

A History of Government Intervention

Lecture 3

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Government Intervention in Europe

From minimal state to the Welfare State to austerity

① the minimal state

- as late as 1930 pension costs did not exceed 1 per cent of GDP in Germany or Sweden
- no price controls
- no government enterprises
- some income taxation

② the Welfare State

- subsidized or free healthcare
- free public education
- cheap housing, childcare and increasing retirement plans
- some income taxation
- government provision of utilities, communication and healthcare

③ Austerity: the keyword after 2010

The Welfare State in Europe

The numbers: a 2005 snapshot

Table 10.2 The uses of local and central government spending in Europe in 2005. Percentage of total

Year 2005	Per cent								
	Denmark	Germany	Greece	France	Italy	Poland	Sweden	UK	Norway
Public service	15	17	27	20	24	20	17	21	13
Welfare provisions	57	63	53	59	53	53	56	54	57
Education and R&D	15	10	7	11	11	15	14	15	15
Envn. protection	1	1	1	2	2	1	1	1	1
Other	12	9	12	8	10	11	12	9	13

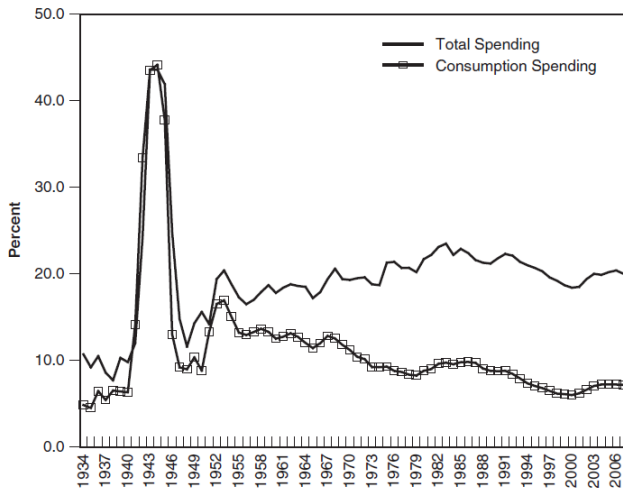
Source: Eurostat on line.

The Mixed Market Economy in US

The data: overall government

FIGURE 26.1

Two Measures of the Size of the Federal Government, as Percentages of GDP, 1934–2007



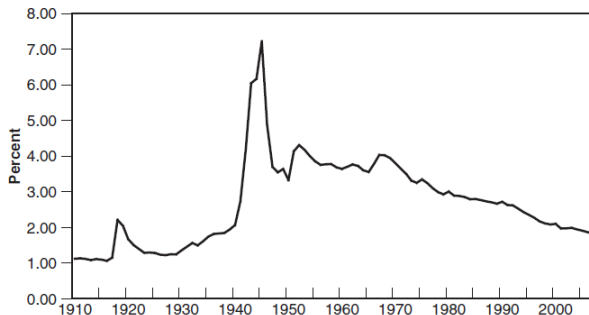
Source: Historical Statistics 2006, table Ca120-134; Economic Report of the President 2009,

The Mixed Market Economy in US

The data: public employment

FIGURE 26.2

The Ratio of Federal
Civilian Employment to
the Total Labor Force
1910–2007 (percent)



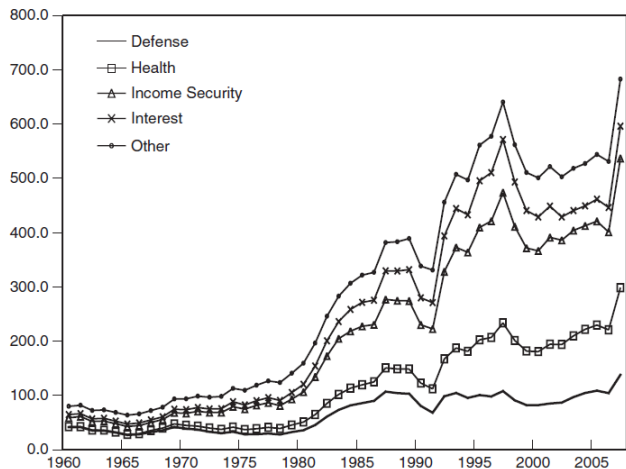
Source: Historical Statistics 2006, table Ea894-903; Statistical Abstract of the United States 2009, table 478.

