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**RECENT TRENDS IN THE SIZE AND GROWTH OF  
GOVERNMENT IN OECD COUNTRIES**

Peter Saunders

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## **Abstract**

Developments in the size of government in OECD nations over the last two decades have differed markedly from the generally steady rise in the relative size of the government sector during the 1950s and 1960s. This paper discusses the nature and limitations of measures of the size of government before proceeding to examine trends in the size of government in OECD nations through the 1970s and 1980s. After examining aggregate trends, the paper turns to looking at how the structure of government has changed. The findings for different nations are compared and contrasted and the patterns and trends related to social, economic and political factors. The analysis reveals that overall differences in government outlays between countries can largely be explained by differences in the level of spending on transfer payments.

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# **1 Introduction**

A common feature of the post-war economic development of all the industrialised nations which comprise the Organisation of Economic Cooperation and Development (OECD) is the expansion of the size and scope of government. The size of the government sector and its rate of increase have varied across countries, reflecting different social, political and economic factors and priorities. The public sector - of which the general government sector forms a large part - has grown in size in all OECD countries and now represents a very considerable proportion of gross domestic product (GDP) in each of them. Developments in the size of government over the last two decades have, however, differed markedly from the generally steady rise in the government sector during the 1950s and 1960s. The reasons for this difference are to be found in the changing economic conditions confronting OECD countries since the 1970s, shifting views on the role and impact of macroeconomic policies and hence of the role of fiscal policies generally, and an ideological shift in favour of market-based as opposed to government-initiated solutions to policy problems. Overlaying these changes have been a number of other factors, including demographic changes and induced behavioural responses to government programs which have caused concern about what public policies could achieve, and at what cost.

The 1970s was a period of great turbulence in the world economy and, as a consequence, of the role of government in domestic economies. The size of government increased very rapidly in the years immediately following the first oil shock in 1973, partly as a direct consequence of the rise in unemployment which then appeared and partly as a result of the expansionary fiscal policy response to worsening economic conditions. By the end of the 1970s, most OECD governments had become convinced that the size of the public sector had exceeded the willingness of voter-taxpayers to finance it. The government sector came to be seen as detracting from optimal private sector performance rather than providing a structure and series of programs which facilitated a vibrant private sector. The aim of this paper is not to discuss the validity of this view, but rather to assess how governments have responded to it in terms of their own levels of operation.

The unwillingness of government to raise taxes for fear of the likely political consequences saw a trend towards deficit financing of government spending, a trend which contributed to rising levels of public debt as well as raising intergenerational equity concerns about the financing of government programs. These developments saw government spending restraint become central to the broader economic policy agenda of the 1980s, in order that budget deficits could be brought under control, that the growth in public debt could be arrested and then reversed, and (eventually) that cuts in taxation could be delivered.

This paper summarises available comparative information on trends in the size of government in OECD countries throughout the 1970s and 1980s. A major aim is to highlight the contrast between the turbulent but rapid growth of government in the 1970s and the steadier growth and, eventually, the decline in the relative size of government in the 1980s. However, although these broad trends are discernible across the OECD region as a whole, there is a variety of experience within individual countries. By adopting a comparative approach, the analysis in the paper can hopefully highlight the general trends while at the same time pointing to the richness and diversity of individual country experience.

The paper is organised as follows: in the following section the basic concepts and definitions used to measure the size of government are explained and their limitations noted. Section 3 presents comparative data on two indicators of the growth of government over the last two decades, total government outlays relative to GDP and government employment relative to total employment. Section 4 considers some more detailed aspects of these aggregate trends, focusing on how the structure of government has changed. Finally, the main conclusions are summarised in Section 5.

## **2 Measuring the Size of Government**

The multi-dimensional nature of the scope of government intervention in modern mixed economies means that no single measure can ever encompass all aspects of government activity. Nor can such a single measure ever be devised, because it is not possible to express all the various forms of government activity in a single aggregate measure for the government sector

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as a whole. This does not mean, however, that comparative measures of government size are impossible to construct. Rather, it serves to warn against placing too much faith in what must inevitably be only partial and, for some purposes, imperfect indicators.

The framework that has conventionally been used to develop comparative indicators of the size of government in the economy is the national accounts, specifically the System of National Accounts (SNA) developed by the United Nations. The SNA framework is used by international bodies like the OECD and the International Monetary Fund (IMF) to collect and present comparative national accounts statistics. The key concept in the SNA in the present context is the general government sector which includes central, state and local government agencies but excludes most public enterprises except those which mainly produce goods and services for government itself or primarily sell goods and services to the public on a small scale. Public enterprises, which operate on a more commercial basis, are excluded from the SNA general government sector, even though their operations may be controlled and/or owned by agencies in the general government sector. This paper thus focuses on the general government sector and excludes the operations of those public enterprises which are encompassed in the more broadly defined public sector.

The basic measure of the size of government within the SNA framework is the total consolidated spending of all general government agencies, after netting-out transfers between the different levels of government. The resulting aggregate is referred to as general government outlays, and these data undoubtedly provide the best available measure of government size on which to base cross-country comparisons. Yet even the comparability of these data is compromised because of the different policy approaches that may be adopted in different countries to address what may be the same policy problem.

Consider, for example, the case of an environmental problem which is seen as requiring some form of remedial government policy. Such a policy could take a number of forms, including the granting of subsidies or tax concessions in order to induce private individuals or companies to act in more environmentally desirable ways, or the introduction of regulations designed to achieve the government's environmental objectives directly. Each approach will have different consequences for the level of general

government outlays, with the latter two options (tax concessions and regulatory intervention) having little or no impact on outlays as compared with the subsidy option. Because of these differences, general government **outlays** will not be comparable as a measure of total government **intervention** in the economy.

