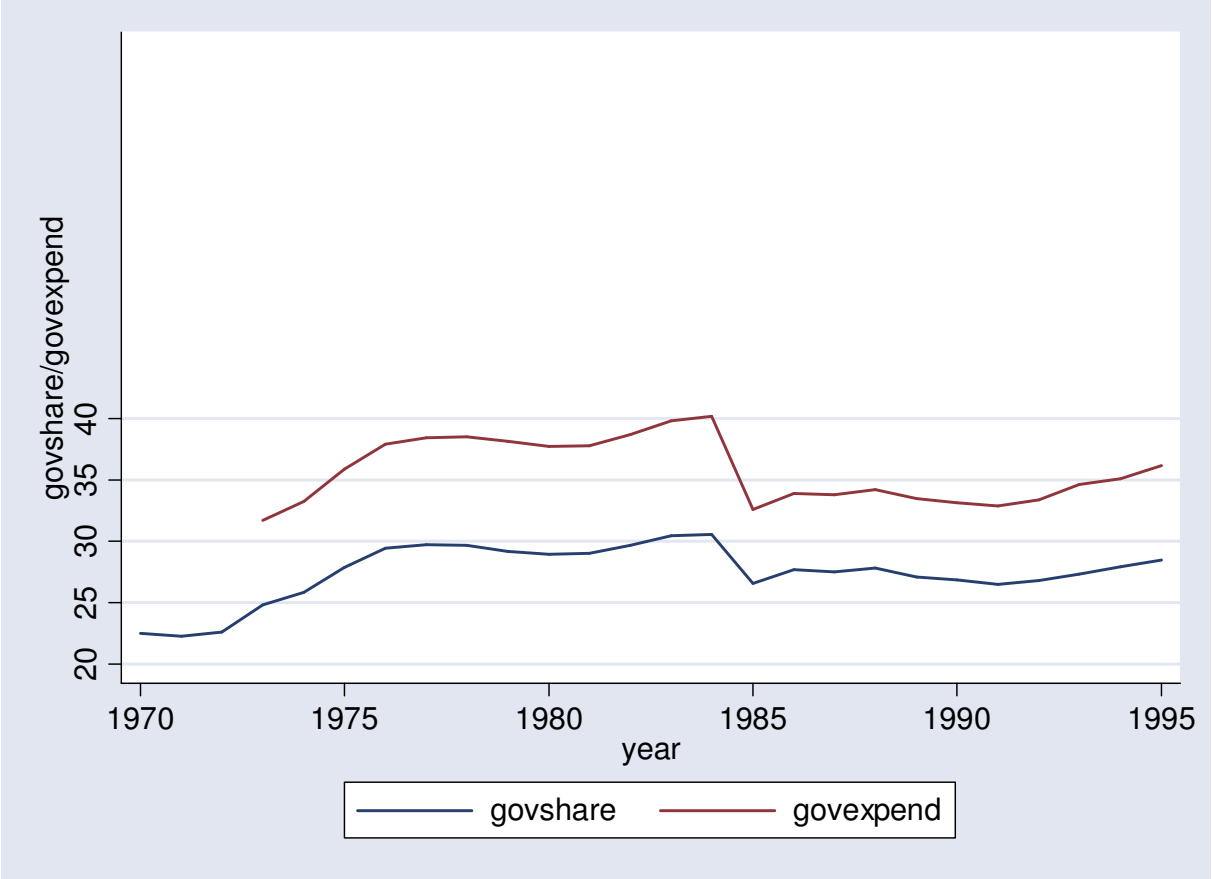
**Portugal**



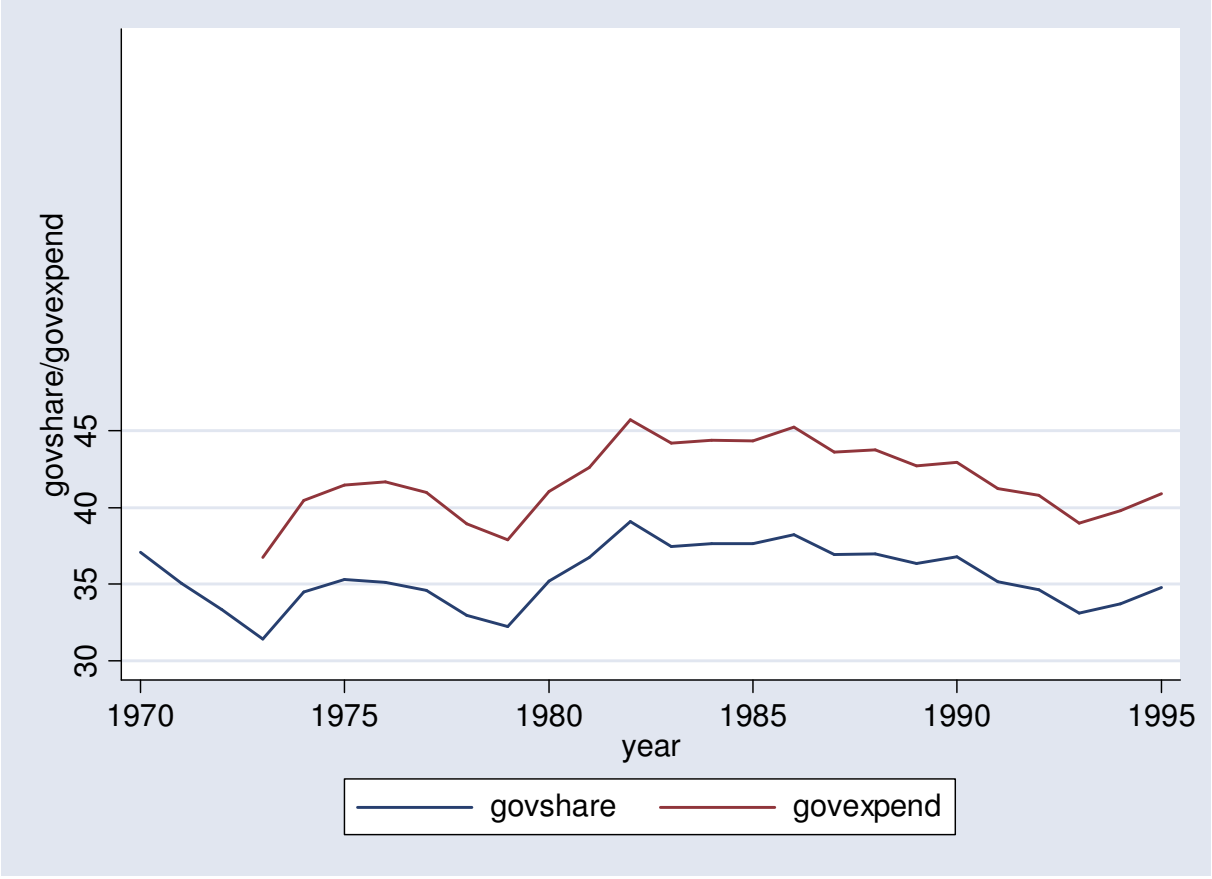
**Spain**



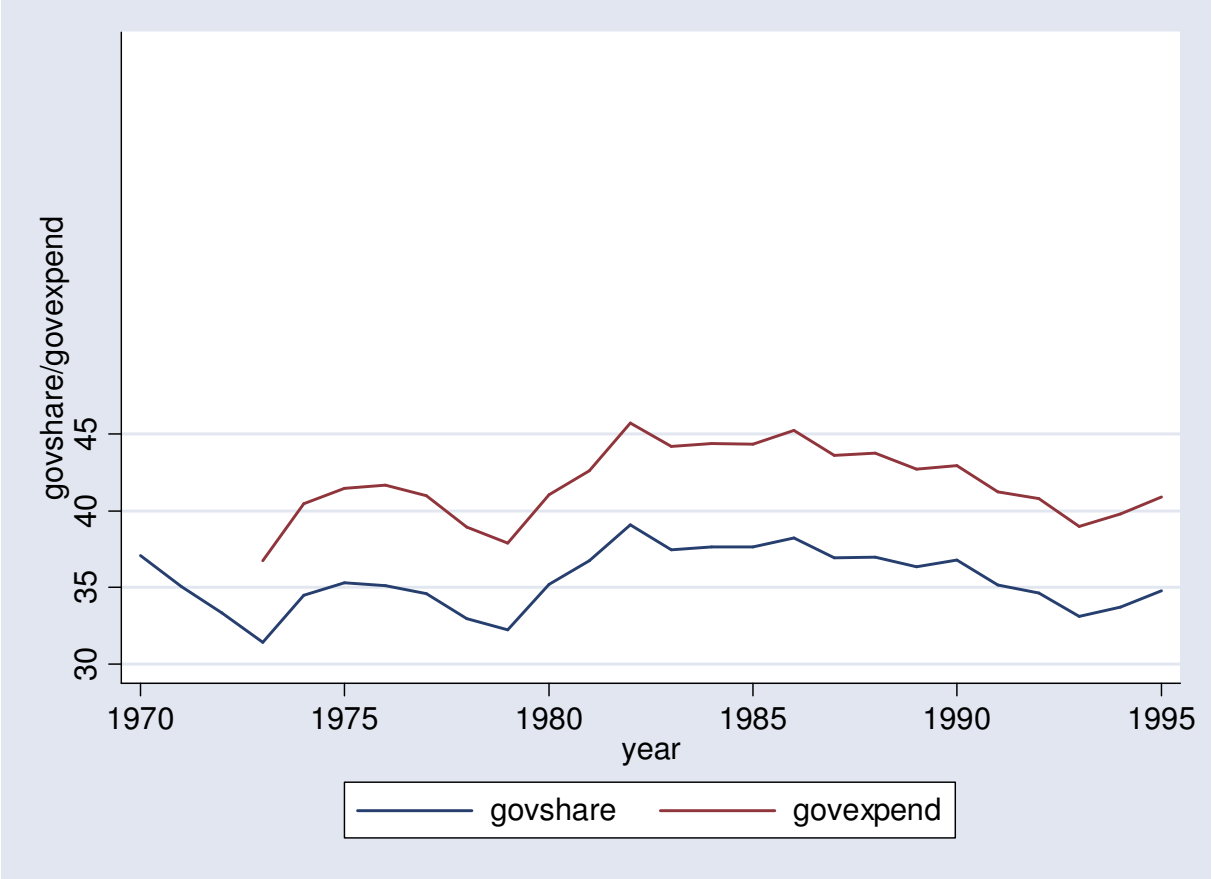
**Sweden**



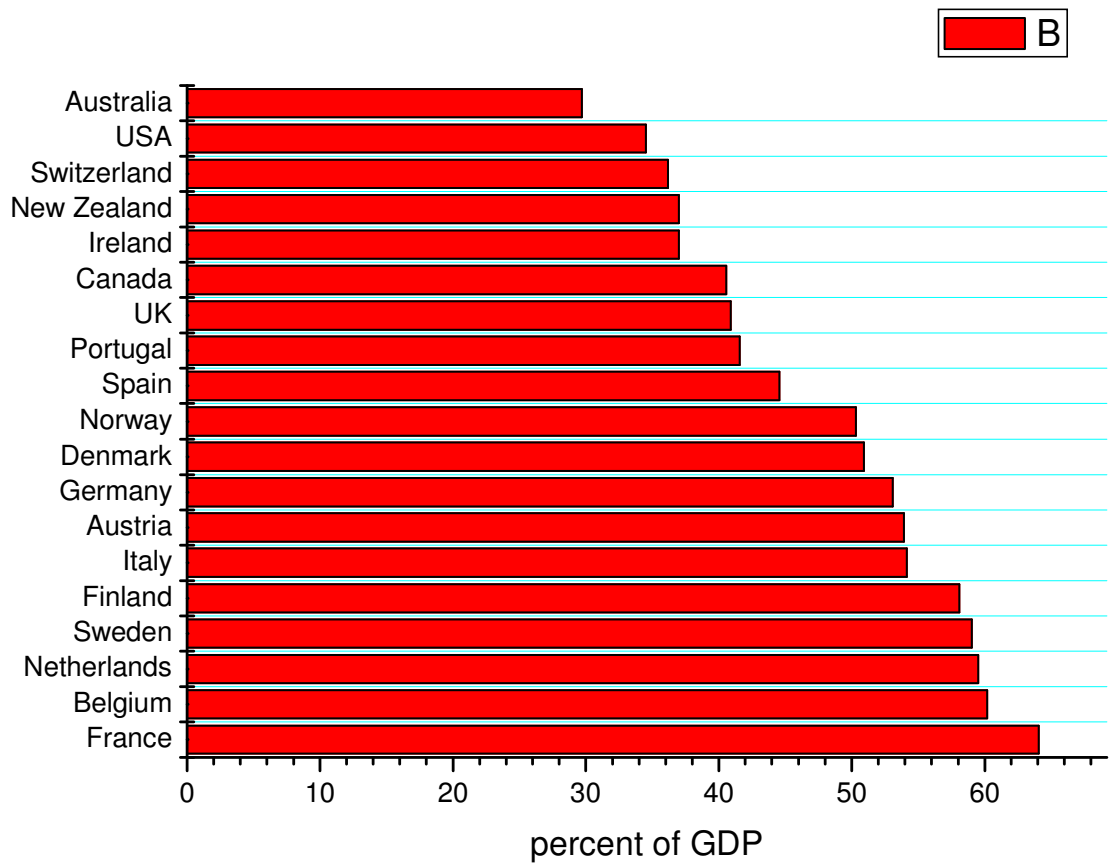
**Switzerland**



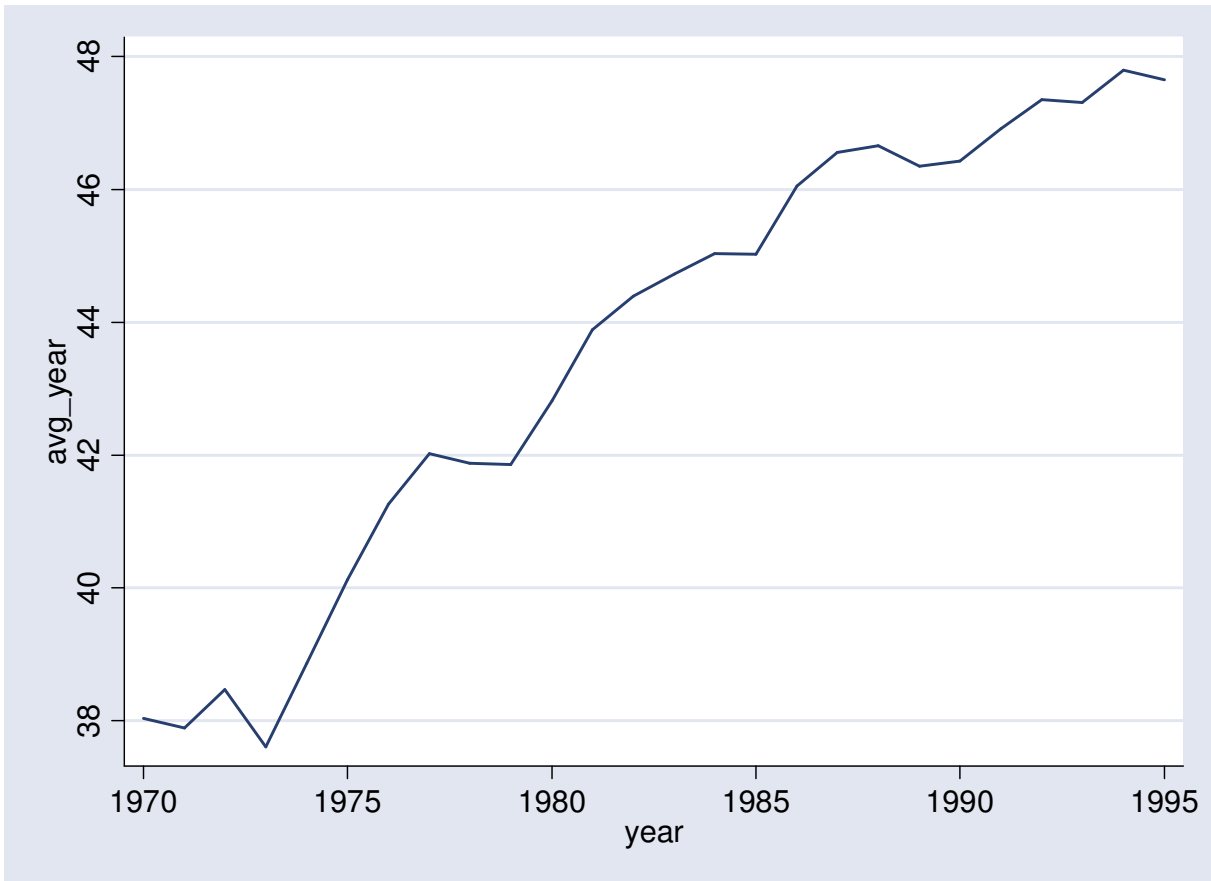
**UK**



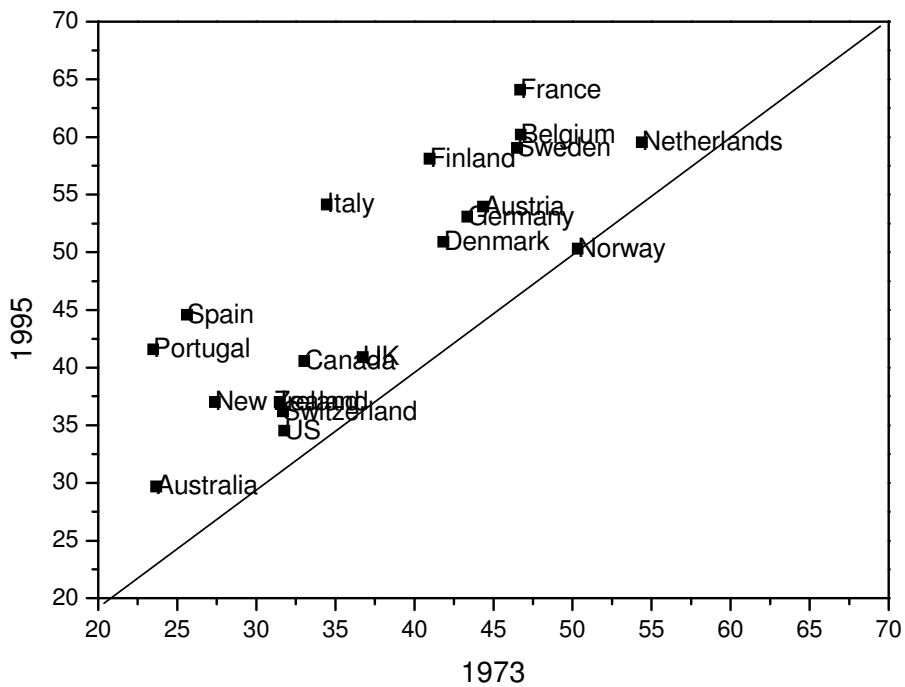
**USA**



1995



## Increase of Government Expenditure over Time



## Across Countries

## **Competing Explanations**

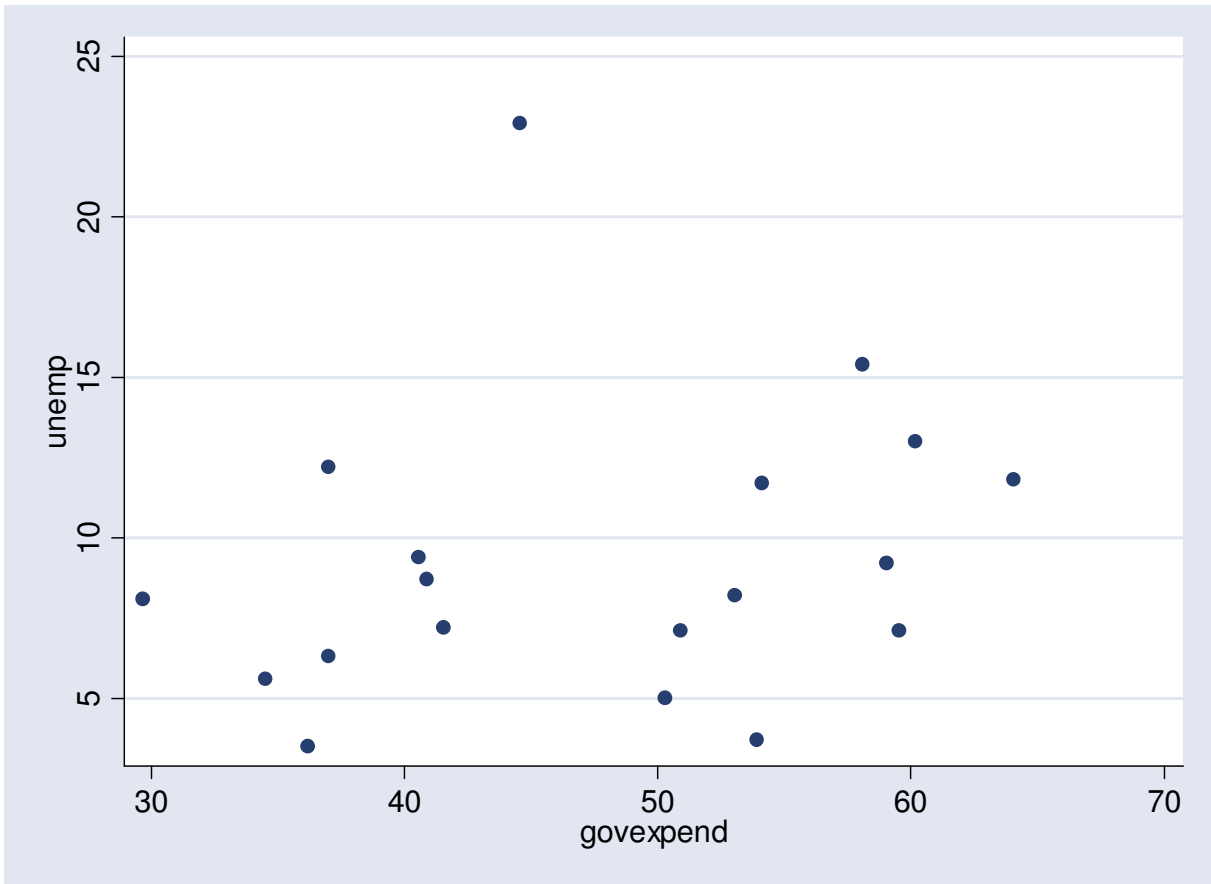
**Unemployment**

**Aging**

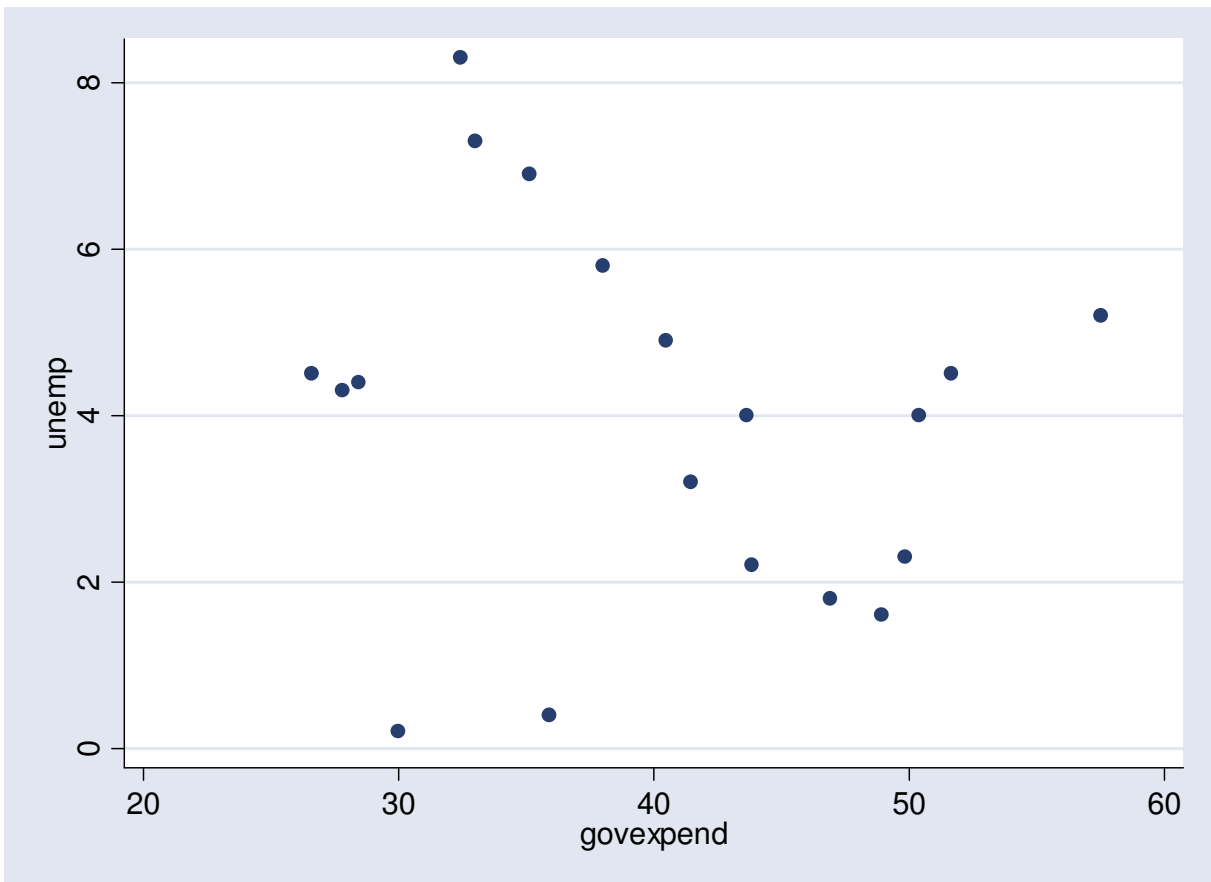
