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Introduction

At the heart of progressivism is the belief that government—not big government, or small government, but effective government—has a critical role to play in ensuring the well being of its citizens. Public spending serves an important function in pursuing economic growth objectives while ensuring that gains are widely distributed to promote broad-based increases in living standards. But governments' relative fiscal positions, how much they spend, and the composition of that spending is likely to make a difference in achieving these objectives. Spending in certain areas is more likely to contribute to growth and a wider distribution of benefits than spending in others.

Member countries of the Organization for Economic Cooperation and Development—an international organization consisting primarily of developed, free-market economies[1]—vary significantly in 1) their relative fiscal positions, or deficits and surpluses, 2) their amount of public spending, and 3) how they allocate spending across different categories to reflect priorities.

This descriptive study examines how OECD countries have addressed the current economic situation through their fiscal balance sheets, and then goes on to consider similarities and differences in public spending across OECD countries through the prism of economic and social objectives. Countries are compared according to three relative measures of government spending: spending as a share of GDP, spending per capita, and spending by category as a percentage of total government expenditure.[2]

There are several reasons countries run surpluses, although OECD countries generally run deficits, or small surpluses. Fiscal deficits can grow quickly during an economic crisis such as the current one, which poses an economic and political problem. But they are both inevitable and necessary to nurse the economy back to health. There is little disagreement that a balanced budget is desirable in the long term, however.

Of equal importance is how much a government spends, and particularly how effectively it puts the revenues it collects through taxes back into the economy. A period of economic recession transforms the calculus for fiscal balance and determines which types of expenditures are likely to help economies stabilize, recover, and grow in a way that leads to broad-based increases in living standards. But at all times, expenditures that help the economy should go beyond those that directly promote business to include social expenditures on health, education, and social protection. Done well, these social expenditures can reap significant economic rewards.

Fiscal balance

Fiscal deficits are both inevitable and appropriate during an economic downturn, but few would disagree that maintaining a balanced budget in the long run is desirable in order to avoid unsustainable debt dynamics and to ensure that future generations are not short changed.

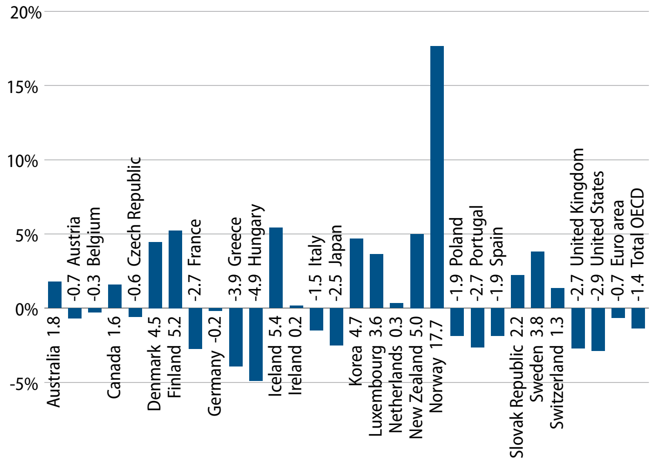
There is wide variation in debt posture among the OECD countries and their propensity to run deficits or surpluses. Countries maintain surpluses for a variety of reasons. It may be in anticipation of demographic shifts that are likely to change fiscal needs in the future as pension obligations come due and pressure is exerted on public health services. Or a country may have a depleting source of revenue from a natural resource, and use surpluses during the bountiful times to save for less bountiful periods to come. Countries also run surpluses to reduce debt levels that were built up during periods of profligacy or exceptional need. Currency exchange rate manipulation—sometimes done to prevent effective balance of payment adjustment or to gain an unfair competitive advantage over other countries—is another end that countries can achieve through running surpluses. Although there are a number of reasons to run surpluses, OECD countries generally run deficits or only small surpluses.[3]

Nine OECD countries regularly ran surpluses in their general government financial balance during the decade preceding the current global economic crisis (1998-2007):[4] Australia, Canada, Denmark, Finland, Ireland, South Korea, Luxembourg, New Zealand, and Norway. Fourteen out of 28 OECD countries[5] had a fiscal surplus in 2007: Australia, Canada, Denmark, Finland, Iceland, Ireland, South Korea, Luxembourg, Netherlands, New Zealand, Norway, Spain, Sweden, and Switzerland (Figure 1). The amount of the surplus ranged from 0.2 percent of nominal gross domestic product in Ireland to 17.7 percent of nominal GDP in Norway.