The great advantage of the SNA data on general government outlays is, however, that they measure the scope of the same types of government activity in exactly the same way in different countries. Furthermore, by being expressed in monetary terms, general government outlays have immediate and practical relevance to the financing requirement of governments. The monetary equivalent of total government outlays must be financed, either from taxes imposed on the current generation of taxpayers, or by borrowing and thus by implication imposing a financial burden (though not necessarily a real economic burden, depending on the form that government spending actually takes) on future generations of taxpayers.

General government outlays thus have immediate macroeconomic relevance, even if they are only imperfect indicators of the overall size and impact of government intervention. Although it would be preferable to supplement outlay-based measures of government size with indicators of other forms of public sector intervention, this has proved to be difficult to achieve in practice, at least within a comparative framework. A major reason for this is the failure to reach agreement on common international standards for the measurement of the cost of tax concessions (or tax expenditures) or regulatory activity, or on how to identify the scope and size of the public enterprise sector. In relation to tax expenditures, for example, there is no agreement on what constitutes the 'normal' or 'benchmark' tax system which can be used to identify and cost tax expenditures (OECD, 1984; Surrey and McDaniel, 1985). Similarly, a common definition of a public enterprise has not been produced, different countries preferring to use their own definitions based on national concepts of government ownership or control criteria (Pathirane and Blades, 1982).

A single measure of the entire scope of the activities of the public sector - as opposed to the more narrowly defined general government sector - is thus not available, with the result that measures of the size of the public sector are necessarily multi-dimensional (Saunders and Klau, 1985). Furthermore, the possibility of substitutability between the general government sector and

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the broader public sector implies that the comparative nature of measures of the general government sector are themselves compromised to a certain extent.

It is common to express general government outlays relative to GDP in order that the size of the government sector can be gauged relative to the overall size of the economy. Although this standardises the measure across countries and avoids the complications of using different currency units, it is not the only available approach. It is possible, for example, to express government outlays per head of population, converted to a common currency unit using some variant of exchange rates or a measure of relative purchasing power parities. There is no single correct comparative measure to use, the choice between alternatives being determined by the task at hand and the precise issues being addressed. However, because of its popularity and common usage, the outlays to GDP measure will form the basis of most of the comparisons presented here.

### **3 Comparative Trends in General Government Size Since 1970**

The most recently available comparative data on general government outlays are shown in Table 1 for selected years since 1970. The data for all countries except Greece and Switzerland include all general government outlays in the form of final consumption expenditure, transfer payments and gross fixed capital formation. For Greece and Switzerland, data on government gross fixed capital formation are not available and these are thus excluded from the figures in the table. Both the numerator and denominator of the ratios shown in Table 1 are expressed in current prices. Similar ratios, calculated on the basis of constant price aggregates may exhibit different trends to those shown, because of differential movements in the price index used to deflate government outlays and that used to deflate GDP. This differential, referred to as the relative price effect, is discussed in Heller (1981), Saunders and Klau (1985), and Gemmell (forthcoming) and will not be pursued further here.

Table 1 indicates that in 1989, the size of general government outlays relative to GDP ranged from 26 per cent in Turkey and around 33 per cent

**Table 1: Trends in General Government Outlays (Percentages of GDP)**

|                             | 1970        | 1979        | 1982        | 1984        | 1989        | Maximum<br>Ratio in: |
|-----------------------------|-------------|-------------|-------------|-------------|-------------|----------------------|
| Australia <sup>(a)</sup>    | 26.8        | 33.4        | 37.1        | 38.6        | 34.3        | 1985                 |
| Austria                     | 39.2        | 48.9        | 50.9        | 50.8        | 49.4        | 1987                 |
| Belgium                     | 36.5        | 49.3        | 55.3        | 54.1        | 48.9        | 1982                 |
| Canada                      | 34.8        | 39.0        | 46.6        | 46.8        | 44.2        | 1983                 |
| Denmark                     | 40.2        | 53.2        | 61.2        | 60.3        | 59.5        | 1983                 |
| Finland                     | 30.5        | 36.7        | 39.1        | 39.8        | 38.3        | 1987                 |
| France                      | 38.5        | 45.0        | 50.4        | 52.0        | 49.3        | 1985                 |
| Germany                     | 38.6        | 47.6        | 49.4        | 48.0        | 45.1        | 1982                 |
| Greece <sup>(b)</sup>       | 22.4        | 29.7        | 37.0        | 40.2        | 46.3        | 1989                 |
| Iceland                     | 30.7        | 32.8        | 34.2        | 32.1        | 38.4        | 1989                 |
| Ireland                     | 39.6        | 46.8        | 55.8        | 54.0        | 46.4        | 1983                 |
| Italy                       | 34.2        | 45.5        | 47.4        | 49.3        | 51.7        | 1989                 |
| Japan                       | 19.4        | 31.6        | 33.7        | 33.2        | 32.9        | 1983                 |
| Luxembourg                  | 33.1        | 52.5        | 55.8        | 51.8        | n.a.        | 1981                 |
| Netherlands                 | 43.9        | 55.8        | 61.6        | 61.0        | 55.7        | 1983                 |
| Norway                      | 41.0        | 50.4        | 48.3        | 46.3        | 52.9        | 1989                 |
| Portugal                    | 21.6        | 36.2        | 43.0        | 44.4        | 40.9        | 1983                 |
| Spain                       | 22.2        | 30.5        | 37.5        | 39.3        | 41.8        | 1985                 |
| Sweden                      | 43.6        | 61.0        | 66.3        | 63.5        | 60.6        | 1982                 |
| Switzerland <sup>(b)</sup>  | 21.3        | 29.9        | 30.1        | 31.4        | 29.7        | 1984                 |
| Turkey                      | n.a.        | 33.5        | 28.3        | 24.7        | 26.2        | n.a.                 |
| United Kingdom              | 38.8        | 42.5        | 46.9        | 47.2        | 39.7        | 1981                 |
| United States               | 31.6        | 31.7        | 36.5        | 35.8        | 36.5        | 1986                 |
| <b>Average (unweighted)</b> | <b>33.1</b> | <b>41.9</b> | <b>45.8</b> | <b>45.4</b> | <b>44.0</b> | <b>-</b>             |

