Growth or Welfare State? Optimal Composition of the Government Expenditure*

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Abstract

In developing countries, the government often has to promote at once growth-enhancing and generational distribution policy. However, under such a situation, it is difficult for the government to carry out both policies and therefore, it is unavoidable to determine which policy they should carry out or the allocation of tax revenue through political compromise. Then, this paper incorporates both pay-as-you-go type pension and public investment into an overlapping generations model and shows how the contents of economic policy varies under the situation in which the policy determination is dependent on political issue.

Keywords: Commitment ; Growth-enhancing vs. Redistribution Scheme; Overlapping Generations Model; Structure-induced Equilibrium.

JEL Classification: E61, H54, H55.

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1 Introduction

Traditionally, in analyzing economic policies such as fiscal or monetary policy, economists have assumed that the government is a monolithic organization that is intended mainly to maximize social welfare or the economic growth rate. In this regard, the following points should be emphasized: First, various entities (voters, bureaucrats, representatives, organizations, etc.) that are involved in policy determination foster conflicts. Therefore, it is impossible for the government to organize a policy based on only one situation or position. In other words, the government cannot avoid determining a policy that incorporates implications of numerous opinions. Second, even if a policy were derived that maximizes social welfare or the growth rate, carrying out such a policy with certainty would be difficult: it is hard to commit to such a policy. Some conflicts exist even within actual governments. As just one example, the Ministry of Finance and the Ministry of Health, Labor and Welfare in Japan have frequent conflicts. These two organizations seek different objectives: the former seeks to decrease the deficit or debt, whereas the latter is responsible for promoting a social security system, even if it is very costly. Consequently, a contraposition of duties pertains between the two organizations. As a result, we cannot regard actual governments as monolithic organizations, as many economists have assumed. Nevertheless, many studies assume that policy variable is one-dimensional. Given the existence of such conflicts, "political compromise" is inevitable; it is difficult to maintain the government commitment entirely. As countermeasures for such a situation, we find that it is necessary *ex post* to carry out some kind of coordination policy to attenuate inefficiencies that result from discretionary policy. Then, as a source of such conflicts, we can point that the policy determination is not necessarily one dimensional but often multi-dimensional. Therefore, it is necessary to expand the past analysis into multi-dimensional policy-determination. This paper specifically considers the situation in which the government has two kinds of policy options; pension and public investment.

In this paper, we specifically consider the situation in which there exit two kinds of committee in the government and one is related to public investment and the other is pension system. Under such a situation, how does the content of the policy determine ? This paper is an attempt to answer such a question. The present paper analyzes how the contents of the policy varies through time, assuming that policy is determined based on the result of voting.

Then, let us consider the case of Japan. Fig.1 depicts the flow of the proportion of pension and public investment to gross domestic production[1]. From this figure, we find that the cost of pension

[1] Data Source:
Social Security : "the costs of social security" given by SNA; *The National Institute of Population and Social Security Research.*