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THE CAUSES AND CONSEQUENCES OF GOVERNMENT GROWTH 1860 - 2010

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ABSTRACT

Government growth theories have traditionally been only able to explain disjointed portions of government growth over time. This is a direct result of previous growth theories excluding the institutional and ideological context within which government operates. Only with the creation of rent-seeking political groups at the end of the Civil War, the progressive movement of the early 1900's, and the promulgation of Keynesian Economics during the Great Depression were the institutions and ideologies conducive to sustained government growth created and institutionalized into the American political landscape and psyche. These institutions and ideologies contributed to the American Government's sustained growth beginning in the latter half of the twenty-first century and continuing to present day; thus resulting not only in the continuing expansion of governmental powers but contributing to an ever weakening capitalistic society as political institutions slowly and deliberately replace the invisible hand which cements a capitalistic society together with that of government.

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Introduction

Before any analysis is presented in this paper, it is important for the reader to understand what exactly is being addressed. The fundamental question this paper attempts to answer is how and why the U.S Federal Government has grown over time. But before this question can be answered, evidence must be presented which confirms the a priori analysis to follow: that the U.S Federal Government has grown over time. That is, a definition of government growth and evidence to support this position must be presented before the causes and consequences of government growth can be analyzed. What follows is a definition of government growth, its common measurements, and evidence which supports the a priori basis of this paper.

A definitive definition of government growth is elusive in economics. Researchers of government growth present measurements of it, but never define what is meant by government growth. It is often left to the reader to assume an implicit definition. Many times, this implicit definition of government growth is as follows: the encroachment of government (public) economic activity into the realm of private economic activity. The most extreme case of such an encroachment would be the nationalization of an entire industry. Although rare, it illustrates concisely what is meant by government growth: a previous privately controlled industry is now a government (publicly) controlled industry. This is obviously an extreme example of government growth. A more subdued example of government growth would be the government provision of previously un-provided goods and services, e.g. a national missile defense shield. In this case, the government is either purchasing or producing a product or service previously completely purchased and produced only in private markets. As a result of this expansion in government economic activity, private economic activity must now compete with government economic activity for resources. This is what is meant by government economic activity encroaching on private economic activity: private economic activity must compete with government economic activity for the same goods and services.

Although there are other definitions of government growth belonging to other disciplines, such as an encroachment of government onto civil liberties belonging to the discipline of political science, using such a definition of government growth would be inappropriate for the current economic analysis. Although it could be argued that an encroachment onto civil liberties affects economic activity, it does not fit the economic definition of government growth and therefore would be inappropriate to use in an economic analysis. Having said this, it should be noted that the scope of government economic activity is closely related to the political process and power of a government, which political science is adept at explaining. This is to say that any expansion of government economic activity is a result of the political process and institutions, not because of any economic law. This means that a thorough understanding of any expansion of government economic activity and its consequences cannot exist without an understanding of the political process and institutions which produce them. This melding of political institutions and structure into economic analysis is commonly known as institutional economics and is the methodology presented herein.

U.S Federal Government Growth through Time

There are many ways to measure the growth of a government through time. Some of the most common methods presented in literature are total government spending, government spending per capita, and government spending as a percentage of gross domestic product (also sometimes referred to as the ratio of government spending to gross domestic product). Each of these three measures of spending will be discussed in turn below. Of the three methods total government spending is the easiest to conceptually understand, albeit most prone to misinterpretation.

Total Government Spending

Although an intuitive measurement of government growth, total government spending through time can be misleading when trying to determine whether government growth has actually occurred. The primary issue with using total government spending as a measurement of government growth is that changes in population, both in absolute and percent change, easily skew data interpretation. For example, an increase in a nation's population would inevitably cause an increase in total government spending as a result of the government increasing its provision of pre-existing public goods to its new citizens. The increase in expenses the government incurs to provide these goods and services is offset by the increase in population; as the population expands so does the tax base of the government, providing the government with the additional revenue it needs to efficiently provide its citizens with public-goods.

It is important to realize that although the government in question may be purchasing and using more resources in the economy to provide public-goods, the government itself has not grown; the government is not encroaching on private economic activity. That is, the government may be purchasing more of the same private goods, but there is no transformation of a private economic activity into a public economic activity. Put another way, the government has not expanded its economic activity, only increased it in proportion to the population. This means that while total government spending may increase through time as a result of increasing population, the government itself may not have grown even though its expenditures and tax receipts could have.

Figure 1 represents total government spending from 1800 – 2008 along with decennial census population. The data shows some interesting characteristics. First, notice the two spikes in total government spending, roughly around 1918 and 1940, coinciding with World War I and World War II respectively. Although outliers, these two crises will become important for government growth theories presented in the coming pages. What is interesting about the data is that despite the flaws which total government spending present as a measure of government growth, one can still look at the data and discern noticeable features. For instance, despite a continually increasing U.S population from 1800 - 1900, there is a relatively constant level of total government expenditures. More so, the data then shows that beginning from roughly 1900 – 1950 there was a modest and constant increase in government spending, again, this is despite continually increasing population growth. Finally, the data then shows that from 1950 – 2008 total government spending increased dramatically. The data shows something abnormal: there are three distinct periods of total government spending despite a continually increasing population. Put another way, population increases seem, on the surface, irrelevant to total government spending; there must be something more to increases in total government spending than the simplistic notion that increases are a result of the government providing public goods to an ever increasing population.

Spending Per Capita

In order to better measure government growth, many researchers use government spending per capita. Although government spending per capita better reflects an expansion of a government's economic activity, it suffers from similar data problems that total government spending presents.

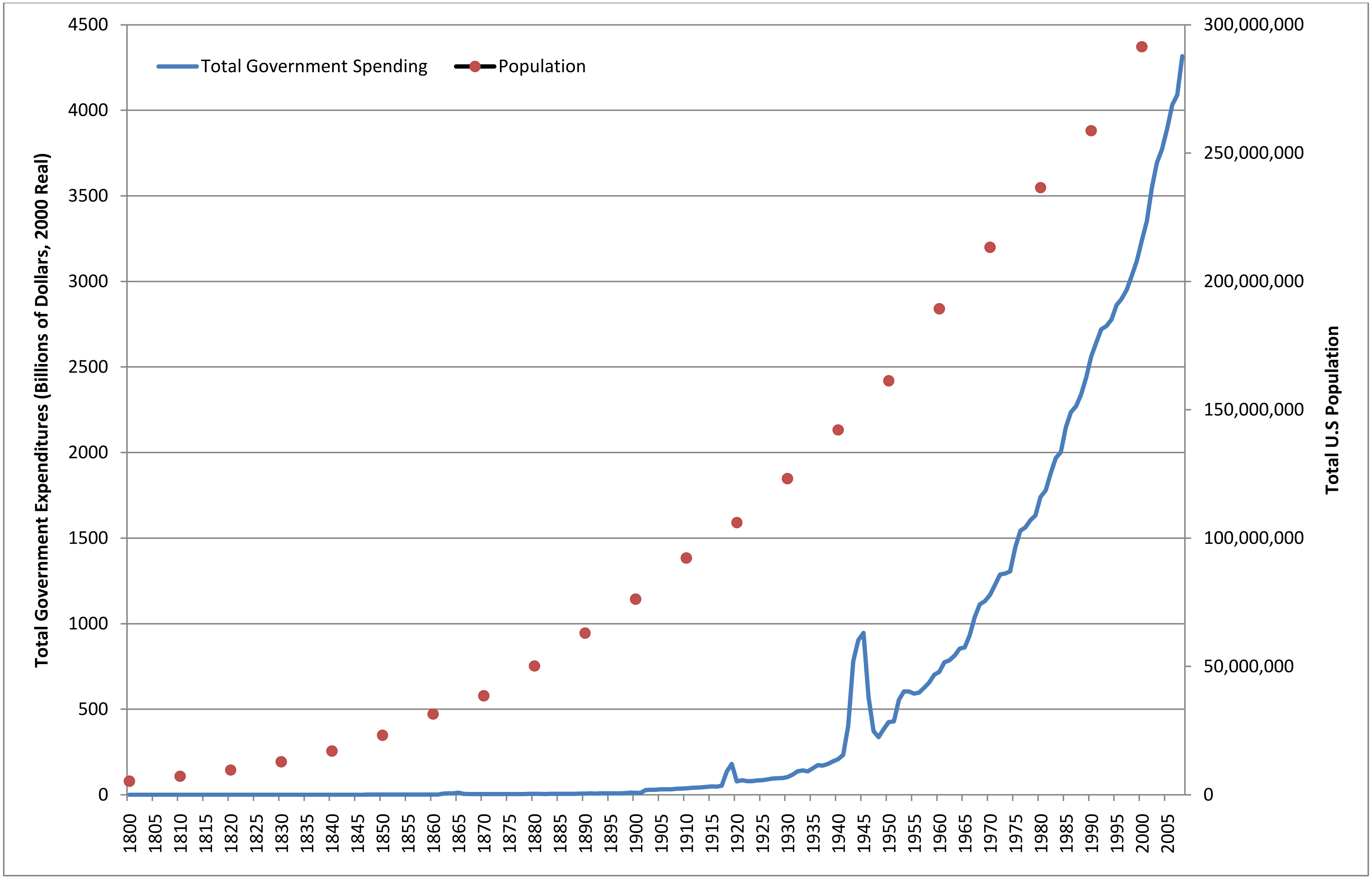

Figure 1: Total U.S Government Spending (1800 – 2005)

The issue with government spending per capita is determining whether increases in government spending per capita are a result of an expansion of government economic activity or increases in government economic activity. Both are legitimate causes for increases in spending per capita, but determining which is the cause proves problematic.