**Notes:** (a) Fiscal year beginning on 1 July.  
 (b) Current disbursements only.  
 n.a. Not available.

**Sources:** OECD *Historical Statistics, 1960-1988*, Table 6.5 and Oxley et al. (1990), Table 6.

in Australia and Japan, to 60 per cent in Denmark and Sweden. The outlays to GDP ratio exceeded 50 per cent in five countries in 1989 and was close to 50 per cent in a further three countries. The average outlay share of 44 per cent represents an increase of one third over the 1970 average general government outlays to GDP of 33 per cent. A clear break in the rate of change of general government outlays relative to GDP is apparent from the early 1980s. Whereas the outlay ratio rose steadily between 1970 and 1982, by around one percentage point a year on average, thereafter it stabilised for

a few years before declining slightly in most countries. As the last column in Table 1 indicates, this reversal in the growth of government began at different times in different countries, but by 1989 outlays had fallen below their peak in all countries except Iceland, Italy and Norway (and possibly also in Greece).

Between 1970 and 1989, the general government outlay to GDP ratio increased by around 20 percentage points in Denmark, Greece, Portugal and Spain. With the exception of Denmark, the rapid increase in the three Southern European countries probably represented a process of 'catch-up' to the far larger government sectors in other OECD countries. Yet even after this increase, Greece was the only Southern European country that had a spending ratio in 1989 above the OECD average. Increases in the outlay ratio of less than 10 percentage points over the period were experienced in Australia, Canada, Finland, Germany, Iceland, Ireland, Switzerland the United Kingdom and the United States. Of these, by far the lowest increase - less than one percentage point - was experienced in the United Kingdom, although the UK spending ratio reached a maximum of almost 48 per cent in 1981. In between these two groups of countries is a third group - comprising most of Northern Europe, including the Scandinavian countries - where the spending ratio rose by between 10 and 20 percentage points between 1970 and 1989. These patterns of relative spending growth reflect the stage and rate of economic development in each country, the state of maturity of existing government programs and the extent to which economic policy formulation became dominated in the 1980s by doctrines that stressed the need to reduce the size of government.

Although the ratio of general government outlays to GDP is an important indicator of the size of the general government sector, the ratio itself does not indicate the extent of the government sector's claim on total resources. This partly reflects the fact that, as explained earlier, no account is taken of relative price movements when calculating the ratio, but more importantly it reflects the kinds of expenditures included in government outlays. As will be shown later, a considerable proportion of the outlays shown in Table 1 takes the form of transfer payments, which involve a redistribution of resources with no associated direct claim on resources (aside from those required to administer redistributive programs). In order to gain a better

understanding of the size of the government sector's usage of total economic resources, other indicators are thus required.

One such measure, the proportion of general government employment in total employment, is shown for selected years since 1970 in Table 2. These trends - discussed in more detail in Martin (1982), OECD (1982) and Heller and Tait (1983) - indicate that in broad terms, the employment ratios in Table 2 exhibit a similar pattern across countries and over time as the outlay ratios shown in Table 1. General government employment is, however, far smaller relative to total employment than total outlays are relative to GDP, primarily because the direct employment requirements of transfer payments are very low. On average, the general government sector accounted for around 18 per cent of total employment in 1989. Between 1970 and 1989, however, the proportionate increase in the average employment share exceeds the proportionate increase in the average outlay share. The levelling off and eventual decline in output which occurred in many countries after 1982 (Table 1) is only apparent somewhat later in the employment data, and even then only as a levelling off. The employment share was still rising in 1989 in a considerable number of countries, even though outlays were steady or falling by then relative to GDP.

The ranking of countries according to the employment ratios in Table 2 is broadly similar to their ranking on the basis of the outlay ratios in Table 1. There are, however, several exceptions to this general rule. These arise primarily where countries have unusually high (or low) levels of transfer payments which, as already noted, are reflected in the total outlay data whilst having little direct impact on government employment. As noted by Saunders (1987), the relationship between government employment and government outlays is much closer when transfer payments are excluded from the latter. Thus, for example, the low level of spending on transfer payments in Australia and the high level in the Netherlands (see Table 3) helps to explain why Australia's employment ratio appears high relative to its outlay ratio and why the Netherlands' employment ratio appears low relative to its outlay ratio.

