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Small government or big government?

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Abstract:

Since the beginning of the twentieth century, economists and philosophers were polarizedon their positions beyond the role that the government should have in the economy.

On one hand John Maynard Keynes represented, within the optics of market economy, a position where the state should intervene in the economy to maintain the aggregate demand and the employment in the country, without hesitation in creating budget deficits and public debt expansion. This approach happens especially in the moments when the domestic economy and global economic trends show a weak growth or a recession. This means a heavy interference inthe economy, with higher income but with high expenditure to GDP too.

On the other side, Liberals and Neoliberalsled by Friedrich Hayek advocated a withdrawal of the government from economic activity not just in moments of economic growth but also during the crisis, believing that the market has self-regulating mechanisms within itself. The government, as a result will have a smaller dimension with lower income and also low expenditures compared to the GDP of the country.

We took the South-Eastern Europe countries distinguishing those with a "Big Government" or countries with "Small Government". There are analyzed the economic performances during the global crisis (2007-2014). In which countries the public debt grew less? Which country managed to attract more investments and which were the countries that preserved the purchasing power of their consumers?

We shall see if during the economic crisis in Eastern Europe the Great Government or the Liberal and "Small" one has been the most successful the model.

Keywords*: Liberal state, Crisis, Eastern Europe, Economic growth, Big Government.*

Introduction

John Maynard Keynes has been the principal actor that built the **Keynesian economics.** His view was focused in the short run. Especially during recessions, economic output is strongly influenced by aggregate demand (total spending in the economy). In the Keynesian view, aggregate demand does not necessarily equal the productive capacity of the economy. Instead, it is influenced by a host of factors and sometimes behaves erratically, affecting production, employment, and inflation.

The theories forming the basis of Keynesian economics were first presented into *The General Theory of Employment, Interest and Money*, published in 1936, during the Great Depression. Keynes contrasted his approach to the aggregate supply-focused 'classical' economics that preceded his book. The interpretations of Keynes that followed are contentious and several schools of economic thought claim his legacy. Keynesian economists often argue that private sector decisions sometimes lead to inefficient macroeconomic outcomes which require active policy responses by the public sector, in particular, monetary policy actions by the central bank and **fiscal policy actions by the government** [1], in order to stabilize output over the business cycle. Keynesian economics advocates a mixed economy that allows private sector, but with a role for a strong government intervention, especially during recessions.

He saw the economy as unable to maintain itself at full employment and believed that it was necessary for the government to step in and put under - utilized savings to work through government spending. Thus, according to Keynesian theory, some individually rational microeconomic-level actions such as not investing savings in the goods and services produced by the economy, if taken collectively by a large proportion of individuals and firms, can lead to outcomes where in the economy operates below its potential output and growth rate.

Keynes argued that the solution to the Great Depression was to stimulate the economy ("inducement to invest") through some combination of two approaches:

1. A reduction in interest rates (monetary policy), and
2. Government investment in infrastructure (fiscal policy).

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By reducing the interest rate at which the central bank lends money to commercial banks, the government sends a signal to commercial banks that they should do the same for their customers.

In this situation the Government Budget was almost the half of the entire GDP of a country.

Keynesian economics served as the standard economic model in the developed nations during the latter part of the Great Depression, World War II, and the post-war economic expansion (1945–1973). After 1973, at the same time Unemployment and Inflation were raising up, causing a stagflation underminingtheKeynesian and macroeconomic theories.

On the other hand, building on the earlier work of Ludwig von Mises, Friedrich Von Hayek also argued that while in centrally planned economies an individual or a select group of individuals must determine the distribution of resources, these planners will never have enough information to carry out this allocation reliably. This argument, first proposed by Max Weber, says that the efficient exchange and use of resources can be maintained only through the price mechanism in free markets.

Hayek theories were followed by Margareth Thatcher and Ronald Reagan. Politically speaking this policies were known as **Reaganomics** [2] and were applied during 1981-1989.