Because of the data problem, it is easy to misinterpret government spending per capita. Take for instance an increase in a nation's population. The increase in the nation's population would result in an increase of government economic activity as it purchases or provides its citizens more of the same goods and services. However, as the government in question purchases more of the same goods and services to provide its citizens, the demand for the goods and services the government desires increases. The natural result would be a marginal increase in prices of the goods and services the government seeks to purchase. Put another way, as the government purchases more of the same goods from the economy, the price of these goods increases, resulting in an increase in price. This would increase government spending per capita as a result of more money being spent on the same services, but government has not grown. Again, there is no expansion of government activity, only an increase in government activity. Another cause for an increase in government spending per capita could be that the government is choosing to provide a higher quality of goods and services to its citizens. There is no easy way to determine what the cause of increases in spending per capita is: increases in government economic activity or expansions of government economic activity.

Although there are issues with government spending per capita, it is a much better measurement of government growth than total government spending. The impact of government purchases on price levels is minimal in the real world, and as such it is usually safe to assume that most, if not all, increases in government spending per capita is a result of economic expansions of government rather than price increases associated with an increase in government economic activity. However, this is an assumption, and as such isn't sufficient to be persuasive evidence for the economic expansion of government. Figure 2 presents decennial population and per capita government spending. What is interesting to note is that the data shows the similar anomalies that total government spending presented. Per capita government spending was very stable from 1800 – 1900, despite an increasing population. This is to be expected if it is true that increases in government spending are a result of providing public goods for an increasing population: as population increases, government spending per capita remains relatively stable. However, from 1900 – 1950, per capita government spending rises at a modest but stable pace, even though population is continually increasing. This could imply that an expansion of government economic activity could have taken place; that is, the government is spending more per capita on its citizens then it was previously, and more interestingly its spending per capita continues to increase at a relatively modest pace. Then, as seen in total government spending, from 1950 – 2008 per capita government spending drastically increases. Despite what appears to be a fairly constant increase in population, government spending per capita increases almost exponentially. Similar to what the data shows in total government spending, on the surface population seems irrelevant to per capita government spending. That is to say that the data presented using per capita government spending still shows three distinct periods of government spending.

Government Spending as Percentage of Gross Domestic Product

A measurement which better discerns between an increase in government economic activity and an expansion of government economic activity is government expenditures as a

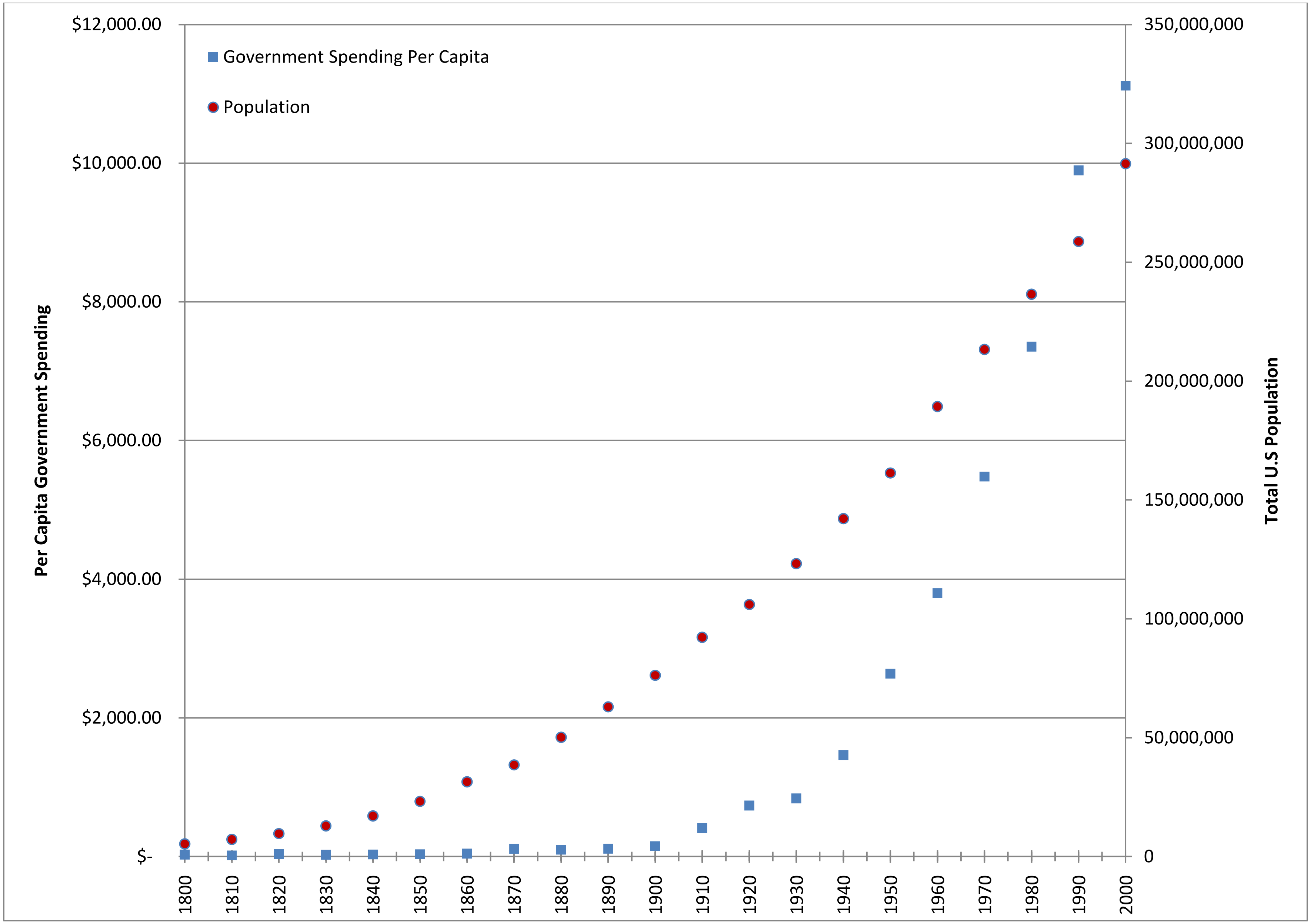

Figure 2: Government Spending Per Capita (1800 - 2000)

percentage of gross domestic product (GDP). This measurement of government growth captures the essential question I seek to answer: has government economic activity, through time, been encroaching onto private economic activity?

The reason government spending as a percentage of GDP is a viable source of government economic growth is that since GDP represents the sum total of all goods and services produced in an economy in a given year, there are only so many goods and services produced within a country in a given year. This means that the entire spectrum of goods and services in an economy must be competed for between different economic actors, both private and public, annually. This presents an interesting dichotomy: all goods and services within an economy are purchased by either private or government (public) economic agents. Put another way, as a government purchases products or services within an economy, the ratio of government expenditure to GDP increases and more of the available resources are being used for government economic activity. Therefore, an increase in the ratio of government spending to GDP implies an encroachment of government economic activity onto private economic activity. Because there is a finite number of goods and services produced within an economy, any good and service purchased by the government must come at the private sector's expense. This leaves fewer resources to be used for private consumption. This is known as crowding out. Although the same logic could be applied to increases in spending on services already provided instead of expansions in the scope of government services, this measure of government growth shows how much government is consuming of the national economy relative to the private sector, an important piece of information that other government growth measures fail to include. Even if the entirety of increases in government contribution to GDP were to be accounted for by increases in services already provided, the government would be consuming an ever larger share of goods and services at the private sector's expense. This means fewer goods for private consumption, and as a result the scope of government economic activity increases by means of attrition to the private sector.

Figure 3 presents U.S government spending as a percentage of GDP. The data presented shows the same anomalies which the previous measurements of government growth presented as well. U.S government spending as a percentage of GDP was remarkably stable for the years between 1800 and 1900. Although there were spikes in government spending, most notably around 1810 and 1860, these were results of the War of 1812 and the Civil War respectively. Starting in 1900 the stable trend in government spending changed to a continued, although erratic, increase in government spending. Again, the massive spikes in spending are the results of World War I and II. Even with the most reliable measure of government growth data, there seems to be an inconsistent story at work.

The conclusion to the analysis presented thus far is that although government growth can take many shapes and forms, there are distinctive and noticeable changes in government expenditures at specific time periods. These changes in government spending patterns are unrelated to changes in population, or increases in GDP. When looked at critically, and with the right data, changes in government spending can be synonymous with changes in government growth. The question then becomes not if changes in government spending and growth happen, but what causes these changes and what are its consequences.