Overall, the results presented in this Section show what an important role the general government sector plays in the economies of modern nations. Even after the slowdown in government growth in the 1980s, government

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**Table 2: General Government Employment as a Percentage of Total Employment<sup>(a)</sup> (Percentages)**

|                          | 1970        | 1975        | 1979        | 1984        | 1989                |
|--------------------------|-------------|-------------|-------------|-------------|---------------------|
| Australia <sup>(b)</sup> | 11.8        | 15.4        | 16.2        | 17.4        | 15.7                |
| Austria                  | 12.9        | 15.9        | 17.3        | 19.1        | 20.2                |
| Belgium                  | 13.6        | 15.6        | 18.3        | 19.9        | 19.9 <sup>(c)</sup> |
| Canada                   | 19.0        | 20.7        | 19.5        | 20.8        | 20.3                |
| Denmark                  | 17.2        | 23.6        | 26.9        | 30.2        | 30.2                |
| Finland                  | 11.4        | 14.0        | 17.2        | 18.9        | 20.9                |
| France                   | 17.6        | 19.0        | 19.9        | 22.1        | 22.7                |
| Germany                  | 11.1        | 13.8        | 14.7        | 15.5        | 15.4                |
| Greece                   | 7.4         | 8.2         | 9.1         | 9.4         | 10.5                |
| Ireland                  | 12.0        | 14.4        | 16.1        | 18.2        | 18.1                |
| Italy                    | 12.3        | 14.6        | 15.8        | 16.6        | 17.3                |
| Japan                    | 7.7         | 8.7         | 8.8         | 8.7         | 8.2                 |
| Luxembourg               | 9.4         | 9.7         | 10.6        | 11.3        | 11.3 <sup>(c)</sup> |
| Netherlands              | 12.2        | 13.6        | 14.7        | 16.1        | 15.2                |
| Norway                   | 17.9        | 21.6        | 24.3        | 28.0        | 30.8                |
| Portugal                 | 7.9         | 8.5         | 10.5        | 13.3        | 14.1                |
| Spain                    | 5.5         | 7.8         | 10.0        | 12.8        | 14.2                |
| Sweden                   | 20.9        | 25.7        | 29.9        | 32.9        | 31.5                |
| Switzerland              | 7.5         | 9.0         | 10.1        | 10.2        | 10.6                |
| United Kingdom           | 18.1        | 20.9        | 21.2        | 21.8        | 19.5                |
| United States            | 16.0        | 17.1        | 16.1        | 15.3        | 15.1                |
| <b>Mean (unweighted)</b> | <b>12.8</b> | <b>15.1</b> | <b>16.5</b> | <b>18.0</b> | <b>18.2</b>         |

**Notes:** (a) The employment ratios shown in this table are calculated on the basis of the number of equivalent full-time workers.  
 (b) Estimates for Australia have been derived by the OECD Secretariat.  
 (c) 1988.

**Source:** Oxley et al. (1990), Table 12.

outlays still correspond to almost 50 per cent or more of GDP in one third of OECD countries, and government employment accounts for a fifth or more of the employed labour force in around a third of OECD countries. In order to gain a better insight into the precise forms that government represents in each country and to compare them, it is necessary to look beyond these aggregate measures to indicators of the structure of general government outlays.

**Table 3: Government Outlays by Economic Category<sup>(a)</sup>**  
**(Percentages of GDP)**

|                                 | 1968                                |                      |                               | 1988                                |                      |                               |
|---------------------------------|-------------------------------------|----------------------|-------------------------------|-------------------------------------|----------------------|-------------------------------|
|                                 | Final<br>Consumption<br>Expenditure | Transfer<br>Payments | Gross<br>Capital<br>Formation | Final<br>Consumption<br>Expenditure | Transfer<br>Payments | Gross<br>Capital<br>Formation |
| Australia                       | 14.1                                | 6.4                  | 3.6                           | 17.9 <sup>(b)</sup>                 | 15.4 <sup>(b)</sup>  | 2.6 <sup>(b)</sup>            |
| Austria                         | 14.7                                | 19.1                 | 6.8                           | 18.4                                | 27.4                 | 4.8                           |
| Belgium                         | 13.6                                | 19.3                 | 3.4                           | 15.3                                | 33.7                 | 1.7                           |
| Canada                          | 16.9                                | 11.6                 | 3.9                           | 18.8                                | 22.9                 | 2.7                           |
| Denmark                         | 18.6                                | 12.7                 | 5.0                           | 25.8                                | 31.5                 | 2.9                           |
| Finland                         | 15.3                                | 12.6                 | 4.9                           | 20.2                                | 16.7                 | 3.3                           |
| France                          | 14.8                                | 20.6                 | 5.0                           | 18.6                                | 28.3                 | 3.4                           |
| Germany                         | 15.5                                | 18.5                 | 5.1                           | 19.5                                | 23.6                 | 3.5                           |
| Greece                          | 12.9                                | 10.6                 | n.a.                          | 20.6                                | 25.1                 | n.a.                          |
| Iceland                         | 13.1                                | 11.8                 | 8.9                           | 18.6                                | 11.9                 | 6.6                           |
| Ireland                         | 13.4                                | 16.1                 | 5.7                           | 17.9 <sup>(b)</sup>                 | 32.1 <sup>(b)</sup>  | 3.4 <sup>(b)</sup>            |
| Italy                           | 13.6                                | 17.4                 | 3.7                           | 17.2                                | 28.9                 | 4.7                           |
| Japan                           | 7.4                                 | 6.5                  | 5.3                           | 9.4                                 | 17.4                 | 6.1                           |
| Luxembourg                      | 12.1                                | 20.7                 | 4.5                           | 16.3 <sup>(c)</sup>                 | 29.9 <sup>(c)</sup>  | 6.1 <sup>(c)</sup>            |
| Netherlands                     | 14.9                                | 22.9                 | 6.1                           | 15.7                                | 37.6                 | 4.6                           |
| Norway                          | 16.6                                | 17.0                 | 4.3                           | 20.6 <sup>(b)</sup>                 | 27.0 <sup>(b)</sup>  | 3.5 <sup>(b)</sup>            |
| New Zealand                     | 13.0                                | n.a.                 | n.a.                          | 17.1                                | n.a.                 | n.a.                          |
| Portugal                        | 13.1                                | 5.5                  | 2.3                           | 15.4 <sup>(c)</sup>                 | 25.0 <sup>(c)</sup>  | 3.5 <sup>(c)</sup>            |
| Spain                           | 8.8                                 | 9.0                  | 3.5                           | 14.0 <sup>(c)</sup>                 | 22.1 <sup>(c)</sup>  | 5.6 <sup>(c)</sup>            |
| Sweden                          | 20.5                                | 15.4                 | 6.9                           | 26.6 <sup>(b)</sup>                 | 31.2 <sup>(b)</sup>  | 1.2 <sup>(b)</sup>            |
| Switzerland                     | 10.4                                | 10.3                 | n.a.                          | 12.8                                | 17.6                 | n.a.                          |
| Turkey                          | 12.6                                | 2.9                  | 6.4                           | 8.7                                 | n.a.                 | n.a.                          |
| United Kingdom                  | 17.6                                | 15.9                 | 5.8                           | 20.5 <sup>(b)</sup>                 | 20.7 <sup>(b)</sup>  | 2.0 <sup>(b)</sup>            |
| United States                   | 18.8                                | 9.5                  | 2.4                           | 18.3                                | 16.5                 | 1.5                           |
| <b>Mean</b>                     |                                     |                      |                               |                                     |                      |                               |
| <b>Percentage<sup>(d)</sup></b> | <b>14.3</b>                         | <b>13.6</b>          | <b>4.9</b>                    | <b>17.7</b>                         | <b>24.7</b>          | <b>3.7</b>                    |
| <b>Mean Share<sup>(e)</sup></b> | <b>43.6</b>                         | <b>41.5</b>          | <b>14.9</b>                   | <b>38.4</b>                         | <b>53.6</b>          | <b>8.0</b>                    |