The Mixed Market Economy in US

The data: expenditure breakdown

FIGURE 26.3

Real Federal Spending
by Major Category,
1960–2007 (billions of
dollars at 1950 prices)



Source: Economic Report of the President 2009, table B-90.

The Mixed Market Economy in US

Additional trends after WWII

Until about 1975:

- ① continued growth in the size of government
- ② more regulations and bureaucratic authorities: more control over the private sector
- ③ **regulatory capture**

Why these trends?

- markets are flexible but unstable
- government is stable but inflexible
- continue the **New Deal policies**
- a response to the initial success of **central planning**

Meanwhile in the Eastern Bloc

From Capitalism to Socialism to Collapse...

Intellectual origins: K. Marx – the labor theory of value → workers unite and revolt → state appropriates means of production to build socialism

The features of the planned economy:

- abolition of private ownership of resources and capital
- state control over prices
- very high investment ratios
- bias towards investment in capital goods industries
- neglect of consumer goods production
- neglect of services
- 5-year plans
- soft budget constraints

The Socialist Experiment

The data

Table 10.1 GDP per capita in the USA, Russia and Eastern Europe relative to Western Europe 1950–90. Western Europe = 1

	1950	1973	1990
USA/Western Europe	2.08	1.46	1.45
Russia/Western Europe	0.67	0.57	0.49
Eastern Europe/Western Europe	0.46	0.44	0.34

Source: Own estimates from data in A. Maddison, *Contours of the World Economy, 1–2030 AD* (Oxford University Press, 2007), p. 337.

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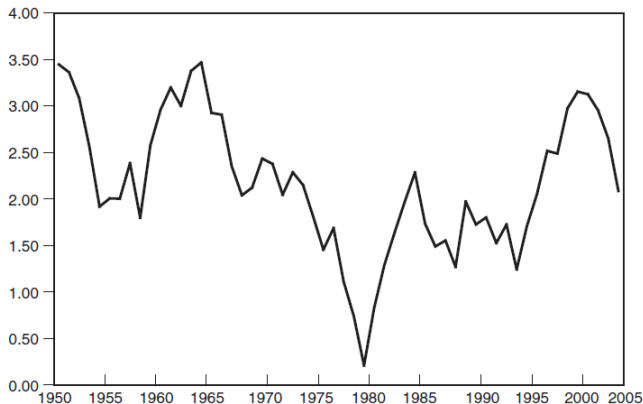
Persson, Ch.10: K. Marx argued that social systems thrive and expand only if they can develop **technologies** and sustain an increase in material welfare. The demise of the socialist experiment fits well into Karl Marx's historical explanation: it failed because it **did not deliver** technological progress and material improvements on a scale comparable with the market economies of Europe.

The Productivity Slowdown in US

The data motivates policy intervention

FIGURE 28.1

The Growth of Output per Hour in the Non-farm Business Sector: Average Annual Percent Change Per Year for the Previous Five Years, 1950–2007



Note: The growth of labor productivity slowed dramatically in the 1970s.

Source: Historical Statistics of the United States Colonial Times to 1970 1975, *Series D-684*; and Economic Report of the President, 2008, *Table B-49*.

Responses to the Productivity Slowdown

Deregulation, privatization, lower taxation: Reaganomics, Thatcherism

After about 1975:

- 1 **Deregulation**: withdrawal from directing pricing, entry, exit at industry level – airlines, trucking, railroads, finance
- 2 **Privatization**: withdrawal from state ownership
- 3 **lower taxation**: motivated by A. Laffer (the Laffer curve)

Why these trends?

- supply-side policies → efficiency
- Reagan: “Government is not the solution to our problems; government is the problem.”

Think: Is Reagan right? – regulatory capture; the prohibition

International Spread of Reaganomics and Thatcherism

The role of IMF and the World Bank

After 1990:

- imposing **Washington Consensus** reforms:
 - ① fiscal discipline and redirection of public expenditures
 - ② tax reforms
 - ③ interest- and exchange-rate liberalization
 - ④ trade and capital account liberalization, incl. FDI
 - ⑤ deregulation and privatization
 - ⑥ secure property rights

Why these trends?