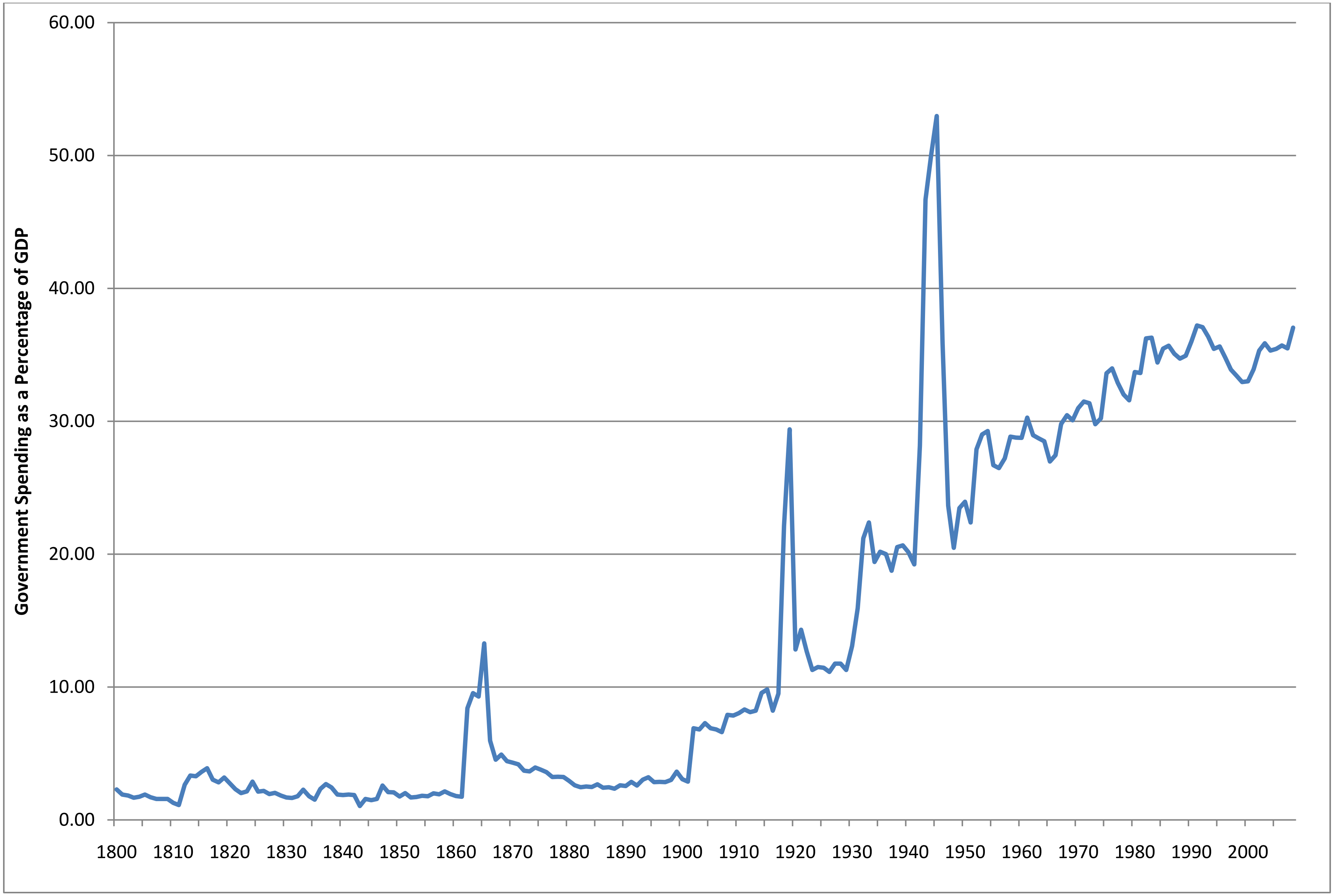

Figure 3: Government Spending as Percentage of GDP (1800 – 2008)

Explanations for U.S Federal Government Growth

When looking at the historical causes and consequences of U.S Federal government growth, public choice economics has much to offer in explaining the trends observed through time. Buchannan[1], Peakcock and Wiseman[2], and Holcombe[3] have each contributed to the topic of U.S Federal growth; however, none of their explanations are completely satisfactory on their own. The reason for their unsatisfactor ability in explaining the historical account of central-government growth lies in the fact that the trends observed in U.S Federal government growth, as displayed in Figure 3 above, have changed drastically over time, and no single theory proposed captures all aspects of these trends.

U.S Federal government growth has traditionally been broken up into three distinct periods. The first period begins in 1787 (the adoption of the U.S Constitution) and ends in 1865 (the end of the Civil War). This first period of growth is a period of non-growth, characterized by remarkably small and stable U.S Federal government growth as measured by all government growth measurements (total spending, per capita spending, and spending as a percent of GDP). The second period of U.S Federal government growth is one of transition from stagnant government growth to one of rapid and sustained growth. This transitional period of U.S Federal government growth begins in 1865 (the end of the Civil War and the start of reconstruction) to the beginning of the Great Depression. The last period of government growth lasts from the beginning of the Great Depression to the present day. This period is marked by sustained and often rapid growth in the U.S Federal government through institutionalizing the changes which took place in the transitional period of U.S Federal government growth. Although these periods of government growth are well known and observable in the data, there is no firm understanding

[1] "An Economic Theory of Clubs", *Economica* (February 1965), pp. 1-14.
[2] "Approaches To the Analysis of Government Expenditure Growth," *Public Finance Review*, Vol. 7, No. 1, 3-23 (1979)
[3] "Veterans Interests and the Transition to Government Growth: 1870 – 1915," *Public Choice* (June 1999), no. 3 – 4pp. 311-326.

of what transpired over these time periods to combine all three disparate time periods into one theory of U.S Federal government growth. Tullock (2009) summarizes the current understanding of U.S Federal government growth over these time periods as follows:

> "Central government's share of the economy was remarkably stable for nearly 150 years but grew quite rapidly throughout the latter two-thirds of the 20th century. […] While economists and political scientists have offered many theories about what determines the level of government spending, there really is no known explanation for either part of this historical record."

Before delving deeper into the issue of U.S Federal government growth, it is necessary to summarize the most prominent explanations of government growth and their flaws.

Ratchet Effect

The Ratchet Effect, theorized by Peacock and Wiseman (1961), attempts to explain government growth through time by arguing that if a crisis raises expenditures far above the average level of expenditures for some period of time, expenditures will never again go below the pre-crisis levels. The reason for this observation is based in the idea that in crises politically powerful organizations can receive concessions from the government, such as lucrative war contracts that last beyond the length of the crisis. Later, the contracts are renewed with little resistance as the contracts are viewed over time as part of the standard budget. The Ratchet Effect is most notably observed during times of war when government spending drastically increases at the outset of the war and drastically decreases at the end of the war; however, the post-war levels of expenditure are nearly always higher than their pre-war levels. The reason that post-war levels are higher than pre-war levels is a result of war funds being redirected to new government spending rather than simply being completely phased out over time. Although a vast majority of war funds do tend to be phased out over time, as can be seen in the modest increases in post-war government expenditures as compared to pre-war government expenditures, the scope of government is left a little wider than before. The Ratchet Theory, although explaining rising government expenditures after crises, cannot explain level government expenditures prior the Civil War where spending levels were remarkably stable for many decades despite this time period containing many crises such as the War of 1812 and the Trail of Tears. It also cannot explain the sustained growth in central-government spending in the latter half of the 20th century.

It could be argued that if crises occur at a rapid pace, government growth could appear constant as the ratchet is continually in motion upwards. However, the crises that this argument implies are not the crises traditionally thought about, such as war or natural disaster. Instead, the argument in question requires social crises, such as the 'Global Warming' or the 'War on Drugs', or the 'Healthcare Crisis' to ratchet government spending to new levels, with new social crises following one after another in rapid succession. Such crises are examples of rent seeking behavior, which is the process of using the government to obtain higher than normal returns (lobbying). Although the social activists may be well intentioned, the method which their aims are achieved falls within the realm of rent seeking behavior.

From a purely political science concept of American democracy, the Ratchet Theory is very compelling. It is argued that voter-consumers demand action during a crisis thereby creating the incentive for politicians to temporarily enlarge the government to deal with the said crisis. After the crisis the same voter-consumers could then demand the actions government took to enlarge itself to deal with the crisis be repealed. As historical data show, although the incentive for government to enlarge itself is there at the onset of a crisis; government lacks the incentive to revoke entirely its engorged crisis state in a post-crisis environment often because voter-consumers become rationally irrational [4]or rationally ignorant [5]about the probability of the same crises happening in the future and as a result leave the scope of government influence a little wider than before the crises.

The reason government lacks the incentives to fully revoke its crisis state is a result of framing the role of government in a post-crisis environment. Politicians can, and often do, counter any demand to repeal whatever growth was achieved in the crisis by the simple argument: ‘What if the crisis happens again?’ or, the cliché of all governments ‘We need to ensure public safety’. What recourse do voter-consumers have against such an argument? They cannot argue against public safety, for then they look like monsters in the public eye, and are demonized for not caring about ‘the public welfare’. They cannot argue against the crisis not happening again as it just did occur. It seems that, in the end, the only argument voter-consumers have at their disposal is to demand the repeal of government enlargement is that of their political ideology, usually on the basis that government expansions destroy freedom and personal choice. This is a difficult ideology to defend and argue; ideals, beliefs, and virtues, it seems to be argued, cannot save voters from crises, only government, through whatever means it deems necessary is able to ‘ensure public safety’ and protect voters from any future crises.

In the end, government participants have little incentive to revert to a pre-growth state after voters demand its growth: each politician’s political clout marginally increases during an enlargement of government. The incentive to repeal government growth would be to diminish each politician’s political importance and political clout. Repealing the actions taken during the crises could also signal an acceptance that government cannot protect individuals from the crisis;

[4] A voter has very small chance of influencing policy. Therefore, the vote he casts is of little consequence to him. There is no incentive for a voter to invest time and energy analyzing the consequences of a policy. However, a voter derives some benefits from voting. It allows him to signal the kind of person he is, who he associates with. If there are no consequences in being mistaken about the effect of a policy, it becomes "rational" to hold the most pleasant opinion or the one most conducive to socialization.

[5] Rational ignorance occurs when the cost of educating oneself on an issue exceeds the potential benefit that the knowledge would provide.

it can only react to the crisis. But admitting this also means admitting that government cannot 'ensure public safety' it can only 'ensure public order' and is therefore not omniscient or a panacea for every problem or crisis. The reason why politicians feel the need to 'ensure public safety' can never be known. However, one theory of government growth leverages upon the idea of politicians and their dogmatic desires for 'ensuring public safety' and their desire for political clout: the Leviathan Theory.