The pillars of his economic vision were:

1) Reduction of the public debt growth
2) Reducing taxes on labor and capital income
3) Reduction of regulation on business (deregulation)
4) Control of the money supply and inflation reduction

This policy reduced the government role on the economy allowing a bigger level of freedom for the business. The government budget in this case was reduced to 30% of GDP. A reason for adopting minimal government interference in the economy is for its beneficial consequences in GDP, Inflation, Unemployment and not for any ideological reason. At the heart of economic neoliberalism are various theories that prove the economic neoliberal ideology [3].

The advent of the global financial crisis in 2008 has caused a resurgence in Keynesian thought, encouraging the government role to resolve or to lessen the impactof the global crisis [4]. For many countries, this meant an increase of public expenditure, through unemployment benefits and through an increase of the size of the state in the economy. In parallel with the increase in public spending was allowed an increase in taxation and thus prevented the economic growth.Other countriespreferrednot to raise taxesbutto increase thedeficitand consequentlythe public debt. Thisled to thesovereign debt crisisespeciallyon the European continent.

What about the Balkans during the last global economic crisis? Does the Balkans countries have a big dimension of the state budget compared with the national economies or do they follow neoliberal economic theories?

Which are the countries that were affected to a lesser extent by the global crisis and whom managed to protect the purchasing power of their citizens? Are they countries that have followed the Keynesian theories that grew mostly during the crisis? In which country, as required, public debt and became problematic? At the end, this paper aims to highlight if during the last global crisis, were the countries that followed neoliberal policies those who faced the crisis better or if the increased size of the state and the government, according to the Keynesian doctrines, helped to overcome the economic crisis.

2. Methods

The data examined belong to eight years an axis of time, from 2007 to 2014. In that line we can see the situation of the countries of the South Eastern Europe before the beginning of the Global Crisis and their evolution over the years. The countries surveyed are ten: Albania, Kosovo, Bosnia, Montenegro, Macedonia, Serbia, Croatia, Bulgaria, Romania and Hungary.

Were taken yearly data on total revenues and expenditures of the countries analyzed a total of 160 data. This was done to distunguere the states in countries with governments or Neoliberal Keynesians. Later in the year we analyzed the evolution of public debt by noting an annual average the countries that have done most to increase their sovereign debt. Finally, we have highlighted the total investment of the total economy. Thus you can see in countries such investment and therefore economic growth was higher. There is not necessary to implement econometric analysis in this case. Through Excel program we can made calculations that shows concrete results on the behavior of countries.

In the Balkan and South European and we highlighted the main macroeconomic and indicators on the lens of the Keynesian and Neoliberal doctrines.

3. Results

In the table above we can see the revenue budgets of the states analyzed. As you can notice the countries can be divided into two groups. The groups are distinguishable because follow the theories of Hayek and more generally those neoliberals. These are the countries that have a tax burden below 35% of GDP. These countries are Albania, Kosovo, Macedonia, Bulgaria and Romania. On the other hand countries like Bosnia, Croatia, Hungary, Montenegro and Serbia have a great status or income tax exceeds 40% of GDP. This means that the fees are usually higher than those of most "Neoliberal" countries but also the expenditures will be higher.

The smallest Governments in Revenues are the Albanian and the Kosovo one. The biggest tax revenues are collected in Montenegro and Bosnia.

In the table 2, below, we can see that the biggest government expenditures occur in Serbia, Hungary and Bosnia, on the opposite side there is Kosovo government. During the crisis years, no country changed its own believes about the government dimension compared to the economy. The Keynesian countries (white stripes) carried on taxing and spending to support the economy instead the Neoliberal countries (yellow stripes) continued to promote a contained role of testate in the economy.

