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World Politics, Vol. 33, No. 3 (Apr., 1981), 413-435.

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Research Note

PUBLIC REACTIONS TO THE GROWTH OF TAXATION AND GOVERNMENT EXPENDITURE

By DOUGLAS A. HIBBS, Jr. and HENRIK JESS MADSEN*

I. RECENT DEVELOPMENTS IN THE POLITICAL ECONOMY OF THE WELFARE STATE¹

ALTHOUGH “welfare-state backlash” is difficult to measure quantitatively,² and hence not easy to compare on an international or intertemporal basis, there is little doubt that public resistance to the growth of taxation and state expenditure has increased in many Western industrial societies during the last decade. This resistance has been expressed in several ways.

One such way is reflected in the recent bargaining behavior of trade unions. In Great Britain, for example, there is evidence that, when wage inflation pushed blue-collar workers into high direct-tax brackets in the mid-1960s, real net-of-tax market wages stagnated.³ Jackson, Turner, and Wilkinson argue that, as a result, the trade unions militantly pursued even higher money wage settlements which in turn led to a sharp increase in the British strike rate. In other words, increases in the rate of personal taxation brought on by the inflation of nominal wage levels and the expansion of public expenditure reduced

* We are grateful to Gösta Esping-Andersen, Hugh Heclø, Gerald Kramer, Peter Lange, Nils Mattsson, and Harold Wilensky for comments on an earlier draft. H. J. Madsen acknowledges financial support from the Danish Social Science Research Council and Egmont H. Petersen's Fond, Copenhagen. Douglas Hibbs acknowledges support from National Science Foundation Grant SOC 78-27022, and from the Center for International Affairs at Harvard University.

Earlier versions of the paper were delivered at the Carnegie-Mellon Conference on Political Economy, May 11-12, 1979, and the Annual Meeting of the American Political Science Association, September 1979.

¹ This section is based on Douglas A. Hibbs, Jr., *Long-Run Trends in Strike Activity in Comparative Perspectives*, monograph, Center for International Studies, Massachusetts Institute of Technology (Cambridge, 1976), and Hibbs, “On the Political Economy of Long-Run Trends in Strike Activity,” *British Journal of Political Science*, VIII (Part 2, 1978), 153-76.

² But see the attempt by Harold Wilensky, *The “New Corporatism,” Centralization and the Welfare State* (Beverly Hills: Sage Professional Papers in Contemporary Political Sociology, 1976). Since Wilensky included racist and xenophobic outbursts along with genuine antitax, antispending activities in his attempt to measure “tax-welfare backlash,” we did not make use of his quantitative scores.

³ See Dudley Jackson, H. A. Turner, and Frank Wilkinson, *Do Trade Unions Cause Inflation?* 2d ed. (Cambridge: Cambridge University Press, 1975).

labor's net real wage and prompted greater militancy in wage bargaining.⁴ A recent OECD study reports similar evidence suggesting that net-of-tax wage bargaining has become a significant phenomenon in many other industrial societies.⁵

In recent years, moreover, trade unions in Denmark, Norway, Sweden, as well as in the United Kingdom have negotiated or at least acquiesced in incomes policy agreements with the state that reduce personal taxes in exchange for restraint in wage bargaining. Although the trade-offs were not always spelled out explicitly, one of the aims of these government-coordinated quasi-incomes policy schemes has been to preserve real personal income without incurring the inflationary pressures of large nominal wage settlements.

Much of the tax reduction was fictitious; indirect taxes were raised (in Sweden and Great Britain, for example) to compensate for the loss of direct tax revenue. Although personal tax reductions were generally skewed to the advantage of those who earned lower wages, attempts to increase labor's net market income at the expense of public revenue—and, implicitly, public consumption, subsidies, or transfers—were made nonetheless. One *might* therefore interpret labor's participation in such incomes policy bargains as well as tax-push wage inflation induced by the trade unions' demands as an implicit preference for strengthening the hand of the private market and weakening the impact of the state on the distributional process.

The sharpest challenge to the high-taxing, high-spending state has not come from the unions' strike action or from quasi-incomes policy bargains involving reduced direct taxation; rather, it was the result of electoral mobilization by anti-welfare state, "new bourgeois" political movements in several of the Scandinavian social democracies. The most dramatic example was the rise of Mogens Glistrup's Progress Party in Denmark.

Until the 1973 election, postwar Danish politics had been dominated by two established political blocs: the "old bourgeois" bloc (consisting of the Conservative, Agrarian Liberal, and Radical Liberal Parties), and the socialist bloc (composed of the Social Democrats, the Socialist People's Party, the Left Socialists, and the Communists). These established blocs were very competitive and, prior to 1973, controlled more than 90 percent of the popular vote.

⁴ Evidence consistent with this argument also appears in J. Johnston and M. Timbrell, "Empirical Tests of a Bargaining Theory of Wage Rate Determination," *The Manchester School of Economic and Social Studies*, xli (June 1973), 141-67.

⁵ Organisation for Economic Co-operation and Development, *The Tax/Benefit Position of Various Income Groups* (Paris: OECD, 1978).

The traditional two-bloc Danish party system experienced a severe shock in the election of 1973, when two new "protest" parties burst upon the political scene.⁶ The more significant of these was the Progress Party; it was formed by Mogens Glistrup, a tax lawyer who compared tax dodgers to the Danish resistance fighters during the Nazi occupation, and who publicly boasted of having paid no taxes in 1972, despite a sizable income and net worth. Glistrup exploited the enormous publicity surrounding his tax case by attacking the income tax, the bureaucracy, and the incompetence and unresponsiveness of the established parties, and thereby mobilized support for his Progress Party. The Glistrup movement constituted a fundamental political assault on the Danish system of high collective consumption and transfers by advocating a drastic rollback in the state bureaucracy and government expenditures in order to achieve a sharp reduction in taxes and, in particular, the abolition of the income tax.

The "new bourgeois" protest parties received a combined total of 23.7 percent of the vote; the share of the established bourgeois and socialist blocs fell from 96.1 percent to a postwar low of 69.3 percent. Glistrup's party alone commanded 15.9 percent of the vote and 28 of the 175 parliamentary seats, making the Progress Party the second largest (after the Social Democrats) in the Danish *folketing*. Although the traditional political blocs recovered in the subsequent election of January 1975, the Glistrup Progressives showed increased support in the 1977 election, which appeared to come primarily at the expense of the old bourgeois bloc. The 1979 election resulted in a minor comeback for the badly weakened Conservative Party, which during the campaign managed to convince Progress Party voters of its singular dedication to the reduction of public expenditure. However, the Progressives retain considerable strength in the political preference polls and therefore clearly do not represent the short-lived, flash phenomenon initially predicted by election specialists.⁷

It is clear from the extensive survey analysis of Rusk and Borre⁸

⁶ See Ole Borre, "Denmark's Protest Election of December 1973," *Scandinavian Political Studies*, IX (1974), 197-204, and Eric Einhorn, "Post-Industrial Politics and the Threat of Stalemate: The Scandinavian Experience," paper prepared for delivery at the Annual Meeting of the American Political Science Association, San Francisco, September 2-5, 1975.