The Leviathan Theory

The Leviathan Theory of government growth, as argued by Robert Higgs in his book *Crisis and Leviathan* (1989), theorizes that government tries to control as much of the economy as possible by means of growing during times of crises when voters demand action and do not necessarily care what action so long as action is taken. This theory and the Ratchet Effect theory are very closely related. However, the Leviathan Theory expressly argues that politicians try to control as much of the economy as possible because of their motive for political influence and the special benefits they receive. This is in contrast to the Ratchet Theory which argues that politicians passively expand government through their desire for the 'public welfare.' In each theory, politicians use crises to expand government, but the motivation and ideology is different. Because of the similarities, the Leviathan Theory suffers the same critiques that the Ratchet Effect suffers: it fails to explain level government expenditures prior to the Civil War, and it cannot explain the sustained growth in central government through the 20th century. Although the motive to expand political influence might have been as strong prior to the Civil War as was throughout the 20th century, politicians needed to change voter-consumers' conception of what the proper role of government is before politicians could actively seek to enlarge their political clout.

According to the Leviathan Theory, government spending should rise drastically to deal with times of crises, as can be seen during the Civil War, World War I, and World War II. Following the crises, government spending should remain relatively steady until the next crisis. Unlike the Ratchet Theory, spending rises to a new level and remains there until the next big crisis; there is generally no decrease in expenditures (the exception being the post-war reduction in war-related expenditures). Visually, if the Leviathan Theory were true, the data should appear as a stair-step; however, this is not the case in the U.S., as can be seen in Figures 1, 2, and 3. Because of this failure of the Leviathan Theory to accurately depict the historical data, the theory must be modified slightly. The theory holds that government tries to control as much of its economy as possible, this usually happens in times of war. The data does indeed show huge increases in government spending associated with times of war, but the data only shows such activity during times of war. Although this theory can help explain government expenditures during three important events, these events (Civil War, World War I, and World War II) are outliers in government growth data. Explaining outlier events, while important, does not give an accurate picture of what is causing government to grow outside of these periods of crisis. In order to use the Leviathan Theory to explain government growth over other time periods it must be modified to include the preference of politicians that voters prefer.

What the Leviathan Theory implies is that Americans must either have a tendency to vote for politicians who desire government growth, or whose choices of politicians for whom to vote are limited to those who favor government growth[6]. If this tendency to elect politicians who desire government growth is true, then the economic way of thinking must be used to analyze under what conditions and circumstances would an individual be willing to forego a vote for a

[6] For example, individuals whose true preference may be for no government growth at all may vote for the candidate who offers to grow government at a positive but slow rate because the alternative candidate offers a plan which is further from the voters' preferences. Another issue could be politicians may run on a platform of no or little government growth to get elected, but once elected pursue a policy of government growth.

politician who favors personal and economic freedom for a politician who favors government growth. The idea here is that government's perceived role must be understood, for when individuals vote in a democracy they vote for their conception of what government is and what it can achieve for them. If government growth was stable prior to the Civil War and later expanded drastically in the 20th century, this must imply that the perceived role of government changed. "The bottom line is that governments have grown in recent decades, that they did not do so earlier, and that economists do not really know why" (Tullock 2002). This is a direct result of traditional growth theories ignoring the institutional and cultural context in which government operates.

It may be suggested that examining the mix of government spending—that is, on what the government is spending money—may shed some light on the changes in the voters' perception of the role of government. However, doing so offers little insight into the transition of government from a stable period of expenditures to one of steady and often rapid growth of expenditures. The Public Goods argument for government is fairly weak in explaining the current state of government growth as the majority of government expenditures today are not on public goods, such as national defense, but rather on social welfare programs and transfer payments. Even looking at who receives transfer payments doesn't help to explain how or why government is growing. Transfer payments tend to go to those individuals who are relatively well off, such as the First Time Homeowner Tax Credit which tends to benefit those who already can afford housing. Many economists attribute these unique aspects of government spending and regulation to rent seeking. However, such trends in government spending and growth are new, and rent seeking only explains the recent sustained growth in government expenditure, not the stable period of the first 150 or so years of the U.S. Rent seeking explains the continued increase in government spending in the latter half of the 20th century as the perceived role of government changed after the Civil War from one of protector of property rights to one of politically powerful groups seeking benefits from the government at the expense of others.

Rent Seeking

Rent seeking behavior as an explanation for government growth is a strong contender as a viable explanation for sustained government growth in the latter half of the 20th century, but it fails to provide any traction as an explanation of stable government growth in the early decades of the American Government. Rent seeking behavior is the ability to use government to obtain higher than normal returns (rents). In 20th century vernacular it is synonymous with lobbying. Although not without its political merits, lobbying has increasingly been an unproductive economic endeavor. Although rent seeking behavior will be addressed in more detail later in this analysis, it is important to summarize its implications.

Often times rent seeking is a result of organized interest groups lobbying government and comes in many different forms. Most common is the creation of government sanctioned cartels, such the Northeast Organic Dairy Producers whose stated goals are:

1. Establishing a fair and sustainable price for their product at the wholesale level.
2. Promoting ethical, ecological and economically sustainable farming practices.
3. Developing networks with producers and processors of other organic commodities to strengthen the infrastructure within the industry.
4. Establishing open dialogue with organic dairy processors and retailers in order to better influence producer pay price and to contribute to marketing efforts.[7]

[7] http://www.nodpa.com/about.shtml

The above stated goals are clearly in violation of the Sherman Anti-Trust Act, specifically Section 1 which states: “Every contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade or commerce among the several States, or with foreign nations, is declared to be illegal.”[8] The fact that this cartel exists despite the Sherman Anti-Trust Act is a result of lobbying efforts by these associates to continue operating with government approval.

Sometimes, organizations petition government to impose import restrictions or quotas. One of the more known quotas is that relating to sugar. The U.S. imposed high tariffs on sugar in 1816 in order to placate the growers in the newly acquired Louisiana territory. In the 1820s, sugar plantation owners complained that growing sugar in the United States was like warring with nature as a result of the U.S. climate being unsuited to sugar production. Naturally, the plantation owners believed that all Americans should be conscripted into the war.[9] Today, according to the USDA’s website, the USDA administers re-export programs involving sugar. The USDA’s Sugar-Containing Products Re-Export Program is designed to put U.S. manufacturers of sugar-containing products on a level playing field in the world market. The Refined Sugar Re-Export Program is designed to facilitate the use of domestic refining capacity to export refined sugar into the world market.[10]

As will be discussed later in the paper, rent seeking behavior allocates entrepreneurial activity to unproductive gains. As government expands its taxing authority and regulatory influence, it can sometimes be easier for organizations to lobby for transfer payments or quotas than it is to produce goods and services which survive the free-market. The result is a positive feedback loop: in exchange for votes a politician promises to provide a rent-seeking organization with favorable taxing policies or transfer payments, increasing overall government expenditures.

[8] 15 U.S.C. § 1
[9] http://www.fff.org/freedom/0498d.asp
[10] http://www.fas.usda.gov/itp/imports/ussugar.asp

Once organizations realize they can petition their respective politicians to curry favors, they begin to engage in non-productive entrepreneurial activities which cause government to increase transfer payments or regulatory enforcement. The Refined Sugar Re-Export Program provides subsidies and import quotas to U.S sugar producers in order to 'protect' their industry, causing not only an increase in government spending via transfer payments to U.S sugar producers, but also a rise in domestic sugar prices. At the same time, given the reduced level of productive entrepreneurship, the rate of growth in the private sector slows, further allowing for government expenditure as a percent of GDP to rise.

Bureaucracy Theory

Although rent-seeking behavior is often attributed to the private sector, the public sector, or government itself, often engages in rent-seeking behavior. The issue raised here is Nisakanen's (1971) model of bureaucracy. Nisakanen hypothesized that government agencies face different incentives than do their private sector counterparts. In the private sector a person succeeds by making the company he or she works for profitable and capitalizing on gains of trade. However, government agencies do not operate on the profit motive and as such different incentives must be at work to incentivize individuals to succeed at their government sponsored work. Nisakanen argued that these incentives can include, but are not limited to, perquisites of office, power, reputation, and political patronage. Government agencies are funded by tax revenue and as such bureaucrats must fight for government funds by promoting the perceived value of the services the agency offers while downplaying the perceived costs so as to obtain more funding. The ability to obtain over-funding, or funding beyond what is necessary to provide an adequate level of agency services, can lead to an overall increase in government spending per capita while leaving the scope of government services unchanged.

Much like the other theories presented, this theory can explain the period of government growth from roughly 1900 – 2008, but fails to explain stable government expenditures from roughly 1800 – 1900. The incentives facing politicians, and more importantly independent government agencies, changed during the transitional period of government growth. Not only did the incentives change, but the number of independent organizations increased. As the number of independent government organizations increase, it only exacerbates the problem bureaucracy Theory supposes. Simply put, Bureaucracy Theory fails to fully explain government growth.

Transitional

Many theories fail to explain both episodes of government spending, but a theory of government spending, to be accepted, need not include both episodes of government spending at the same time. It would seem by its very nature one theory cannot explain the two distinct phenomena—the long period of stable government size and the more recent period characterized by rapid government growth. By using an analytic narrative and positioning this analysis within the institutional and cultural context of the time period, as opposed to solely looking at data to understand government growth, one can begin to see multiple and distinct but interrelated stories of government growth. Three stories will emerge: one explaining the level periods of government expenditures prior to the Civil War, another explaining the sustained and rapid growth in government expenditures in the 20th century, and the third story bridging the seeming disparity in the previous two stories. This transitional theory would explain the transforming of stable government expenditures prior to the Civil War to continued government growth in the 20th century. By analyzing government growth this way, a unified theory of government growth can be seen which explains the inconsistency in government growth; however, a theory of government growth must be based in the economic way of thinking and be rooted in the incentives that both voters and politicians face. What I argue borrows from and builds upon many past theories, but provides the institutional and historical context these theories leave out.