The Maastricht Treaty establishing the European Community stipulates that budget deficits should not exceed 3 percent of GDP with an escape clause

Figure 1: General government financial balances (2007)

Percent of GDP



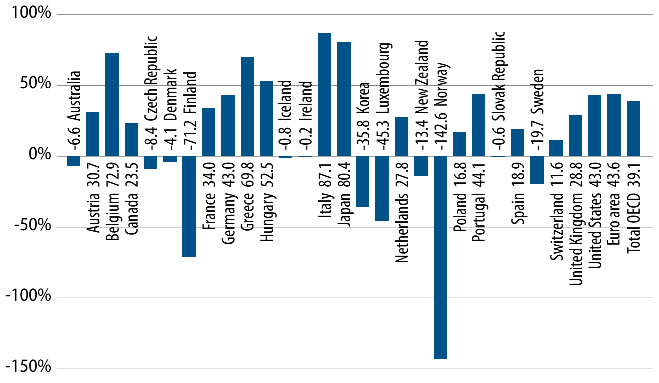
Source: OECD Economic Outlook 85 database

suggesting that the deficit can be higher under exceptional and temporary circumstances, but should still stay close to the reference value. Greece and Hungary were the only European Union and OECD member states in 2007 that ran deficits larger than the 3 percent reference value; their deficits were 3.9 and 4.9 percent of nominal GDP respectively.

Large and sustained deficits pose an economic and political challenge. A big deficit can reduce national savings and domestic investment, lower future incomes, and lead to high interest rates and inflation that are damaging to the economy and residents. It can also affect exchange rates. The threat of these developments in large economies can also precipitate a financial crisis as trading partners, investors, and consumers take actions to minimize their risks that collectively freeze the system. The large levels of debt begat by deficits mean that a country has less flexibility in time of crisis. High debt levels also mean large debt-servicing costs, which limit a government's ability to make needed investments (Figure 2).

Figure 2: General government net financial liabilities (2007)

Percent nominal of GDP



Source: OECD Economic Outlook 85 database

Significant deficits are also a political problem. Balancing a seriously out-of-balance budget is typically an excruciating political experience that generally entails unpopular spending cuts and tax increases.

Deficits in the Great Recession

Deficits in one country at a time of economic crisis—and in an era of increased global interconnectedness—have ripple effects in others, making fiscal choices a matter of more than domestic concern. This has been seen during the recent crisis. The economic and financial collapse created massive wealth loss and severe employment declines, which caused consumers to retrench, businesses to cut investments, and the downward spiral of a global recession to take hold.

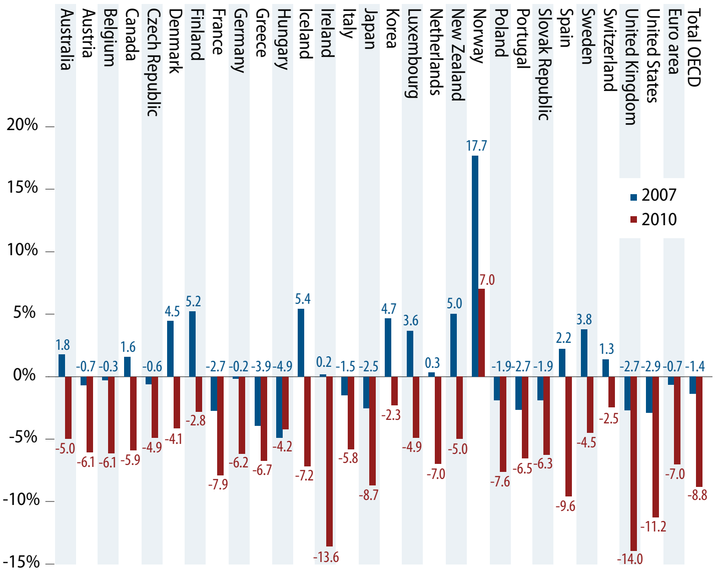
Countries addressed these challenges by allowing their fiscal deficits to grow; they replaced private consumption with public consumption with the goals of creating jobs, restoring confidence, and jumpstarting economic growth. Such measures in any nation help to stimulate the other countries' economies as added consumption—both by government and that induced in the private sector—draws imports across borders. This linkage underpinned the push for coordinated fiscal stimulus packages in countries that could afford them. There was an active debate on whether countries were doing less than they could afford to do to boost the global economy or doing too much—risking destabilization through excessive deficits.

