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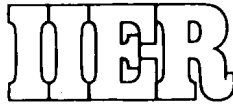
WHY GOVERNMENT GROWS

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INTRODUCTION

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Original Paper 4
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WHY GOVERNMENT GROWS

Allan H. Meltzer, *Introduction* by Roger A. Freeman

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INTRODUCTION

Roger A. Freeman

It is novel and possibly significant that all candidates who emerged in leading positions during the 1976 United States Presidential primaries voiced opposition to big government and its seemingly perpetual and irrepressible growth, while candidates known to favor governmental expansion fell by the wayside early. This seems to suggest that many Americans — maybe a majority — are apprehensive about the rapid expansion in the size and power of government, that they expressed this sentiment in their votes during the first half of 1976, and that the political leaders so interpreted the trend of public feeling.

But this should not lead us to expect that an anti-big-government attitude will necessarily lead to effective restraint on government or that candidates elected on such platforms will, when in office, refrain from adding to the magnitude and reach of government.

Professor Allan Meltzer presents the theory that the amazing growth of government is not, as widely assumed, the result of certain recent events or changes in attitudes — the depression of the 1930s, war, urbanization, and related factors. He feels that it is, for better or worse, an inherent and built-in characteristic of representative government. His theory somewhat parallels a thesis advanced nearly a century ago by the German economist, Adolf Wagner, as the “law of the increase of government activities among progressive people.” Wagner’s law did not attract much support at the time, nor later, but study of long-range and recent trends lends much credibility to it.

Professor Meltzer now asks why the public acquiesces in the incessant growth of government and why it does not, in countries with a system of free government, act to stop or reverse the process. He offers an explanation for the origin and strength of the trend: the costs of government are diffused and the benefits concentrated. Thus there is organized and effective political support for expansion, but feeble and

widely dispersed resistance to increased public spending programs.

A candidate who promises cutbacks in certain programs faces strong opposition from groups with an interest or stake in those functions. If the candidate aims to pursue austerity throughout government, the manifold spending forces will coalesce and “gang up” on him to assure his defeat. Moreover, most of the experts and specialists in each of the various fields of domestic public functions are likely to advance a justification for greater spending in their area, as will the bureaucracy charged, or likely to be charged, with the administration of such programs. This adds much publicity and force to the drive for expansion.

Costs are diffused over a large number of sources, many of them hidden, of which the public often is unaware. Consumers usually do not realize the huge amount of indirect and business taxation — which enjoys great popularity with certain segments of the public — that will probably be passed on to them (an opium of the people). They do not feel the pain of income taxes that are withheld (“just a bookkeeping entry”) as keenly as they would if they had to fork over the money after receiving it. They do not connect public spending without sufficient taxation, *i.e.*, huge budgetary deficits, with the price inflation that has beset us for so long.

Public aids, subsidies, benefits, and programs, on the other hand, are tangible, visible, even obtrusive. They offer an attraction which few politicians and voters can spurn. Redistribution of income, from those who earn it to those who yearn it, offers a seemingly irresistible temptation.

A private business which operates inefficiently is apt to be wiped out — survival of the fittest. Many firms do in fact go out of business, every year. But failure of government programs to produce promised returns, or any positive results, will usually be blamed on inadequate appropriations which “ought” to be, and often then are, doubled or tripled. The belief that someone else will pay for the desired benefits, or that federal money channelled to state and local governments and purposes comes for free, from some unnamed beneficent source, lends additional strength to the drive for enlarged spending.

Professor Meltzer attempts to measure the growth *rate* of government and finds the best yardsticks to be the proportion which taxes bear to the nation's economy (gross national product), and which public employment bears to the total labor force. By those measures government has grown approximately twice as fast as the economy and the labor force since the turn of the century. Of course, as government grows, more persons have a financial stake in it, as recipients or beneficiaries, and they tend to support it politically.