Table 1: Countries Tax Revenues

Country Revenues	2007	2008	2009	2010	2011	2012	2013	2014
Albania	26.1	27.3	26.6	26.4	25.8	25.1	24.1	26.1
Bosnia	46.7	45.5	44.9	46.8	45.9	46.3	45.1	45.1
Bulgaria	38.2	38.0	35.3	32.7	32.4	34.0	35.5	36.3
Croatia	39.8	39.2	39.0	38.2	37.4	38.6	38.1	40.1
Hungary	45.6	45.5	46.9	45.6	54.3	46.9	47.7	48.3
Kosovo	25.9	24.3	28.0	26.4	27.1	26.1	24.6	24.7
Macedonia	32.7	33.1	31.2	30.3	29.7	30.0	29.5	31.4
Montenegro	49.2	48.4	42.5	41.3	38.5	40.1	41.3	42.6
Rumania	32.3	32.2	31.2	32.2	32.6	32.9	31.8	33.1
Serbia	44.0	42.8	42.2	42.5	40.6	42.1	40.6	41.1

Source: World Bank Database

Table 2 Countries Government Expenditures

Gov. Expenditures	2007	2008	2009	2010	2011	2012	2013	2014
Albania	29.2	32.3	34.3	30.6	29.4	28.6	29.3	32.8
Bosnia	47.1	49.7	49.6	50.3	48.8	48.9	47.0	49.2
Bulgaria	34.9	35.2	36.2	36.7	34.4	34.4	37.4	39.0
Croatia	40.8	40.1	42.2	42.7	42.0	41.9	43.5	44.8
Hungary	50.6	49.2	51.4	49.9	50.0	48.9	50.0	51.2
Kosovo	18.9	24.5	28.9	28.7	28.9	28.7	27.8	26.9
Macedonia	32.1	34.0	33.9	32.7	32.2	33.8	33.6	34.8
Montenegro	42.9	51.6	47.8	45.9	43.8	45.9	44.6	44.1
Rumania	35.4	37.0	38.5	38.6	36.8	35.4	34.3	35.3
Serbia	44.9	44.8	46.0	46.4	45.0	49.4	46.3	50.0

Source: World Bank Database

In the table 3 we can see the course of the public debt of the countries has been outlined. At this point already it may be noted that the Public Debt to GDP ratio on Neoliberal countries (Albania, Bulgaria, Kosovo, Macedonia and Romania) grew on average by 2.8% per year. In the countries with high Revenues and Expenditures (Bosnia, Croatia, Hungary, Montenegro and Serbia) the Public Debt to GDP growth ratio was 4.4% on average.

This increase in public debt by countries interventionist economy was predictable because the increasing public expenditure cannot be filled by an increase in taxation. In fact, in countries with high tax revenues a further tax increase would lead to an extreme economic slowdown and social unrest. Consequently governments that adopted a Keynesian approach have no other alternatives to debt.

Table 3: Sovereign Debt

Sovereign Debt	2007	2008	2009	2010	2011	2012	2013	2014	Average
Albania	53.4	56.1	60.8	58.8	60.4	62.9	70.5	72.1	2.7
Bosnia	18.7	30.9	35.8	39.1	40.8	44.6	42.5	46.1	2.5
Bulgaria	18.6	15.5	15.6	14.9	15.4	17.5	16.4	25.2	1.6
Croatia	32.9	29.3	35.8	42.6	47.4	54.2	60.2	66.3	6.2
Hungary	67.0	73.0	79.8	82.1	82.1	79.8	79.3	79.1	1.0
Kosovo									
Macedonia	23.0	20.9	24.1	24.5	27.9	33.4	35.9	36.3	2.6
Montenegro	27.5	29.0	38.2	40.9	46.0	54.0	58.0	60.3	5.2
Rumania	12.7	13.6	23.8	31.1	34.3	38.2	39.4	39.9	4.4
Serbia	34.6	33.4	38.1	46.5	49.5	62.4	65.8	75.6	7.0

Source: World Bank Database

Looking at each country, we can see that despite many experts warned and proposed extreme measures to control the public debt in Albania, from 2007 to 2014 the increase in Sovereign Debt was 18.7% of GDP. It might seem very much but out of nine countries analyzed, Albania was one of those who less increased its public debt.