⁷ It was widely believed among Danish election specialists that Glistrup's Progressives would quickly recede from the political scene. See, for example, Eric Damgaard, "Stability and Change in the Danish Party System over Half a Century," *Scandinavian Political Studies*, IX (1974), 103-26, who speculated just after the 1973 election about the likelihood of an early "reinstating" election.

⁸ Jerrold Rusk and Ole Borre, "The Changing Space in Danish Voter Perceptions 1971-1973," *European Journal of Political Research*, II (No. 3, 1974), 329-61.

that the appeal of the new bourgeois protest parties was based on dissatisfaction with the performance and increasing financial burdens of the welfare state, combined with a lack of confidence that the established parties were likely to provide relief. It was of course entirely rational for voters who were disenchanted with the Danish welfare state to look outside the established party system to the new bourgeois parties for effective opposition to the continued growth of the public sector. The welfare state was the creature of the Social Democrats, but governments of the old bourgeois parties had shown little inclination to change the system appreciably. Indeed, taxes rose sharply during the 1968-1971 period of bourgeois rule. Whether Glistrup's Progress Party will persist in the long run will undoubtedly depend on whether the traditional Danish bourgeois parties are able (or willing) to establish credibility with voters who are opposed to the large scale of the public sector.

The archetype of the advanced welfare state is Sweden. However, in contrast to the recent political experience of Denmark (and, to a lesser extent, Norway), the Swedish party system has exhibited considerable stability. The Swedish system, like the Danish, is largely defined by a single left-right dimension with two established political blocs: the (small) Communist Party and the Social Democrats form the socialist bloc; the Center Party, the People's Party, and the Conservatives (now the Moderates) make up the bourgeois bloc. Until their defeat in 1976, the Social Democrats had governed continuously since the early 1930s, even though the popular vote has been fairly evenly split between the two blocs since the early 1950s.

In focusing on the Scandinavian countries, the interesting question for our purposes is why Sweden has not experienced a new bourgeois, anti-welfare state movement similar to the Glistrup phenomenon in Denmark or to the less successful Anders Lange Party in Norway. One explanation surely is that Sweden is the only highly developed welfare state in which the traditional bourgeois parties had, until 1976, been in opposition for the entire postwar era. Responsibility for the growth of the bureaucracy, public expenditure, and taxation therefore rests wholly with the Social Democrats; consequently, the old bourgeois bloc represented a plausible alternative to the welfare state. Popular discontent with the system of high collective consumption and state transfers was therefore channeled through the established right-of-center parties.

Survey evidence suggests that such discontent is widespread, and that it increased significantly in the first half of the 1970s. The shift to

the right on the issue of social welfare coincided with the gradual erosion of the socialist bloc's electoral strength, which began in 1970, continued into the 1973 election, and culminated in the first outright defeat of the Social Democrats in 44 years in September 1976. It is difficult to say precisely to what extent high taxation and social spending contributed to the victory of the bourgeois bloc, since the electoral shifts were actually quite modest. Most Swedish experts have identified nuclear power, anxiety over the Meidner plan⁹ and socialization, bureaucratic arrogance and popular frustration with the "permit state"—but *not* the elaborate system of social security—as the issues that hurt the Social Democrats most in the 1976 election.¹⁰ Nonetheless, it is probably premature to exclude the tax-and-spending issue as a factor that contributed to the defeat of the Social Democrats. After all, tax relief was the most salient issue for the Swedish electorate in 1976 and voters believed by a wide margin that the tax burden would be lighter under a bourgeois-bloc government than under a Social Democratic government.¹¹

Although there are signs of increased public resistance to the growth of taxation and the public economy in many—perhaps most—industrial democracies, Denmark clearly is a distinctive case. It is the only country in which a sizable backlash movement significantly disrupted the traditional electoral order.

In the section that follows, we shall examine scattered survey data on popular attitudes toward taxation, government expenditure, and social services in five European industrial societies—Denmark, West Germany, the Netherlands, Sweden, and the United Kingdom. We use these survey data in conjunction with nonsurvey-qualitative observations in order to establish a rough rank-ordering of the backlash sentiment within these five countries.

In subsequent sections, we shall consider the cross-national patterns of opposition to the welfare state in relation to aggregate trends in the magnitude, composition, and consequences of taxation and government spending. Section III follows the work of Wilensky in linking

⁹ The Meidner Plan was the LO's (the blue-collar peak union) proposal to gradually place ownership and control of large firms in the hands of the trade unions.

¹⁰ See Olof Petersson, "The 1976 Election: New Trends in the Swedish Electorate," *Scandinavian Political Studies*, 1 (new series, Nos. 2-3, 1978), and Hans Zetterberg, "The Swedish Election of 1976," paper presented to the World Association of Public Opinion Research, Uppsala, August 1977.

¹¹ Taxation was rated as an important issue by 84 percent of the electorate. Forty percent of the voters thought taxation would be lower under a bourgeois government than under a Social Democratic one; only 17 percent believed the reverse. See Olof Petersson, *Valundersökningar. Rapport 3. Teknisk Rapport* (Stockholm: Statistiska Centralbyrån, 1977).

discontent with the welfare state to the composition of taxation—notably highly visible, direct, general taxation.

In section IV, we examine the aggregate composition of state expenditure; our argument will focus on the mix of transfers to households and to government consumption. Here we shall show that the “high-backlash” Danish welfare state, which has relied heavily on government-supplied services, stands in sharp contrast, for example, to the low-backlash Dutch welfare state, which redistributes income directly by large-scale transfers to individuals. We argue that the relative emphasis given to cash transfers as opposed to in-kind services offers very different opportunities for successful political attacks on the welfare state. Evidence suggests that, if governmental consumption is low relative to transfers to households, and if the growth rate of salaries in the public sector does not markedly exceed the growth-rate trend of wages in the private sector, popular discontent is likely to be minimized.

In section V, we address the important question of why taxation and social spending became prominent political issues in the 1970s and not earlier. We shall focus on the political consequences of income tax-induced gaps between pre- and post-tax growth rates in real earnings that were opened up in a period of high and accelerating inflation.

II. PUBLIC ATTITUDES: SOME AGGREGATE INTERNATIONAL PATTERNS

Table 1 contains some aggregate international survey data on public attitudes toward government expenditures, services, and taxation.

We are acutely aware of the problems of making inferences from survey responses—particularly responses to questions about state spending and taxation that do not explicitly invoke a budget constraint. It is even more hazardous to make cross-national comparisons of such data. Obviously, the results should be interpreted cautiously.