Professor Meltzer regards the trend of ever-expanding government as a flaw in the system of representative government. He does not deem the trend to be inevitable for all the future if a remedy in the form of a constitutional limitation can be adopted. Such an amendment has, in fact, been pending in the Congress for some years, and hearings were held as recently as fall 1975. The task of getting such an amendment adopted is great, indeed, and whether some day it will be added to the Constitution remains an open question.

WHY GOVERNMENT GROWS

Allan H. Meltzer

Wherever we look, the state is large or growing. Food, shelter, and medical care are subsidized, regulated, or controlled to some degree in all the once-liberal economies. Regulation, control, and direction of the economy increase in both scope and detail from decade to decade. Deregulation is exceptional, not commonplace. The powers that the state acquires are not often surrendered.

Many attempts to explain this process consider only the costs and benefits as seen by the regulators. Theories of bureaucracy and the behavior of bureaucrats, whatever their other merits, cannot adequately explain the growth of government. Self-interest of bureaucrats may be a satisfactory explanation of *their desire* for the growth of government. It does not explain *our acquiescence*. Citizens of countries in which governments are chosen by popular vote have an opportunity to stop or reverse the process. Nowhere is this done.

Two centuries ago Adam Smith understood that producers prefer monopoly to competition in the markets in which they sell. Governments, as suppliers of services, seek to monopolize the markets in which they provide services, either by rules that prohibit entry or by pricing below cost of production. Again, the question occurs: Why does the public permit the restrictions on entry and the loss of efficiency to persist and even to grow?

Bureaucracy and the inefficiency and growth of government are everywhere a subject for discussion and complaint. Dissatisfaction with the high cost and low quality of government services or the arrogance of public employees is the campaign platform for such strange bedfellows as Ronald Reagan and the Italian Communist Party. Yet, neither in

NOTE: I have treated these issues at somewhat greater length in "Too Much Government," *The Economy in Disarray*, R. Blattberg, editor (New York, 1976).

Italy nor in the United States is there any prospect that government soon will decline in absolute or even relative size.

Widespread dissatisfaction has not produced any sustained effort to reduce the size of government. A common explanation is that voters are not aware of the costs of the services they receive. Explanations of this kind make the outcome of the political process depend on irrational behavior. There is, I believe, a rational explanation of the growth of government in societies with a sizable middle class and political representatives elected by popular vote: The government grows faster than the private sector whenever the costs of government can be diffused and the benefits concentrated. Diffusing costs while concentrating benefits creates incentives for expansion and disincentives for reduction in the size of government.

A candidate for elective office must organize support by offering programs that appeal to a plurality. He can find a group that is willing to accept the program he offers, or he can search for a following by suggesting programs. Each new program both attracts some potential followers and repels others. If a sufficient number is attracted by a particular program, the program becomes part of the candidate's platform.

Each time a candidate opposes a program, those who benefit from the program have an incentive to vote for the opposition. Other voters will be attracted and will pledge their votes. Generally, fewer votes will be gained than lost, because the gain to an average voter from eliminating a program is smaller than the loss to the beneficiaries. And this is so whenever benefits are concentrated and taxes are diffused. If taxes were concentrated and benefits diffused, a coalition in favor of tax reduction could be organized to eliminate programs and reduce taxes.

Candidates often run on programs favoring tax reduction, efficiency in government, elimination of waste and of the "crushing burden" of regulation and taxation. But the promises are not implemented. Again, the reason is that coalitions in favor of tax reduction or efficiency are costly for the politician to maintain. Because taxes are diffused, each of us gains only a little from tax reduction or cost saving. Some of us can gain much more if taxes are maintained and programs are

adopted that benefit us. The benefits from new programs can be concentrated to help the voters who supported the candidate or promise to support him in the future. Coalitions in favor of benefits are, therefore, more efficient than coalitions in favor of tax reduction. They can be organized more readily and remain viable longer.

A competitive political process sustains efficient coalitions and eliminates inefficient coalitions. Those who favor tax reduction and smaller government can be bid away — diverted and converted — by finding benefits that reward them. Such benefits include specific tax reduction, subsidies, regulation of competition, tariffs, licensing, pension plans, and schooling.

