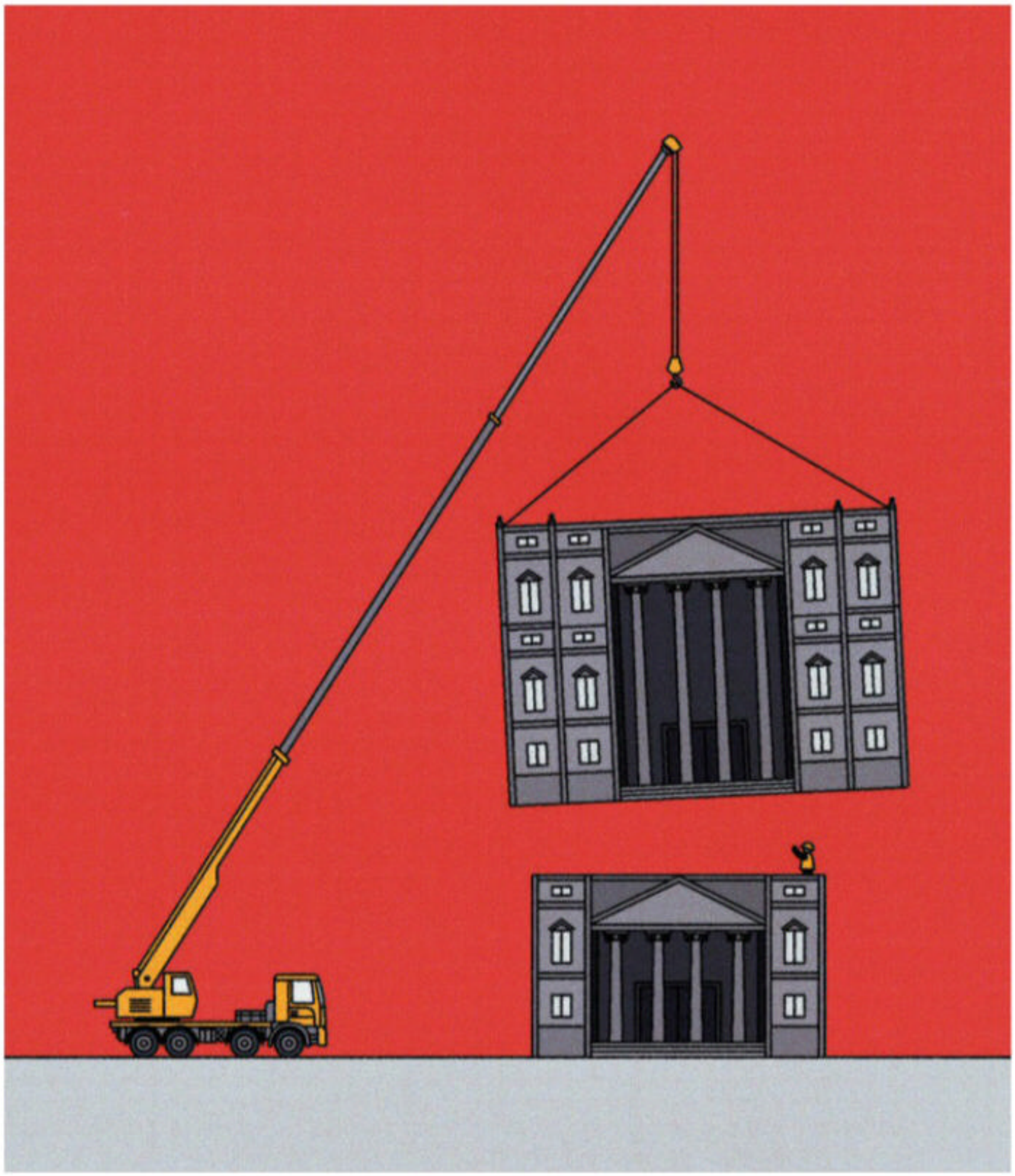

The great embiggening

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Why government expands almost all of the time

