ECONOMIC NOTE

Montreal Economic Institute

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The Scope of Government and the Wealth of Quebecers

This report will examine the growth of Canadian government over the last few decades and provide some empirical estimates of the cost of this government expansion on the lives of Canadians generally and Quebecers in particular.

Like many medicines, a small dose of government may lead to a healthy and vigorous society, but it can be a dangerous poison if taken in too large a dose. A large government, though useful in many respects, deprives the private sector of resources needed for the creation of wealth. This report attempts to summarize the trade-off that exists between government and private sector wealth creation.

The Size of Government

Figure 1 shows the total size of government in Canada and the United States—that is, spending by all levels of government (national, provincial/state, and local) on all government services including transfers—by decade since 1960. Canada's government in 1960 accounted for 28.6% of gross domestic pro-duct (GDP), approximately the same as the United States. But by 1996, it had grown to 46.4% of GDP, considerably higher than the United States' level of 34.6%.

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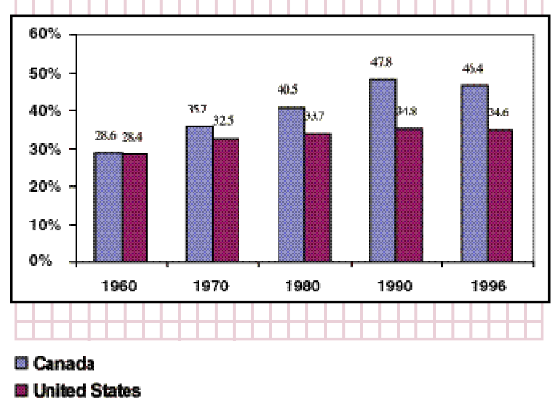
Figure 1

Total Size of Government in Canada and the U.S. by Decade as Percentage of GDP



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Likewise, per capita income in the two countries was comparable in 1960. Real per capita income in the U.S. was C$14,442 compared with C$12,593 in Canada—a difference of just 8.1%. But by 1998, real per capita income in the U.S. was C$45,171, 54.5% higher than Canada's C$28,425. Alternatively, between 1960 and 1998, per capita income in the U.S.increased by 222% whereas in Canada it increased by just 126%. [1]

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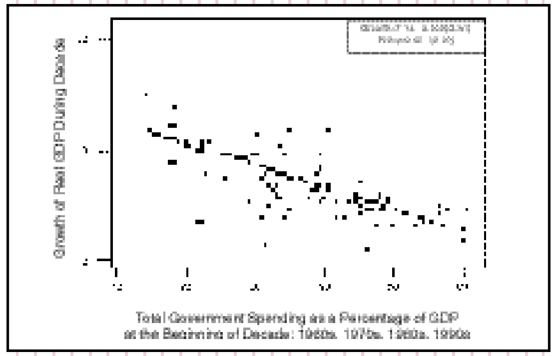
Figure 2

Higher Government Spending Reduces Economic Groth Among OECD Countries



The Trade-off Between Government and Economic Growth

Figure 2 examines the relationship between the size of government and economic growth using data since 1960 from the highly developed nations of the Organization for Economic Cooperation and Development (OECD). The size of government at the beginning of each decade is measured on the x-axis, while the growth of real GDP during the decade is recorded on the y-axis. So there are four dots for each of the 23 OECD members—one for each of the four decades—for a total of 92 dots.

The slope of the regression line indicates that for every 10 percentage point increase in the size of government relative to GDP, there is a reduction in economic growth of 1 percentage point per annum. While such a relationship may appear small, over time even small reductions in economic growth rates can exert large impacts on the level of income. [2]

Comparing the Experience of Canada and the United States

The size of government in both Canada and the United States has grown since 1960, but the growth has been much larger in Canada. Based on the results above, we can estimate approximately how much lower the economic growth of both Canada and the United States has been as a result of government growth since 1960. [3]

For every 10 percentage point increase in the size of government relative to GDP, there is a reduction in economic growth of 1 percentage point per annum.

The size of government in the United States has grown to 34.6% from 28.4% of GDP over the last four decades. This represents the smallest increase in government size among the OECD nations. As a result, the United States has paid only a relatively small price for its growing government. Based on the regression model above, it is estimated that per capita income in the United States would have been C$8,185 higher in 1998 had the government of the United States remained at its 1960 level. [4]

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[1] All figures are in real 1998 Canadian dollars. The exchange rate was used to convert U.S.dollar figures to Canadian dollars. Source: World Bank, *World Development Indicators on CD-ROM:2000* (Washington,DC:The World Bank),2000.

