

The Size and Quality of the Public Sector



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Size of the Public Sector

- Defining the responsibilities of the public sector (further role specification)
- Measuring the size of the public sector
 - Inclusions and exclusions
 - Misreading and misleading
- Examples from East Timor, Singapore, and the USA + international comparisons

Public Sector as Leader or Enabler

The Public Sector as Leader (“Row Boat”)

- Dominant position in the economy
- Principal agent of development
- Lead in development planning and implementation

The Public Sector as Enabler (“Steer Boat”)

- Catalyst in economic development
 - Facilitate and complement economic development initiatives of private & non-profit sectors
- Stylized distinction: matter of degree, proper mix; varies by place and time, country context and point in history
- Avoid unintended consequences: do no harm

Measurement Issues

Government Expenditure / GDP:

- On-budget vs. off-budget
 - State-owned enterprises
 - Central bank quasi-fiscal operations
 - Special funds
 - Contingent liabilities
 - Tax expenditures
- Central government vs. subnational government
 - State and local government
 - Sanctioned and unsanctioned
 - Transfers and double-counting
- International comparisons
 - Over time and across countries
 - Definitions and footnotes

Measurement Tricks

Decrease Expenditures

- Tax expenditures (exemptions, credits, deductions) vs. subsidies for individuals, households, and businesses
- Tax expenditures (exemption of interest on state and local bonds, deductibility of state and local taxes) vs. direct transfers to state and local governments

Increase Revenue

- Record receipts when state assets sold, but not cost of asset reduction
- Raise level of tax withholding

Shrink Overall Size of Public Sector

- Move off-budget (see previous slide)

Measurement Cases

East Timor: FY 2001

- International norms? → 20-30%
- Indonesian rule? → 68%
- Current/anticipated expenditures? → 45%