Many countries enacted significant stimulus packages, watched their automatic stabilizers such as unemployment benefits kick in, and allowed substantial fiscal deficits to build in response to domestic and, partly, international pressure. The enactment of these packages is one illustration of how the interdependence in the effects of countries' fiscal policies can influence the composition of public expenditure. The use of this deficit spending varied by country. In each case there was a different balancing of addressing the hardships that the recession was imposing on individuals, boosting demand quickly, inducing private investment, and making public investments that would serve the country over a longer stretch of time. Most countries ran larger deficits in the end than fiscal conservatives felt comfortable with, and spent less than many believed was needed to truly get the world economy back on track. The amount of stimulus spending has fallen far short of the amount of consumer expenditures and business investments that have been lost.

The OECD's 2010 projections show that all of the OECD countries that are also members of the European Union will run deficits, most well above the 3 percent reference value. The only exception is Finland, which is expected to run a 2.8 percent of GDP deficit. Of all OECD countries for which there is data, Norway alone is projected to still have a surplus of 7 percent of nominal GDP in 2010 as it continues to stock away the returns from its rich natural resources. The United Kingdom is projected to have the biggest budget deficit in 2010 at 14.0 percent of nominal GDP; Ireland is expected to be at 13.6 percent and the United States is projected at 11.2 percent (Figure 3).

Figure 3: General government financial balances (2007 and 2010)

Percent of GDP



Source: OECD Economic Outlook 85 database

Amount of public spending

Examining variations in the size of the public budget as a share of GDP across countries sheds some light on differences in the expectations that citizens of different countries have in terms of the role that democratically elected governments should play in their society and economy. A new set of factors now come into play as globalization and economic integration introduce greater competitive pressures, and trade agreements limit the mechanisms by which a country can preference domestic industries. In addition to such legal limits, the relatively free movement of capital and goods at a time when the movement of labor is still limited puts pressure on countries to compete for jobs. Countries then tend to become more competitive by limiting their regulation of corporate activity and levels of taxation—hence spending levels.

On the other hand, countries may be inclined to devote more resources to expenditures that are most clearly associated with gaining competitive advantage—such as technological research and education.[6] The restructuring of economic activity resulting from globalization may also create greater demand for social welfare expenditure such as adjustment assistance and unemployment benefits,[7] especially in the context of internal debates over trade, in order to maintain or lift living standards. Changing demographics, especially an aging population, also put pressure on countries to increase spending levels.

There is longstanding debate over the optimal level of government involvement in a country's economy, and this is unlikely to be resolved any time soon. Yet the most recent financial and economic crisis, as well as growing inequality and economic stagnation in many parts of the world, suggest the pendulum has swung too far in the direction of laissez faire in many countries. There is now a growing respect for the importance of the government's role in producing economic growth and positive social outcomes.[8]

The level of public spending as a share of GDP reflects underlying expectations about the role that government plays in a country's society and economy. Total public spending as a share of GDP varies significantly across OECD countries. South Korea is at the low end with public spending at 27.3 percent of GDP, while Sweden is on the high end with

Table 1: Total public spending as a share of GDP (2004-2007 average)