**Change in Productivity**

**'Globalization'**

**Ideology**



**1995**



**1975**

# **Unemployment**

## **Theory:**

**An increase in unemployment causes an increase in government expenditure, because more voters demand unemployment benefits and transfers increase if an unemployment transfer scheme exists.**

## **Comment:**

**Unfortunately, an increase in government expenditure also causes an increase in unemployment as private investment and/or private consumptions declines.**

**Moreover, with little exceptions, OECD countries experienced similar shocks. Yet, unemployment did not rise similarly.**

**Rather, unemployment is a consequence of the welfare state, i.e. generous unemployment transfers.**

Table 3. Arbitrarily chosen versus optimized lags: A comparison

	Model 3.1: uniform lags	Model 3.2: optimized lag
Unemployment	1.2146 (0.8830)***	1.2168 (0.0860)***
GDP per capita growth	-0.2604 (0.0403)***	-0.2608 (0.0401)***
Dependency ratio	-0.7384 (0.1267)***	-0.6655 (0.1229)***
LEFT (no lags)	0.0002 (0.0041)	
LEFT (optimized lags)		0.0083 (0.0038)**
Christian Democrat portfolios	-0.0418 (0.0093)***	-0.0338 (0.0088)***
Trade openness	0.0507 (0.0290)*	0.0515 (0.0285)*
Low-wage imports	-0.1488 (0.0436)***	-0.1567 (0.0420)***
Foreign direct investment	-0.0910 (0.0951)	-0.1217 (0.8604)
N	529	524
R <sup>2</sup>	0.940	0.944
