# The Expansion of the Public Economy: A Comparative Analysis*

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*In spite of the traditional legitimacy accorded the market mechanism of the private sector in advanced capitalist nations, governments in those nations have become more influential as providers of social services and income supplements, producers of goods, managers of the economy, and investors of capital. And in order to finance these various activities the revenues of public authorities have increased dramatically—to a point where they are now equivalent to one-third to one-half of a nation's economic product.*

*This growth in governmental activity in advanced capitalist society is examined by considering the causes, and some of the consequences, of the expansion of the public economy—defined, following Schumpeter's discussion of the "tax state," in terms of the extractive role of government. The primary concern of this article is to discover why some nations have experienced a far greater rate of increase in recent years and, as a result, have a much larger public economy than other nations. Five types of explanation are elaborated to account for the growth of the scope of governmental activity: (1) the level and rate of growth in the economic product; (2) the degree to which the fiscal structure of a nation relies on indirect, or "invisible," taxes; (3) politics—in particular the partisan composition of government and the frequency of electoral competition; (4) the institutional structure of government; and (5) the degree of exposure of the economy to the international marketplace. The article evaluates the five explanations with data for 18 nations, and concludes by discussing some implications of the analysis.*

During the three decades following World War II, the role of government in most advanced capitalist economies increased dramatically. With the maturation of the "welfare state," governments increased their provision of social services and income transfers for the unemployed, the sick, the elderly, and the poor. Furthermore, governments have become important producers of goods, and in several European nations publicly owned corporations dominate the petroleum, automotive, and transportation industries. In addition, by using a variety of fiscal and monetary instruments such as public spending programs, taxes, and discount rates, governments have attempted to manipulate the levels of unemployment and inflation and dampen the effects of business cycles. They have also sought to guide the long-term development of the economy through the creation of planning institutions and, occasionally, through their control of the assets of financial institutions. And in order to finance their activities in each of these domains, governments have instituted new taxes and raised the levels of old taxes. Indeed, the growth of the extractive role of public authorities has been so great that Schumpeter's words, written half a century ago and pertaining to the historical development of Europe, seem even more appropriate today: "Tax bill in hand, the state penetrated the private economies and won increasing dominion over them" (1918, p. 19).

This article explores the causes of the expansion of the extractive role of government during the recent past in 18 relatively developed capitalist nations. The first section presents several alternative explanations of that expansion. Following the argument developed, rather imprecisely, by Wagner (1883) in the late nineteenth century, most economists have concentrated on the impact of economic growth in accounting for the inexorable increase in government activity. In addition to outlining the Wagnerian argument, I will discuss several alternative causes of the expansion of public revenues. In particular, the analysis examines the impact on taxation of two aspects of the policy-making environment whose effects have been frequently disputed or neglected in many comparative studies of public policy: (1) the electoral politics of a nation—for example, the existence of electoral competition and the partisan composition of government; and (2) the institutional structure of government—for example, the existence of unitary or federal

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government, and the extent of fiscal centralization. The analysis also considers the extent to which the scope of government activity within a nation is influenced by the position of the domestic economy vis-à-vis the world economy. In this regard, the analysis investigates whether the openness, or exposure, of a nation's economy to the international marketplace stimulates an expansion in the rôle of government.

The several explanations of the expansion of the public economy[1] will be evaluated by analyzing the experience of 18 nations since 1960. All 18 have capitalist economies; this criterion allows the inclusion of nations for which the expansion of the public economy might represent a source of tension and conflict with the traditional reliance on, and legitimation of, the market economy for the allocation of goods. The nations are: the United States, Canada, Britain, Ireland, Australia, Japan, the Federal Republic of Germany, France, Italy, Spain, the Netherlands, Austria, Belgium, Switzerland, Sweden, Norway, Denmark, and Finland.

## Measuring the Scope of the Public Economy

The scope of activity of public authorities can be described by enumerating the programs and types of expenditures carried out by government (King, 1973). However, in the contemporary era in the nations considered here, the increase in the level of expenditure and the multiple uses of funds has been accompanied by an expansion of the revenue-generating capacity of government. Although imbalances occasionally occur between the aggregate totals of all government revenues and expenditures, the two have usually moved in tandem. Thus, the scope of the public economy can be compared as well by considering the revenues of governments rather than their expenditures—that is, by considering the extractive aspect of government.[2] The public economy is defined in terms of the total of all revenues obtained by all levels of government in a nation. Included are all direct taxes, e.g., those on personal and corporate incomes and property; all indirect taxes, e.g., those on sales and value added; all social insurance contributions by employers and employees; and all other fees, taxes, rents, and withdrawals from enterprises which flow into governmental treasuries. To convey the relative importance of the funds which are appropriated (and subsequently distributed) by public authorities, and to control for the obvious differences among nations in the size of the economy, I have calculated the ratio of all governmental revenues to Gross Domestic Product (GDP). This ratio, calculated for all years between 1960 and 1975 (the latest for which data are available), is treated as a measure of the scope of the public economy.[3] In order to measure and compare across nations the degree of expansion in the scope of the public economy, I have calculated the first-order difference in this ratio for the earliest and latest years.[4]

There has been significant variation in both the level and rate of change in the scope of the public economy among these 18 nations. In 1960, for example, the scope of the public economy, which averaged 28.5 percent of GDP, varied from 18 percent in Spain to 35.4 in Germany. By 1975, the average scope of the public economy increased to 38.5 percent of GDP and the variation among the nations also increased, ranging from 23.5 percent in Japan to 53.5 percent in the Netherlands. Thus, while there was a general trend of expansion of the

[1]The term "public economy" refers here to that portion of a nation's economic product which is consumed or distributed by all public authorities.

[2]In most nations, during most years, the total of all governments' revenues exceeds the total of all governments' expenditures. During the world recession of 1975, the aggregate of all governments' expenditures exceeded all revenues in six nations—the United States, Belgium, Germany, Ireland, Italy, and Britain. In the prior half-decade (1970–74), however, only two nations (the United States in 1971 and Italy in 1971–74) experienced an aggregate deficit. Thus, a measure of the public economy based on revenues is less likely to understate the fiscal scope of governmental activity than one based on expenditures. See Organisation for Economic Co-operation and Development (O.E.C.D.) (1977a).

[3]The data were obtained from O.E.C.D. (1973, 1977a). The measure includes withdrawals from, but not operating revenues of, public enterprises, which in some nations (for example, Austria, Finland, Britain, and Italy) are among the largest industrial firms.

[4]First-order differences, rather than percentage changes, are used in order to avoid artificially deflating the magnitude of change in nations with a relatively *high* value in the initial year. To control for the tendency of first-order differences to deflate the magnitude of change in nations with relatively *low* initial values, regression analyses will include both the value in the initial year and the measure of change.

public economy at work in all the nations, there were also great differences among them in the rate of expansion. Why that rate of expansion varied as much as it did is the question to which we now turn.

### Five Explanations of the Expansion of the Public Economy

Several distinct explanations of why the scope of the public economy changes over time can be identified. This section elaborates five types of explanation–one economic, the second fiscal, the third political, the fourth institutional, and the fifth international in character–and derives predictions to account for the considerable differences in the rate of expansion of the public economy in the 18 nations.

**The Economic Explanation.** The most frequently mentioned explanation of the increase in the scope of the public economy is that derived from Wagner's "law of expanding state activity" (1883, pp. 1–8). The "law" holds that, among European nations, the "pressure for social progress" leads inevitably to the growth of the public sector. Writing in the midst of a period of rapid urbanization and industrialization, and just as Bismarck was developing the first programs of the welfare state, Wagner recognized the growing role of the state as a provider of social overhead investments in such areas as transportation and education and the need, even in an authoritarian state, for the state to retain legitimacy by providing public funds to compensate for the human costs of economic development.

As elaborated by numerous scholars of public finance,[5] Wagner's "law" suggests that citizen's demands for services and willingness to pay taxes are income-elastic, and therefore bound to increase with the increase in economic affluence. If this "law" is correct, one would expect that, in comparing the experiences of a number of nations, the greater the increment in economic affluence of a nation during a given period, the greater the expansion of the public economy.