When, in 1996, President Bill Clinton announced that "the era of big government is over", supporters to his left feared that saying so would only serve to make it so. They were wrong. So was Mr Clinton. Between 1996 and 2019 America's annual government spending grew by one percentage point of GDP. And when, last year, the economy crashed, it rose by another ten (see chart 1 on next page). Now President Joe Biden is building on what started as emergency pandemic-related policy, expanding the child-tax credit, creating a universal federally funded childcare system, subsidising paid family leave and expanding Obamacare.

America's government spending remains somewhat below the developed-world average. But this change is not just a matter of catching up; the target is moving. Government spending as a share of GDP in the OECD as a whole has consistently inched higher in the six decades since the club was formed in 1961.

Some countries buck the trend, a bit, for a while. Germany's spending as a share of GDP in 2019 was the same as it was in 2006, Angela Merkel's first full year as chancellor. But the stable level was also a pretty high one. And German attempts to impose frugality elsewhere were short-lived. Spain and Italy both went on courses of strict austerity during the euro-zone crisis of the early 2010s. But in both cases public-sector spending, relative to GDP, was higher in 2019 than in 2006.

Examples of genuine state retrenchment in developed countries are few and far between. Sweden managed it in the 1980s. In the early 1990s Ruth Richardson, then New Zealand's finance minister, cut the size of the state drastically. Wags called her plan "Ruthanasia". The patient did not die. State spending is now six percentage points lower as a share of GDP than it was in 1990. But this is a rare achievement, and perhaps one doomed to pass. Grant Robertson, the current finance minister, pledged to "address the most inequitable of the changes made 30 years ago" as he promised a large boost to welfare payments.

This is a sorry state of affairs if you believe that low taxes and small government are the right, and possibly the only, conditions for reliable, enduring economic growth. The argument that even the best government cannot know what millions of sovereign individuals need better than they do themselves, an argument made by Friedrich Hayek, an Austrian philosopher, Milton Friedman, an American economist, and others in the mid-20th century, has fallen from favour. The practical argument that governments rarely meet this ideal and, corrupting and ineffective, strangle growth is still made, but to little electoral effect. Yet this hardly constitutes a triumph for the left, which continues to see insufficient government spending as fundamental to a whole raft of problems.

The tendency for government to grow is a hallmark of modernity. From 1274 to 1691 the English government raised less than 2% of GDP in tax. Over the 18th and 19th centuries that changed, with the tax-raising and spending capacities of the government massively expanding, especially at times of war. In the 1870s the governments of rich countries were spending about 10% of GDP. In 1920 it was nearer 20%. It has been growing ever since (see chart 2 on next page). It is now much higher in the rich world than either in the past or in developing countries.

The growth in what governments spend typically comes with a growth in what they do, and how much they control the doings of others. In America the number of federal regulations has more than doubled since 1970. The total word count of Germany's laws is 60% larger today than it was in the mid-1990s.

Governments have not grown more powerful by all measures. Bureaucrats no longer, as a rule, set wages or prices, nor impose strict currency controls, as many did in the 1960s or 1970s. In recent decades the public sector has raised hundreds of billions of dollars from privatisations of state assets such as mines and telecoms networks. If you find it faintly amusing to ▸▸

hear that, from 1948 to 1984, the British state ran its own chain of hotels, that is because the "neoliberal" outlook on the proper place of government has triumphed.

Yet in other areas today's governments have more power than ever. Building things requires developers to jump through more environmental, conservation and local-opposition hoops than it used to. Health-and-safety laws have proliferated. Occupational licensing has grown dramatically across Europe and North America.

For decades unions in many rich countries successfully argued against government-imposed minimum wages, saying they would do a better job of raising pay themselves. But as they have withered, the government has stepped in to provide wage floors. Rules relating to other workplace matters such as parental leave and gender-pay gaps go in only one direction.