Wald $\chi^2$	13035.32	12310.68
Prob. > $\chi^2$	0.0000	0.0000
PCSE	yes	yes
Time dummies	no	no
Country dummies	yes	yes

Notes: \*\*\* p < 0.01; \*\* p < 0.05; \* p < 0.10.

## **Aging**

**Theory: Similar to unemployment. An increase in the number of pensioners increases the demand for generous public pension schemes.**

**(three-generation models demonstrate that majority of voters is in favor of public pension schemes once they exist)**

**Comment: very little empirical evidence for this theory, increase in public pension schemes does obviously not explain the increase in government spending – at least not the variation across countries.**

## **Change in relative productivity.**

**Theory: voters' demand for the relative share of public and private goods is constant over time. However, most public goods are in fact services, most private goods are manufactures goods. Since the increase in productivity tends to be higher in manufacturing than in services, the relative costs of public good provision increases over time.**

**Comment: smart theory, cannot explain the huge variation across countries. Shall we believe that low govspend countries had lower increases in industrial productivity?**

## **Globalization**

**Theory 1 (compensation theory): Globalization increases demand for social transfers as likelihood of unemployment and economic volatility increase.**

**Comment: theory wrong. Larger markets are less volatile and trade does not stimulate unemployment – or only a tiny little bit.**

**Theory 2 (efficiency theory): Globalization and particularly tax competition reduces governments ability to effectively provide inefficient government services: capital flight in case of high government expenditure.**

**Comment: tax competition has not led to a decline in government spending. Rather, taxes on mobile factors have been reduced, taxes on immobile factors have been increased by governments.**

## **Ideology**

**Theory: Left parties provide more public goods than conservative parties because of voter alignment. Most individuals with below average income vote for left parties, these voters demand more redistribution.**

**Comment: Theory not wrong, however, historical time heavily intervenes. In the 1970s, all parties favored redistribution, in the 1990s only a few (left-wing) parties favored redistribution. On average, there might be a partisan effect, but impact of left government on spending varies largely over time.**

**(Even left parties learn ... ;-)**