Several scholars have rejected the logic and evidence in support of Wagner's "law." Bird (1971, p. 19), Musgrave (1969, pp. 112–13), and Gupta (1968) find that any positive cross-national relationship between economic growth and government share in the economic product disappears when analysis is confined to the wealthier nations of the world. Apparently there exists an upper threshold to the scope of the public economy; beyond certain levels of income, international demonstration effects and internally derived perceptions of marginal benefit are less likely to generate increases in spending. Peacock and Wiseman (1967) also reject the "historical determinism" implicit in Wagner's "law" and in their discussion of the "displacement effect" emphasize the importance of crises such as war and depression in inducing infrequent but large changes in the tolerable burden of taxation. This provides little assistance in explaining a secular upward trend during periods of prosperity and peace (both of which existed in most of the 18 nations during most of the period between 1960 and 1975). However, the Peacock and Wiseman argument, taken with the findings of Bird, Musgrave, and Gupta, might lead one to expect a negligible relationship between economic growth and state expansion.

Wildavsky (1975, pp. 232–35) provides a third perspective on the economic sources of public sector expansion. In what might be termed a "counter-Wagner" law, Wildavsky suggests that the degree of expansion in the scope of the public economy varies inversely, rather than directly, with economic growth. Where national affluence increases very rapidly, as in Japan, any increased demand for public funds can be met by the added revenues obtained by applying a constant public share to a larger economic product. But where economic growth is so modest that it generates insufficient revenues to meet demands for additional public goods, as in Britain, those demands must be met through an expansion of the public share of the economic product. In short, Wildavsky's argument would predict that the relationship between growth and public sector expansion would be negative, indicating the greatest expansion of the public economy in low-growth nations.[6]

**The Fiscal Explanation.** The second type of explanation of public sector growth is fiscal in nature. As elaborated by Downs (1960) and Buchanan and Wagner (1977), this perspective emphasizes the structure of the system of

[5]See Bird (1970, p. 70; 1971), Musgrave (1969, p. 74), and Gupta (1968).

[6]The data for the level of per capita Gross Domestic Product are reported in United Nations (1976, pp. 701–02). The data for the average annual increase in real GDP were obtained from O.E.C.D. (1977b, Technical Annex).

revenue generation as a determinant of how much revenue can be raised. Downs argues that because public goods are inherently nondivisible, costs and benefits are not directly linked. Benefits frequently are uncertain (as in preventive or long-term policies). In addition, public goods are, when taken as a whole, inevitably suboptimal, since each citizen will pay for some programs that provide no individual benefit. As a result, the costs, i.e., taxes, are perceived to exceed the benefits of public goods. Therefore, it is only when public officials can conceal the costs of policies in a "fiscal illusion" that they can spend large amounts without incurring the wrath of the electorate. As Buchanan and Wagner (1977) argue, "complex and indirect payment structures create a fiscal illusion that will systematically produce higher levels of public outlay than those that would be observed under simple payments structures" (p. 129).

The major form of tax concealment, according to Downs (1960, p. 558), Wildavsky (1975, pp. 235–39), and Wilensky (1975, p. 52), is indirect taxation. In addition to taxes on value added or sales, relatively invisible forms of revenue generation might include taxes which are paid before individuals receive income, e.g., social insurance contributions by employees, and taxes which can be passed on to third parties, e.g., the social insurance contributions of employers. Applying this "fiscal illusion" argument to the present analysis, one might expect that the nations with the largest increase in the scope of the public economy would be ones in which there is a large and increasing reliance on indirect taxes and social insurance contributions.[7]

**The Political Explanation.** A third type of explanation of the expansion of the public economy involves politics. The impact of politics on the scope of the public sector has seldom been recognized, in spite of Downs' assertion (1960, p. 541) that "in a democratic society, the division of resources between the public and private sector is roughly determined by the desires of the electorate." Recently, however, studies by Kramer (1971), Nordhaus (1975), Tufte (1975, 1978), and Hibbs (1978) have suggested that politics—especially electoral politics—exerts a significant influence on the public economy. Two aspects of politics may influence the magnitude of expansion of the public economy: (1) the effect of electoral competition in "bidding up" the scope of expenditure programs; and (2) the effect of variations in the partisan composition, and presumably the ideological preferences, of government.

In his revision of the classical doctrine of democracy, Schumpeter (1950, p. 269) defined democracy in terms of electoral competition: "the democratic method is that institutional arrangement for arriving at political decisions in which individuals acquire the power to decide by means of a competitive struggle for the people's vote." As elaborated by Downs (1957), this theory of democracy implies that the contenders for political office alter their programs in order to enhance their electoral appeal. An important weapon in this competitive struggle is the public economy: some political contenders will attempt to garner votes by promising cuts in taxes; others will promise increases in spending; and others will promise both (see Downs, 1960; Buchanan and Wagner, 1977).

Ever since Key (1949) noted the propensity of political opponents to appeal to the "have-not" voters by promising more spending, scholars have been virtually unanimous in attributing to electoral competition an expansionist impulse (see Brittan, 1975, pp. 139–40). Empirical studies of the American electorate by Kramer (1971) and Tufte (1975) have demonstrated that voters have tended to provide short-term electoral rewards to incumbents who can effect, through their tax, fiscal, and monetary policies, increases in real personal income. And as Tufte (1978, Ch. 2) demonstrates, because incumbents are aware of this relationship, most adopt policies in anticipation of elections which stimulate the economy and increase personal income by pumping funds into the economy. As a result, periodic electoral competition frequently produces a long-term cyclical effect on the economy. The most important consequence, for our concerns here, is that this "political business cycle" is marked by increased spending and other reflationary policies in the period immediately before and after an election (Nordhaus, 1975; Lindbeck, 1976).

The existence of a "political business cycle," the likelihood that incumbents will attempt to use spending policies to enhance their support in anticipation of elections, as well as the tendency of opposition parties to build electoral support by promising more spending on particular government policies, all tend to suggest that public spending increases at an

[7]Data pertaining to the structure of governments' revenues, and the portion that was generated through indirect taxes and social security contributions, are reported in O.E.C.D. (1973, 1977a).

unusually rapid rate immediately before elections (and immediately afterward, if the opposition takes control of government). One application of this argument to the cross-national perspective is to consider the impact of variations among nations in the frequency of national elections. Since the measure of the scope of the public economy relies on revenues (i.e., taxes) rather than expenditures, frequent electoral competition might be expected to dampen the growth of the public economy. However, because revenues and expenditures moved in tandem in most, if not all, of the nations during the period under consideration, the effects of electoral competition on public spending tended to be reflected in tax increases (often in the post-election period). Therefore, one might expect that nations with frequent elections during 1960–75 experienced larger increases in the public economy than nations with infrequent elections, since there were more opportunities for government and opposition elites to indulge in "competitive bidding."[8]

One of the most contested issues in political science is whether or not partisanship influences public policy, and if so, how. Many scholars conclude that parties do not differ significantly in their positions on major issues. Proponents of the "decline of ideology" thesis argue, for example, that parties—particularly those on the left—have forsaken traditional ideologies in order to assemble larger electorates.[9] Even if parties resist the temptation of assembling socially and ideologically heterogeneous electorates and retain some measure of ideological distinctiveness, they may be unable to implement their preferences when in office. The complexities of the internal processes of revenue and spending decisions (Klein, 1976), the vagueness of campaign proposals and the frequent lack of experience, and turnover, of ministers (Gordon, 1971), the importance of policy professionals in the civil service (Heclo, 1974, p. 301), the impulse of incrementalism and the tendency to follow established routines (Wildavsky, 1974), as well as the occasional movement by governments in directions not consistent with their traditional ideologies (King, 1969, p. 136) all do much to circumscribe the impact of party. Largely for these reasons, King concludes that the policy role of parties is "sharply restricted.... While organized party generally remains one of the forces ... in the formation of public policy ... it has never been the only one, and there is reason to suppose that in many countries in the late 1960's it is not even a major one" (pp. 136–37).