Supply and Demand of Government

The demand and supply of government can be analyzed from a microeconomic perspective. By using the traditional determinants of supply and demand, such as income, tastes and preferences, and so on, we can analyze how the quantity and price of government can change. Once the determinants of supply and demand of government have been explained sufficiently, they will be applied to the historical and institutional context of the U.S following the Civil War, which previous government growth theories have left out. For example, Cowen (2009) argues that the demand for large government has always been present, but that the technology necessary for a large government to exist were not present, such as information gathering tools like computers. Although Cowen raises an interesting point, the issue is not whether the demand for government has always been present from the founding of the United States, but rather what unleashed this demand for government shortly after the U.S Civil War as there are arguably no improvements in technology capable of unleashing demand following the Civil War. Understanding what happened to unleash demand for government shortly after the Civil War will help in explaining government growth through time. Although there are many causes that could unleash demand for government, I argue that the ability to rent-seek, and therefore the incentives that individuals and politicians face, drastically changed in this time period, leading to a radical shift in the idea of what government is and what it ought to do. However, in order to see why this is, the supply and demand of government must be understood. To start, a more thorough definition of government must be developed.

Definition & Role of Government

Government can be viewed as a form of exchange: individuals, in their self-interest, band together to create constitutions that define individual rights and the limits of government power. Although there are many organizations which are based on the same principle as outlined above, such as a school club, one of the distinguishing characteristics of government is its use of coercion. When individuals form an organization on a small scale, such as a school club, members are free to choose to join the organization or not depending on whether they wish to agree to the constitution and rules; there is no coercive action taken to force individuals to join and follow the club's constitution. There can be no coercion in voluntary exchange. This is in contrast to a government which has sovereign control of a geographic area and can use coercive action to force the individuals living within its geographic borders to abide by its constitution. However, the definition of government must be more specific than an organization of individuals with the monopoly power of coercion over a geographic area, as a retail store could fit into this definition, or any property owner.

Although government has the monopoly power of coercion in a geographic area, it is the type of coercive power that government uses on its citizens that separates the coercive power of government from that of a club. Holcombe (1994) defines government as "an organization that has the ability to finance its activities by compulsory contributions from all individuals in a given geographic area." It is the ability to force individuals to contribute to the organization against the will (a non-voluntary exchange) which separates government from all other organizations. The issue all governments face is to decide what to do with this money. Although the above definition narrows the definition of government to that of nations, it mentions no function which government is to take with this money. Adam Smith himself quintessentially outlined the function of government in his book *An Inquiry into the Nature and Causes of the Wealth of*

Nations (1776): to provide a national defense, administration of justice (law and order), and the provision of certain public goods (e.g., transportation infrastructure and basic and applied education). Economists today have lumped Smith's three functions into two main categorical obligations of government. The first is to provide public goods, or goods which are non-rival and non-excludable. The second economic role of government is to encourage positive externalities and discourage negative externalities, such as subsidizing education and taxing pollution.

However, in a democracy the role of government can easily change, as it only takes a majority vote for a government to be influenced away from the economic ideal role and into the ideology the majority in a democracy favor. As a result, the supply and demand for government is sensitive to tastes and preferences both in the role and function of government. The supply of government through law and legislation conforms to the demand of the majority in democracies and to the demand of a single person in a dictatorship. In both cases, the issues of public interest and of political agenda dictate the role and function of government. This interaction between supply of government and demand of government plays an important role in determining the incentives faced by politicians in democracies. It is the incentive of a politician in a democracy to get elected into office by popular vote. That is, politicians in America have become career politicians, it is the endeavor to get elected and be kept in office: the only way to accomplish getting elected is by majority vote. However, with voters being rationally ignorant or irrational about many policy issues, the incentives politicians in democracies face are often not in line with providing their constituents with the most beneficial legislation at the least cost. This is to say that the supply of government is determined by the demand for government regardless of how beneficial that supply might be.

For example, although arguably well intentioned, the 2009 U.S ‘Cash for Clunkers’ program came at a huge cost to taxpayers with little benefit associated with the program . That is, politicians supplied their constituents with very small benefits but at a large cost. This is what is to be expected though; voters only bear a very small part of the cost individually, and as such many voters favored the program with little understanding of the costs or benefits. The program was sold to voters as a method to increase car sales and stimulate the economy. Many voters therefore expected substantial net benefit from the program; however, Edmunds reported that “Nearly 690,000 vehicles were sold during the Cash for Clunkers program, officially known as CARS, but Edmunds.com analysts calculated that only 125,000 of the sales were incremental. The rest of the sales would have happened anyway, regardless of the existence of the program.”[11] The program had a marginal impact on the economy, yet the cost to the American taxpayer was, according to Edmunds, $24,000 per car. In the end, politicians face very little incentive to provide their constituents with cost efficient policies as each voter only bears an extremely small portion of the cost: politicians instead focus on policies which garner votes, or put them into office regardless of efficiency of or desirability of the program.

The demand for government is set by voters in the form of Political Action Committees or political agendas. This is to say that there are two forces at work influencing government action: voters and lobbyists. Although Political Action Committees and lobbyists are powerful influencers of legislation and political agendas, ultimately it is voters, some of whom are members of PACs, who decide which politicians remain in office. Because of this, politicians must at the very least placate their constituents. The resulting outcome is that voters form the ideological basis which legislation and law is built around, with Political Action Committees and lobbyists determining the wording and details of the legislation. Despite what may seem as a

[11] http://www.edmunds.com/help/about/press/159446/article.html

dysfunctional feedback mechanism, democratic governments conform quickly to the wishes of the people and often have checks and balances to align the tastes and preferences of voters and the incentives politicians face. As such voters' tastes and preferences for the role and function of government are manifested through law and legislation by means of the political process, although the exactness and methods to achieve what the voters want is often the result of Political Action Committees and lobbyists.

Demand for Government

Government can be said to be a normal good; that is as incomes rise, demand for government increases. One theory is that as individuals become wealthier there is higher demand for the rule of law and protection of wealth. Another explanation is that as income rises individuals are able to afford to be taxed more while keeping the same, if not higher, standard of living. As long as an economy is growing, opposing taxation seems to be a small quarrel with government if the tax money goes to what voters perceive as good and valuable. Such is the story behind the current U.S government initiatives to fight global warming through carbon taxes, and massive subsidies to green technology. Although the debate about global warming is beyond the scope of this paper, it is enough to note that many government initiatives to fight global warming such as 'Cash for Clunkers' result in huge losses to tax payers with very little, if any, gain. Despite economic inefficiency, the U.S government can afford to undertake such programs through taxation, and individuals seem to enjoy the thought of fighting global warming no matter the cost, as suggested by Bryan Caplan in his book *Myth of the Rational Voter* (2007), . This is to argue that as a nation becomes wealthier, its government's original functions begin to extend beyond their original purpose as tax revenue increases and voters are able to afford more disproportionate cost-benefits.

The reason for this is a result of rational irrationality among voters. The idea of the government fighting for a cause can be very appealing to voters. Idealizing the role of government as an organization which fights global warming, and solves world hunger, leads to voters supporting policies which they believe are morally right or justified regardless of the expected success of the proposed policies. The catch is that the ability for the government to address these issues is a normal good. In developing nations, governments are concerned with the rule of law, crime, and poverty. Many developing nations pay little attention to any global causes, such as climate change. This is a result of citizens in these countries wanting their governments to protect their livelihoods and provide food and shelter. The demands placed on government in developing nations are much different than that of developed nations. As a nation gets wealthier, and its citizens take for granted the rule of law, the role of their government can shift to a more global perspective. Along with the role of government changing over time, tax revenue also increases as a result of citizens becoming wealthier. As tax revenue increases, the government can undertake more functions and objectives; as a nation becomes wealthier its role and function changes.

The demand for government is relatively price inelastic. In order for a government to engage in a social or economic endeavor, such as climate change, it must tax its citizens; however, because government is a monopoly, the price of related goods, or the tax rate of other governments, play very little into the supply and demand for government. This is to say that as taxation changes, people have few alternatives. It could be argued that people could move to other countries when taxation becomes a burden, but such drastic measures only serve to show how limited individuals' choices are when taxation becomes burdensome. Indeed, the only choice a consumer of government has is to move outside the government's jurisdiction, which is costly, often too costly to make worthwhile. As Holcombe's definition of government suggests, it is the ability to force individuals through taxation to support the regime, and, as such, individuals (even in democracies) have very little say in taxation policy. This isn't to say that individuals don't have any say in taxation policy, but there is a dichotomy at work: voters want the government to provide as many services as possible at the lowest possible taxation rate, but it is the incentive of a politician to tax as much as the population will allow to have as big of a budget as possible. The political incentives of taxation are complicated, but it comes down to the ability to rent seek; the incentive voters have is to stay within the country and vote where the tax revenue should end up. The logic goes that if the population is to be taxed, the voters should at least decide where the tax money goes. Because of this, as taxation increases, demand for government should increase as individuals fight for limited tax revenue. Such a theory is consistent with the Leviathan view of government growth and Niskanen's bureaucracy theory.

The reverse argument could be made, that individuals demand certain services be provided by the government, and that government then raises the revenue to provide these services, such as the recently passed Health Care Legislation. However, this is the same argument presented above but from a different perspective. The logic is that since a citizen is going to be taxed, that citizen might at least demand where the tax revenue goes. The end argument is that government's role and function play are a deterministic where tax revenue goes, not whether it taxes at all. The demand for government arises out of the ability for government to tax: that is, government itself is a result of its ability to tax as Holcombe's definition of government implies. The role and function of government determine where the tax revenue is to be spent.