Low (Below 40%)		Medium (41-49%)		High (50% and above)	
South Korea	27.3%	Luxembourg	40.0%	Hungary	50.2%
Ireland	34.2%	Norway	42.2%	Austria	50.5%
U.S.	36.7%	Poland	42.9%	Denmark	52.5%
Slovak Republic	36.9%	Iceland**	43.1%	France	52.9%
Japan	36.9%	OECD Avg.	43.6%	Sweden	54.4%
Spain	38.7%	Greece	43.6%		
New Zealand	38.9%	U.K.	43.9%		
Canada*	39.9%	Czech Republic	44.1%		
		Netherlands	45.5%		
		Germany	45.8%		
		Portugal	46.5%		
		Italy	48.1%		
		Finland	49.1%		
		Belgium	49.6%		

*Canada: 2004 **Iceland: 2004-2006 average Source: OECD

54.4 percent public spending as a share of GDP. Table 1 places the OECD countries for which there is data into three categories based on their average total public spending as a share of GDP for 2004-2007: low, medium, and high levels of public spending.

All of the countries in the high spending category have chosen to devote a relatively large share of their national income to public purposes. This reflects a desire for a larger government role in society and the economy. Countries in the low spending category—namely South Korea, the United States, Japan, and Canada—tend more toward leaving the private sector to itself with less government intervention.

Spending as share of GDP is a good measure of what a country spends relative to what it can afford and of the role government plays in the country's economic life. Another way to look at spending is per person. This can be a rough measure of the services a country delivers to its population, although the per-capita measurement is not optimal for quantifying actual services delivered due to the imperfections of comparing costs between countries. Spending per person is also, as a simple matter of arithmetic, related to GDP per capita. Most countries rankings are similar by both measures, but the exceptions are those that have particularly high or low per-capita GDP, as in the cases of Luxembourg and Hungary (Table 2).

Table 2: OECD countries ranked according to their total spending as a share of GDP, in terms of per-capita GDP

	Share of GDP	Per-capita
Austria	4	5
Belgium	6	8
Canada	19	16
Czech Republic	12	22
Denmark	3	4
Finland	7	10
France	2	6
Germany	10	13
Greece	14	18
Hungary	5	23
Iceland	15	11
Ireland	25	14
Italy	8	15
Japan	22	17
South Korea	26	26
Luxembourg	18	1
Netherlands	11	7
New Zealand	20	21
Norway	17	2
Poland	16	25
Portugal	9	20
Slovak Republic	23	24
Spain	21	19
Sweden	1	3
U.K.	13	12
U.S.	24	9

Source: OECD

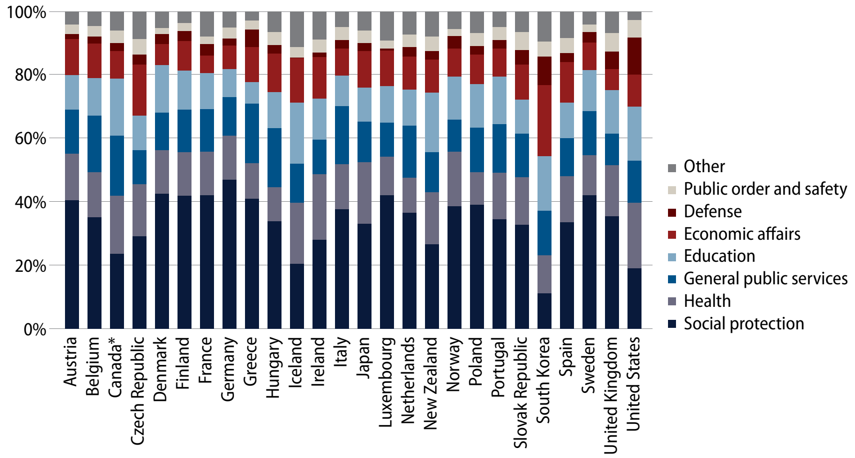
Allocation of public spending and government priorities

National budgets are a way to allocate financial resources to achieving human purposes. Looking at spending as a share of the total budget provides an indication of how countries prioritize certain purposes or functions over others. There is also a significant literature that examines how the composition of government spending is associated with economic growth and promoting broad-based increases in living standards. Government expenditures on certain functions are theoretically more likely than others to contribute to economic growth and broader distribution of benefits.[9] Expenditures that help the economy do, of course, extend beyond those that directly promote business. Done well, social expenditures on health, education, and social protection can reap economic rewards.