In spite of the support which can be mustered for the skeptical view of the importance of parties in the policy process, some evidence suggests that parties may be relevant in defining the scope of the public economy. For example, Hibbs (1978) contends that strike activity decreased in European nations where Social Democratic and Labor parties increased their representation in cabinets in the 1930s and 1940s. This decrease occurred, says Hibbs (p. 165), because of the propensity of leftist parties to provide funding for new and expanded welfare programs. This caused a much larger portion of the national income to flow through the public sector, thereby shifting the locus of the distributional struggle from the private sector, where labor and capital compete through industrial conflict, to the public sector, where these economic actors compete through electoral mobilization and political bargaining with each other and with government.[10]

The budgetary studies of Davis, Dempster, and Wildavsky (1966, 1974) provide additional evidence that the partisanship of government may influence public policy. In their first study, the authors found "shift points" in the incremental drift of spending which coincided with changes in the control of the White House. Wildavsky's analysis (1975, p. 371) of British budgets during 1964–74 found that the direction of the trend line of public spending shifted when the Conservatives replaced the Labour party in government in 1970.[11] Also, Davis,

[8]During 1960–75, the number of national legislative elections ranged from zero in Spain to seven in Australia and Denmark. During this period, of course, Spain was nondemocratic; thus our arguments concerning the impact of electoral competition on fiscal policy are irrelevant for that case. For purposes of comparability with the other nations, we treat only the four American presidential elections rather than all eight congressional elections. It is, of course, true that the argument regarding the effect of electoral competition on fiscal policy is relevant to the latter elections; see Kramer (1971) and Tufte (1975).

[9]See Lipset (1960, pp. 439–56) and Bell (1960). For rejoinders, see LaPalombara (1966) and Putnam (1973).

[10]The most dramatic instances of reduced industrial conflict after World War II are found in Scandinavia. For discussions of the institutionalization of industrial conflict in those nations, see Elvander (1974) and Ingham (1974).

[11]The effect is less pronounced when one considers the trend in British expenditures, in part because the government of Edward Heath ran down the surplus of

Dempster, and Wildavsky (1974) found that the magnitude of the increments granted to American federal agencies was influenced by such partisan variables as the strength of the liberal wing of the Democrats in Congress and Democratic control of the presidency.

The Hibbs and Wildavsky studies suggest that as the partisan composition of government varies over time, within a nation, and among nations, so too the priorities and substance of policy vary, including the definition by governments of the "proper" scope of the public economy. One might expect, therefore, that the considerable variation among nations in the rate of expansion of the public economy reflects differences in the frequency of control of national governments over a period of years by parties which, in general, favor that expansion. Following Downs (1957, p. 116), who viewed leftist parties as more favorable than others to the extension of governmental intervention in the economy, one might expect that the rate of expansion of the public economy was positively associated with the extent to which governments relied for their support on leftist parties during 1960–75.[12]

**The Institutional Explanation.** A fourth type of explanation of the expansion of the public economy involves the institutional structure of government. Two aspects of that structure are considered here: (1) the formal relationship among levels of government within a nation—in particular, the existence of multiple, independent centers of public authority; and (2) the degree of fiscal centralization.

Downs (1964), Niskanen (1971), Wildavsky (1974), and Tarschys (1975) argue that government bureaucracies develop internal pressures for self-aggrandizement and expansion. If that is true, then a multiplicity of autonomous governmental bureaucracies would enhance this tendency. Thus, in nations where no single authority controls the bulk of public spending—where, in other words, spending authority is fragmented—and where the institutional structure guarantees that some units and levels spend funds that were raised by other units or levels (Tarschys, 1975, p. 25), the rate of increase in spending should be unusually high. The institutional arrangement of government which most closely approximates this situation is federalism: that arrangement provides considerable autonomy for subnational and local governments, fragments the control of public spending, allows some levels or units the luxury of spending funds which have been raised by other levels or units, and multiplies the number of self-aggrandizing bureaucracies. Therefore, one might expect that nations with a federal structure of government experienced larger increases in the scope of the public economy than those with a unitary structure.

A second aspect of the institutional structure of government that may influence the expansion of the public economy is the degree of fiscal centralization. Centralization, defined here as the proportion of all governments' revenues generated by the central government, reflects, to some extent, the formal institutional structure of government; nations with unitary government tend to be more centralized than federal nations. Nevertheless, the degree of centralization varies widely among both the

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funds allocated to capital formation. The result was a marked increase in borrowings from abroad, beginning in 1972, and actual deficits beginning in 1975. See Klein (1976, p. 418) and Brittan (1975).

[12]Leftist parties are defined as those which are Social Democratic, Labor, or Communist. Thus, the American Democratic party is not considered to be leftist; it is, of course, true that the party is to the left of the Republican party and that it does matter whether Republicans or Democrats control the executive and legislative branches. (In this regard, see Tufte [1978, pp. 71–83].) Nevertheless, it is also true that it differs considerably from most European Socialist and Social Democratic-Labor parties—for example, in its electoral support among middle-class voters and in its unusually large body of self-declared "middle-of-the-roaders" and "conservatives." See, on the former point, Hamilton (1972, pp. 190–93). In regard to the latter point, Flanigan and Zingale (1975, p. 114) find that 66 percent of 1972 Democratic identifiers called themselves "conservative" or "middle-of-the-road" rather than "liberal." The measure of the partisan composition of government was calculated as follows: in each year, I summed the votes received in the previous national legislative election by all parties participating in government (i.e., holding cabinet positions) and divided the total into the number of votes received by all Social Democratic, Socialist, Labor, Communist, and smaller leftist parties (such as the Dutch Radicals and the Danish Socialist Peoples' parties) that were participants in government. This proportion ranges from 0 (when no leftist parties were in government) to 100 (when the government was composed entirely of leftist parties). I then summed the values for the 16 years between 1960–75 and calculated the average. That average represents the average proportion of the government's electoral base that was accounted for by leftist parties. It is highly correlated (on the order of $r = .99$) with a measure of the proportion of Cabinet portfolios held by leftist parties. The electoral data were obtained from Mackie and Rose (1974, 1975, 1976).

federal and the nonfederal nations considered here, and it is plausible to think that it exerts an impact on the scope of the public economy that is independent of the formal structure of government.[13]

Several studies conclude that government spending tends to increase most rapidly at subnational and local levels of government. Wagner (1883, p. 8) was perhaps the first to note that local authorities' requirements for funds were most likely to expand when administration was decentralized. Recent studies of the United States (Freeman, 1975, p. 208), Britain (Bacon and Eltis, 1976), and Sweden (Tarschys, 1975, p. 25) have found that increases in public spending were greater at the subnational and local, rather than at the national, levels of government. Heidenheimer (1975, p. 28) suggests a reason for these findings in his comparison of the difference in spending for health care in Britain and Sweden: "The monopolistic control of the national Treasury and the Health Ministry over financing sources enabled Britain, much better than Sweden [where health financing is decentralized and the responsibility of the counties], to hold down the proportion of national income allocated to the health sector." In other words, the ability of central government decision makers to oversee spending and, presumably, their awareness of the cost-benefit tradeoffs among policy sectors serve to limit aggregate spending. These studies support a contention that, for the same reasons mentioned in regard to the impact of federalism, relatively decentralized nations experienced larger increases in the scope of the public economy than did highly centralized nations.

**The International Explanation.** The four alternative explanations of the expansion of the public economy presented thus far share a common element. The rate of economic growth, the degree of "invisibility" in the revenue-generating mechanisms of the state, electoral politics, and the institutional structure of government all involve internal aspects of nations. However, nations are not wholly autonomous and entirely independent of the external world. In fact, certain nations are highly dependent on their external environments as markets for export goods or sources of capital.[14] To the extent that there is a high degree of substitution of foreign and domestic goods, with domestic prices of commodities, labor, and capital established by supply and demand in the international rather than the domestic market, these economies are "open" (see Lindbeck, 1976, p. 2). They are, in other words, exposed to pressures on markets and prices which are transmitted from other nations via international exchange.