Two patterns are apparent in Table 1. First, in the countries for which a few time-series observations are available (Denmark, Sweden, Great Britain), disapproval of the scale of taxation, expenditure, and social services seems to have increased between the early and mid-1960s and the early 1970s. Second, if one is willing to engage in the risky exercise of making cross-national comparisons of different survey items, popular opposition to the scale of the public economy appears to be considerably higher in Denmark (particularly in the early 1970s), and lower in the Netherlands and Germany, than in Great Britain and Sweden.

Despite our reservations about these survey data, we are reassured by the fact that the aggregate patterns are consistent with the distinctiveness of Denmark on the backlash dimension, which has been revealed by actual electoral behavior since 1973. Similarly, the comparatively low level of antitax, antispending sentiment implied by the German and Dutch surveys is confirmed by the fact that there has been no sign of successful organized political opposition to the welfare state in the Federal Republic or—in spite of very permissive electoral laws—in the Netherlands.

III. THE MAGNITUDE AND COMPOSITION OF TAXATION

What accounts for the political distinctiveness of Denmark and, more generally, for the international patterns of the survey data? One popular argument holds that there is a critical tax/expenditure threshold: once the state's share of gross revenues or expenditures approaches 50 percent of the national income, serious political resistance to further extension of the public economy begins to appear.¹² However, Figure 1 shows that international variation in aggregate rates of taxation bears no relation to gross cross-national differences in backlash identified earlier. By the mid-1970s, government revenue as a fraction of Gross Domestic Product (GDP) was 42 percent or higher in Sweden, the Netherlands, and Denmark, whereas it was 35 and 38 percent in the U.K. and West Germany. What does distinguish Denmark, however, is the *rapid rise* of the aggregate tax rate between 1969 and 1971, brought on by the pay-as-you-go tax reform enacted by the bourgeois government in 1970.¹³

Denmark also is distinctive because of the high *visibility* of its tax system—a point emphasized in Wilensky's study of welfare backlash. The data in Figure 2 on household direct taxes as a percentage of all taxes show that by 1974, the Danish direct tax share was just about 30 percentage points higher than the Dutch direct tax share, notwithstanding the fact that the gross scale of taxation and public expenditure was roughly equivalent in these two countries. In view of the fact that the degree of backlash differed sharply for Denmark and the Netherlands, the data in Figure 2 imply considerable *tax illusion* among the public. Probably as a result, the percentage share of direct

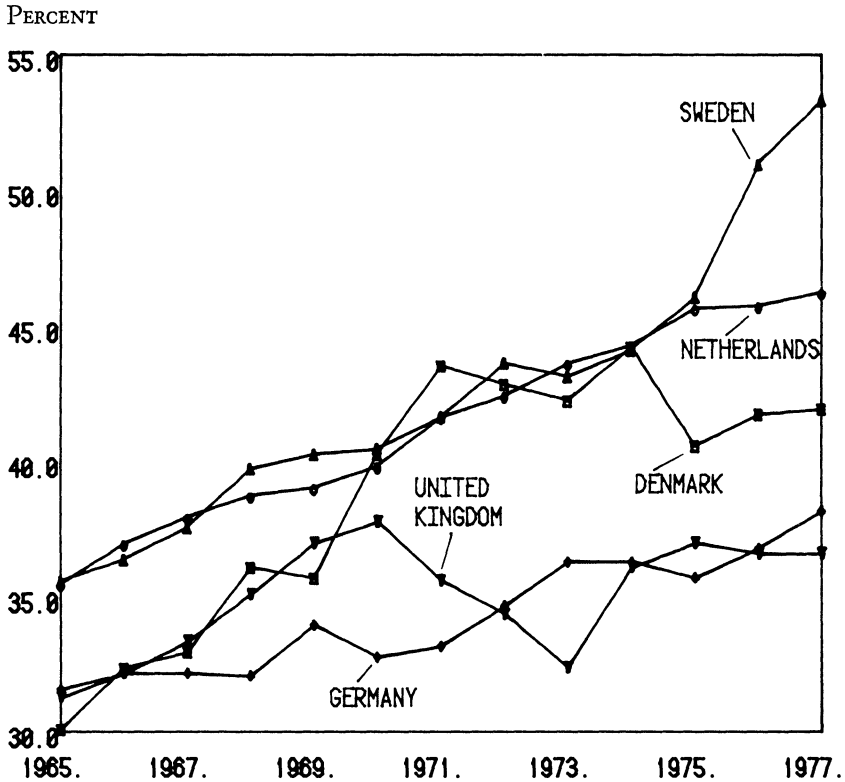
¹² Several decades ago the politically critical share was generally assumed to be about 25 percent of the national income.

¹³ Before 1970, income taxes in Denmark were paid on the income of the previous year. Since nominal incomes were growing rapidly, a rapid increase occurred in the contemporaneous effective tax rate because book rates were not adjusted downward.

TABLE I
 AGGREGATE PATTERNS IN PUBLIC OPINION TOWARD GOVERNMENTAL
 EXPENDITURE, SERVICE, AND TAXATION

	1963	1964	1966	1967	1968	1969	1970	1971	1973	1974	1975	1976	1977	1978
DENMARK														
% agreeing that politicians are too lavish with taxpayers' money	—	—	—	—	—	—	—	85	91	—	84	—	77	—
% agreeing that too many people receive social payments without really being in need	—	—	—	—	—	—	—	—	87.4	—	60.9	—	57.8	—
SWEDEN														
% agreeing that social reforms have gone so far that state should reduce rather than increase social benefits and support	—	—	—	—	41	52	—	—	60	—	—	60	—	—
% agreeing that a big proportion of taxes is used for meaningless purposes	—	—	—	—	—	56	—	—	—	—	—	—	—	—
% disagreeing that all benefits considered, taxes are not too high	—	—	—	—	—	54	—	—	—	—	—	—	—	—
% agreeing that the present social welfare system is too expensive and should be cut back	—	—	—	34	—	—	—	—	—	—	—	—	—	39
GREAT BRITAIN														
% preferring tax reduction to spending more	51	—	56	—	—	—	61	—	—	—	—	—	—	—
% preferring present level rather than more spending	—	23	48	—	—	—	51*	—	—	47**	—	—	—	—
% saying welfare benefits have gone too far	—	—	—	—	—	—	—	—	—	34	—	—	—	—

FIGURE I

TOTAL TAXATION AS A PERCENTAGE OF GROSS DOMESTIC PRODUCT
(1965-1977)