Although there are many other determinants which affect the demand for government, the ability and the extent to which government taxes its citizens and the wealth of the country are two very important determinants for the demand for government. The wealthier the country, the more tax revenue is at a government's disposal and as a result an increase in rent-seeking activities. The extent to which a government can tax its citizens also affects the demand for government by means of the ability to increase tax revenue when needed, or wanted.

But the ability to access this source of wealth is unique to this time period in American History. The transitional period of government growth is the transition from a limited ability of the U.S Government to tax its citizens to a robust taxation mechanism, as well as the organization of groups to lobby and access government to funnel tax revenue to these organizations through rent-seeking. All this is reinforced by a branch of economics, most notably Keynesian economics, which advocate for the institutions which allow such activities to exist.

The Transitional Period of Government Growth: 1865 – The Great Depression

Formation of Rent Seeking Groups

Directly following the Civil War there was very little government (federal or state) assistance for veterans of the war. This lack of assistance by the U.S government for veterans of the Civil War provided the right atmosphere for a friendly social order to organize and provide the services these veterans demanded. The first friendly social order to provide services in the name of veterans' interests was in 1865 with a group called the United States Soldiers and Sailors Protective Society. As Holcombe (1999) points out: "This group was non-political and hoped to further the interests of veterans through 'mutual confidence and mutual help.'" This organization was quickly swept aside by its more aggressive competitor the Grand Army of the Republic

(GAR) founded by Union veteran Dr. Benjamin Stephenson. The GAR was organized to be a political organization and as such its membership was restricted to only Union veterans. GAR quickly became a powerful political force: between 1868 and 1908 no Republican was nominated to the presidency without a GAR endorsement. The key point to note is the GAR's close political affiliation with the Republican Party. To say veterans' interest groups, and more specifically GAR, ushered in the era of rent seeking behavior is a mild understatement. As Holcombe (1999) argues:

> "Veterans made up the first organized interest group that was able to use the political process to systematically transfer large sums of money to themselves through the political system, and so created the precedent for interest group transfers that are such a visible feature of the 20^{th} century democratic government"

Although political interest groups existed before this time, this was the first time a group of individuals interested in a specific issue banded together to lobby the U.S Federal government successfully. Although taken for granted today, the actions taken by the Veterans were unheard of during this time period; however, their skill in exploiting the political process proved to be very effective for Union civil war veterans: in exchange for votes, Northern Congressmen would increase Union Civil War Veterans' pensions.

The end of the Civil War established the first rent seeking special interest group: veterans' affairs; however, it did more than that. The end of the Civil War and reconstruction also established the dominance of the national government over the states, increasing federal influence in states' affairs. This has drastic effects on the role the national government can play. Before this time period states had more control over their localities. The political ideology after the Civil War radically shifted the balance of political power and influence in the United States away from local and state legislatures and governments to the national legislatures and government thus shifting political incentives away from states and onto the central government. The result was a drastic, and swift, centralization of political power and influence which could not be challenged by the states.

Realizing that national interests are much harder to appeal to, as each state and locality demand different public goods, it is easier to gain support from blocks of voters spread over a small geographic area as opposed to appealing to a broad general public. In exchange for a block's support, it would be understood that the block of voters would receive something in return. At this time, however, there were limited means for government to placate rent seeking interest groups. Because there was no income tax at this time, monetary transfer payments were difficult to achieve, and as such most benefits received by rent seeking groups were in the form of regulation.

It should be noted that regulatory favors are still rent seeking. There is a tradeoff between regulation and transfer payments: when money transfers are politically difficult, regulation will be a politician's choice of pandering to interest groups; however, if money is easy to transfer, this is the preferred method. However, in either case, the special interest group ultimately becomes wealthier at the expense of the general public. In the case of the Civil War veterans, money was easy to come by. The U.S was running a surplus and it was politically easy to transfer money to Civil War Veterans through their well funded pension plans. Not only this, but Union voters also exerted little resistance due to their willingness to reward and honor those who fought for the Union.

Given these facts, we can now begin the analysis of how the increased activity of interest groups, led by Civil War veterans, increased the demand for transfers and laid the foundation for the transition to government growth. Veterans set the standard for how to influence government. They were able to extract concentrated benefits funded through dispersed costs (taxation of the general taxpayer). As Holcombe (1994) points out:

> "[…] Confederate veterans were not eligible for federal pensions, meaning that veterans' benefits were a transfer from taxpayers in general to recipients in Northern states. Thus, there was a natural alliance between veterans groups and the Republican Party. […] The Republican Party relied on veterans for electoral support, and paid off their supporters with increasingly generous veterans benefits"

The ability to transfer funds, either directly or indirectly is key to any rent-seeking policy, and Civil War veterans were very good at obtaining such funds. In fact, empirical research (Holcombe 1999) has shown that there was a statistically significant relationship between the surplus of the American government and increases in veteran's pension benefits. The key implication from this empirical research is that whenever there was a surplus in government funds it would be spent on increasing veteran's pensions benefits rather than saving for a recession, or giving a tax rebate. The great success which veterans had in transferring funds to their interest group caught the attention of other organizations. However, because Congress was transferring money to veterans in forms of more lenient pension legislation, these other interest groups sought transfers of wealth through regulation. As long as it is difficult to transfer money, which was the case before the 16th amendment and the income tax, transfers would largely have to come from regulation. Soon after veterans' benefits began increasing regulation of all forms began to take hold in the United States. Many regulations were proposed by so called 'progressives' who argued for more government intervention in private markets for the 'public welfare'. Before the progressives became a strong political movement, there was very little in the way of regulation. However, the progressive movement ushered in the era of constitutional government regulation.

The first case to test whether government regulation was indeed constitutional was Munn v. Illinois in 1876. Munn, a partner in a Chicago warehouse firm, had been found guilty by an Illinois court of violating the state laws providing the setting of maximum charges for storage of grain. Munn appealed, contending that the fixing of a price ceiling constituted a taking of property without due process of law. In this case the Supreme Court ruled that a private company could be regulated in the public interest, so long as the private company could be seen as a utility operating in the public interest, thus establishing the constitutionality of government regulation. Having established the constitutionality of government regulation, progressives turned their attention to railroads. Wabash, St. Louis & Pacific Railroad Company v. Illinois was one of the first instances of government assuming responsibility for economic affairs that had previously been delegated to the states. This case transfers power of economic regulation from the states to the central government. This would make sense as the trend in power is to centralize. The Civil War clearly demonstrated the central government is superior to the states, so it would only make sense that the courts would rule that regulatory powers would be from the central government. This court ruling established the Interstate Commerce Commission (ICC) in 1887 and limited the rights of states to control interstate commerce. The central government now had power to control regulatory affairs. As such, the government could now more easily cater to interest groups through regulation rather than transfers as money

The model of special interest group lobbying introduced by Civil War Veterans transformed the interests which voters and politicians face. With large groups of voters mobilized into solidified voting blocks, politicians now must cater to groups of individuals. This began the idea of dispersed costs and concentrated benefits; so long as the costs of pandering to one group of individuals are dispersed and the benefits are concentrated, political pandering to special interest groups is feasible. In return for political pandering, politicians gain votes of the groups to which they pander. At the same time, groups of individuals, led by the progressives, realized that they do not need to form political parties to become elected, but only act as a group and offer support for politicians who sympathize with their interests. Voters' incentives were to become mobilized into political action groups whose purpose was not to get elected, but to convince politicians of their interests, and to elect those politicians whose policies are in line with the political action groups.

This time period is also the beginning of substantial bureaucratic rent seeking. As voters demanded the government take a more active interest in the economy, regulation became of increasing importance to the federal government as well as the need for public servants (bureaus and bureaucrats). The Pendleton Civil Service Reform Act of 1883 placed most of the federal government employees on the merit system and marked the end of the 'spoils system' of civil service. The spoils system was deemed, by the progressives, as unfair as it rewarded political support rather than merit. Under the merit system, federal employees were no longer able to be appointed or un-appointed depending on who was in power, and as a result greatly increased their political clout. In fact, the incentives of bureau management no longer were to pander to the ideology of the current administration, but rather to grow the bureau as large as possible. The incentives bureaus faced were to increase their own power and influence, most often through proposing new regulations which their organization would oversee, creating a positive feedback loop of bureaucratic growth. These actions are still rent seeking: government agencies become interest groups within government.

Robust Taxation Mechanism: The Income Tax

Veterans' creation of rent-seeking and the policies which followed helped lead to the increase of strong government growth in regulation up until 1913. Because it was relatively difficult to transfer payments from one group and give it to another group, transfers had to come from regulation more often than not. The ratification of the 16th amendment drastically changed the rules of rent-seeking and what it allowed politically powerful organizations to accomplish. As Holcombe (1999) says:

> "Before 1913, however, the federal government grew in other ways, by enlarging its power and changing its mandate. By 1913 the federal government had been transformed into an organization not to protect rights, but, ostensibly, to further the nation's economic well-being"

The 16th amendment was not the cause of federal growth, only a new chapter as it suddenly became easier to promote 'economic well-being' as the government could simply tax and give money rather than regulate. It should be noted that none of the enacted policies or taxes were for economic efficiency, but more for "economic well-being" of particular politically connected groups—that is the financial well-being of specified interest groups. Politicians "[…] transform the economic basis of costs and benefits into political costs and benefits. The latter, and not their economic counterparts, define rational decisions for political actors" (Weingast, Shepsle, and Johnsen, 1981).