The concept of the open economy is applicable, in varying degrees, to almost all of the advanced capitalist societies considered here, but it is especially relevant for the smaller nations. As Dahl and Tufte (1973) note, trade dependence—one aspect of openness—is strongly, and inversely, related to the size of a nation:

> By free trade, small political systems can achieve the same economies of scale as large systems.... [Thus] a partial solution to the problem for small systems [is] to engage in foreign trade.... In general, the smaller a political system the higher the proportion of foreign trade to total trade.... Few relationships with size hold up more uniformly than this one (p. 115).

In several of the smaller nations considered here, such as Belgium and the Netherlands, the value of imports and exports is almost as large as the Gross Domestic Product. In fact, the value of trade exceeded 50 percent of GDP in 12 of the 18 nations in 1975.[15] Even in the larger nations, such as the United States and Japan, however, the economies are not impervious to the international economy. Like the smaller nations, they depend on external producers for important commodities such as oil and other raw materials, and they depend on external consumers to provide the markets for export goods.

The most important political consequence of an "open" economy is the constraint it imposes on the effectiveness of a variety of macroeconomic policies (see Krasner, 1976, p. 319). To quote Dahl and Tufte again (1973, pp. 116, 130):

[13]The measure of the formal structure of government is binary: 0 for unitary nations; 1 for federal nations. The measure of centralization was obtained from O.E.C.D. (1973). The degree of centralization in 1960 for the federal nations varied between 38.2 percent (Germany) and 79.7 percent (Australia). Among the unitary nations, the measure of centralization varied from 59 percent (Italy) to 85.8 percent (Ireland). The correlation between the measure of federalism and that of centralization is $r = -.53$.

[14]See Lindbeck (1975, 1976, 1977); Aukrust (1977); Cooper (1972); and Keohane and Nye (1977).

[15]The figures refer to exports and imports of all goods and services, and are derived from data reported in O.E.C.D. (1973, 1977a).

> economies of scale tend to erode the independence and autonomy of the smaller democracy, making it dependent—officially or not—on the actions of people outside the country.... In order to develop and maintain a relatively high standard of living, the small country must go beyond its own boundaries in search of markets, and often in search of raw materials, labor, and capital investment as well. As a consequence, the small country is highly dependent on the behavior of foreign actors not subject to its authority.

Lindbeck (1975, 1977) and Aukrust (1977) have noted the several ways in which the trade dependence of the Scandinavian economies has limited the ability of national officials to manage aggregate demand and control inflation. Aggregate demand in small, open economies is, in part, a function of the demand in the world market for domestically produced export goods; thus, unemployment, which is a function of demand relative to operating capacity in the economy, is somewhat uncontrollable. And since price levels in export industries are set in the world market, they may not move in accordance with changes in domestic costs, causing either low profitability (if external demand, and prices, do not increase with increases in domestic costs) or high profitability (if external demand, and prices, increase more than domestic costs). Whether export profits are small or large, they may destabilize the economy: a lack of profits in the export sector may cause a reduction in the funds available for capital investment and, ultimately, a reduction in the rate of growth; a high level of export profits may, on the other hand, contribute to inflation, since they may be used to justify higher wages in the export industries and these wage increases may, in turn, be generalized to the nonexport sector through centralized collective bargaining.[16]

Just as a high degree of dependence on the international economy for markets for export industries may limit a government's ability to manage aggregate demand and control levels of unemployment and capital formation, a high degree of penetration of the domestic market by external producers also limits the control by the national government over the economy. High levels of imports tend to remove decisions regarding the production, and pricing, of goods for domestic consumption to external actors. In addition, import penetration may transmit inflationary pressures from the rest of the world—particularly if the domestic demand for particular commodities is relatively inelastic with regard to price, as, for example, oil (see Aukrust, 1977; Lindbeck, 1975). Furthermore, high levels of imports may contribute to balance of payments deficits, the solution of which usually requires the funding of deficits with foreign borrowings, devaluation, and the institution of deflationary "austerity" programs—all of which may be unattractive to national policy makers.

Several scholars have suggested that the vulnerability of the open economy can be lessened by an assertion of the role of the state. Gilpin (1975, p. 45) concludes, for example, that a likely result of the national anxieties and insecurities produced by economic interdependence will be a resurgence of mercantilism—that is, of states intervening between the domestic and international economy on behalf of national economic objectives. Myrdal (1960) suggested a similar development nearly two decades ago when noting that in order to protect national objectives of internal stability, employment of workers, and undisturbed domestic production and consumption in a world of more chaotic economic relations, "all states have felt themselves compelled to undertake new, radical intervention, not only in the sphere of their foreign trade and exchange relations, but also in other sectors of the national economy" (pp. 70–72). More recently, Lehmbruch (1977) reached a similar conclusion, arguing that

> in a national economy subject to strong interpenetration with international markets, monetary policies often are of rather limited effectiveness. The same is more and more true of "Keynesian" techniques of macroeconomic budgetary and fiscal demand management.... Faced with "control deficits" of this sort, governments increasingly turn to more direct attempts at influencing the economic behavior of business and/or labor (p. 98).

Lindbeck (1975, p. 56) argues that governments can dampen the effects of the open economy on production, employment, and consumption by increasing the scope of the public economy. He notes that the growth of social insurance and tax systems represent "built-in stabilizers" which allow policy makers

[16]Recent Swedish experience confirms the argument here. Capitalizing on the rise in prices in several of the nations to which it exports goods, Swedish exports enjoyed high profits in 1973–74. Subsequent wage negotiations in late 1974 provided unusually large increments. As a result, prices for Swedish goods rose in the world market and, even with slender profit margins, firms lost markets. The result has been large balance of trade deficits, three devaluations since 1976, and negative growth in 1977.

to "smooth out" the peaks and valleys of business cycles. And through extensive labor market policies which include not only unemployment compensation but also subsidies to firms to retain and retrain workers who might otherwise be laid off, as well as through large increases in public employment, governments can maintain near-full employment in spite of the uncertainties of demand inherent in an open economy. In addition, through the provision of capital funds to the private sector (Lindbeck, 1974, pp. 9, 214–27), governments may be able to dampen the effect on capital accumulation of volatile profits in export industries as well as stimulate the development of import-substitution industries.[17]

It may not always be the case that an expansion of the role of the state provides a sufficient means by which governments can enhance their control over open economies. Indeed, Vernon (1974) suggests that the efforts by European states to formally "plan" their economies failed because of increasing openness produced by the creation of the EEC and EFTA and the maturation of multinational enterprises: "None of these efforts to shore up the idea of the independent comprehensive national plan had much chance of succeeding; the contradiction between independent national plans of that sort and open national boundaries was simply too strong" (p. 16). In spite of this caveat, it is reasonable to expect that the arguments of Myrdal, Lehmbruch, and Lindbeck may be reflected in the experience of the 18 nations during the last two decades. Applying their arguments about the response of governments to a condition of external economic dependence, one might expect that the expansion of the public economy was most pronounced in nations in which the economy is relatively "open," in the sense of being exposed to the vagaries of the international economy. Using the ratio of imports and exports as a proportion of GDP as a measure of "openness," this argument would predict a strong positive association between the level, and the rate of increase, of "openness" and the expansion of the public economy.

[17]More recently, Lindbeck (1977, pp. 13, 42) notes that the increased internationalization of the economy has caused an upsurge in international coordination of economic policy. Two recent examples are the development of protectionist limitations on imports and domestic capacity restrictions in the European steel industry (the Davignon plan), and the institution of annual economic summit conferences of western heads of state (Rambouillet, 1975; Puerto Rico, 1976; London, 1977; Bonn, 1978).