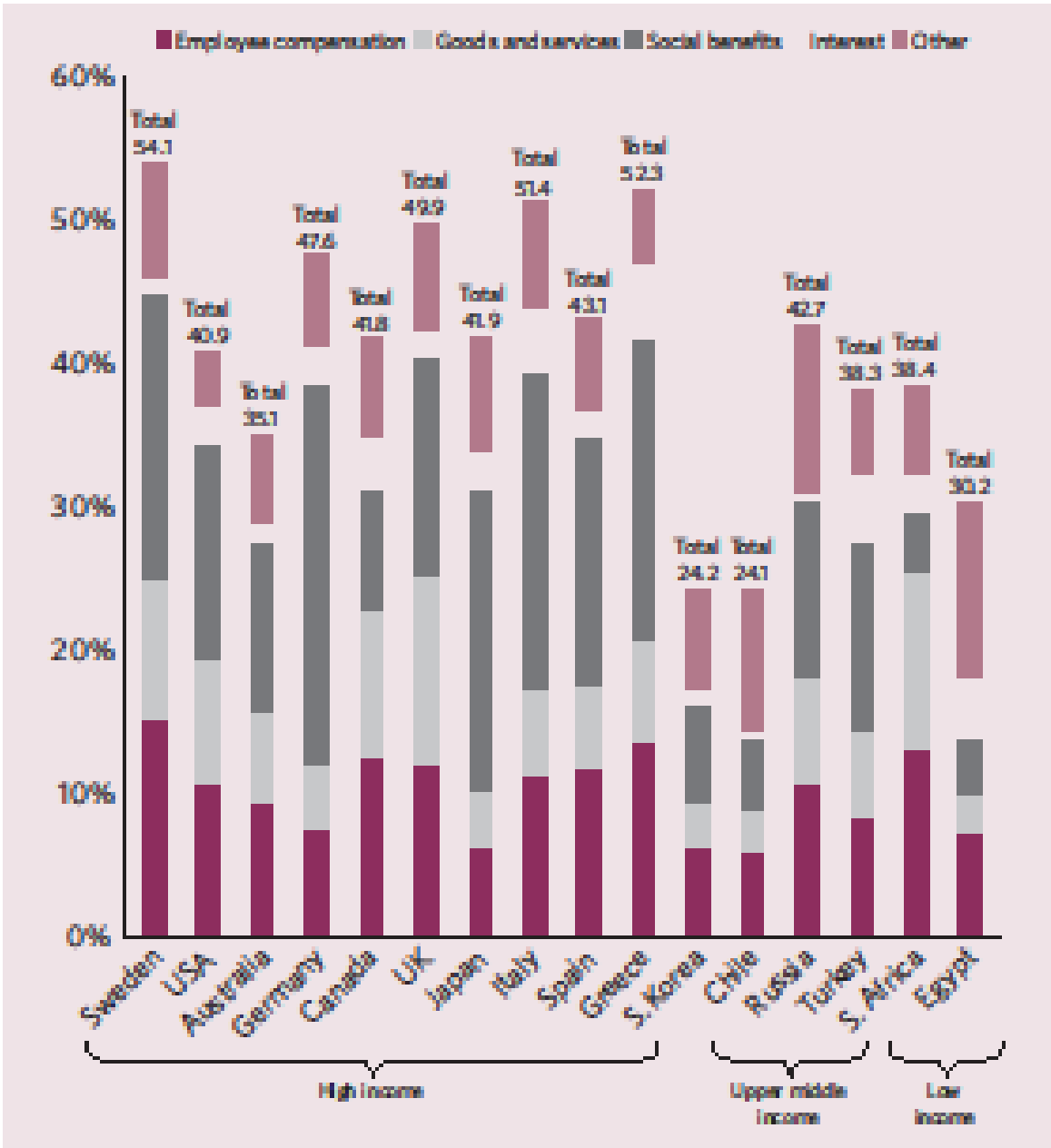
Singapore: FY 1998

- Tax Revenue/GDP? → 16-18%
- Total Revenue/GDP? → 43%

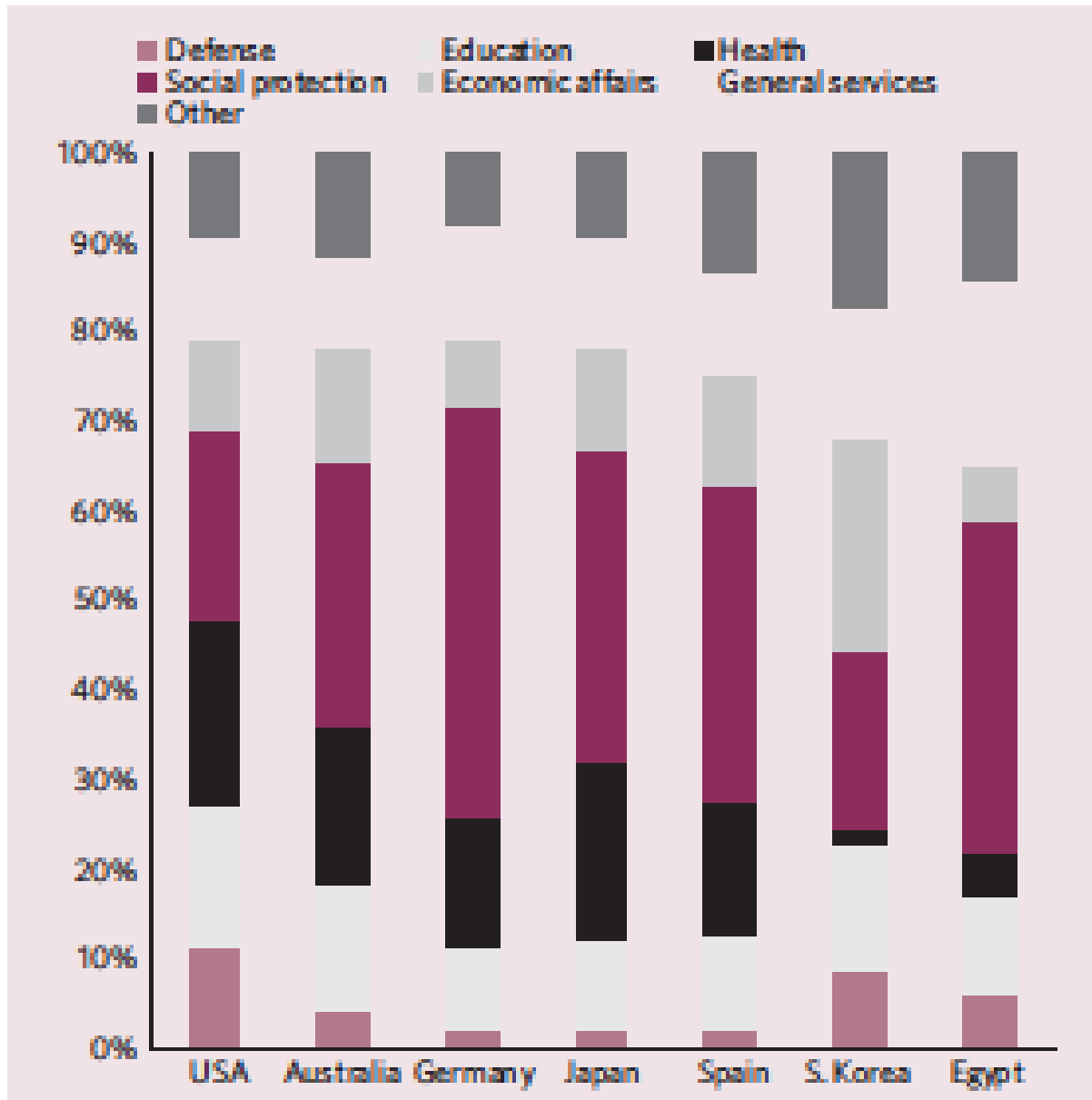
United States: FY 2017

- Tax Revenue/GDP? → 21.2% (federal) + 11.1% (S&L) = 32.3%
- Tax Expenditures/GDP → 7.8%

Government Expenditures as a Percentage of GDP in 2009



Composition of Government Expenditures in 2009



Quality of the Public Sector: Government Failure



Cycle of Despair

- Market Failures →
Government Interventions
- Government Interventions →
Government Failures →
Government Disengagement
- Government Disengagement →
Unmitigated Market Failures

Government Failures

→ *See Chapter 8 in Stiglitz and Rosengard*

- Limited Information
 - Planning, Implementation, Evaluation
 - Normative and Positive Policy Analysis (next slide)
- Limited Control Over Private Market
 - Firm and Household Behavior
 - Production/Provision vs. Consumption/Utilization
 - Time Lag in Implementation
- Limited Control Over Bureaucracy
 - Legislative vs. Executive
 - Politicians vs. Bureaucrats
 - Ambiguities of Intent
 - Division of Responsibilities
- Limitations Imposed By Political Process
 - Special Interest Groups
 - Information Failures
 - Time Frame