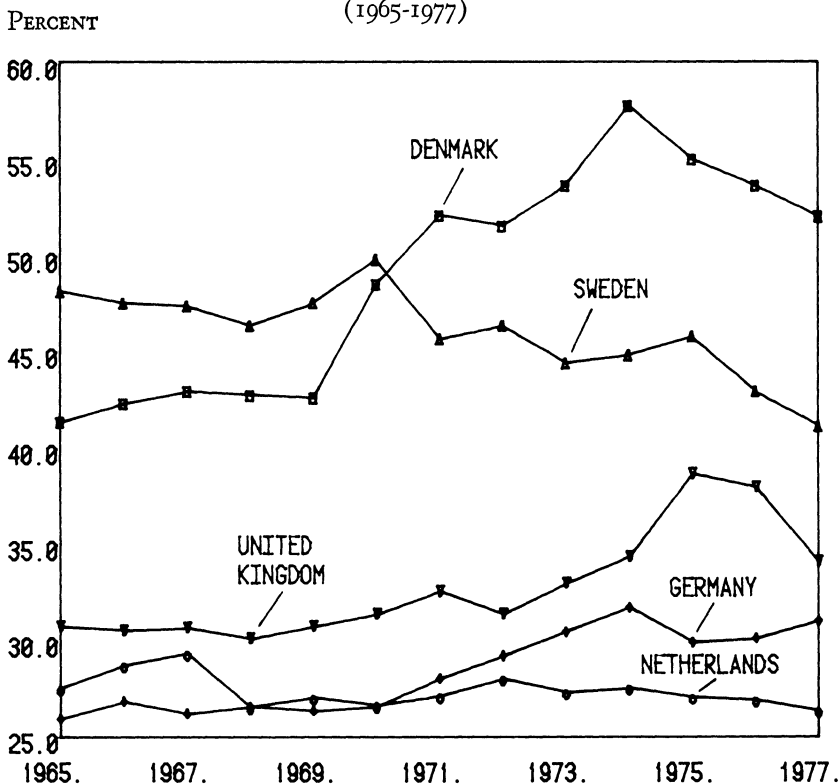
Source: Organisation of Economic Co-operation and Development, *Revenue Statistics of OECD Member Countries* (Paris: OECD, 1979), table 3.

taxes has dropped in several countries in recent years. The decline was most pronounced in Sweden, where it reflected a conscious policy.¹⁴ In Denmark, the reduction of direct taxes from the peak in 1974 can be attributed directly to the government's response to Glistrup's successful mobilization of antitax sentiment.

Although some evidence of tax illusion is implied in the data reviewed so far, public resentment is probably confined to direct, "general revenue" income taxes. *Programmatic taxes* on personal incomes—most prominently, social security taxes in which the connection between costs and ultimate benefits is at least superficially explicit—

¹⁴ See Nils Elvander, "The Politics of Taxation in Sweden 1945-1970: A Study of the Functions of Parties and Organizations," *Scandinavian Political Studies*, VII (1972), 63-82.

FIGURE 2
DIRECT TAXATION ON HOUSEHOLD INCOME AS A PERCENTAGE
OF TOTAL TAXATION
(1965-1977)



Source: Organisation of Economic Co-operation and Development, *Revenue Statistics of OECD Member Countries* (Paris: OECD, 1979), table 1.

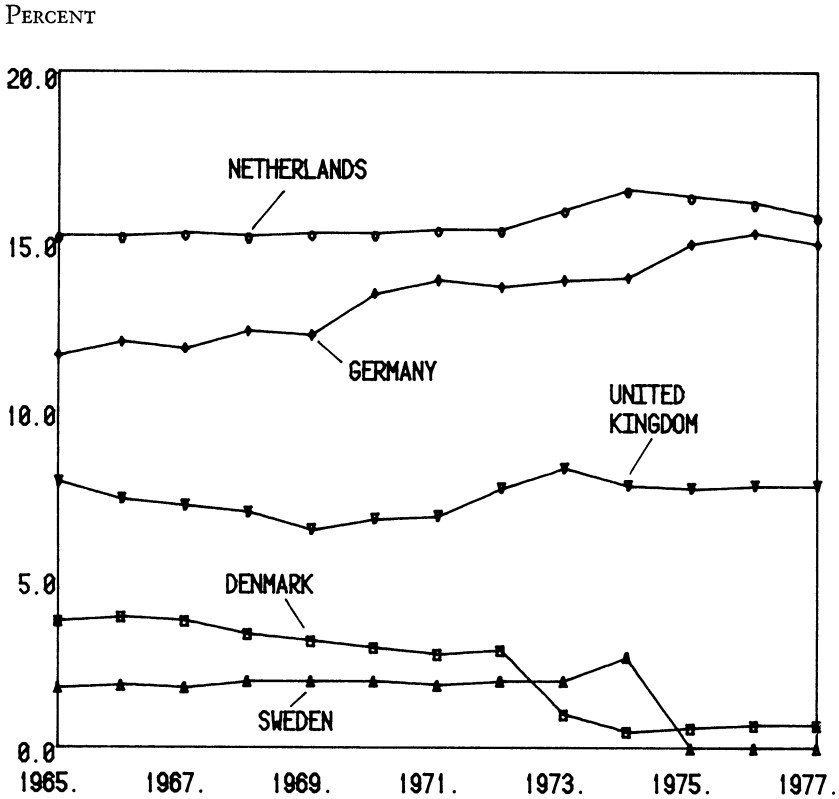
appear to generate relatively little tax resistance.¹⁵ Therefore, we believe it is not coincidental that in Denmark social security taxes on individuals as a percentage of GDP and as a share of all taxes stood lower in 1977 than in 1965, whereas in Germany and the Netherlands, which have not experienced significant antitax or anti-welfare state movements, the share of social security taxes generally increased (most dramatically in Germany); by 1977, it had attained the highest levels in the OECD area. Figure 3 charts the data for social security taxes as a percentage of all taxes. Again, the United Kingdom, and to a lesser degree Sweden, fall between the polar cases of Denmark, West Germany, and the Netherlands.¹⁶

¹⁵ This appears to be true even though social security or public pension schemes in all countries are effectively based on intergenerational transfers.

¹⁶ A change in the Swedish pension system shifted all social security taxes to employers and self-employed income earners after 1974.

FIGURE 3

SOCIAL SECURITY TAXES ON INDIVIDUALS AS A PERCENTAGE
OF ALL TAXES
(1965-1977)



Source: Organisation of Economic Co-operation and Development, *Revenue Statistics of OECD Member Countries* (Paris: OECD, 1979), table 17.

IV. THE COMPOSITION OF PUBLIC EXPENDITURE

Although it has often been claimed that the productivity of state agencies supplying goods and services is substantially lower than the productivity of their market counterparts, there are few hard data to support this assertion. It is true, however, that *labor-intensive* services (regardless of the sector of origin) provide few possibilities for gains in efficiency; that is probably the reason why the rate of growth of the government consumption deflator has outstripped the inflation rate of market goods and services during the 1960s and 1970s in virtually all

industrial societies.¹⁷ This productivity gap exposes welfare states that rely heavily on direct provision of services (government consumption expenditures)—as opposed to cash transfers to individuals—to political attacks focused on bureaucratic inefficiency. Aggregate data on the mix of governmental consumption and transfers appear to support this conjecture.