### Findings: Why the Public Economy Expanded in 1960–75

Table 1 presents the result of an analysis of the five plausible explanations of the expansion of the public economy. That analysis, based on data for the 18 nations, supports the following conclusions:

(a) Contrary to Wagner's "law," the rate of growth in the economic affluence of a nation does not contribute to the expansion of the public economy. Apparently citizens' demands for services and their willingness to accept higher levels of taxes, or both, are not income-elastic. Instead, the analysis supports Wildavsky's argument that the public economy grows, in relative terms, when economic growth is modest ($B = -.35$). In high-growth nations such as Japan and France, the demands of government for funds can be met with the "dividend" produced by applying a constant share to an expanding economic product. In low-growth nations, where governments do not enjoy that dividend, however, the almost inevitable increase in funding required for "uncontrollable" costs associated with mandated programs, as well as discretionary increments and new programs, absorbs a larger share of the economic product.

(b) Contrary to Downs and to Buchanan and Wagner, budgets do not expand most easily when taxes are concealed in a "fiscal illusion." A high and increasing reliance on "hidden" taxes exerted a significant dampening effect on the degree of expansion of the public economy, as indicated by the strong negative coefficients in Table 1. Instead, the public economy expanded most rapidly after 1960 in nations which relied heavily, and to an increasing degree, on wealth-elastic taxes, such as those on personal and corporate incomes.

(c) Contrary to the skeptics' view, politics is important in influencing the scope of the public economy. The partisanship of government is associated with the rate of expansion, and whether a nation's government was generally controlled by Social Democrats (and their leftist allies), or by nonleftist parties, provides a strong clue to the relative degree of change in the scope of the public economy ($B = .54$). Thus, nations such as Sweden, Norway, and Denmark, in which leftist parties tended, on average, to possess a majority of the government's electoral base, experienced increases in

**Table 1. The Expansion of the Public Economy: Economic, Fiscal, Political, Institutional, and International Explanations**

| Variable | Level and Rate of Increase in Economic Output | | Reliance on Indirect and Social Security Taxes | | Partisanship of Government and the Frequency of Elections | | Inter-Governmental Structure and Degree of Centralization | | Openness of the Economy | |
|---|---|---|---|---|---|---|---|---|---|---|
| | Regression Coefficient | Beta Coefficient | Regression Coefficient | Beta Coefficient | Regression Coefficient | Beta Coefficient | Regression Coefficient | Beta Coefficient | Regression Coefficient | Beta Coefficient |
| Governments' revenues as percent of GDP, 1960 | 0.28 (0.91)[a] | .25 | 0.42 (1.49) | .36 | 0.09 (0.34) | .08 | 0.52 (1.78) | .46 | 0.09 (0.45) | .08 |
| GDP per capita, 1960 | −0.002 (0.77) | −.22 | | | | | | | | |
| Average annual increase, 1960–75, in real GDP | −1.34 (1.16) | −.35 | | | | | | | | |
| Percent of all governments' revenues from indirect taxes and Social Security contributions, 1960 | | | −0.15 (1.10) | −.27 | | | | | | |
| Increase in percent of all governments' revenues from indirect taxes and Social Security contributions, 1960–75 | | | −0.17 (0.75) | −.18 | | | | | | |
| Percent of government's electoral base composed of Social Democratic or Labor parties, 1960–75 | | | | | 0.10 (2.15) | .54 | | | | |
| Number of national legislative elections, 1960–75 | | | | | 0.21 (0.29) | .07 | | | | |
| Federal structure of government | | | | | | | −2.56 (0.82) | −.23 | | |
| Percent of all governments' revenues received by central government, 1960 | | | | | | | 0.13 (0.92) | .28 | | |
| Exports and imports as a percent of GDP, 1960 | | | | | | | | | 0.19 (4.86) | .79 |
| Increase in percent of GDP represented by exports and imports, 1960–75 | | | | | | | | | 0.00 (0.00) | .00 |
| Coefficient of determination ($R^2$) | .19 (.02)[b] | | .20 (.03) | | .37 (.24) | | .31 (.16) | | .67 (.60) | |

[a]Parentheses contain the regression coefficient divided by its standard error.

public revenues which were much larger, as a proportion of GDP, than those in nations such as Japan, Italy, or France, where the Left either participated in government only as the minority partner of nonleftist parties or was excluded from government altogether.

The frequency of electoral competition displays a modest positive correlation with the increase in the public economy, indicating that competition may indeed exert an inflationary impact on budgets. However, after we control for the effects associated with the partisan composition of government, the impact of the frequency of electoral competition is negligible ($B = .07$).

(d) Contrary to our predictions, federalism tends to dampen the degree of expansion of the public economy and centralization tends to facilitate that expansion. Any inherent tendency for aggregate revenues to increase in federal systems because of the fragmentation of spending authority among several quasi-autonomous levels of government is apparently more than offset by other effects. Among these may be the larger number of access points which federalism provides for those who wish to intervene in public policy making in order to oppose the extension of government activity (Heidenheimer, 1975, pp. 20–29, 48–65). Also, the fragmentation of authority which characterizes federalism may contribute to an aggregate pattern of offsetting policy developments among the subnational units that lessens the magnitude of change in the nation taken as a whole. A high degree of centralization, on the other hand, seems to facilitate the expansion of the public economy ($B = .28$). Thus, it appears that that expansion was greatest in unitary, highly centralized nations. We might speculate that that institutional arrangement minimizes the effects of fragmentation and provides the means by which national elites can insure uniformity in existing policies and can most easily avoid the institutional obstacles to policy innovation.

(e) As the discussion of the concept of the open economy suggested, a high degree of trade dependence is conducive to a relatively large expansion of the public economy. Nations with open economies were far more likely to experience an increase in the scope of public funding than were nations with relatively closed economies ($B = .79$). Apparently, governments in nations with open economies have sought to counter the effects of external dependence by expanding their control over the domestic economy through the "nationalization" of a large portion of consumption (Lindbeck, 1974, p. 9).[18]

In order to ascertain the importance of each of the explanations presented in Table 1, I performed a regression analysis which included the six variables most closely associated with the expansion of the public economy. Table 2 presents the results of that analysis. The analysis suggests that about 75 percent of the variation among the nations in the degree of expansion can be accounted for by the six variables. The analysis also suggests that two variables are far more important to the explanation than the others; the two are the partisanship of government ($B = .34$) and the openness of the economy ($B = .58$).

Figure 1 arrays the measure of the expansion of the public economy with that for the partisanship of government. The array provides a clue as to why the strong bivariate relationship between the two ($r = .60$) is reduced in the regression analysis. It suggests that the dominance in government of leftist parties was a sufficient condition for a relatively large increase in the scope of public activity; there was no nation in which the Left had a large share of the government's electoral base which did not also experience a relatively large increase in the public economy. However, leftist domination was not a necessary condition, since several nations experienced large increases in spite of the absence of a strong leftist representation in government. Included in this latter group are the Netherlands, Belgium, Ireland, and Canada. All share at least one common trait: their economies are relatively open. To some extent, then, the impact of partisanship on the scope of the "tax state" is more pronounced in larger nations with more closed economies than in the smaller nations with more open economies. In the latter, apparently, all governments—whether formed by leftist or nonleftist parties—have been impelled by the exigencies of the open economy to expand the role of the state. To illustrate this, Table 3 presents the year-by-year change in the measure of the public economy in four nations in which the partisan control of government alternated between leftist and nonleftist parties. In the two larger nations, Britain and Germany, a clear partisan effect is noted.

[18]Lindbeck notes here the distinction—relevant to Sweden and several other small open economies—between the nationalization of the consumption of income, which implies a large "tax state," and the nationalization of the production of income, which implies, instead, a large number of publicly owned enterprises.