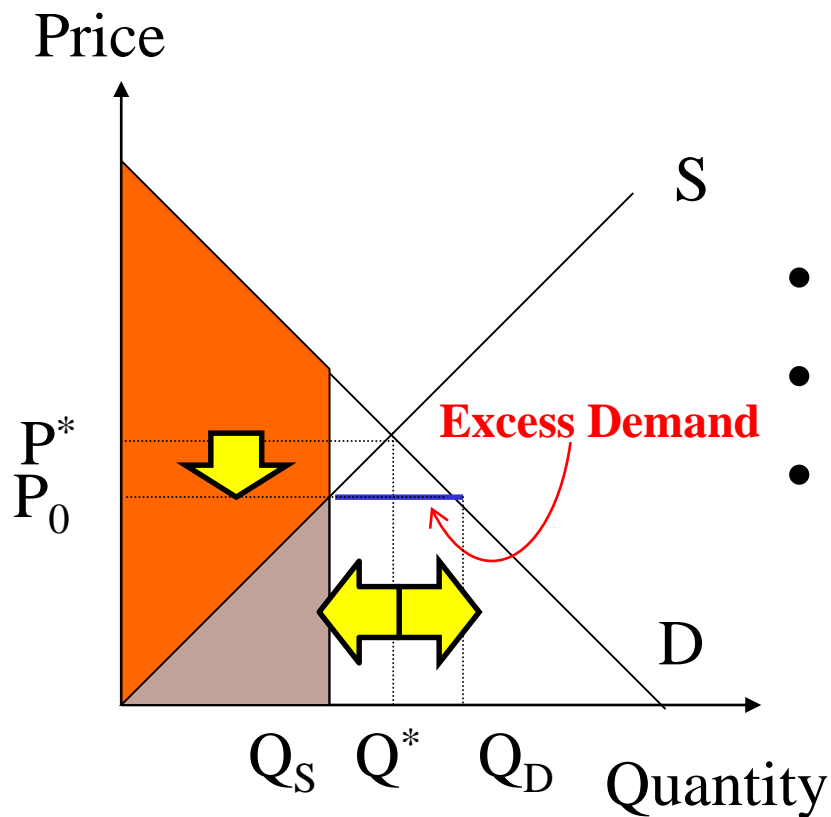
Positive vs. Normative Economics

- **Positive Economics:** “Everyone is entitled to his own opinion, but not his own facts.” Daniel Patrick Moynihan
 - Descriptive (What Is & What Will Be)
 - Portrait of Current Economy
 - Prediction of Anticipated Effects
 - Modeling and Simulation
- **Normative Economics:** “Every judgement of conscience, be it right or wrong, be it about things evil in themselves or morally indifferent, is obligatory, in such wise that he who acts against his conscience always sins.” Thomas Aquinas
 - Judgmental (What Should Be)
 - Evaluate Policy Alternatives
 - Based on Objectives, Values, Tradeoffs Between Winners and Losers
 - Utilizes Positive Economics

Government Constraints

- Organizational differences between public & private sectors
 - Soft budget constraints
 - Political concerns
 - Limited competition
 - Additional restrictions on personnel, procurement, and budgeting
- Individual differences between public & private sector employees
 - Weaker “carrots” and “sticks”
 - Principal-agent problems
 - Bureaucratic size/expenditure maximization
 - Risk aversion/red tape

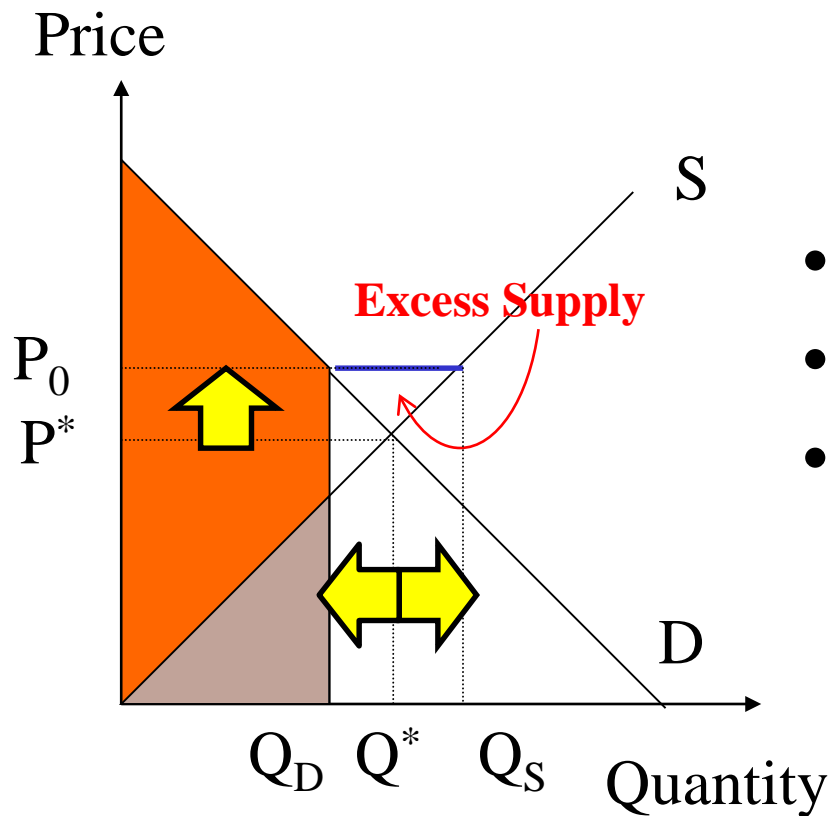
Market Disequilibrium: Price Ceilings → Excess Demand



When the actual price is less than the competitive market price it is inefficient, as it:

- Increases demand
- Reduces supply
- Creates excess demand due to changes in demand and supply from the market output at equilibrium (Q_d & Q_s at P_0 vs. Q^* at P^*)

Market Disequilibrium: Price Floors \rightarrow Excess Supply



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(Q_s & Q_d at P_0 vs. Q^* at P^*)