An inefficient *private* enterprise provides an opportunity for someone to buy the assets, improve their use, and capture the gain. Waste and inefficiency can be converted into wealth, and the gain can be captured by those who acquire the assets.

The *political* process does not offer comparable opportunities. A coalition has little incentive to eliminate the inefficiency of public enterprises, reduce the size of government, and cut taxes. Such gains must be shared with those who contribute little or nothing to the coalition. The benefits must be diffused. A coalition that efficiently serves its members imposes costs on the community, wastes resources, and increases the taxes we pay.

* * * * *

If this argument is correct, there is a flaw in the operation of representative government. The flaw produces the growth of government. The government grows, faster at times, slower at times. On average, government grows.

The general argument does not depend on a particular type of tax system. A graduated income tax may facilitate the growth of government by fostering the belief that the “rich” can be made to pay a disproportionate share of the cost. But government grows or remains large in countries like Italy, where income taxes are said to be difficult to collect, and also in Britain and the United States, where evasion is more difficult. Moreover, government in the United States grew

more rapidly than the private sector in the 19th century, when the income tax was unconstitutional.

Tax diffusion can be achieved by using sales or value added taxes or by taxing imports. Tariffs on imports were a significant source of revenue in the 19th century, and much political activity was directed toward tariff issues. Coalitions formed to secure two types of benefits. One restricted imports of goods which competed with home products. The other permitted imports of raw materials desired by American producers. High tariffs on competing foreign goods and no tariffs on inputs most cheaply acquired abroad appealed to domestic manufacturing interests. By making the tariff sufficiently complex, the benefits could be concentrated. The immediate costs paid by the user were hard to detect, and the general costs resulting from the elimination of competition, restriction of choice, and reduced efficiency were even more diffuse.

* * * * *

Industrialized countries in which governments are elected by popular vote are particularly likely to have the cost of government diffused over a large part of the population. The reason is that a modern industrial society employs a wide range of specialized skills and talents. If skilled workers, managers, and professionals are well paid, much of the population is pushed away from the extremes and toward the center of the income distribution. As the middle class grows relative to the extremes, a broad-based tax system becomes feasible.

A wide distribution of skills, talents, interests, products, and attitudes provides opportunities also for political activity. The existence of a large number of identifiable groups increases the opportunity for a candidate to develop a political program that appeals to a specific group. The gains from the program can be concentrated so as to benefit the members of this group and no others. As tax rates rise, each individual has more potential gain from tax exemption and the services provided by government at the expense of other taxpayers, so more join groups that demand benefits. Their gains from political activity increase.

In a growing economy, per capita income increases. This makes absolutely easier the diverting of time from work or

leisure to political activity, but also increases the alternative cost of such activity.

Joining a group is a way of reducing this cost. The group can hire a manager or a lobbyist who seeks to make the group interest seem a matter of public interest. Two related elements appear to be critical to the success of this strategy. One is the system of representative government. The other is the distribution of income.

A "direct" democracy that required citizens to consider and approve programs would make the organization of effective minority coalitions more difficult. Information about the beneficiaries of government programs would be widely disseminated, and voters would be required to vote taxes to pay for programs. Direct democracy is costly to operate, however.

Societies with a few rich and many poor rarely sustain representative government. The opportunity for the poor to tax the rich is too obvious to ignore and too attractive to avoid. Even if a majority recognizes that investment and economic development raise the future income of the entire group, there are opportunities for some to gain now by increasing their own benefits and taxing the "rich." Concentrating benefits while directing costs to others raises the wealth and position of those in the successful coalition. While they hold power, they gain.

Of course, the exploited group need not be the rich. Any group with property or labor can be taxed to pay for the benefits distributed to the members of the ruling coalition. The result of this process in many countries is a series of coalitions that frequently ends, as in Africa or Latin America, with the establishment of dictatorship. A non-elected government maintains power and redistributes wealth to its supporters.