**Notes:** (a) Transfer payments mainly comprise subsidies, social security transfers to households and public debt interest payments.  
(b) 1987.  
(c) 1986.  
(d) Unweighted mean ratio.  
(e) Unweighted percentage share of total outlays.  
n.a. Not available.

**Source:** *OECD Historical Statistics, 1960-1988*, Tables 6.2, 6.4 and 6.5.



## 4 The Structure of Government Outlays

Because the national accounts provide the basic framework for the collection of data on general government outlays, the disaggregation of those outlays according to an 'economic' classification can most easily be undertaken using national accounting concepts. It is thus straightforward to disaggregate total outlays into those corresponding to government final consumption expenditure, gross capital formation and transfer payments, because these represent the basic economic categories on which the national accounts are constructed. Within this classification, final consumption expenditure includes general government spending on materials used in public production, purchases of the outputs of private producers, or wage and salary payments to general government employees. Of these, the latter is easily the most important individual component. Included in transfer payments are subsidies, social security benefits, social assistance grants and public debt interest payments, while gross capital formation includes expenditure on government plant and equipment like schools, roads, hospitals and medical equipment. Following the SNA convention, all general government expenditure on defence is recorded as part of final consumption expenditure, even though much of it corresponds to the purchase of equipment.

Information on the structure of general government outlays according to the 'economic' classification of expenditures for the 20 years to 1988 is shown in Table 3. These data reveal the extent to which the growth of government in the 1970s and 1980s reflected the growth of transfer payments. On average, the absolute growth in transfer payments relative to GDP accounts for 11 of the 13 percentage points by which total outlays rose relative to GDP. Government final consumption rose on average by 3.4 percentage points, while government investment fell on average by 1.2 percentage points. These developments thus indicate a marked change in the structure of government outlays and, by implication, in the kinds of activities in which governments were engaged. Increasingly, government spending has been directed to the payment of transfers to specific groups within the population, rather than to the purchase of the labour and equipment needed for the provision of public services.

By 1988, on average almost 54 per cent of total outlays were devoted to transfer payments. Thus, over half of the resources diverted to government

through taxation were being transferred directly to specific beneficiary groups, rather than used to finance government production or purchases of goods and services. Over the last three decades, income redistribution has become the major activity of most OECD governments. Not surprisingly in light of this, Table 3 also reveals that the main reason for the cross-country differences in total outlays shown in Table 1 is differences in the levels of spending on transfer payments. This can be illustrated by again comparing the situation in Australia and the Netherlands. Table 1 shows that the total outlay ratio in the Netherlands in 1989 (55.7 per cent) was far higher than that in Australia (34.3 per cent). However the absolute difference between them (21.4 per cent) was entirely due to the fact that transfer payments in the Netherlands correspond to 37.6 per cent of GDP, while in Australia they represented only 15.4 per cent of GDP. Thus, if spending on transfers in the two countries were to have been the same relative to GDP, their total outlay ratios would also have been virtually identical.