And if direct government control of the economy has weakened, it has been more than replaced by redistribution. The objective correlative of Mr Clinton's claim that the era of big government was over took the form of tax credits; he tripled those for low earners with children, and introduced the universal credit for children that Mr Biden now wishes to expand. In 1979 the bottom fifth of American earners received means-tested transfers worth on average 32% of their pre-tax income, according to the Congressional Budget Office. By 2018 the figure was 68%. Total social-protection spending in the OECD—comprising cash benefits, direct in-kind provision of goods and services, and "tax breaks with social purposes"—grew from 15% of GDP in 1980 to 20% in 2019.

Three forces stand out as driving the trend: the incentives which bureaucrats and politicians face; the rising costs of services provided by the government; and the demands of voters.

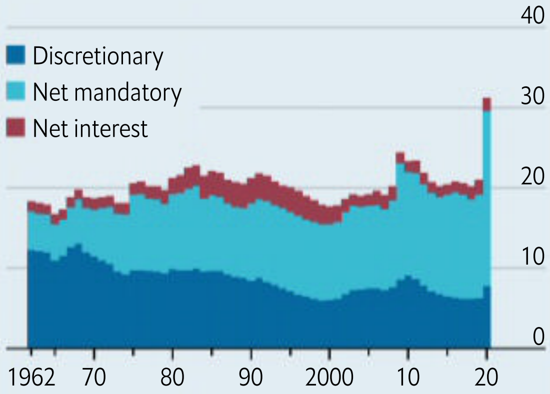
Governments and bureaucrats are at least partly self-interested: "public-choice theory" says that unrestrained bureaucracies will defend their turf and seek to expand it. A good recent example would be central banks. Their mandates typically compel them to control inflation and see off bank runs. Yet in recent years, with a cursory and often unconvincing nod to those mandates, central bankers have taken on fresh responsibilities. America's Federal Reserve seems to believe it has both the obligation and the tools to reduce racial inequality, while many central bankers want to raise the relative cost of capital for fossil-fuel companies via interventions in the corporate-bond market.

Politicians have their own incentives to expand the state. It is generally more rewarding for a politician to introduce a new programme than it is to close an old one down; costs are spread across all taxpayers

An era unended 1

United States, federal spending by source

% of GDP



Sources: Congressional Budget Office; Office of Management and Budget

while benefits tend to be concentrated, thus eliciting gratitude from interest groups and sometimes even voters.

Technology, in particular communications technology, has served to strengthen the bureaucracy's grasp. It is no coincidence that bigger governments emerged at roughly the same point in the 20th century as large corporations, which also required a new communications infrastructure. More rapid economic growth powered by those new arrangements made the growth of government less burdensome than it might have been.

Hardly cromulent

The second broad factor behind the growing power of the state is what William Baumol, an economist, named "cost disease". In the 1960s Baumol noted that productivity in some sectors is greater than in others. But wages must rise in less productive sectors as they rise in more productive sectors to prevent workers quitting. So despite the fact that an orchestra at the Royal Albert Hall contains about the same number of musicians as it did when the venue opened in 1871, each musician is paid a lot more today, given the vastly greater opportunities that are on offer in the economy.

A lot of government spending is in areas where labour-productivity growth is slow, most notably the provision of education and health care (see chart 3 on next page). As the real wages of doctors, nurses and teachers go up at a rate set by other parts of the economy, so does spending. What is more, education and health care are also what economists call "superior" goods. As people become richer they spend a higher fraction of their income on them. If it is the government that provides those services, it must spend more. Across the OECD overall health spending has risen from 8% of GDP in 2005 to 10%, and governments are responsible for the bulk of that.