Before the 16th amendment, Congresses was limited in the ability to tax, and therefore also limited in its ability to raise revenue to expand its functions or increase transfer payments. In fact from 1817 to 1861 the federal government collected no internal revenue. Instead, the government received most of its revenue from high customs duties and through the sale of public land.[12] Until the enactment of the 16th amendment, tariffs were used as a source of revenue. It was only with the Civil War that the United State Congress thought necessary to impose a taxation mechanism to match its growing needs. With large sums of money required to fund the Civil War, the Union Congress needed a more robust revenue stream. A new system of taxation was needed in order to supply the Union Congress with a reliable, and readily available, stream of revenue. This new system of taxation was the imposition of the first federal income tax. This was the result of the Union Congress' passage of the Revenue Act of 1861.

The Revenue Act of 1861 imposed a flat income tax to be "levied, collected, and paid, upon the annual income of every person residing in the United States, whether such income is derived from any kind of property, or from any profession, trade, employment, or vocation carried on in the United States or elsewhere, or from any other source whatever […]". The tax was levied at three percent on all incomes higher than $800 a year, or $17,679 in 2008 dollars. This tax on personal income was a new direction for a Federal taxing mechanism previously based almost exclusively on tariffs and sale of public land. The Revenue Act of 1861 was a flat tax; the next leap in Federal taxing authority was to result in a progressive taxing structure. This leap came in 1862 with the 1862 Revenue Act.

[12] http://www.ustreas.gov/education/fact-sheets/taxes/ustax.shtml

The Revenue Act of 1862 was passed by the Union Congress to help fund the American Civil War. The act was intended as a temporary measure that would terminate in 1866. This Act taxed incomes exceeding $600 but no more than $10,000 at a rate of three percent. Incomes exceeding $10,000 were taxed at five percent. What is most intriguing about this taxing mechanism is that taxable income, to assure timely collection, was to be withheld at the source by the employer, a method which the current taxing system mimics nearly identically. The Act also imposed a duty on paymasters to deduct and withhold the income tax and to send the withheld tax to the Commissioner of Internal Revenue. This method of collecting taxes was a preview, and really an experimentation of, future federal taxing structures. The Revenue Act of 1862 also created the position of Commissioner of the Internal Revenue whose job it was to "[…] be responsible for the administration and enforcement of the Internal Revenue laws." [13]That is, this act was the first step in creating a bureaucratic taxing authority. At this time taxing authority was relegated to the Department of Treasury through the Bureau of Internal Revenue; although it wouldn't be until 1952 that the Bureau of Internal Revenue would be restructured and the Internal Revenue Service established. The Revenue Act of 1861 was the first step in the creation of a robust taxing mechanism and the institutions needed to support them.

Following the expiration of the Revenue Act of 1862 in 1866, Congress took it upon themselves to revive the income tax in the Revenue Act of 1894. The Revenue Act of 1894 imposed a flat tax of two percent on incomes more than $4,000, or $88,400 in 2008 dollars in exchange for reductions in tariffs. Ironically enough, the fight over which tariffs to reduce was a spectacle in the Senate. Protectionist senators operated behind the scenes of the senate adding more than 600 amendments which nullified most of the reductions in tariffs and raised many instead. The "Sugar Trust" in particular made changes that favored domestic sugar producers at

[13] Treasury Order 150-10, Delegation--Responsibility for Internal Revenue Laws, U.S. Dep't of the Treasury (April 22, 1982)

the expense of the consumer, for instance. The Revenue Act of 1894 was only to be enacted for five years; however, the act faced its first hurdle when its constitutionality was challenged in 1895 in Pollock v. Farmers' Loan & Trust Company. The constitutionality of the income tax was challenged on grounds that it violated the rule that direct taxes be apportioned. The rule of apportionment requires the amount of a direct tax collected to be divided by the number of Representatives in the United States House of Representatives, the quotient is then multiplied by the number of representatives each State has to determine each State's share of the tax which it then needs to lay and collect through its own taxing authority. It was argued that the income tax was a direct tax and therefore had to be appropriated.

The court ruled in Pollock's favor in 1895, arguing that the income tax was a direct tax and therefore unconstitutional as a result of the apportionment rule. Although the income tax was ruled unconstitutional, the dissenting opinions are important to quote, as they foreshadow the course of government growth and taxation policies. Justice White dissented arguing that:

> "It is, I submit, greatly to be deplored that after more than 100 years of our national existence, after the government has withstood the strain of foreign wars and the dread ordeal of civil strife, and its people have become united and powerful, this court should consider itself compelled to go back to a long repudiated and rejected theory of the constitution, by which the government is deprived of an inherent attribute of its being—a necessary power of taxation." [14]

[14] 158 U.S. 601, 638

It seems Justice White's argument is that if government can tax its citizens, then it doesn't matter how it does it; to Justice White any form or kind of tax is legitimate since it is the government's right to tax its citizens.

In the same vein, Justice Brown argued that: "The decision involves nothing less than the surrender of the taxing power to the moneyed class...Even the spectre of socialism is conjured up to frighten Congress from laying taxes upon the people in proportion to their ability to pay them."[15]

Justice Brown seems to argue for a progressive, or at least proportional, taxing structure; those who can afford to pay more taxes should. Progressivity of taxes is a widely debated topic to this day, the beginning of the argument on whether an income tax should be flat or progressive can be traced back to this time period.

Justice Harlan took a more interesting stance in his dissent:

> "When, therefore, this court adjudges, as it does now adjudge, that Congress cannot impose a duty or tax upon personal property, or upon income arising either from rents of real estate or from personal property, including invested personal property, bonds, stocks, and investments of all kinds, except by apportioning the sum to be so raised among the States according to population, it practically decides that, without an amendment of the Constitution—two-thirds of both Houses of Congress and three-fourths of the States concurring—such property and incomes can never be made to contribute to the support of the national government."[16]

[15] 158 U.S. 601, 638

[16] Irons, Peter. *A People's History of the Supreme Court*. New York, Penguin, 1999, p. 244

The dissenting opinions are but a preview of the logic which government justifies its robust taxing mechanisms: that taxation is a necessary power of government no matter how it is achieved and that taxing is not socialism but a civic duty of every citizen in a democratic nation. The ideology of income taxation was being developed in the court system. Having lost the battle for an income tax to the courts, the battle to a national income tax became political in nature. The ruling in Pollock was very controversial in a nation where the Federal government was beginning its battle against monopolies and trusts and where a great deal of wealth was concentrated in the hands of a few. The year following the Pollock case, the Democratic Party, which had grabbed hold of the progressive movement, included the income tax in its election platform. The income tax was now a political weapon; if the courts ruled that an income tax was illegal, government can just change the laws to make it legal.

The ruling came just at the right time politically as well. Up until the 16th amendment, raising revenue for the federal government involved taxing goods coming into the United States from other counties. Using tariffs as a taxing mechanism creates the incentive for rent seeking organizations to exert influence on which products to impose a tariff, as applying a tariff would help protect certain industries from foreign competition. Put another way, which items to apply tariffs to were political questions, and a method for politicians to appease rent seeking organizations. The Payne-Aldrich Tariff Act of 1909 is a case in point. By the time it passed the Senate, it had so many amendments attached to it that it raised many tariffs: 650 tariff schedules were lowered, 220 raised, and 1,150 left unchanged. The political polarity of tariff reductions and increases resulted in the bill providing for the creation of a tariff board to study the problem of tariff modification for congressional and presidential usage. The Payne-Aldrich Tariff's passage had the immediate effect of frustrating both proponents and opponents of reducing tariffs. In the end, taxing goods entering the country as a means to raise revenue became too politically risky for some in Congress in that modifying tariff rates risked losing support from many voters at large or from some vital interest groups. As a result, Howard Taft in 1909 proposed an amendment to remove the apportionment requirement for income taxes. This amendment was passed unanimously in the Senate and by a vote of 318 to 14 in the House of Representatives. It was quickly ratified by the states, and in 1913, it became a part of the Constitution as the 16^{th} Amendment. The 16^{th} Amendment removed the requirement that income taxes be viewed as direct taxes and therefore not be apportioned among the states according to population. Thus, the Pollock decision was overturned by the Sixteenth Amendment. Thereafter, taxing of income was a reliable and robust method of raising revenue for the federal government and as a result quickly outpaced the revenue garnered from tariffs alone.

The ability to have a robust taxing mechanism is important for government growth; without the ability to easily and readily raise revenue it is difficult for the government to have the funds to grow. The income tax as implemented in the United States is the main source of government revenue, but it was not always the case. As argued above, the U.S Constitution of 1787 limited the ability of the Federal government to tax its citizens. This inability for the federal government to easily and readily tax its citizens confined its growth; it wasn't until the Civil War that the Federal government needed to find a way to quickly and reliably raise revenue. The easiest way was the implementation of an income tax. The success of the income tax in that it raised revenue for war delighted many of those in Congress. As such, Congress continued to impose an income tax until it was ruled unconstitutional in 1895. As rent seeking organizations became more powerful in nature, their demands of politicians began to include taxation policy. In order to protect their industries, organizations would have the interest to demand tariffs be applied to the imported goods and services of their foreign competitors. As a result, the decision regarding which tariffs to increase and which to reduce became too politically risky. In the end, the taxing structure had to change with the role and function of government for two reasons. Firstly, rent seeking interest groups made tariff decisions too politically risky to make it an effective taxing mechanism. Secondly, the income tax is a much more reliable and robust method to raise revenue. Although separately rent seeking interest groups and changes in the taxing mechanism would be seen to affect government growth, combined they create a positive feedback loop. With the increased interest of politically powerful organizations to gain political favor in exchange for voting for a certain political candidate, and with tariffs becoming too politically risky for politicians to use as a means to gain votes from these organizations, politicians had the incentive to find new means and ways to appease these organizations. Politicians soon found their answer with the creation of a new taxing structure. Politicians could easily include transfer payments or pork with legislation as a means of political pandering to certain organizations. Not only could politicians now easily raise revenue to fund transfer payments, but they could tax certain groups of people directly.