One reason for the different outlay structures shown in Table 3 is due to the different demographic structure in each country. Although OECD nations share common economic and political systems, the demographic structures of their populations differ markedly. Thus, where the proportion of elderly people in the total population is high, government spending on pensions and health care will also tend to be high. This will be true even if the basic level of service provision and the nature of pension entitlements are fixed. This illustrates the important point that many government outlays are the outcome of complex demographic, economic and social forces. These forces mean that governments never have complete control over expenditure levels in the short run, and even in the medium term their influence may be limited.

Although a high proportion of elderly people in the population is often accompanied by a low proportion of young people - leading to lower demands for government services in areas like education, family assistance, and so on - the cost to government of each elderly person generally exceeds the cost to government of each young person by a considerable margin (OECD, 1988; Saunders, 1988; Heller, Hemming and Kohnert, 1986). This means that the level and structure of government outlays are not independent of the age structure of the population. There are, however, many other factors that help to explain the differences shown in Table 3, as

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the work of Cameron (1978), Saunders (1988), Lybeck (1986), Solano (1983) and Tait and Heller (1982) illustrates. What is relevant for current purposes is to establish that these differences exist and to measure, rather than explain, them.

The breakdown of government outlays in Table 3 is of only limited interest to those concerned with analysing and understanding the impact of government programs on the operation of the economy and the living standards of the population. For such purposes, a breakdown of outlays by functional areas like defence, law and order, education, health, social security and so on, is of far greater significance. Such a breakdown allows a clearer picture to be developed of what governments actually do and a better understanding of how they do it. Unfortunately, although the SNA incorporates agreement on the framework and definitions underlying such functional area data, in practice only relatively few OECD countries currently provide such data in comparative form. Such data as were available were first summarised and analysed in the comparative study of the role of the public sector undertaken by Saunders and Klau (1985). That work has recently been updated by Oxley et al. (1990). Table 4 summarises data from these two sources, covering developments over the period from 1970 up to the mid to late 1980s, the latest period for which these data are currently available.

The functional outlay data in Table 4 have been constructed so as to conform to the conventional analytical and conceptual frameworks of public economics and social policy. This has involved taking data from a range of both international and national sources. These data are thus not always entirely consistent, which explains the presence of the Balancing Item in Table 4. This lack of strict comparability should not be lost sight of when these data are used for comparative or interpretive purposes.

The three main areas of government expenditure identified in Table 4 are referred to as the Traditional Domain, the Welfare State and the Mixed Economy. The first area incorporates those activities of government that have existed as long as government itself - defence of the realm, maintenance of law and order, the administration of government through the public (or civil) service, and so on. The second area, the Welfare State, includes those aspects of government associated mainly with post-war social welfare policies designed to equalise opportunities and access to key