Figure 4 consists of five time series showing the ratio between aggregate cash transfers to households and total governmental consumption expenditure in nominal and real terms. As anticipated, the contrast between Denmark and the Netherlands is striking. In Denmark the nominal ratio between governmental consumption and transfers was flat over the period, with aggregate transfers oscillating at just above one-half of total consumption spending. Although the ratio increased slightly in real terms, only in 1975 did transfers exceed—by a very small margin—spending on services. In the Netherlands, on the other hand, both series rose continuously and rapidly over the period. By 1977, nominal transfers were about twice as high as nominal consumption expenditure and more than four times greater in real terms. (The difference is explained by the unfavorable rate of growth in the prices of government consumption.)

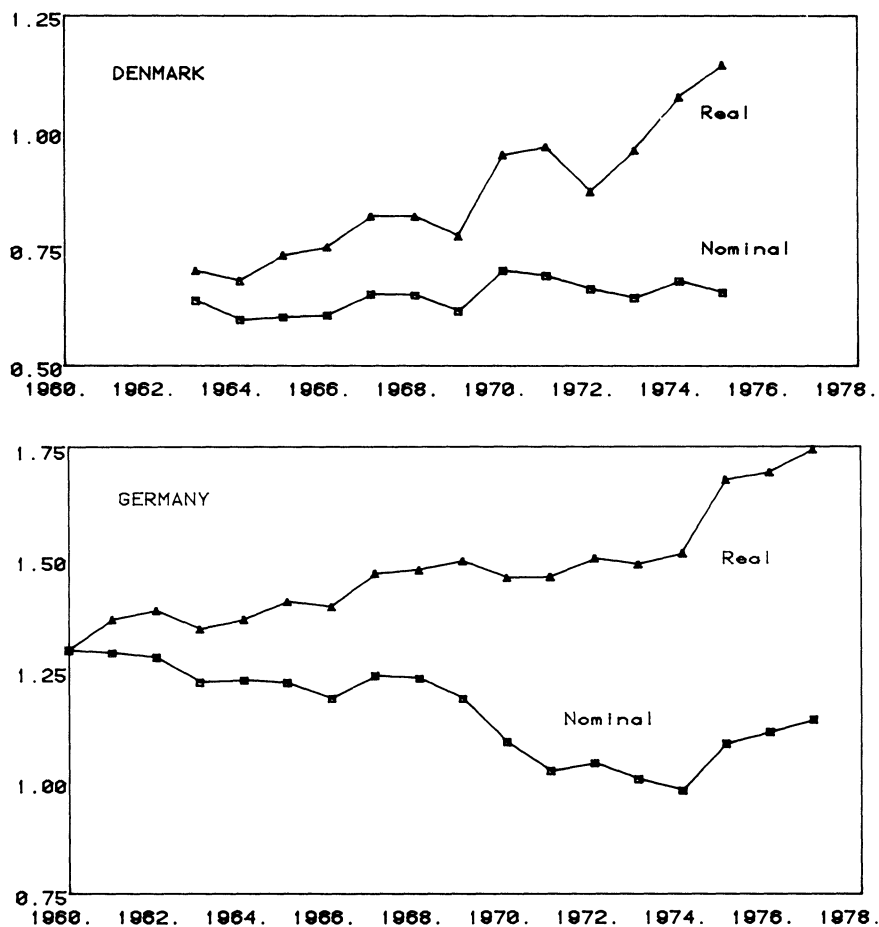
In the remaining countries, real transfers to households also increased by varying degrees relative to real consumption; but only in Sweden, which started at a level in the vicinity of Denmark's, was the rise due in part to the explicit funneling of expanding nominal resources to transfer as opposed to consumption programs; elsewhere, the real increase stemmed from differential movements in government consumption prices and consumer prices. Nonetheless, the Swedish ratio stood significantly lower in both nominal and real terms than the ratios describing the composition of the West German governmental budget.

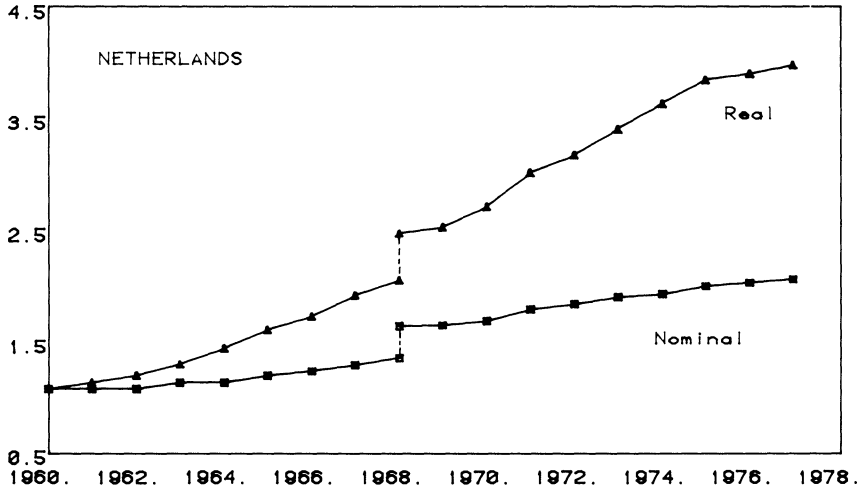
The relatively large governmental consumption (service) component in the Danish public budget made public employees' wages a rather sensitive political issue, which was exacerbated by the widening differential between the growth rates of earnings in the public and the private sectors. Figure 5 illustrates this differential comparatively for four countries. In contrast to the Federal Republic of Germany and the United Kingdom, the gap between growth rates in public and

¹⁷ On productivity differentials between labor-intensive and non-labor-intensive activities, see William J. Baumol, "Macroeconomics of Unbalanced Growth: The Anatomy of Urban Crisis," *American Economic Review*, xxix (June 1967), 415-26, and Tim Hazeldine, "Unbalanced Growth in the Welfare State," *Scottish Journal of Political Economy*, xxxiii (No. 3, 1976), 221-34.