The OECD provides a breakdown of government expenditure according to purpose. Economic flows of expenditure are aggregated into 10 categories according to the Classification of the Functions of Government, or COFOG: social protection; health; defense; public order and safety; economic affairs; environmental protection;[10] housing and community amenities; general public services; recreation, culture, and religion; and education. These categories include spending on a variety of government functions. But COFOG allows for a general classification of spending on a variety of functions that is presented in different ways in the budgets of different national and subnational entities, which means that comparisons of categories should be understood to be generalizations.

Figure 4: Government spending as a share of total budget

Percent of budget



Source: OECD Economic Outlook 85 database

There is a fair degree of variation in what countries prioritize, as Figure 4 shows. Large categories tend to be large for every country and small categories small for every country, but there is still a great range. Germany is at the upper end, spending 47 percent of its government spending on social protection; Denmark spends about 43 percent; and Sweden, France, Luxembourg, and Finland spend 42 percent. South Korea is at the other end of the scale, spending about 11 percent, with the United States above it at 19 percent, Iceland at 21 percent, and Canada at 24 percent. And social protection is a category with less variation between countries in spending as a share of GDP than the other nine categories.

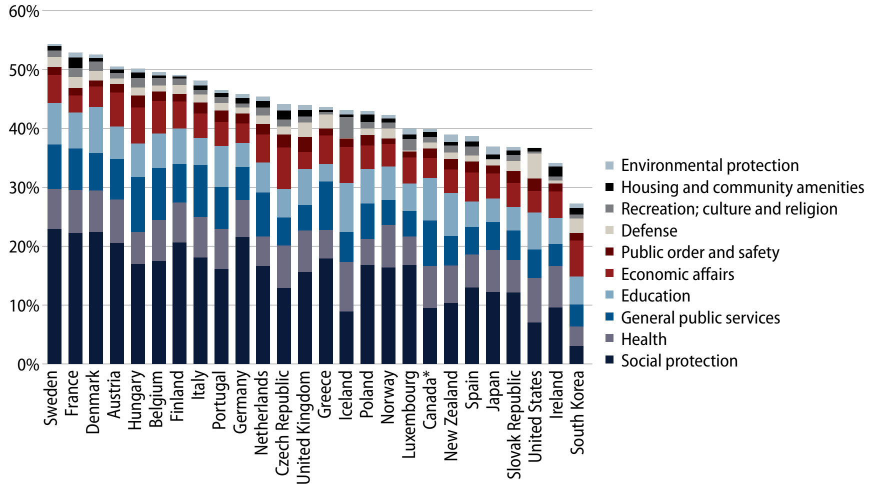
The greatest range is, not surprisingly, in defense spending. The United States tops the list, putting about 12 percent of government spending toward the military. South Korea is the next highest at 9 percent, and the United Kingdom and Greece are at 6 percent. Iceland and Luxembourg are at the other extreme, spending less than 1 percent, and Ireland, Austria, Belgium, and Germany spend about 2 percent.

There is little in the way of strong patterns—high spending in one category is not necessarily predictive of low spending in another particular category, beyond isolated correlations. For example, the United States and South Korea have high defense spending and low social protection spending, but the U.K. and Greece are relatively high in both—making up for defense spending in other categories.

Spending on social protection is one way of gauging the level of government intervention in the economy—at least with respect to a commitment to ameliorating distributional inequities and protecting residents from the risks of the marketplace. Social protection consists of "all income transfers (or benefits) in kind and in cash that a society affords to its individual members in order to: avoid or alleviate poverty; or assist them in coping with a series of life contingencies or risks which, if they occurred might otherwise lead to a loss of income … or reduce or correct inequalities created through the primary (pre-transfer) income distribution."[11]

There is a closer relationship to spending on social protection and the overall level of spending than in other categories. That is, a country with generally high spending as a share of GDP is very likely to have relatively high spending on social protection. The exception is Hungary, which is in transition after four decades of Communist rule—all of the other countries in the high category in Table 2 rank within the top 8 out of 26 in terms of spending on social protection as a share of total budget (averaged between 2004-2007).