Dictatorship is not the only outcome. Multi-party systems with shifting coalitions have governed in Italy, in France, and elsewhere for long periods. If the governing coalition has a small majority, few new laws or regulations may be passed. The growth of government continues, however, by administering existing programs to benefit supporters. Crises occur when new taxes must be levied to pay for the additional costs

of public programs. At such times, the multi-party coalition may break apart, and a new coalition forms. But government grows on.

* * * * *

Most popular explanations of the growth of government differ from the argument advanced here. They attribute the current size of government to some recent event or change in attitude. The depression of the thirties, war, the growing power of the military, urbanization of the population, are all offered as explanations. None of these explanations alone is satisfactory. None explains why free men in countries all over the world permit the process to continue. Furthermore, the growth of government occurs in countries with both large and small military establishments, in countries with different degrees of urban concentration, in countries differing in many dimensions. While these distinctions may help to explain differences in the rate of increase of government, they cannot explain a process that appears wherever governments are elected by some form of popular vote.

Some explanations of the growth of government might be dismissed more readily if we knew more about the growth rate. There are no simple, unambiguous measures of the size of government, the growth of government, or the power of government. Governments conduct diverse programs and engage in commercial and industrial activities. Governments may be relatively small but despotic, or large and benevolent. Power and size increase together, but not in a one-to-one relationship.

Consider two measures of the growth of government. Both are measures of relative growth, and both are imperfect. One compares the growth of *tax payments* to the growth of *total income* produced in the country (gross national product), both in dollars of constant purchasing power. If government takes a larger share of income, government has grown. The second compares the growth in the *labor force employed by government* to the *total labor force*. Government grows, according to this measure, when the bureaucracy increases relative to the labor force. The table shows data for the United States from 1901 to 1974 for both measures and for several sub-periods. All levels of government — federal, state, and local — are included.

Years	Average Annual Growth of Taxes (%) A	Average Annual Growth of Income (%) B	Relative Growth of Govt. A/B	Annual Growth of Govt. Labor Force (%) C	Annual Growth of Total Labor Force (%) D	Relative Growth of Govt. C/D
1901-74	5.39	3.17	1.70	3.46	1.62	2.14
1901-29	4.67	3.20	1.46	3.43	2.06	1.67
1929-51	7.17	2.92	2.46	3.40	1.26	2.70
1951-74	4.55	3.37	1.35	3.56	1.57	2.27

Sources: *Historical Statistics of the U.S.* and *Economic Report of the President.*

Roughly, the government has grown twice as fast as the economy during this century. The columns labelled "Relative Growth of Government" (columns A/B and C/D) show that taxes have increased at a rate that is 1.7 times greater than the growth of the economy on average for this century, and employment by government has increased more than twice as much as the labor force. At times, especially in 1929-51, the years of depression and of war, the government grew substantially faster, as much as 2.5 to 2.7 times faster, than the growth of the economy and of the labor force. Recently, taxes have increased at a slower rate, but real tax burdens continue to rise relative to income.

Data for federal government tax collections are available from 1792 on, so we can compute the annual average growth of the federal government during the more than 180 years since Washington became president. From 1792 to 1974, taxes paid to the federal government rose 5.5 percent a year, after the estimated effect of inflation has been eliminated. It appears that this rate of increase is above the growth rate of income. Per capita income in 1792 would have been only twenty dollars if per capita income and taxes had increased at that same rate. Twenty dollars per capita is too low to be a correct estimate of income in the early years of the Republic.

The problem of large and growing government is of long standing. The government has grown faster than the private sector throughout our history. During the current century, the growth of government has continued at nearly twice the rate of the private sector.

At the turn of the century, taxes absorbed 8 percent of

income, and government employed 4 percent of the labor force. By 1929, the share of income taxed away was 11 percent, and 6 percent of the labor force was employed by government. And by 1974, 33 percent of income (as measured by gross national product) was taken in taxes, with 15 percent of the labor force employed by government at all levels. If recent rates of growth continue, the government will absorb 50 percent of income and employ 25 percent of the labor force by the end of the century.