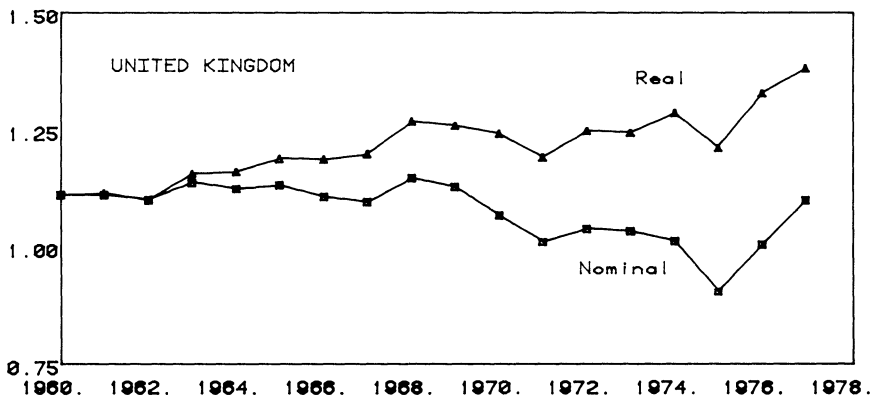
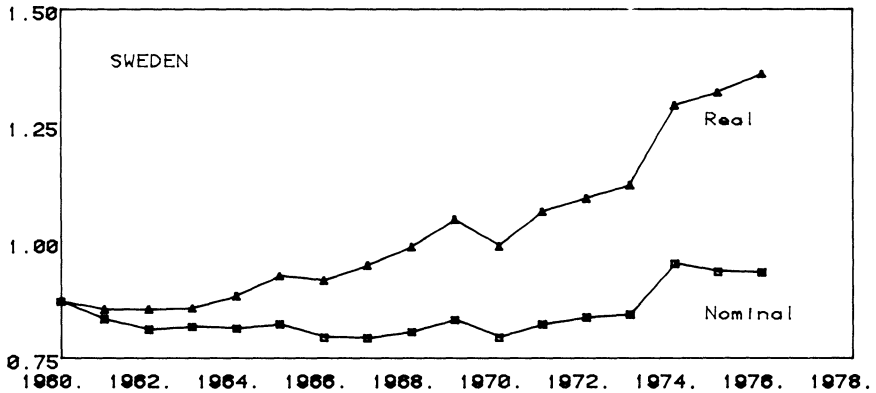
private sector earnings in Denmark increased dramatically between 1960 and 1975. The growth rate of Dutch earnings differentials also favored public employees over the first part of the period, but this trend was partly reversed by the mid-1970s. Meanwhile, the relative importance of government-supplied services declined steadily in the Netherlands, as public expenditures were channeled increasingly into cash transfers (cf. Figure 4).

FIGURE 4
NOMINAL AND REAL RATIOS
BETWEEN AGGREGATE TRANSFERS TO HOUSEHOLDS AND
TOTAL CIVILIAN GOVERNMENTAL CONSUMPTION EXPENDITURE





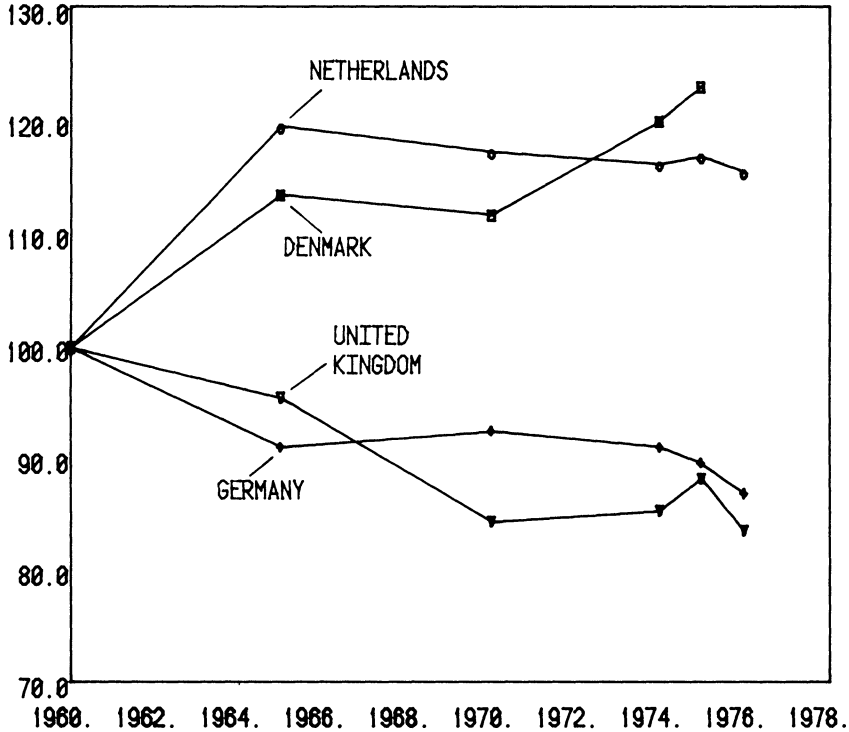
1960-1968: Old System of National Accounts.
 1968-1977: New System of National Accounts.



Sources: Organisation of Economic Co-operation and Development, *National Account Statistics 1950-1969* (Paris: OECD, 1970); *National Accounts*, Vols. I and II (Paris: OECD, 1976, 1977, 1979).

FIGURE 5

INDEX FOR RATES OF GROWTH OF AVERAGE WAGE DIFFERENTIALS
BETWEEN PUBLIC- AND PRIVATE-SECTOR EMPLOYEES*
(1960-1976)



* The index is defined as the change in the logarithm of average public sector earnings *minus* the change in the logarithm of average private sector earnings. The index is set to equal 100 in 1960.

Source: Organisation of Economic Co-operation and Development, *Public Expenditure Trends* (Paris: OECD, 1975), table 4.B.

In view of the relative growth rates of wages in the public and private sectors, and the weight of government consumption (public provision of services) in the Danish public budget, it is not surprising that the Danish public has identified the salaries of public employees as a target for cutbacks, but has given quite solid support to such cash transfer programs as rent allowances, child allowances, and pensions. The Danish public's expenditure priorities, as revealed in Table 2, resonate remarkably well with Glistrup's colorful criticism of military expenditures and, of course, with his flamboyant attacks on public servants. Indeed, Glistrup's singling out of these two items of public

TABLE 2

PUBLIC SUPPORT FOR VARIOUS EXPENDITURE CATEGORIES IN DENMARK

Question: "One hears a lot about cutting public spending. Of the areas down below, which ones would you suggest should be cut?"

PERCENTAGE MENTIONING EACH CATEGORY*	1973	1977
1. Defense	58	51
2. Salaries of Public Employees	49	39
3. Student Grants	39	11
4. Highways and Bridges	36	28
5. Rent Allowances	23	24
6. Child Allowances	22	15
7. Libraries	19	19
8. Primary Education	12	3
9. Pensions for Disabled	10	2
10. Hospitals	5	3
11. Police	2	3
12. Nursing Homes	2	1
13. Old Age Pensions	1	1

* As many as 3 categories could be mentioned.
Sources: *Gallup Vaelgerundersøgelse 1973, 1977.*

expenditure was a brilliant tactical move: no one in particular benefited from the Danish defense effort, and nearly everyone (except public employees) was disadvantaged because private salaries were growing more slowly than public ones.

More generally, the distributive impact of publicly supplied services is unclear. Scattered evidence suggests that, although cash transfer programs clearly redistribute resources in favor of lower income groups,¹⁸ higher income groups may be the greatest beneficiaries of at least some of the major government service programs.¹⁹ On grounds of equity, efficiency, and politics, therefore, prudent governments might have shifted state resources away from public consumption to

¹⁸ See OECD (fn. 5), Table 17; Franz Frazen, Kerstin Lövgren, and Irma Rosenberg, "Redistributional Effects of Taxes and Public Expenditures in Sweden," *Swedish Journal of Economics* (1975), 31-55.