Figure 5: Government spending as a percent of GDP (average 2004-2007)



Source: OECD Economic Outlook 85 database

All OECD countries for which there are data spend the highest share of their total budget on social protection, with the exceptions of South Korea and the United States. South Korea spends the highest share of its total budget on economic affairs, and the United States spends the highest share of its budget on health. South Korea and the United States spend the least on social protection as compared to other OECD nations (Figure 5).

The data show that, generally speaking, spending more on social protection does not appear to come at the expense of spending less on other functions. Rather, countries that prioritize these social expenditures tend to raise more revenue to pay for social protection.

The harshest critics of social protection attack its efficacy, arguing that it hampers dynamic growth because it often costs more than it yields and is therefore unsustainable, or because it hinders flexibility and therefore economic productivity. Critics also say that social protection undermines work incentives or otherwise suffers from moral hazards that render it counterproductive. Yet social protection can also be seen as a necessary investment that fosters productivity through consumption smoothing, and if governed appropriately, can behave as a productive factor by bringing more people back within the economic mainstream who would otherwise be marginalized.[12]

Economists have also shown that "a bigger tax bite to finance social spending does not correlate negatively with either the level or the growth of GDP per capita."[13] There are sound reasons why countries that devote a third of their national product have not necessarily grown more slowly than countries that devote only a seventh of their GDP to social transfers. Social protection funds become assets to the economy to the extent that social protection funds are well spent to bring people into the economic mainstream.

It should be noted that money collected in taxes to pay for social protection does not disappear from the economy. Social spending expenditures have multiplier effects just as the funds extracted through taxes do. The net economic impact depends on what those factors are: the nature of the taxes used to fund social protection and the way those social protection funds are spent—either as investments in human capital or funding consumption that re-enters the economy. It is therefore possible to design a system that is in equilibrium, where the costs and benefits are in balance such that the system is sustainable and of benefit to all.

Health spending is the next highest spending priority after social protection among OECD countries. A well-run health system can facilitate greater efficiency and production. Ready access to health care has benefits in terms of preventing individuals from becoming sick and therefore unproductive. Health care is both an important and a large share of national economies; it is therefore an area where inefficiencies can be a very costly drain on the economy. Wise investments in health care can conversely serve as a direct means of making an economy more efficient.

Spending on health as a share of total budget is in the top three priorities for all countries except in Hungary where it ranks fifth, and in Korea, the Netherlands, Poland, Portugal, and Sweden where it ranks fourth. Ireland and the United States dedicate 21 percent of their spending to health, and in Japan and Iceland it is 19 percent. Poland is at the other extreme, spending only 10 percent of their budget on health, and Hungary, Greece, and the Netherlands spend 11 percent.

Education is the third highest priority for OECD countries. Longer-term investment in education and human capital plays an important role in maximizing productivity. Wealthy countries tend to invest high shares of their GDP on building human capital.[14] This allows for greater innovation and specialization in higher value added activities. Investments in education and training have multiplier affects that contribute to further innovation and growth. Education is in the top five priorities for every country. It ranks second in Denmark, Iceland, South Korea, and New Zealand; third in Ireland, Luxembourg, Netherlands, Norway, Poland, Portugal, Sweden, the U.K., and the United States; and fourth or fifth in the remaining countries. Iceland and New Zealand dedicate about 19 percent of their spending to education, more than any of the other countries; Canada puts 18 percent of its budget toward education; and South Korea and the United States dedicate 17 percent of their budgets to it. Greece is at the low end, giving 7 percent of its budget to education, while Germany spends 9 percent, Italy spends 10 percent, and eight countries spend about 11 percent.

There is a similar range of prioritization in the rest of the categories, and there are social and economic implications for each. Of course, much depends on how the funds are spent within all of these categories—both in the sense of how money is allocated and whether the programs themselves are efficient or wasteful. There is substantial difference, for example, in a defense budget that is primarily used to pay military personnel who make important contributions but whose service does not directly help the economy, and a defense budget that is focuses on creating demand for domestically produced technology that can spur investment that is of great economic value. And if a country's military procurement system is poorly designed, it will likely waste funds, even if the budget looks on paper like it should be helpful to the nation's economic well-being.

