Example 2.2
Government Sectors in the Industrialized Market Economies

The governments of all the developed capitalist countries respond to market failures, but not to the same degree. Table E2.2 (overleaf) compares the government sectors of the 21 industrialized market economies of the Organization for Economic Cooperation and Development (OECD) in 2006.[1] The comparison is made in two ways. The first two columns rank order the countries by final government consumption as a percentage of GDP. Government consumption expenditures are the resource-using goods and services that governments purchase – the expenditures that are always labeled G in economics textbooks. As such, they give an indication of the relative sizes of the public and private sectors in terms of their command over a country's scarce resources. The last two columns rank order the countries by total general government expenditures as a percentage of GDP. Total general expenditures consist of government consumption expenditures (G) plus government transfer payments. The transfer payments include transfers to people and business through programs such as Social Security and public assistance, interest payments on the government debt, and grants-in-aid to other governments. Transfer payments are not resource-using expenditures. A tax and transfer program redistributes purchasing power within the private sector (and within the public sector in the case of grants-in-aid); it does not increase the size of the public sector relative to the private sector.

[Continued overleaf]

[1] 2006 is chosen for comparison because it was the last year before the Great Recession of 2007, which has had a temporary and large effect on government revenues and expenditures in many of the industrialized economies.

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Table E2.2: Government Consumption and Total Government Expenditures of the OECD Industrialized Market Economies, 2006

General Government Final Consumption (2006)		Total General Government Expenditure (2006)	
Country	General Government Final Consumption %GDP	Country	Total General Government Expenditure %GDP
Sweden	28.7	Sweden	55.5
Denmark	25.5	France	53.4
Netherlands	25.3	Denmark	51.4
Iceland	24.8	Italy	50.1
France	23.6	Austria	49.2
Belgium	22.6	Belgium	49.0
United Kingdom	22.2	Finland	48.6
Finland	21.4	Netherlands	46.7
Portugal	20.5	Portugal	46.1
Italy	20.3	Germany	45.7
Canada	19.3	United Kingdom	45.0
Norway	19.3	Iceland	42.8
Germany	18.5	Norway	40.5
Australia	18.2	Luxembourg	40.4
Austria	18.1	Canada	39.3
Japan	18.1	Spain	38.5
Spain	17.9	Japan	38.1
New Zealand	17.5	New Zealand	38.1
United States	16.0	United States	36.6
Ireland	15.9	Australia	34.4
Luxembourg	15.9	Ireland	34.4

Source: OECD in Figures 2007, OECD Observer, 2007/Supplement 1, Public Finance>Government Sector, 2006, 56–57.

The table reveals a number of features about the government sectors of the industrialized market economies. One is that all these countries have sizable government sectors. Their

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economies are very much mixed public–private sector economies; they are far removed from being pure market economies. Nonetheless, there is considerable variation among them in the percentage of resources allocated to public consumption, with a range of nearly 2 to 1 between high-end Sweden and low-end Ireland and Luxembourg. According to the table, three countries devote over 1/4 of their resources to the public sector (Sweden, Denmark, and the Netherlands), seven between 1/5 and 1/4 of their resources, eight between 1/6 and 1/5, and three (just) below 1/6.

The U.S. is really quite an outlier on the low end in one respect. The U.S. and the UK are the only two countries for which defense spending is a major component of the national government's budget, with the U.S. far ahead of the UK in this regard. In 2006, U.S. federal expenditures for defense accounted for 85% of federal consumption expenditures and 1/4 of total federal, state, and local general consumption expenditures.[2] They were approximately 4% of U.S. GDP. Therefore, the U.S. used only about 12% (1/8) of its total resources for domestic (non-defense) government consumption, much less than any of the other industrialized market economies.

Another feature that stands out in the table is the extent to which the industrialized market economies are willing to redistribute purchasing power through government transfer payments.[3] Indeed, transfer payments exceeded government consumption expenditures in all but four of the countries (Sweden, Netherlands, Iceland, and Australia), and three of those are among the high-end countries in terms of government consumption. When transfer payments are added to government consumption expenditures, government spending exceeds 1/3 of GDP in all the countries and is over half of GDP in four countries (Sweden, France, Denmark, and Italy – with Austria, Belgium and Finland falling just under 1/2). These large transfer payments may not increase the size of the government sectors, but they do have to be financed by tax revenues. And, as is explained in Chapter 15 of the text, higher tax rates lead to greater inefficiencies in proportion to the square of the tax rates.

Notice that the U.S. is among the low-end countries in terms of transfer payments at 20.6% of GDP (20.6%=36.6%–16.0%), just as it is for government consumption. Only three countries had transfers-to-GDP ratios below 20% (Ireland at 18.5%, Iceland at 18.0% and Australia at 16.2%). Even so, 20% of U.S. GDP in 2006 was approximately $2.6 trillion, or $8,700 per person. The U.S. has certainly not shied away from redistributing resources.

These large sums notwithstanding, perhaps fiscal conservatives in the U.S. can take some comfort in knowing that, among the industrialized market economies, the U.S.

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[2] *Budget of the United States Government, Fiscal Year 2008, Supplement* (Washington, D.C.: U.S. Government Printing Office, 2007), Part Five: Historical Tables, Table 3.1, and *Economic Report of the President, 2007*, Council of Economic Advisers (Washington, D.C.: U.S. Government Printing Office, February 2007). Table B-83.

[3] Transfer payments are the difference between total general expenditures and final general consumption expenditures, with both expressed as percentages of GDP in the table.

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ranks among the low-end countries in transfer payments as a percentage of GDP, and has by far the lowest ratio of non-defense government consumption to GDP. Government spending in the U.S. has been kept well in check, at least relatively speaking.

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