Serbia was the country most affected by an increase in public debt which grew by 41% of GDP from 2007 to 2014. The following country was Croatia which increased the debt by 33.4% of GDP and Montenegro with 32.8%. All together the three countries have a large state with high taxes and to even more high expenditures.

If we can say that the increase of expenditures may cause the increase in debt, on the other hand is normal to think that the excess spending is spent in investments by the government. You can expect consequently that countries with a larger public

expenditure have higher levels of investment in their economies. We must not forget, however, that the government investments are a minority part of the total investment, led by entrepreneurs, which tends not to invest in the presence of a high tax burden.

Again you can see that the countries that followed Neoliberal economic policies had the largest total investments. Albania had the highest percentage of total investment to GDP in a virtuous competition between state, domestic investors and foreign investors. The following countries are Bulgaria and Romania, both with low income and low expenditures.

The countries with the lowest percentage of Investments are Bosnia and Hungary.

On average Neoliberal countries during the period 2007-2014 had a percentage of the Investments on GDP of 26.8% while Keynesian countries have only 22% of GDP made by Investments.

Purchasing Power Parity rate is useful to understand an average of the being of population, through a given amount of one currency thus has the same purchasing power whether used directly to purchase a market basket of goods or used to convert at the PPP rate to the other currency and then purchase the market basket using that currency.

Observed deviations of the exchange rate from purchasing power parity are measured by deviations of the real exchange rate from its PPP value of 1.

PPP exchange rates help to minimize misleading international comparisons that can arise with the use of market exchange rates.

For example, suppose that two countries produce the same physical amounts of goods as each other in each of two different years.

Since market exchange rates fluctuate substantially, when the GDP of one country measured in its own currency is converted to the other country's currency using market exchange rates, one country might be inferred to have higher real GDP than the other country in one year but lower in the other; both of these inferences would fail to reflect the reality of their relative levels of production.

Table 4: Total Investments ratio to Gross Domestic Product

Investments/GDP %	2007	2008	2009	2010	2011	2012	2013	2014	Average
Albania	30.6	33.5	30.5	26.9	25.8	24.3	22.9	24.9	27.4
Bosnia	24.5	26.1	18.6	15.6	18.1	18.1	18.2	19.8	19.9
Bulgaria	34.1	37.5	29.4	22.9	21.9	21.7	20.9	23.5	26.5
Croatia	29.9	31.3	25.9	21.9	21.5	20.5	20.4	19.1	23.8
Hungary	22.4	23.5	18.0	19.3	19.2	17.5	17.6	18.8	19.5
Kosovo									
Macedonia									
Montenegro	33.8	40.7	27.1	22.8	19.5	19.5	15.9	19.6	24.9
Rumania	31.0	31.3	25.4	25.6	26.8	26.0	22.9	22.5	26.4
Serbia	29.0	29.7	18.0	17.2	20.1	21.1	18.5	20.7	21.8

Source: World Bank Database

Table 5: Purchasing power parity per Capita in International USD

Purchasing Power Parity	2007	2008	2009	2010	2011	2012	2013	2014
Albania	7622	8436	8872	9388	9900	10291	10596	11055
Bosnia	8186	8825	8666	8862	9147	9214	9563	9808
Bulgaria	13707	14907	14278	14623	15568	16039	16518	17115
Croatia	20398	21241	19948	19793	20196	20109	20222	20392
Hungary	21667	22336	21012	21529	22381	22525	23236	24336
Kosovo								
Macedonia	10312	11016	10976	11406	11938	12079	12587	13204
Montenegro	12580	13687	12977	13435	14129	13990	14666	15219
Rumania	14875	16308	15374	15410	16142	16560	17440	19397
Serbia	10687	11361	11090	11384	11855	11982	12465	12605

Source: World Bank Database

In the table 6 we can see that the countries with a small government are those who on average have allowed their citizens to increase their welfare. Albania is the country that guides this ranking for two reasons. The first is a definite development of the country which has continued, albeit at lower rates, despite the economic crisis. The second reason is that the population of the country has decreased, increasing the purchasing power per person with 45% during the period 2007-2014.