The Keynesian Revolution: A Justification

The original justification for the income tax was to provide a means to pay for the Civil War; however, after the 16th amendment the justification for taxation become more complex. With the end of the Civil War the justification for the income tax came to an end but with the income tax still in effect, and its resounding success, politicians needed to find a new justification for it. That is, the taxing obligations of government changed to meet its new role and function of government. Much like the Ratchet Theory would argue, the federal government could now fight the social wars, such as the war on hunger, or the war on poverty with greater ease and flexibility. However, social issues weren't the most pressing matter at hand. Following the end of the Civil War, the issue of economic stabilization became a pressing matter for politicians. However, it wasn't until the Keynesian Revolution that government could legitimately justify its economic expansion into the private sector of the economy.

The time period immediately following the Civil War up to the turn of the 19th century is known as the gilded age. Rapid economic development following the Civil War laid the groundwork for the modern U.S. industrial economy. By 1890, the United States leaped ahead of Britain for first place in manufacturing output, often called the "Second Industrial Revolution." Industry was transforming life: railroads were connecting the country; cities were being lit for the first time by the electric light; the telephone improved communication drastically. Many Americans came to idealize the businessmen behind these societal transformations who amassed vast financial empires, even to this day their names are heard: John D. Rockefeller, Andrew Carnegie, Pierpont Morgan, and Henry Ford. However, with rapid industrialization a strong middle class in America began to form, and with a robust taxing system now in place, lobbying groups began to form on behalf of middle-class Americans. At first, these organizations called upon Congress to have oversight in the economy. Muckrakers influenced popular opinion, and books such as *The Jungle* shifted public opinion toward government regulation and influence in the economy. As a result, the late 19th century saw rise in new regulatory agencies, such as the Interstate Commerce Commission, the Sherman Antitrust Act, the Federal Trade Commission, and other regulatory agencies. However, it wasn't until the 20th century that these laws were enforced fully. That is, government enacted these laws to appease their constituents, but it took time before constituents and lobbying organizations demanded their enforcement. Put another way, the beginning of the 20th century saw a sudden explosion of individuals who demanded government take action in regards to the economy, but with little economic science backing to their demands. This movement in American history is known as the progressive movement. It wouldn't be until the late 1930's that an economic theory would allow for an economic justification for increased governmental involvement in the economy, actions which are generally taken for granted today.

The progressive movement sought to remove corruption and undue influence from government, include more people more directly in the political process, and the conviction that government must play a role to solve social problems and establish fairness in economic matters. The main result of the progressive movement was to make social and economic matters political. Prior to the 20th century, government was removed from economic and social issues for the most part, but with rent seeking political pressures mounting, and the government's regulatory and taxing influence expanding, individuals and organizations seized on the opportunity to initiate economic and social change. The issue to be argued here is not whether economic and social issues should be political, but the incentives and consequences when they are.

When economic and social issues become political in nature, there is a strong incentive for both individuals and organizations to engage in nonproductive entrepreneurial activity. As Baumol (1990) argues:

> The basic hypothesis is that, while the total supply of entrepreneurs varies among societies, the productive contribution of society's entrepreneurial activities varies much more because of their allocation between productive activities such as innovation and largely unproductive activities such as rent seeking or organized crime.

They key to the current analysis is rent-seeking behavior. The idea that Baumol presents is that entrepreneurs are always residing in a society; there are always individuals seeking to make profit from undiscovered profit opportunities. Usually entrepreneurship occurs in the private market, in which new inventions are made, new products are marketed, and fortunes are made. However, when economic activity becomes political, entrepreneurship inevitably spills over into the political sphere. Individuals will seek to make profit through the political process instead of by engaging in private enterprise creating products. As Baumol argues, entrepreneurs are always in a society but their allocation between productive and unproductive endeavors depends on the rules of law and the relative payouts; sometimes it is more cost effective to petition government for subsidies or import quotas than to produce a higher quality product. As economic issues become political, and with the ability of the government to easily raise revenue for transfer payments through the income tax to supply subsidies, unproductive endeavors during the early 20th century became easier to obtain and therefore more cost effective. The results today are measureable; in 2008 alone companies spent over $1 trillion dollars on lobbying efforts to Congress. This money spent on lobbying has no productive gains in the sense that no product is being made; money is being spent solely to influence government actions—to influence the redistribution of wealth. Although the progressive movement rallied against lobbyists, their call for government influence in the economy was the start of unproductive entrepreneurship and only increased the incentive for lobbyists to become involved in politics. The goal of the progressive movement was to protect consumers and promote competition. However, the economic role and function of government was to take a decisive turn during the Great Depression and the Keynesian Revolution.

Prior to the Keynesian Revolution, the prevailing theory of economics was neoclassical in nature: free markets work. However, with the Keynesian Revolution, a "legitimate" argument based inside economics could be made for the expansion of government regulation and taxing authority. Up until this point, government expansions of regulatory power were made on moralistic arguments. That is, it was a moral obligation for the government to provide education, not one based on positive externalities. The frightening conclusion was that economics was used to argue for the expansion of government, rather than its containment.

Conclusion

Regardless of the method by which government growth is measured, the same conclusion is reached: the U.S. federal government experienced relatively slow growth until after 1900 but has since experienced increasing rates of growth. The more interesting question is not if government is growing, but what are the root causes of the pattern of government growth. The reasons are complicated, but can be summarized as follows: the ability for government to grow is a result of institutions. That is, for governments to grow they must have certain institutions in place, such as a robust taxing mechanism, a system encouraging to rent seeking behavior, and a population which supports government involvement in social and economic issues. Conversely, any government which is limited in its ability to raise revenue, which limits rent seeking behavior, and whose population supports limited government will not show growth. What is interesting is that these institutions were in place in American from roughly 1800 – 1900: Government growth data shows that for the first one hundred years of American history, the U.S Government grew very little if at all. It is only in the past 100 years that U.S government growth data shows a continued pressure for government growth. This implies that the institutions within the United States changed roughly around 1900, and it is these changes that have enabled the government to grow. Although no one specific institutional change can be attributed to the drastic growth in government seen today, three important influences are the formation of rent seeking groups after the Civil War, the Sixteenth Amendment to the U.S Constitution, and the Keynesian Revolution.

The Civil War saw the creation of rent seeking groups; organizations whose purpose it was to extract money or favors from the federal government. Although there were politically oriented groups before the Civil War, the GAR was the first organization to petition the government for transfer payments via increases in Union Soldiers' pensions. Realizing that other groups could join the GAR in extracting rents from government, soon the role and function of government changed. No longer was government the protector of private property and the supplier of rule of law, but it was a machine to grant privileges and favors. In order to meet increasing demand for their favors, politicians had the incentive to find a new method to grant special favors to their rent seeking constituents. The income tax was one such method, and likely the most influential. Originally a temporary measure, the success of the program and the increasingly risky nature of changing tariff policies, the income tax created a robust mechanism which politicians could access and use to funnel money to particular organizations. However, the legislation providing transfer payments and special privileges to specific groups lacked theoretical justification, without which the political players risked losing general support for their actions. The Keynesian Revolution and the progressive movement provided the theoretical and ideological basis by which politicians justified their special interest regulation and spending. Put together, the above tells a story of the transformation of American institutions between 1865 and 1930, and it is this transformation which has allowed for government growth experienced over the past several decades and which still occurs today.

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Education

Pennsylvania State University, the Behrend College, Erie, PA May 2010
Bachelor of Arts in Economics with Honors in Economics

Honors & Awards

Runner-Up Sigma Xi Undergraduate Business & Economics Oral Presentation, Spring '09
Dean's List, Fall '06 – Spring '10
Lawrence & Elizabeth Held Scholarship, Fall '07 – Spring '10
Summer Undergraduate Research Fellowship – Summer '09

Exposure to Economic Thought

Institute for Humane Studies Summer Conference: Liberty and Society, Wake Forest University, Summer '09
- Gained exposure to the basic tenets and arguments of classical liberalism and its relation to political, economic, and individual freedom.
- Debated the intellectual foundations of classical liberalism and laissez-faire economics with peers to understand weaknesses and strengths in the arguments presented to me and which I presented.

Foundation for Economic Education: Freedom University II, FEE Headquarters, Summer '09
- Gained exposure to the intellectual framework of Austrian economics and laissez-faire economic theory.
- Became familiar, though the art of debating, with the subtler points of Austrian economics and laissez-faire economic theory and their implications on mainstream economics.

Readings in Economics: Pennsylvania State University, the Behrend College, Fall '09
- Partook in book club which read from diverse authors of economic thought to discuss at weekly meetings.
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Research Experience

Honors Thesis: Causes and Consequences of Government Growth, Summer '09 – Spring '10
- Produced original research on the analytic narrative of government growth from an Austrian economics perspective.
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Econometrics: Do Changes in Gasoline Prices Affect U.S GDP?, Fall '08
- Produced original econometric research on the effects changes in gasoline prices have on U.S GDP.
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Regional Economics: Regional Study of Boulder, CO, Fall '08
- Produced co-authored research analyzing the economic structure of a metropolitan statistical area.
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Teaching Experience

Tutoring: Math, Economics, Writing, Political Science, Fall '08 – Spring '10
- Developed the ability to take abstract concepts and simplify them into their basic components for easier consumption by students.
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GMAT Prep: Quantitative GMAT Prep Course, Fall '09
- Designed and implemented a course preparing students, and individuals from the community at large, for the GMAT quantitative section.
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