Differences in spending levels can also reflect differences in need rather than differences in priorities. South Korea, which borders on a hostile and unstable neighbor, has different defense needs than the island of Iceland. Spending on "public order and safety" may likewise reflect societal differences that are extremely complex and have a long history. High spending in this area may reflect poor public decisions in the past—shortchanging education or social protection, for example—but now could be a matter of need, not a particular bias to put "more cops on the beat."

Conclusion

Public spending plays a key role in the pursuit of economic growth and in ensuring that gains are widely distributed to promote broad-based increases in living standards. In order to effectively achieve these objectives, governments must maintain fiscal balance in the long-run, but also effectively put the revenue it collects through taxes back into the economy. The contribution that public expenditures make to economic growth depends on how those funds are spent and whether they are spent efficiently.

A period of economic recession also changes the calculus for fiscal balance and determines which types of expenditures are likely to yield the biggest bang for the buck. Job creation and helping those who have been hurt by the economic downturn are top priorities in times like these. Using deficit spending to make investments that spur long-term growth is possibly not optimal for generating economic stimulus, but it does help boost the economy in the short term and pays off in the long run. Fiscal stimulus is essentially borrowing from the future to nurse the present economy back to heath, and that longer-run payoff may be very welcome when the debts come due.

Endnotes

1 Australia, Mexico, Switzerland, and Turkey are included due to a lack of data.

2 Based on the Classification of the Functions of Government (COFOG)

3 Robert Price and others, "Strategies for Countries with Favourable Fiscal Positions." Working Paper 655 (Organisation for Economic Co-operation and Development, 2008).

4 Australia had a small deficit of 0.1 percent of nominal GDP in 2001; Canada had a small deficit of 0.1 percent of nominal GDP in 2002 and 2003; Denmark had a small deficit of 0.1 percent of nominal GDP in 2003; Ireland had a small deficit of 0.3 percent of nominal GDP in 2002; Luxembourg had a deficit of 1.1 percent of GDP in 2004.

5 General government financial balances were not available for Mexico and Turkey in the OECD Economic Outlook 85 database.

6 Ismael Sanz, and Francisco Velazquez, "The Evolution and Convergence of the Government Expenditure Composition in the OECD Countries," *Public Choice* 119 (2004): 61-72

7 Dani Rodrik, "Why Do More Open Economies Have Bigger Governments?" *Journal of Political Economy 106 (5)(1998): 997-1032*

8 World Commission on the Social Dimension of Globalization, *A Fair Globalization: Creating Opportunities for All* (Geneva: ILO Publications, 1998)

9 Been-Lon Chen, "Economic Growth with an Optimal Public Spending Composition," *Oxford Economic Papers* 58 (1) (2006):123-136; Oliviero Antonio Carboni and Giuseppe Medda, "Government Size and the Composition of Public Spending in a Neoclassical Growth Model," Working Paper 200701 (Centre for North South Economic Research, University of Cagliari and Sassari, 2007)

10 The accounts of the United States are made according to the NIPA accounting system, which has just 9 branches. The OECD accounts follow SNA 93 which takes into account the division by COFOG, that is to say in 10 branches. The different branch is 'Environment protection'. Since this branch is not isolated, the United States cannot supply the OECD with specific data. The amounts are in fact for the most part spread out across the *housing and community services* function and *economic affairs functions*.

11 Michael Cichon and others, *Financing Social Protection* (Geneva: ILO Publications, 1999): 1

12 "Social Protection as a productive factor: Governing Body Document GB.29/ESP/4" (Geneva: ILO, 2005):.

13 Peter Lindert, "Why the Welfare State Looks Like a Free Lunch," Working Paper 02-7(University of California, Davis - Department of Economics and National Bureau of Economic Research, 2002)

14 "Social Protection as a productive factor: Governing Body Document GB.29/ESP/4" (Geneva: ILO, 2005): 3

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