Others have extended Baumol's ideas, arguing that government intervention inhibits productivity growth. A recent report by Steven Teles, Samuel Hammond and Daniel Takash of the Niskanen Centre, a think-tank in Washington, DC, warns of a vicious cycle in which subsidies for services the supply of which is constrained by regulations, such as housing and education, push up prices, creating demands for further subsidies. One example is student loans: in America 60% of any increase in the maximum subsidised loan is passed through into higher tuition fees, according to a study by the Federal Reserve Bank of New York. American politics is replete with promises of further subsidies for higher education. Pledges to reduce costs are thin on the ground.

The final steroid is the voters' appetite, which depends on who the voters are. Over the course of the 20th century increasing numbers were working class and increasing numbers were women. Political scientists have linked the expansion of women's suffrage across the rich world to growth in social spending, especially on health and education.

Twentieth-century voters were also increasingly likely to have fought in or ▸▸

Spot the trend 2

Government spending, % of GDP

Sources: Vito Tanzi and Ludger Schuknecht; IMF; OECD; AMECO *Forecast †1870-1937 central government, 1960-2021 general government lived through a world war. Both world wars vastly increased spending, and in both cases it never returned back to its pre-war level. Mass-mobilisation in war constituted a compelling claim to the greater peacetime provision of services like unemployment benefits and health care.

And today's voters are increasingly likely to be old. Old people did well out of government even when this was not the case. "Making Social Spending Work", a recent book by Peter Lindert of the University of California, Davis, shows that in 13 welfare states per-person support for the elderly, as a proportion of income, rose faster than spending on public education per school-age child for most of the 20th century. Spending per person levelled off in the 1980s—but more baby-boomers with longer lifespans means total spending is still rising. And political pressure to maintain spending on the old is acute.

While other forces behind the growth of government can be taken to be pretty steady, the demographic factors are strengthening. Over the next 40 years the share of the total rich-world population over the age of 65 will rise by half. The share of the very old, who according to British data demand four times as much health care per person per year, will grow far more rapidly. The rise of chronic conditions is likely to affect both health and social care, increasing the services that people consume before their final years of life.

A paper published by the OECD in 2019 said that health spending across the bloc would rise from 8.8% of GDP in 2015 to 10.2% in 2030. This is likely to end up being a significant underestimate, given that it is already most of the way there: the enormous infrastructure set up during the past 18 months to test for covid-19 and vaccinate populations will not be dismantled any time soon.

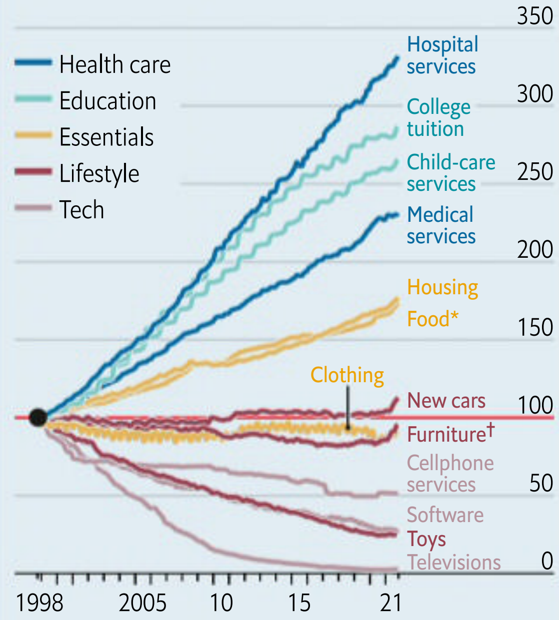
A new factor is at play, too. Rich-world governments are pledging to transform their economies to eliminate net carbon emissions, and this will require huge investment. If governments struggle, as they have thus far, to deploy market mechanisms such as carbon prices to encourage the transition, the number of regulations and subsidies will proliferate. Even with carbon taxation, the Office for Budget Responsibility, Britain's fiscal watchdog, estimates that the spending needed to get to net zero by 2050 will, by the end of that process, have added 21 percentage points to Britain's debt-to-GDP ratio.