As the size of government grows, the costs of slowing the growth increase. More of the population is employed by government, and there are more votes for candidates who promise programs that increase the power and influence of government officials and the income of the bureaucrats. There is an ever-increasing number of recipients of aid and subsidy who see their interest allied to the interest of the bureaucracy. As tax rates rise, the value of government "benefits" to recipients increases, if the benefits are exempt from tax. The programs absorb labor into the government, so average tax rates rise, but redistribution occurs. The winning coalition improves its position at least in a relative sense by expanding the program it favors.

A principal redistribution is from taxpayers in general to government employees. The percentage of the labor force employed by government has increased at about the same rate as the percentage of income paid in taxes. Both have doubled and redoubled in this century. A sizable fraction of those in the labor force — and in the voting booth — benefit directly from programs that increase their income and the power and influence of government.

* * * * *

The present size of government is not a result primarily of some short-term aberration or change in attitude. The process has continued throughout our history, at different rates but in the same direction. Wartime expansions were followed by contraction, but the postwar governments were larger than the prewar governments and continued to grow.

I have argued that to explain the growth of government, we must recognize that there is a flaw in the system of representative government. Voters form groups or coalitions to

redistribute benefits to themselves. More votes are gained by promising to increase benefits selectively than by reducing taxes generally or by eliminating programs. No party or coalition can remain in power permanently, but each party can expect that opponents will use their power to gain selective benefits without reducing the nominal value of benefits received by others.

The government grows as a result of rational behavior. Individuals and groups concerned with their own interests seek benefits. The loss that many experience from the continued growth of government does not produce a winning coalition that gains from reducing the size of government.

Nothing about the process is inevitable. The growth of government could be brought to an end by constitutional limitation. That a limitation of this kind has not been imposed, here or elsewhere, may tell a great deal about the cost of persuading, organizing, leading, and maintaining a group large enough to accomplish that goal.

WHY GOVERNMENT GROWS

Allan H. Meltzer

With an Introduction by Roger A. Freeman

Growing (or already completely dominant) government appears to be universal. This is not a new phenomenon. During the twentieth century in the U.S., tax payments have risen faster than GNP, and government employment has risen faster than the labor force. Indeed, it appears that government has been taking an increasing share of national income from the beginning of U.S. history.

Various theories have tried to account for the pervasive and persistent growth of government — theories of bureaucracy, of governmental propensities to monopolize, of voter ignorance and irrationality, of particular events and aberrations of history. None of these is wholly satisfactory.

Professor Meltzer finds that "government grows faster than the private sector whenever the costs of government can be diffused and the benefits concentrated." Costs are diffused and benefits are concentrated more easily through introducing new government programs and expanding old ones than through reducing or eliminating current programs.

In a nation with representative government, political coalitions can form in support of expanding government activity and its benefits or, alternatively, in support of reducing government activity and its costs. But with concentrated, conspicuous benefits and diffused, camouflaged costs, the coalitions of expansion are the more efficient in achieving their own ends. "More votes are gained by promising to increase benefits selectively than by reducing taxes generally" Over time, political power will shift among coalitions, but typically the shifts will be from one benefit-seeking group to another.

This process of governmental growth through competing expansionary coalitions is most typically found in nations with an advanced economy, a large middle class, and representative government. The growing wealth and the broad variety of developing skills and interests make feasible and inspire the forming of organized groups to pursue specific interests. And more and more people join the government machinery, constantly adding to those with a personal stake in expansion of the bureaucracy.

A "flaw in the system of representative government" is manifested in increasing organization of competing recipients of favors from responsive dispensing politicians and the administering bureaucrats, with attempted redistribution of benefits among coalitions and realized redistribution from the private sector to the governmental.

In his Introduction, Mr. Freeman notes evidence suggesting that there is widespread misgiving in the U.S. about the incessant growth of government. Still, he basically agrees with Professor Meltzer that the growth stems from individual and group behavior which is rational in the face of concentrated benefits and diffused costs.

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