In Britain, for example, the change was positive in every year in which the Labour party was in power (1964–70, 1974–75), and was negative in five of the seven years during which the Conservatives governed. Similarly, in Germany, the years of Christian Democratic government, particularly when Ludwig Erhard, the former minister of economics and proponent of the neoliberal "social market policy," was chancellor (1963–66), were marked by modest increases or decreases, while the period of Social Democratic control was marked by a cumulative increase in the scope of the public economy. In contrast, in Denmark and Norway, nonleftist governments were no less inclined than those dominated by the Social Democratic and the Labor parties to increase the public revenues at a rapid rate, relative to the rate of economic growth. Thus, while the size of the public economy grew considerably in Denmark during the Social Democratic minority government and subsequent "red coalition" of 1964–67, the largest increase occurred during the nonleftist coalition government of 1968–71. Likewise, in Norway, the bourgeois coalition which governed during 1966–71 and again during 1972–73 expanded the scope of state activity at a rate which in some years approached that achieved by Labor governments.

The regression analysis presented in Table 2 suggests that the openness of the economy is the best single predictor of the growth of public revenues relative to the economic product of a nation. In Figure 2, the measure of openness is displayed with that of the change in the scope of the public economy. A strong relationship is observed and no major exceptions appear to the pattern of covariation: larger nations with more closed economies experienced relatively modest increases in the scope of the public economy compared to the smaller nations with open economies.[19] Within the latter group, one finds some distinction between the Scandinavian nations, where the Left frequently governed, and Belgium and Ireland, where centrists or conservatives usually dominated government.

[19]As Dahl and Tufte (1973, p. 130) suggest, there is a strong inverse correlation between the population of a nation and the degree of economic openness (r = –.65).

**Table 2. The Relative Importance of the Economic, Fiscal, Political, Institutional, and International Explanations of the Expansion of the Public Economy**

| | Increase, 1960–75 All Governments' Revenues as a Percent of GDP | | |
|---|---|---|---|
| | Simple Correlation | Regression Coefficient | Beta Coefficient[a] |
| Level of public economy, 1960 (governments' revenues as percent of GDP) | .35 | 0.11 (0.46) | 0.10 |
| Average annual percentage increase, 1960–75, in real GDP | –.31 | 0.06 (0.09) | 0.02 |
| Percent of governments' revenues obtained from indirect taxes and Social Security contributions, 1960 | –.23 | –0.06 (0.68) | –0.12 |
| Percent of government's electoral base composed of Social Democratic or Labor parties, 1960–75 | .60 | 0.07 (1.75) | 0.34 |
| Percent of all governments' revenues received by central government, 1960 | .21 | 0.08 (0.97) | 0.17 |
| Exports and imports of goods and services as percent of GDP, 1960 | .78 | 0.13 (3.22) | 0.58 |

Coefficient of determination ($R^2$) = .75. $\bar{R}^2$ = .61.

[a]Beta coefficient is the standardized regression coefficient

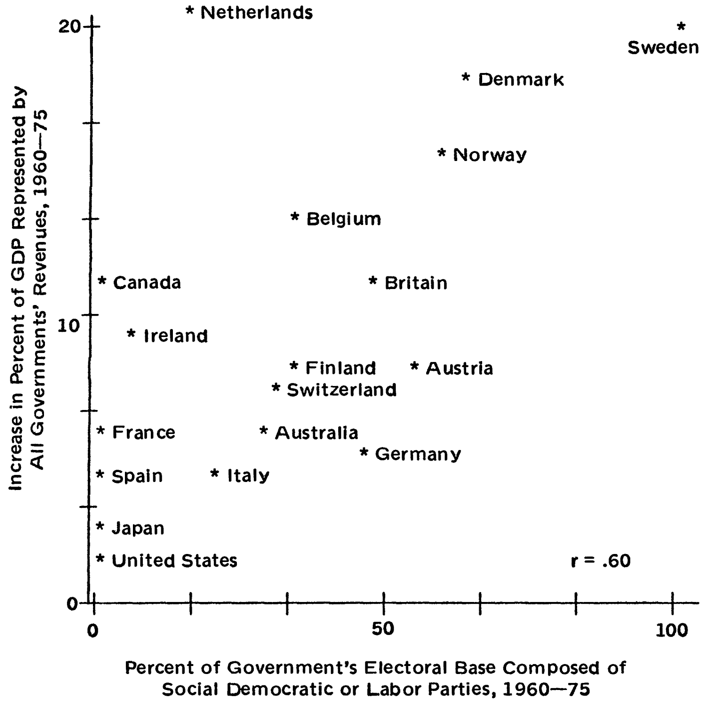



**Figure 1. The Partisan Composition of Government and the Expansion of the Public Economy**

**Table 3. The Partisan Composition of Government and Change in the Scope of the Public Economy in Four Nations[a]**

| Year | Britain[b] | Germany | Denmark | Norway |
|---|---|---|---|---|
| 1961 | 0.5 | 0.8 | **–0.5** | **1.1** |
| 1962 | 1.7 | 0.6 | **1.5** | **1.4** |
| 1963 | –0.5 | –0.1 | **1.5** | **–0.1** |
| 1964 | –0.2 | –0.4 | **0.1** | **–0.5** |
| 1965 | **1.7** | –0.8 | **1.3** | **1.2** |
| 1966 | **1.0** | 0.5 | **2.2** | 1.1 |
| 1967 | **1.8** | *0.6* | **0.6** | 1.6 |
| 1968 | **1.6** | *–0.5* | 2.9 | 0.4 |
| 1969 | **2.1** | *1.8* | 0.2 | 2.1 |
| 1970 | **1.3** | **–0.8** | 4.5 | 0.5 |
| 1971 | –1.9 | **0.9** | 3.4 | **3.1** |
| 1972 | –1.7 | **0.3** | **0.2** | **2.1** |
| 1973 | –0.8 | **2.4** | **0.1** | 1.2 |
| 1974 | **3.3** | **0.3** | 2.1 | **–1.2** |
| 1975 | **0.8** | **–0.4** | **–3.1** | **1.5** |

[a]Entries are the first-order changes between successive years in the percent of GDP received by all governments.

[b]Boldface entries indicate that the Social Democratic or Labor parties controlled government for at least six months during the year. The British entry for 1970 is credited to Labour, in spite of its defeat in the June election. Italicized entries for Germany denote the period of the Grand Coalition between the SPD and CDU/CSU (1966–69).

But the overall message is clear: the best explanation of why public authorities in some nations have expanded their control over the appropriation and allocation of resources while those in other nations have not is international in character. Among the nations considered here, the expansion of the public economy was most closely associated with a relatively high exposure to, and dependence upon, external producers and consumers.[20]

## Discussion

**The Domestic Consequences of the Open Economy.** Why is the degree of trade dependen-

[20]Contrary to our expectation, the extent of increase in openness during 1960–75 is not related to the extent of increase in the public economy. While all 18 nations became increasingly open during this period (in terms of exports and imports as a percent of GDP), the wide variation among the 18 nations was unaltered and the ordering of the nations remained, in 1975, almost as it was in 1960 (r = .95 between the measures of openness in 1960 and 1975). The findings reported here imply that it is the extent of openness, rather than the rate of change, that stimulates an expansion of the public economy.

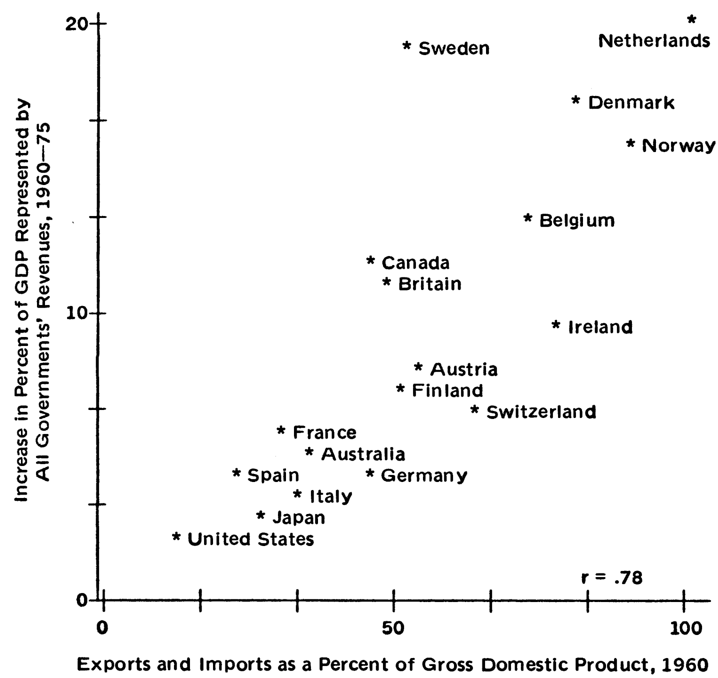



**Figure 2. The Openness of the Economy and the Expansion of the Public Economy**

ce the best predictor of the extent of expansion of the public economy? Is it simply the force of the exigencies posed by exposure to the international economy that causes government to extract and allocate a larger share of the economic product? Or does openness generate certain structural characteristics in advanced capitalist economies which are conducive to an expansion of the scope of the public economy? We shall attempt to provide an answer to these questions by identifying a sequence of economic, sociological, and political characteristics that derive, ultimately, from the openness of the economy. This sequence, presented in Figure 3, includes the following: (a) the degree of industrial concentration; (b) the density of unionization; (c) the scope of collective bargaining; and (d) the strength of labor confederations.