The scene is set, then, for bigger and bigger government. Moved perhaps by this inexorable economic logic, intellectual thought is increasingly statist, not only on the part of the political left, some of whom will never be satisfied with the scale of redistribution, but, more surprisingly, also on the political right. This provides a fourth factor in favour of an ever-larger state: an absence of opposition.

Healers and disease 3

United States, price indices

Selected goods and services, October 1998=100



Sources: BLS; AEIdeas Includes: *Beverages †Bedding

In 2019 *American Affairs*, a conservative journal launched two years earlier, published an article titled "Toward a Party of the State". Acknowledging that "the state now occupies a much greater role than it has heretofore in post-war and modern conservative thought", Gladden Pappin, the author, advised giving "aid and comfort" to, for example, "nation-state-oriented forces in Europe"—think of Hungary offering cash incentives to encourage families to have more children, for instance.

Others on the populist right are happy to preserve spending on the elderly, to intervene in markets in order to help certain interest groups, and at least notionally to favour massive infrastructure investments. Britain's Conservative Party proclaims its small-state credentials louder than most, but Rishi Sunak, the chancellor, is presiding over historically high levels of spending and taxation. There is harrumphing on the backbenches, but little by way of a concrete argument for cuts.

Johan Norberg, a Swedish free-market thinker, says he is politically homeless: "No major political force is listening." In France Gaspard Koenig, a philosopher who runs a think-tank which focuses on economic freedom, is seeking to shift the terms of the debate. But the consensus in France remains clearly in favour of big government and high public spending. The Belgian region of Flanders, where some of those seeking independence see lower taxes and a smaller state as a possible result, is a curiosity, not the start of a movement.

People such as Mr Norberg might seem to have little alternative but to hope for a turn in the intellectual tide like that which saw the ideas of Friedman and Hayek flood the corridors of power in the late 1970s—a turn driven by the increasingly apparent failures of over-regulated, state-dominated capitalism. But in the meantime they still have policies to advocate.

One option might loosely be called "pave the swamp": find ways to improve the structure of bureaucracies such that, while they might remain large, it would at least be easier to move things through them. John Cochrane, a free-market economist at the Hoover Institution, at Stanford University, suggests adding "shot clocks" and sunset clauses to regulations. The former would mean that America's Food and Drug Administration, say, would have a prespecified time in which to assess a new drug or food; no defensible verdict in the time allowed would mean automatic approval. Other sorts of regulation would lapse unless deliberately reinstituted.

Another palliative option favoured by some is to argue that the government needs to play a more activist role in making sure that existing markets work well—say by scrutinising mergers more closely so as to prevent the emergence of monopolies. Efficient markets will provide growth that goes at least some way to offsetting the increase in the government share, as it did in the 1950s and 1960s.

More dramatic options involve not just improving markets but expanding their reach in ways that might, ultimately, shrink the role of the state. One example, touted in "Radical Markets" by Eric A. Posner and E. Glen Weyl, would be to transfer the right to admit immigrants from the government to individual sponsoring households, who could in effect sell their visa quota to would-be migrants.

Dare to dream small

Or, instead of eating away at the state, let people opt out of it. Mark Littlewood of the Institute of Economic Affairs, a Thatcherite think-tank, suggests allowing people to pay less in tax in return for abjuring some state services. If the tax cut is attractive but still less than the cost of supplying the service, that saves money. But because the people keenest to step out from under the umbrella of the state will always be those who already rely least on its protection, the state's tax revenue would probably decline by a lot more than demand for its services.

Margaret Thatcher supposedly once produced her copy of Hayek's "The Constitution of Liberty", slammed it on a table, and pronounced "this is what we believe" to her fellow Conservatives. Today's believers in small government lack the same sense of conviction. But they also face far more challenging circumstances, because stopping further growth of government over the coming decades will be close to impossible. The most important debates to come will be about the state's nature, not its size. ■