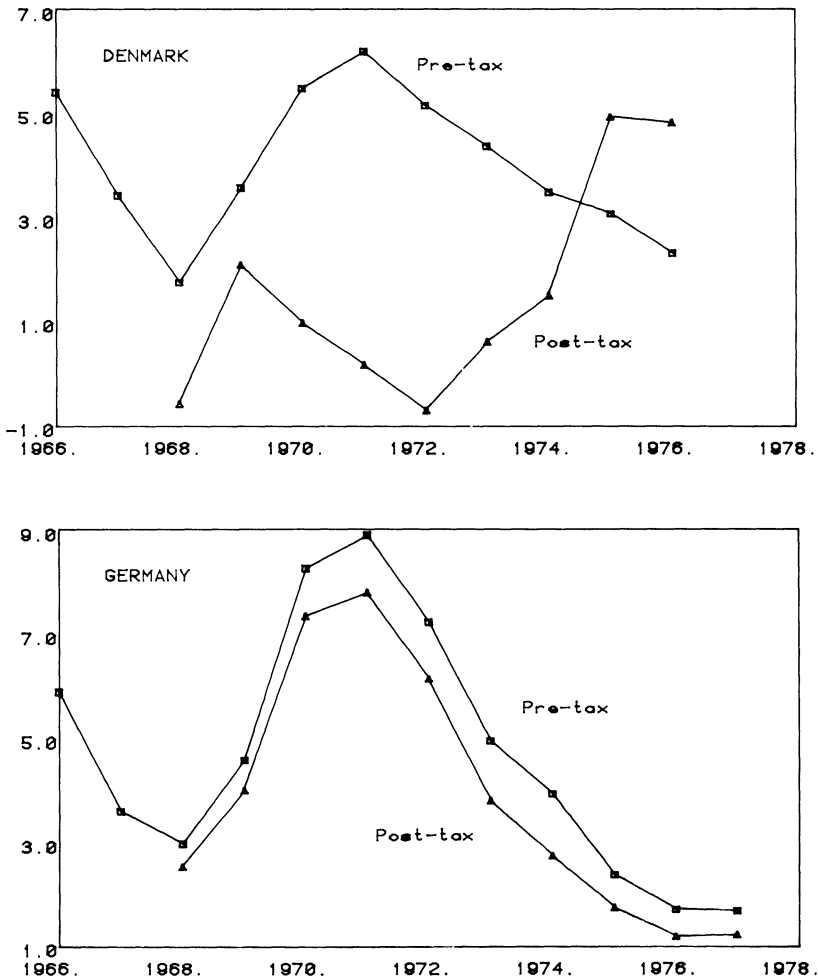
¹⁹ See for example, the OECD's study of higher education, *Education, Inequality and Life Chances* (Paris: OECD, 1975); Julian LeGrand, "The Distribution of Public Expenditure: The Case of Health Care," *Economica*, xxxv (May 1978), 125-42, a study of health care in England and Wales; Marion Platz, *Velkommen til børnehaveklasserne* (Kbhv.: Socialforsknings-instituttet, i kommission hos Teknisk Forlag, 1977), a study of preschool education in Denmark; and Terje Assum, "Hvem har nytte av forbruker-service?" *Artikler fra Statistisk Centralbyrå*, No. 64 (1974), a study of government-supplied consumer services in Norway. Among the most important recent studies is Gösta Esping-Andersen, "Social Democracy and State Policy in Denmark and Sweden," Ph.D. diss. (University of Wisconsin, 1978).

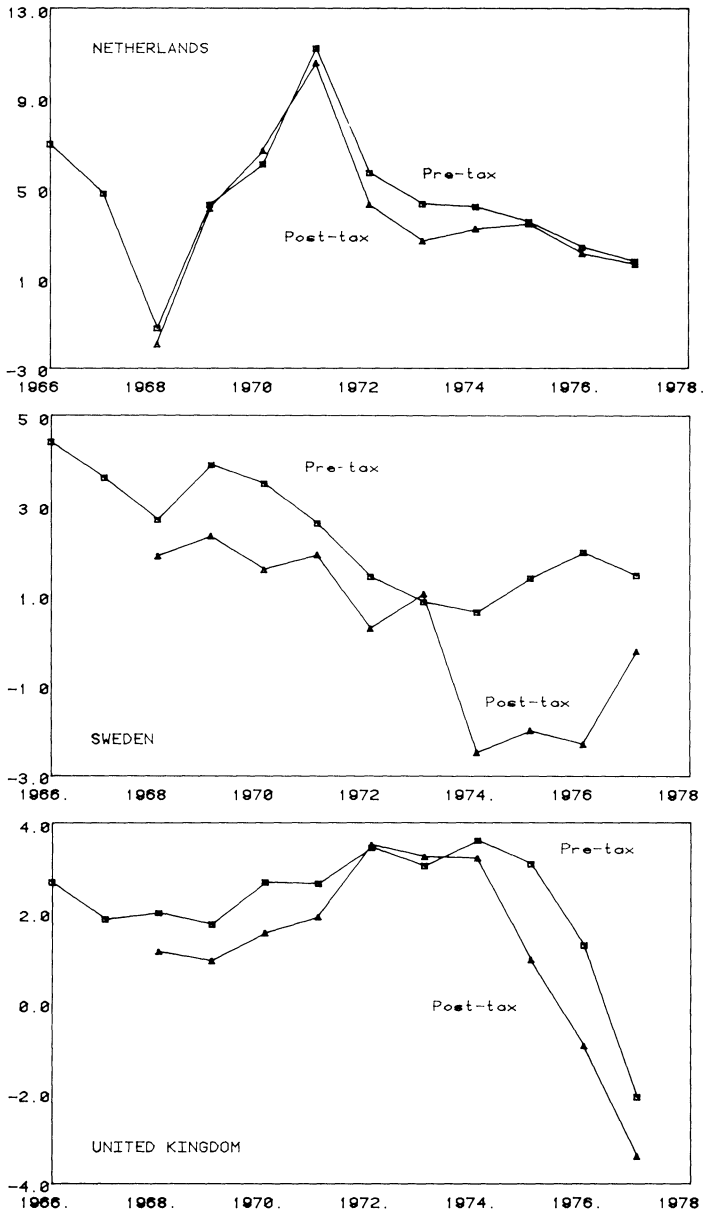
direct cash transfers without sacrificing (and indeed, perhaps enhancing) the egalitarian goals of the welfare state.

V. THE RATE OF GROWTH OF NET REAL EARNINGS

Why did popular discontent with taxation and social spending become politically important during the early 1970s? Trends in the level and composition of state expenditure and taxation had, after all, been apparent for many years. Although a sequence of unique or coinci-

FIGURE 6
ANNUAL RATES OF CHANGE OF PRE- AND POST-TAX
EARNINGS PER LABOR-FORCE MEMBER
(THREE-YEAR MOVING AVERAGES)





Sources: Wages and Salaries—Organisation of Economic Co-operation and Development, *National Accounts* (Paris: OECD, 1976, 1977, 1979). Labor Force Members—Organisation of Economic Co-operation and Development, *Labour Force Statistics* (Paris: OECD, 1972, 1974, 1975, 1979).

