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The political economy of government size

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Abstract

We contribute to the political economy of public-sector growth by integrating three essential elements (i) the 'demand' for government stemming from attempts to coercively redistribute, as well as from demand for public services, often analyzed in a median voter framework; (ii) the 'supply' of taxable activities emphasized in Leviathan and other models of taxation; and (iii) the distribution of 'political influence' when influence and economic welfare are distinct. We combine these elements in a spatial voting framework, and use the comparative static properties of the model to shed light on empirical results in the literature.

JEL classification: D70; H0; H3
Keywords: Size of government; Coercive redistribution; Political influence; Probabilistic spatial voting

1. Introduction

A systematic account of the size of government in democratic countries includes at least three elements. First, 'demand' for government stems from attempts to use the fiscal system to coercively redistribute, as well as from the usual demand for public services. Second, it is necessary to investigate the role of the 'supply' of activities on which taxation may be levied.

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A third key aspect is the distribution and role of political influence, as distinct from the economic welfare of individual voters.

The first two of these elements have been combined in empirical studies of the growth of government, e.g., by Ferris and West (1996) and Kau and Rubin (1981, 2002). Estimates of the effect of unequal political influence have been made by Mueller and Stratmann (2003), using a framework that also pays some attention to demand and supply.[1] In this paper, we combine all three elements in a spatial probabilistic voting model. We provide a closed form solution for government size and use the comparative-static properties of the model to shed light on analytical, and especially, empirical results in the literature. A comparison of the size of government in the integrative model with less realistic median voter and Leviathan frameworks helps to outline the contribution of the broader view that we develop.

We begin in Section 2 with a selective review of literature on the size of government in a demand–supply collective-choice framework, acknowledging other important aspects that are not studied here. The integrative model is developed and solved in Section 3. The building blocks of the model are as follows. ‘Demand’ for government originates from voters with unequal incomes and ‘political influence’ who want public goods and who also attempt to use the fiscal system to coercively redistribute in their favor. The ‘supply’ of taxable activities originates with citizens who pay taxes on their market activities only and who also engage in valuable nonmarket actions. Thus, in addition to the deadweight loss from taxation, political parties take into account the fact that tax revenues vary with the choices that individuals make between market and nonmarket activities.

Political equilibrium is modelled using a probabilistic spatial voting framework. Here, the influence and economic welfare of each voter is distinct, and no single voter or group of voters is decisive. In Section 4, the comparative statics of government size in the integrative model are analyzed and used to comment on selected aspects of the literature (the progressivity of the equilibrium tax system is examined in Appendix A). The integrative model is compared with its distinguished predecessors in Sections 5 and 6 concludes.

2. A selective review of literature

Early research on the ‘demand’ for government, including Wagner (1958), Peacock and Wiseman (1967), and Bird (1970), emphasized the role of income, urbanization, and war as determinants of the demand for public services. Income and factors such as urbanization lie behind the longest standing theory of the growth of government known as ‘Wagner’s Law’: that the income elasticity of the demand for publicly provided goods and services is greater than one. A large number of differing estimates of this elasticity have appeared over the years, including Ram (1987), Gemmel (1990), Tridimas (1992), Kristov et al.

[1] Mueller and Stratmann focus mainly on political influence. Our discussion of their paper assumes that participation in elections and political influence are closely related. See also Bassett et al. (1999), who identify income with influence in different ways and consider the effect of influence so defined on transfer payments.