**Table 4: The Structure of General Government Outlays<sup>(a)</sup> (Percentages of GDP)**

|                                     | Australia   |             | Denmark     |             | France      |             | Germany     |             | Japan       |             | United Kingdom |             | United States |             |
|-------------------------------------|-------------|-------------|-------------|-------------|-------------|-------------|-------------|-------------|-------------|-------------|----------------|-------------|---------------|-------------|
|                                     | 1970        | 1987        | 1971        | 1988        | 1975        | 1986        | 1970        | 1987        | 1970        | 1988        | 1970           | 1986        | 1970          | 1987        |
| <b>Total Outlays</b>                | <b>25.5</b> | <b>36.4</b> | <b>43.0</b> | <b>57.6</b> | <b>43.5</b> | <b>51.6</b> | <b>38.7</b> | <b>46.9</b> | <b>19.4</b> | <b>32.9</b> | <b>39.3</b>    | <b>45.5</b> | <b>32.3</b>   | <b>36.7</b> |
| <b>The Traditional Domain</b>       |             |             |             |             |             |             |             |             |             |             |                |             |               |             |
| <b>Public Goods</b>                 | <b>6.6</b>  | <b>6.7</b>  | <b>6.9</b>  | <b>8.2</b>  | <b>7.2</b>  | <b>7.8</b>  | <b>7.2</b>  | <b>7.9</b>  | <b>3.3</b>  | <b>n.a.</b> | <b>8.9</b>     | <b>8.9</b>  | <b>11.1</b>   | <b>9.7</b>  |
| Defence                             | 3.1         | 2.3         | 2.5         | 2.0         | 3.3         | 3.1         | 3.0         | 2.7         | 0.7         | 0.9         | 4.8            | 4.9         | 7.5           | 6.6         |
| General public services             | 3.5         | 4.4         | 4.4         | 6.2         | 3.9         | 4.7         | 4.2         | 5.2         | 2.6         | n.a.        | 4.1            | 4.0         | 3.6           | 3.1         |
| <b>The Welfare State</b>            |             |             |             |             |             |             |             |             |             |             |                |             |               |             |
| <b>Merit Goods</b>                  | <b>8.3</b>  | <b>12.1</b> | <b>15.7</b> | <b>13.8</b> | <b>15.4</b> | <b>13.4</b> | <b>10.0</b> | <b>12.2</b> | <b>8.0</b>  | <b>11.4</b> | <b>12.8</b>    | <b>12.1</b> | <b>8.7</b>    | <b>6.0</b>  |
| Education                           | 4.2         | 5.2         | 7.5         | 6.8         | 5.8         | 5.5         | 4.0         | 4.4         | 3.5         | 4.3         | 5.3            | 5.1         | 5.3           | 4.5         |
| Health                              | 3.2         | 5.3         | 5.5         | 5.2         | 5.5         | 4.3         | 4.2         | 6.2         | 2.9         | 4.9         | 4.0            | 5.1         | 2.8           | 0.9         |
| Housing and other                   | 0.9         | 1.6         | 2.7         | 1.8         | 4.1         | 3.6         | 1.8         | 1.6         | 1.6         | 2.2         | 3.5            | 1.9         | 0.6           | 0.6         |
| <b>Income Maintenance</b>           | <b>3.8</b>  | <b>7.3</b>  | <b>10.8</b> | <b>15.4</b> | <b>12.9</b> | <b>23.9</b> | <b>12.6</b> | <b>16.4</b> | <b>2.4</b>  | <b>7.9</b>  | <b>7.3</b>     | <b>13.2</b> | <b>6.3</b>    | <b>7.9</b>  |
| Pensions                            | 3.1         | 4.5         | 7.3         | 8.5         | 8.4         | 13.9        | 10.6        | 11.5        | 1.2         | 6.2         | 5.2            | 6.8         | 5.3           | 7.0         |
| Sickness                            | 0.1         | 0.2         | 0.7         | 1.1         | 1.3         | 5.3         | 0.6         | 0.7         | 0.1         | 0.2         | 0.9            | 0.3         | 0.1           | 0.2         |
| Family allowances                   | 0.6         | 1.0         | 1.7         | 2.7         | 2.3         | 3.0         | 0.4         | 0.8         | 0.8         | 1.2         | 0.7            | 1.8         | 0.5           | 0.4         |
| Unemployment                        | 0.0         | 1.1         | 0.6         | 2.8         | 0.8         | 1.7         | 0.3         | 1.5         | 0.3         | 0.3         | 0.5            | 1.8         | 0.4           | 0.3         |
| Other                               | 0.1         | 0.5         | 0.5         | 0.3         | 0.0         | 0.0         | 0.7         | 1.9         | 0.0         | 0.0         | 0.0            | 2.5         | 0.0           | n.a.        |
| <b>The Mixed Economy</b>            |             |             |             |             |             |             |             |             |             |             |                |             |               |             |
| <b>Economic Services</b>            | <b>4.6</b>  | <b>5.1</b>  | <b>6.0</b>  | <b>5.7</b>  | <b>3.9</b>  | <b>3.6</b>  | <b>5.2</b>  | <b>4.7</b>  | <b>4.9</b>  | <b>4.9</b>  | <b>5.2</b>     | <b>4.3</b>  | <b>3.9</b>    | <b>5.7</b>  |
| Capital transactions                | 2.4         | 1.1         | n.a.        | 1.1         | 1.3         | 0.8         | 2.4         | 1.6         | 2.9         | 3.2         | 2.8            | 1.0         | 1.2           | 1.8         |
| Subsidies                           | 0.9         | 1.2         | n.a.        | 2.5         | 1.3         | 1.4         | 1.5         | 1.9         | 1.1         | 0.6         | 1.1            | 1.3         | 0.4           | 0.7         |
| Other                               | 1.3         | 2.8         | n.a.        | 2.1         | 1.3         | 1.4         | 1.3         | 1.2         | 0.9         | 1.1         | 1.3            | 2.0         | 2.3           | 3.2         |
| <b>Public Debt Interest</b>         | <b>2.5</b>  | <b>4.0</b>  | <b>1.4</b>  | <b>8.3</b>  | <b>1.3</b>  | <b>2.9</b>  | <b>1.0</b>  | <b>2.8</b>  | <b>0.6</b>  | <b>4.3</b>  | <b>4.0</b>     | <b>4.5</b>  | <b>2.3</b>    | <b>5.0</b>  |
| <b>Balancing Item<sup>(b)</sup></b> | <b>-0.3</b> | <b>1.2</b>  | <b>2.2</b>  | <b>6.1</b>  | <b>2.8</b>  | <b>0.0</b>  | <b>2.7</b>  | <b>3.0</b>  | <b>0.2</b>  | <b>3.6</b>  | <b>1.1</b>     | <b>2.6</b>  | <b>0.0</b>    | <b>2.2</b>  |
| <b>Net Lending</b>                  | <b>2.2</b>  | <b>0.5</b>  | <b>3.9</b>  | <b>2.5</b>  | <b>-2.2</b> | <b>-2.7</b> | <b>0.2</b>  | <b>-1.9</b> | <b>1.8</b>  | <b>2.1</b>  | <b>2.5</b>     | <b>-2.8</b> | <b>-0.6</b>   | <b>-3.7</b> |

Notes: (a) Totals may not add due to rounding.

(b) The data coverage of these different items is not entirely consistent, which explains the presence of this item.

n.a. Not available.

Sources: Saunders and Klau (1985), Table 8; Oxley et al. (1990), Table 10.

services and thereby to achieve more equitable outcomes within a market economy. This area includes spending on education, health, housing and community services as well as on income maintenance programs which protect the incomes of the sick, the unemployed, the elderly, and so on. The final area, the Mixed Economy, incorporates those aspects of government activity designed primarily to assist and enable the functioning of the private sector. It includes spending in such areas as transport and communication, labour market and employment programs and industry assistance schemes.

The data in Table 4 indicate that in most countries the Traditional Domain now accounts for only a relatively small proportion of government outlays, except in the United States where defence spending is much higher than elsewhere. Not only has this component of government spending been relatively small, it has also been a generally stable proportion of GDP, again with the exception of the United States where defence spending fell noticeably between 1970 and 1987.