Taxation—Organisation of Economic Co-operation and Development, *Revenue Statistics of OECD Member Countries* (Paris: OECD, 1978, 1979).

dental factors may help to explain the rise of Glistrup's Progress Party²⁰ as well as the defeat of the Swedish Social Democrats and of British Labour, some evidence suggests that an unfavorable divergence of pre- and post-tax real earnings may have had a catalytic impact on the political fortunes of these parties.

Both popular and academic writers have identified disappointed expectations associated with declining real take-home pay as one of the most important causes of the alleged crises of political authority, "overloaded" governments, and welfare-state backlash.²¹ In most Western industrial societies, the high economic growth rates of the 1960s allowed easy reconciliation of competing claims between the expansion of the public economy and sustained growth in net real market income. Summarizing the development of the decade, Myrdal observed that the "ordinary man in all countries is inclined to demand more and better public services . . . and at the same time higher retained income for his private consumption."²² Such simultaneously held expectations are proving more difficult to accommodate in less prosperous times. If growth in the supply of transfers and publicly financed goods and services is relatively inelastic (because of budgetary incrementalism, bureaucratic inertia, powerful recipient groups, entrenched special interests, and so forth), then the primary victim of economic stagnation is net market income.

Figure 6 shows the growth rates of pre- and post-tax real earnings per member of the labor force. The data indicate that economic stagnation—i.e., declining real pre-tax market earnings—is less important than the market income "tax loss" in helping to explain variations in backlash politics across the five countries. In Denmark, for example, the growth rates of pre-tax earnings were hardly sluggish in the late 1960s and early 1970s; indeed, real pre-tax earnings were growing briskly in the years prior to Glistrup's appearance on the political scene in 1973. However, post-tax real earnings decelerated during most of that period, thus opening a wide gap between pre- and post-tax earnings. The gap closed after 1974, when the government reduced tax rates in response to Glistrup's challenge and pre-tax income fell in the wake of the OPEC oil embargo. Table 1 shows that disapproval of

²⁰ Cf. Arnold J. Heidenheimer, Hugh Hecllo, and Carolyn Teich Adams, *Comparative Public Policy: The Politics of Social Choice in Europe and America* (New York: St. Martin's Press, 1975).

²¹ See Richard Rose and Guy Peters, *Can Government Go Bankrupt?* (New York: Free Press, 1978) for a prominent illustration.

²² Gunnar Myrdal, "The Place of Values in Social Policy," *Journal of Social Policy*, 1 (No. 1, 1972), 2.

public spending in Denmark declined significantly in 1975, after the growth rate of post-tax earnings had risen above the pre-tax growth rate.

Once again, the data for the Netherlands and West Germany exhibit a dramatically different pattern. Aside from 1968 in the Netherlands, the growth rates of real earnings in both countries are positive and, more important, the pre- and post-tax earnings series track each other with great regularity. Comparatively low and stable direct tax rates in both countries (and a favorable inflation rate in Germany, which has minimized fiscal drag on incomes) meant that politically hazardous adverse fluctuations in the gap between pre- and post-tax earnings were avoided.

Tax-induced "losses" of market income declined in Britain during the late 1960s, but then increased in the last few years of the series, when direct tax rates rose during Wilson's second Labour government, and pre-tax earnings decelerated following the OPEC-induced demand deflation and price inflation. The fact that post-tax market income exhibited a negative growth rate by 1976 probably played an important part in the Labour government's austerity program as well as in Mrs. Thatcher's subsequent victory in May 1978.²³

Sweden perhaps best illustrates the stagnation argument, since growth rates of real earnings declined almost continuously from 1969 to 1974. However, the most significant feature of the Swedish data is the enormous gap that opened up between growth rates of pre- and post-tax earnings in the three years preceding the Social Democrats' electoral defeat in September 1976. Between 1974 and 1976, post-tax real earnings declined by 2.0 to 2.5 percentage points per year despite the fact that pre-tax earnings were rising. It is hardly surprising, then, that tax relief was the most important issue for voters in the Swedish election of 1976. As a result, the new bourgeois government introduced indexation as well as some cuts in direct taxes in 1977 and 1978 (which were partly offset by an increase in employers' social security contributions). Consequently, the gap between pre- and post-tax earnings narrowed in 1977.

VI. CONCLUSIONS AND CONJECTURES

In view of the limited number of countries considered in this paper, and the difficulties of accurately measuring popular resistance to the

²³ See the poll data reported in the *New Statesman*, 18 May 1979, pp. 704-06; also Ivor Crewe, "Why the Conservatives Won," in Howard Penniman, ed., *Britain at the Polls* (Washington, D.C.: American Enterprise Institute, forthcoming).

expansion of public expenditure and taxation, it is not possible to arrive at firm conclusions. However, a number of tentative inferences are consistent with the evidence.

On the *taxation* side, it appears that the long-run cause of welfare-state backlash is the expansion of the system based on rapidly rising, highly visible, general-revenue taxes. The comparative data suggest that the *gross level* of taxation does not make the difference between a country with high backlash (Denmark) and countries with low backlash (West Germany, the Netherlands), but the *composition* of taxation does. From a political point of view, the optimal tax system thus relies heavily on indirect and programmatic (earmarked) taxes. Under these circumstances, of course, redistributive goals will be difficult to pursue effectively through taxation, at least in the long run.

Direct tax systems, which are sensitive to inflation rates and therefore capable of opening wide gaps between the growth rates of pre- and post-tax earnings, appear to be politically problematic even in the short run. It is likely that in Denmark, and perhaps in Sweden and Britain as well, the short-run catalyst of electoral shifts and popular disenchantment with spending and taxation was the divergence of pre- and post-tax market incomes induced by the income tax. Deceleration of post-tax real earnings may be politically tolerable, but not if pre-tax real incomes are simultaneously accelerating.

On the *expenditure* side, political troubles are caused when state resources are channeled into labor-intensive, government-supplied services (public consumption spending) rather than into cash transfers to households. Labor-intensive services are relatively inefficient; hence, welfare systems relying extensively on the direct provision of services invite comparisons between the "efficient" private market and "wasteful" government agencies staffed by overpaid bureaucrats. Moreover, cash transfers demonstrably serve equalitarian objectives, whereas the net distributive impact of many government service programs is probably neutral, and in some areas perhaps even regressive.

Although the public's commitment to an expanding welfare state obviously suffered some erosion in the 1970s, manifestations of welfare-state backlash probably reflect resentment of perceived government inefficiency and reaction against tax systems that visibly distort the connection between pre- and post-tax income growth, rather than constituting popular revolts against equality or social security. Indeed, it is our impression that many interpretations of recent trends in the poli-

tics of welfare states are more polemical than scholarly; they may well underestimate the public's support of genuine social equity and security as well as the state's capacity for political innovation and adjustment. In our view, therefore, the scope of welfare-state activity is unlikely to be reduced dramatically even in the most backlash-prone countries.