One of the structural attributes that frequently characterizes small, open economies is a high degree of industrial concentration—that is, an unusually large share of production and employment in a few large firms. According to Ingham (1974, pp. 40–41), "those societies in which industrialization was based upon exports because of too small a domestic market have tended to develop highly concentrated industries. Sharp competition in the export field has, in these countries, tended to force out the smaller and less-efficient companies which were less able to contend with fluctuations in world markets."

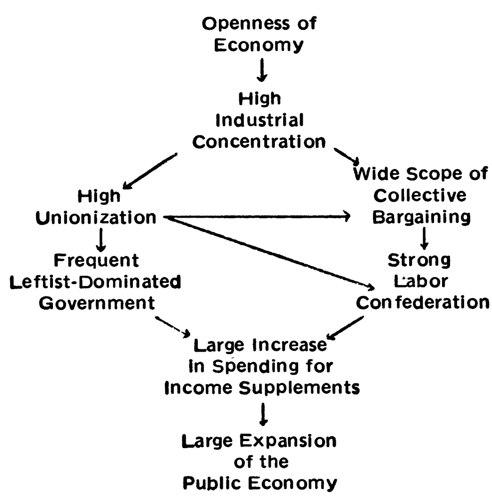



**Figure 3. The Domestic Consequences of an Open Economy**

High levels of industrial concentration appear, in turn, to facilitate the formation of employers' associations and labor confederations which include a relatively large portion of all firms and employees. Ingham notes, for example, that small, open, and highly concentrated economies tend to have "a small number of oligopolistic and non-competitive sectors . . . which facilitates collective organization" (p. 42). And the labor force in such economies tends to be somewhat less differentiated in terms of occupation and skill levels and, as a result, less fragmented (p. 43). The existence of such a labor force—relatively homogeneous and relatively concentrated in large firms in a small number of non-competitive sectors—is conducive to the growth of union organization. The existence of a relatively high level of unionization is, in turn, an important prerequisite for enduring leftist government, since unionized workers provide the core of the electoral base of most Social Democratic and Labor parties (see Stephens, 1978). Thus, in following the left-hand branch in Figure 3, we see that the openness of the economy contributes to an expansion of the public economy by facilitating the development of the social infrastructure upon which Social Democratic and Labor party electoral support rests.[21]

In addition to its effects on unionization and, ultimately, the structure of the party system, industrial concentration influences the scope of collective bargaining. The existence of "a small number of oligopolistic and non-competitive sectors," composed of a relatively small number of large firms, coupled with the proliferation of labor and employer organizations, widens the scope of collective bargaining. In some nations considered here, bargaining is decentralized and usually conducted at the level of the enterprise, either by enterprise unions as in Japan, or by national unions as in the United States. In most European nations, on the other hand, bargaining is conducted at the industry level with important additional negotiations at the enterprise level, as in Britain and Italy, or the regional level, as in Germany. But in the smaller open economies, industry bargaining often follows guidelines established in national negotiations (see Mouly, 1967; Schregle, 1974; Elvander, 1974; Lehmbruch, 1977; Hibbs, 1976). Thus, in Norway, Sweden, and Denmark, economy-wide "framework" agreements are formally negotiated between labor and employer confederations. And in Austria, Belgium, and the Netherlands, institutions exist in which representatives of the major confederations consult about, and occasionally negotiate, collective bargaining guidelines.[22]

One of the more important consequences of industrial and economy-wide collective bargaining is the power it bestows on labor confederations. Since they are the representatives of organized labor in economy-wide consultations and negotiations, they have tended to acquire formal powers over their affiliates in regard to collective bargaining. In Norway, Sweden, Finland, Austria, Belgium, and the Netherlands, for example, the major confederations can withhold strike funds from affiliates, thereby weakening the latter's ability to use the threat of strike action. In Austria, Norway, and the Netherlands, confederations can veto wage settlements obtained by their affiliates, and in these and most of the other open economies in Europe confederations have, *de jure* or *de facto,* the right to consult with affiliates prior to negotiations (Headey, 1970, pp. 421–25).[23]

[21]This argument is supported by the existence of a positive correlation between the measure of the openness of the economy and the proportion of the work force that belong to labor unions (r = .41), and the positive correlation (r = .56) between the extent of unionization and the extent of government by leftist parties. Unfortunately, no satisfactory data exist with which cross-nationally comparable measures of concentration might be constructed. Data on unionization were obtained from Europa Publications (1977). We might note that our argument here implies a more complex relationship between the openness of the economy and the partisanship of government than is suggested by the assumption of independence in the regression analysis reported in Table 2. In fact, there is a positive, albeit modest, correlation between the two measures (r = .37).

[22]The argument in this paragraph is supported by the very strong correlation between the measure of openness and a measure of the scope of collective bargaining derived from Mouly (1967), Schregle (1974), Lehmbruch (1977), and Hibbs (1976). The correlation is r = .74.

[23]The argument that labor confederations are stronger, in terms of their ability to intervene in collective bargaining, in nations in which the scope of collective bargaining is relatively broad is supported by the strong correlation of r = .65 between the measure of the scope of collective bargaining (which ranges from 1 for Japan where collective bargaining often involves enterprise unions, to 6 for Austria, Ireland, Denmark, Norway, and Sweden, where economy-wide "framework" agreements, or similar consultations, take place) and a measure of the formal right of labor confederations to intervene in collective bargaining through prior consultation, post-negotiation approval, and/or control of strike funds.

The ability of labor confederations to intervene in collective bargaining makes them major actors in the political economy. This is especially true in nations where the domain of macroeconomic issues about which confederations consult with employers and/or government has been extended beyond collective bargaining in recent decades. This occurred in some nations through the creation of consultative institutions, such as the Austrian Parity Commission and the Dutch Foundation of Labor and the Social and Economic Council; in other nations, consultation is less institutionalized but equally important, as in Norway and Sweden where the confederation and the Labor party have traditionally represented the two arms of the labor movement (see Lehmbruch, 1977). This access to government can be used by labor confederations in many ways, but two are of special relevance here. Acting as representatives of the labor movement, confederations may advocate policies that will enhance the economic condition of their members by supporting programs that provide income supplements. On the other hand, confederations may act as allies of government—particularly when it is formed by Social Democratic or Labor parties—to moderate wage demands in the export sector in order to maintain international competitiveness. For example, they may voluntarily participate in programs of wage restraint negotiated between themselves, employer federations, and government (see Rall, 1975; Ulman and Flanagan, 1971; Galenson, 1973; Headey, 1970; and Lehmbruch, 1977). More frequently than not, labor confederations involved in such cooperative programs of wage restraint have felt compelled to use their access to government to obtain increments to the disposable income of their members, thereby compensating them for wage sacrifices. Whether they act as the representatives of organized labor or as allies of government, then, the existence of strong labor confederations tends to produce the same effect—an unusually large increase in publicly funded income supplements. And this, in turn, requires a comparable expansion in the scope of the public economy.[24]

**The Consequences of the Expansion of the Public Economy.** Does it matter that in some nations the public economy expanded to the range of 50 percent of GDP, while in others it increased only slightly in the years since 1960?[25] Thus far, this article has examined the reasons for the large cross-national variation in the degree of expansion of the public economy. It is appropriate to conclude, however, by shifting our attention from cause to consequence and examining the impact of changes in the scope of the public economy. A variety of effects might be considered, ranging from macroeconomic policy to electoral behavior; we have chosen two related effects which demonstrate the magnitude of the impact of different rates of cumulative change and the value dilemmas that accompany policy choices in this domain. The two involve economic equality and private capital accumulation.