In contrast, spending on the Welfare State shows much greater variability across countries and has increased markedly in all countries since 1970. The general increase in Welfare State expenditure does not, however, extend to each separate item identified in Table 4. For example, total spending on merit goods actually declined relative to GDP in Denmark, France, the United Kingdom and the United States. Within the merit goods category, country variations are far greater in the areas of health and housing than in education, as noted by O'Higgins (1988). Education spending has also tended to exhibit a more stable pattern over time than either health or housing, where substantial changes are apparent in a number of countries (OECD, 1985; 1987; 1988).

By far the largest increases in expenditure have tended to occur in the income maintenance programs of the Welfare State, as was noted earlier when discussing the general growth in transfer payments. The rate of increase in income maintenance spending relative to GDP has been most rapid in Australia, France, Japan and the United Kingdom. In all countries except Germany, the growth in spending on pensions was the main factor behind overall income maintenance expenditure growth. Spending on unemployment compensation was most important in Germany, but was also significant in Australia, Denmark and the United Kingdom. These comparisons illustrate the importance of demographic developments (which

underlie the increase in pension spending) and economic developments (which, through their impact on the level of unemployment, underlie the increase in spending on unemployment compensation) on trends in total government spending and the structure of that spending.

Spending on the economic services component of the Mixed Economy is generally quite low and in most countries has tended to move broadly in line with GDP over the period. The two main exceptions to this are the marked decline in the United Kingdom and the very substantial increase in the United States. The second component of the Mixed Economy, public debt interest payments, corresponds to a monetary transfer from the government to those holders of government debt who have made loans in order that previous budget deficits could be financed. Continuous deficit financing throughout the second half of the 1970s and into the early 1980s in most countries, in combination with the high level of interest rates since the mid-1980s, has seen a very rapid increase in public debt interest payments in most countries. This rise in government interest payments - another component of transfer payments - has been particularly marked in Denmark, Japan and the United States.

The final row in Table 4 shows the level of general government net lending, defined as the difference between total government receipts and total spending, expressed as a percentage of GDP. A positive net lending figure thus corresponds to a budget surplus and a negative figure to a budget deficit. Table 4 shows that general government net lending fell over the period in all countries except Japan. However, comparisons of net lending in two individual years can be quite misleading, particularly if they correspond to different stages of the business cycle. There are important cyclical effects on budget deficits which operate through automatic stabilisers as well as through policy responses to the cyclical situation. For these reasons, not too much emphasis should be given to the specific falls in net lending shown in Table 4. What is of much greater significance, as emphasised in the recent report by Oxley et al. (1990), is the general decline in net borrowing in most OECD countries since the mid-1980s, a development that has been made possible by the reduction in the government outlays ratios shown in Table 1.

The data in Table 4 provide a clearer picture of cross-country differences in various aspects of government activity in a number of OECD countries over

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the period from 1970 to the mid-1980s. The picture that emerges is one of both similarity and difference. In many dimensions, the size of the general government sector relative to GDP is similar across nations, specifically in traditional areas like defence and general public services, but also in education, economic services and - with the notable exception of the United States - health care. The major differences arise in spending on income maintenance and public debt interest payments.

In relation to income maintenance spending, differences in spending on pensions and family allowances partly reflect demographic differences and the political pressures to which they give rise, while differences in spending on unemployment compensation reflect different levels of unemployment. Spending on public debt interest payments depends upon the cumulative size of past budget deficit levels and the current level of interest rates. These in turn reflect previous fiscal and monetary policy stances and it is hardly surprising that major differences emerge here, both over time as policies change within countries, and across countries choosing different macroeconomic policy mixes at a particular point in time.

## 5 Summary

The emphasis in this paper has been on describing how comparative measures of the size of government are constructed and on using them to investigate how the level and structure of government activity has changed in OECD countries over the last two decades. As is nearly always the case with comparative measures, some compromises have had to be made which make the measures less comprehensive than national statistics normally permit. What is gained in return is a cross-country context that sheds light on some of the broader factors influencing the growth of government in modern nations.

Statistical measures of general government spending derived within the SNA framework are partial in scope and do not encompass all of the public sector, more broadly defined. Because of the failure to reach agreement on how to define and measure the scope of public enterprise activity or how to identify and measure tax expenditures, measures of the size of the general government sector are likely to be the only available comparative indicators of government size for some time to come.

The aggregate measures discussed in Section 3 show how the growth in general government outlays relative to GDP was halted and then reversed in most countries in the 1980s, after at least three decades of steady increase. The latter half of the 1980s thus represents a significant departure from the steady upward trend in the size of government which has characterised the post-war period. The extent of these changes has, however, generally been small, certainly less than the rhetoric of some governments would suggest has been aimed for. Yet despite these recent developments, general government outlays still represent 50 per cent or more of GDP in a third of OECD countries, while the general government sector employs more than a fifth of all workers in a third of all OECD countries.

A more detailed analysis of the structure of government outlays reveals that differences across countries and over time within countries are largely attributable to different levels of spending on transfer payments. In many other dimensions, the picture to emerge is more one of similarity than of difference, that tending to be the more so as time passes. Country differences in spending on transfer payments such as pensions, unemployment compensation and public debt interest payments largely explain the overall differences in government outlays that are observed between countries. Different levels of transfer spending in turn depend upon different demographic and economic developments within countries, as well as different policy choices made in the past.

It is certainly true that different countries have followed different paths in relation to the relative size of the general government sector in recent decades. But there are also a number of factors common to all OECD countries which have led to similar developments in some areas of government in the past and are currently causing a narrowing of some of the differences in other areas. It will be interesting to see the extent to which these processes continue into the 1990s.

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