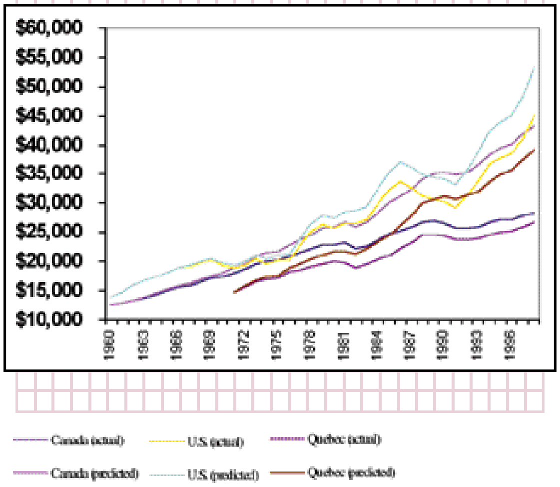
[2] These numbers are derived from the study by James Gwartney, Randall Holcombe, and Robert Lawson, "The Scope of Government and the Wealth of Nations," *Cato Journal* 18(2),(1998):163-190 which was translated into French by the Montreal Economic Institute as *Taille de l'État et richesse des nations*, (2000). More sophisticated econometric analysis can be found in the original study, but the results are quantitatively similar.

[3] The data set used in the original study reported government size data only for 1960,1970,1980,1990,and 1996. The data in this report use straight-line estimates for the intervening years and for 1997 and 1998.

[4] This estimate differs somewhat from the US$5,860 (C$8,693) estimate in the original study. The methodology for this calculation was refined to reflect the actual path of government growth between 1960 and 1998, whereas the original calculations only relied on the endpoints.

Figure 3

Actual and Estimated Per Capita GDP for the U.S., Canada and Quebec



The effect in Canada can be expected to be much larger however because Canada's government has grown so much more than that of the United States.Using the same methodology as above,it is estimated that had the government of Canada stayed at its 1960 level of 28.6%, real GDP in 1998 would have been 53.0% higher, an estimated C$1,318 billion instead of an actual C$861 billion.

Looking at it another way, the per capita income of Canadians would have been C$15,065 larger (C$60,259 for a family of four) had Canada's government not grown beyond 1960 levels.

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In total, the average growth rate during the 1960-1998 period is estimated to have been reduced from 4.77% to 3.61%. That slightly more than one percentage point reduction in growth has, over time, led to a tremendous reduction in Canadian income.

The Effect of Government Growth on Quebec

Data on the Gross Provincial Product (GPP) for Quebec were available only since 1971. But it is possible, using the same methodology, to estimate the reduction in economic growth (and hence income) in Quebec using 1971 as a base year.The reduction in income is likely to be less pronounced than in the case for Canada at large though, because the phenomenon described will have had eleven fewer years in which to make an impact.

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Moreover, this methodology does not specifically take into account the size of the provincial government of Quebec but rather applies to Quebec the overall data for all governments in Canada.Since the government in Quebec is comparatively bigger than the Canadian average,and in particular bigger than the Alberta and Ontario governments,it is very likely that this calculation underestimates the real negative impact on income.

It is estimated that if the overall size of government in Canada had stayed at its 1971 level of approximately 36%, then Quebec's GPP would have been 46.4% higher than was actually the case in 1998. Instead of being C$26,746, per capita income would thus have been C$39,158 — the equivalent of C$12,412 for each and every man, woman and child living in Quebec,or C$49,648 for a family of four.

Figure 3 shows the actual and estimated per capita GDP for the United States and Canada since 1960 had their respective governments remained at their 1960 levels. Figure 3 also illustrates the actual and estimated per capita GPP for Quebec since 1971 had Canada's government remained at its 1971 level.

Conclusions

The report estimates that the Canadian GDP in 1998 would have been over 50% higher had the Canadian government not grown beyond its 1960 level—the equivalent of over C$15,000 per Canadian citizen.

It is estimated that had the Canadian government not grown beyond 1971 levels, Quebecers on average would be over C$12,412 richer each year, or C$49,648 for a family of four.

The different experiences of Canada and the United States since 1960 nicely illustrate the cost of government growth. While both paid a price for growing government,Canada has paid a much higher price. At the beginning of the period, Americans were on average just 8.1% richer than Canadians, but by 1998 they were 54.5% richer. Had both nations held the line at 1960 levels of government,it is estimated that the spread between the two nations would be just 19% today.

Qualitatively similar results are found for Quebec.But because of data limitations, the methodology used 1971 as a base year instead of 1960. Even so, it is estimated that had the Canadian government not grown beyond 1971 levels, Quebecers on average would be over C$12,412 richer each year, or C$49,648 for a family of four.

NOTE:An appendix with detailed data for each of the three jurisdictions is available on our web site at www.iedm.org.

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