In Figure 4, we illustrate the relationship among 12 of the 18 nations between the cumulative expansion of the public economy and measures of economic equality and private capital accumulation. A strong positive correlation ($r = .83$) exists between the size of the increase in the public economy and a measure of economic equality involving the difference in the proportion of all national income received, after taxes, by the top and bottom 20 percent of households. A strong negative correlation ($r = -.89$) exists between the size of the cumulative increase in the public economy and the change in the proportion of GDP represented by private capital accumulation.[26]

[24]This argument is supported by the high correlation between the measure of the right of labor confederations to intervene in collective bargaining and a measure of the increase in the proportion of GNP spent on social security schemes (as defined by the International Labour Organisation) between 1960 and 1971. The correlation is $r = .74$. That increase in spending effort for social security schemes is, in turn, highly correlated with the measure of the expansion of the public economy ($r = .72$). The data on the increase in Social Security spending are reported in I.L.O. (1964, 1976).

[25]By 1975, the public economy absorbed 53.5 percent of the Dutch GDP, 50.2 percent of the Norwegian GDP, 52.2 percent of the Swedish GDP, and 45.0 percent of the Danish GDP. To a very large extent the scope of the public economy in 1975 was determined by the magnitude of the increase between 1960 and 1975. Thus the correlation between the measure of expansion in 1960–75 and the scope of the public economy in 1975 was $r = .89$, compared to a correlation of $r = .35$ between the 1960 and 1975 measures.

[26]The data on the size distribution of income are reported in O.E.C.D. (1976). The data used here represent the first-order difference between the proportion of all after-tax income received by the top 20 percent and the bottom 20 percent of households. To control for national differences in the size of households and enhance the cross-national comparability of the data, the O.E.C.D. reports standardized figures. These are the data used here. The measure of the

The data in Figure 4 suggest the existence of a tradeoff between relatively high degrees of economic equality and increasing rates of private capital accumulation.[27] And they suggest that the collective choice of a nation in regard to this tradeoff is strongly influenced by choices made in regard to taxation policy. Nations such as the United States, Japan, Spain, and Italy, where the extractive capacity of government did not significantly increase, relative to the economic product, have, in a sense, opted for a relatively inegalitarian distribution of income and an increasing rate of private capital accumulation.[28] Other nations, however, have, in the cumulative effect of their policies, made a different choice and have attained a relatively greater degree of economic equality at the cost of lower rates of private capital accumulation. Given the structural features that tend to accompany economic openness—a high degree of unionization, relatively frequent government by Social Democratic and Labor parties, strong labor confederations, and, ultimately, a large increase in taxation—it is perhaps not surprising that the nations which tended to favor distributional equity rather than private accumulation were those with open economies.

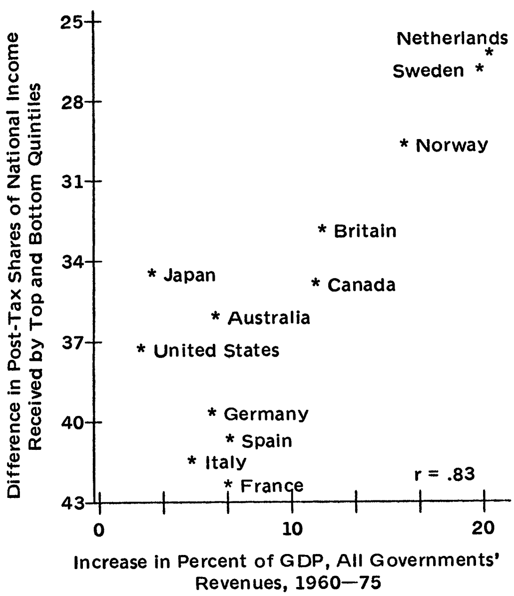
## Conclusion

Most studies of public policy in advanced industrial society confine themselves to an analysis of internal, or domestic, causes and consequences. Only rarely, and only recently, have students of public policy examined the linkage between the international economy and domestic policy (Katzenstein, 1976, 1978). The predominant image implicit in most policy studies is that of political autarky—of autonomous states whose policy processes are wholly insulated from external influences. Yet in a world marked by "complex interdependence" (Keohane and Nye, 1977) such an image is increasingly anachronistic; because, as Cooper argues, "increased economic interdependence . . . erodes the effectiveness of national economic policies and hence threatens national

change in the proportion of GDP that represents all private capital accumulation (i.e., savings and consumption of fixed capital) is the first-order difference of the proportions in 1960 and 1975. The data are reported in O.E.C.D. (1973, 1977a).

[27] That a tradeoff exists between equality and accumulation is further suggested by the high negative correlation between the two measures (r = –.74).

[28] In spite of the increase in the rate of capital accumulation in the private sector, the low rate of governmental savings—and indeed aggregate government deficits in several years—caused the proportion of gross capital accumulation in GDP to drop in Italy and the United States between 1960 and 1975. See O.E.C.D. (1977a).



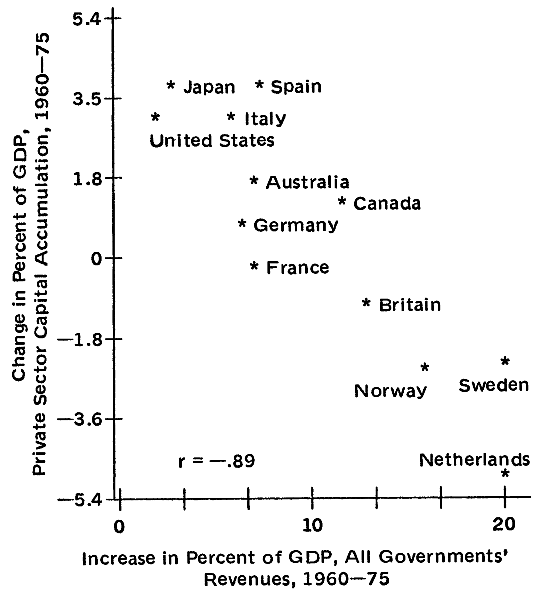




**Figure 4. The Tax Tradeoff: The Expansion of the Public Economy, Economic Equality, and Capital Accumulation**

autonomy in the determination and pursuit of economic objectives," governing elites are likely to feel compelled to use public policy to confront the challenges posed by the international economy (1972, p. 164).

Governments use a variety of policy instruments to shelter their economies from the competitive risks of the international economy. Some states adopt explicitly neo-mercantilist policies (Katzenstein, 1978, pp. 879–920); others favor certain enterprises, whether in the private or public sector, as "national champions" (Vernon, 1974, Ch. 1); still others adopt a variety of industry-specific protectionist measures. Each type of policy has occurred in one or more of the nations considered here during the past decade. However, neo-mercantilism, support of "national champions," and protectionism are often ineffective for nations with open economies, given their small size relative to some of their most important trading partners. For such nations, another type of response is more feasible—one which is more defensive in character and involves a relatively large public economy. Governments in small open economies have tended to provide a variety of income supplements in the form of social security schemes, health insurance, unemployment benefits, job training, employment subsidies to firms, and even investment capital. Prompted in part by the incentive to maintain price competitiveness of export goods in the world market and accentuated by the social structural features generated by economic openness, this expansion of the role of government in the distribution and consumption of national income has dramatically enlarged the scope of the "tax state" in contemporary advanced capitalist society.

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