- lenders imposed conditions on loans
- lack of local reform know-how
- political support for market-oriented reforms

International Spread of Reaganomics and Thatcherism

The role of IMF and the World Bank up to the Great Recession

The Doing Business Database (doingbusiness.org):

- 1 Starting a business, closing a business
- 2 Hiring and firing workers
- 3 Construction permits, getting electricity
- 4 Enforcing contracts
- 5 Registering property
- 6 Getting credit and protecting investors
- 7 Paying taxes
- 8 Trading across borders

The End of Neo-Liberalism?

Political responses to the financial crisis

- Obama: “Instead of establishing a 21st century regulatory framework, we simply dismantled the old one. In doing so, we encouraged [...] devastating dislocations in our economy.” (March, 2008)
- Merkel: “The Anglo-Saxon model of regulation has failed.” (June, 2008)
- Sarkozy: “Let us rebuild together a regulated capitalism in which [...] financial activity [is] not left to the sole judgment of market operators.” (Sept. 2008)
- Soros: “The current economic crisis has its roots in the financial deregulation of the 1980s and marks the end of a free-market model.” (Feb. 2009)
- June, 2010: Dodd-Frank Act: the biggest reform in US financial system since the Great Depression

Why these trends?

- scapegoats VS. growth needed?

The End of Neo-Liberalism?

The Nordic Model

Main features:

- welfare state
- large re-distribution
- low inequality

Reforms in the Nordic model:

- modifications of the welfare state
- deregulation
- fiscal discipline

Handout: How did Sweden reform its model to increase efficiency? Is the model transformed towards or away from more state intervention?

Reforms in the Nordic Model

The data

It can be done

1

Sweden's government spending
As % of GDP



Source: IMF

*Estimate

†Forecast

Reforms in the Nordic Model

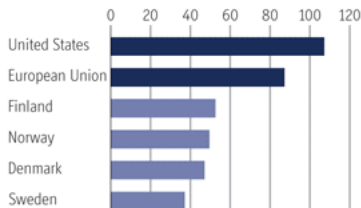
The data

	Population 2012, m	GDP per person 2012, \$'000	GDP, average annual growth rate 2002-12, %
Denmark	5.6	55.4	0.6
Finland	5.4	45.5	1.6
Norway	5.0	99.3	1.6
Sweden	9.5	54.9	2.2

All figures are estimates

Gross government debt

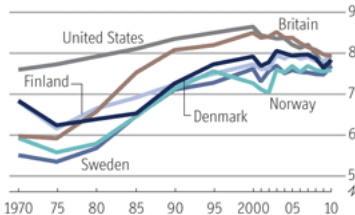
As % of GDP, 2012 estimate



Sources: IMF; national sources; Fraser Institute; OECD

Economic-freedom ratings

10=maximum

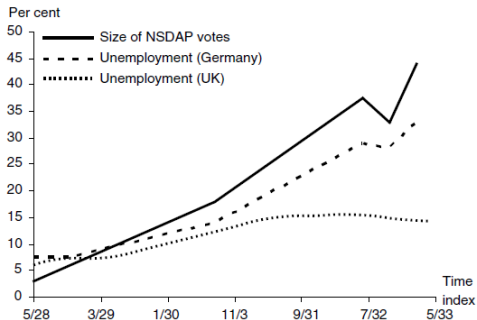


Overall trends in government intervention

Minimal state → Welfare State → Austerity

The Drawbacks of Austerity

What if there is no growth?: the rise of A.Hitler



Unemployment paves the way for Adolf Hitler. Sources: Christian Stögbauer, 'The radicalisation of the German electorate: swinging to the right and the left in the twilight of the Weimar Republic,' *European Review of Economic History* 5 (2001), pp. 251–80; B. R. Mitchell, *International Historical Statistics*, 4th edn (London: Macmillan, 2003).

- ① *** Walton, Gary M., and Hugh Rockoff, (2010): Chapter 26: The Changing Role of the Federal Government
- ② Persson, Karl, (2010): Chapter 10: The Era of Political Economy: From the Minimal State to the Welfare State in the Twentieth Century
- ③ Thornton, Mark, (1991). The Economics of Prohibition
- ④ Kroszner, Randall S., and Philip E. Strahan, (1999). What Drives Deregulation? Economics and Politics of the Relaxation of Bank Branching Restrictions, *Quarterly Journal of Economics*, Vol. 114, No. 4 (Nov., 1999), pp. 1437-1467, The MIT Press. Stable URL: <http://www.jstor.org/stable/2586968>
- ⑤ Northern Lights: *The Economist* Special Report, Feb. 2, 2013. Available here