Table 6: Cumulative percentage growth in Purchasing Power Parity

2007-2014	Growth in %
Albania	45.0
Bosnia	19.8
Bulgaria	24.9
Croatia	0.0
Hungary	12.3
Kosovo	
Macedonia	28.0
Montenegro	21.0
Romania	30.4
Serbia	18.0

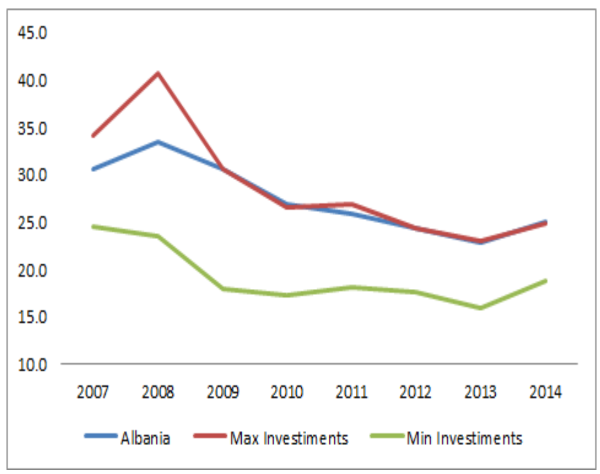

Figure 1: Albanian Total Investments compared with the maximal and minimal investments in the region

Romania and Macedonia, both Neoliberal countries follows the Albanian exploit while welfarist and Keynesians countries, that through the Government intervention would support the economy are those who obtained poor results in the defense of the purchasing power of their citizens.

The differences here are also visible in the averages. Countries with a large Government increased the purchasing power per person by 14.2% over the last eight years while the countries that followed the theories related to the Reaganomics increased the purchasing power by 32.1% per person.

The table 7 shows the sum and the product of all the upper indicators. In fact, the small governments, which have left in the pockets of their citizens the money via low tax, had an economic growth much higher than those who thought that the government could make better use of public money than they could do themselves. The Neoliberal group (Albania, Bulgaria, Kosovo, Macedonia and Romania) had an average year growth of GDP by 2.7% instead the Keynesian group (Bosnia, Croatia, Hungary, Montenegro and Serbia) had an average year growth of GDP by 0.9%.

Table 7: GDP Growth in %.

Country	2007	2008	2009	2010	2011	2012	2013	2014	Average
Albania	5.9	7.5	3.4	3.5	2.3	1.1	0.4	2.1	3.3
Bosnia	6.0	5.6	-2.7	0.8	1.0	-1.2	2.1	0.7	1.5
Bulgaria	6.4	6.2	-5.5	0.4	1.8	0.6	0.9	1.4	1.5
Croatia	5.1	2.1	-6.9	-2.3	-0.2	-2.2	-0.9	-0.8	-0.8
Hungary	0.1	0.9	-6.8	1.1	1.6	-1.7	1.1	2.8	-0.1
Kosovo	8.3	4.5	3.6	3.3	4.4	2.8	3.4	2.7	4.1
Macedonia	6.1	5.0	-0.9	2.9	2.8	-0.4	2.9	3.4	2.7
Montenegro	10.7	6.9	-5.7	2.5	3.2	-2.5	3.5	2.3	2.6
Rumania	6.3	7.3	-6.6	-1.1	2.3	0.6	3.5	2.4	1.8
Serbia	5.4	3.8	-3.5	1.0	1.6	-1.5	2.5	-0.5	1.1

Source: World Bank Database

Albania, in this indicator too, for many years managed to stay close to the maximum levels of economic growth in the South Eastern Europe until 2011 where the economic crisis and the slowdown of credit begun to damage the country's economic growth.

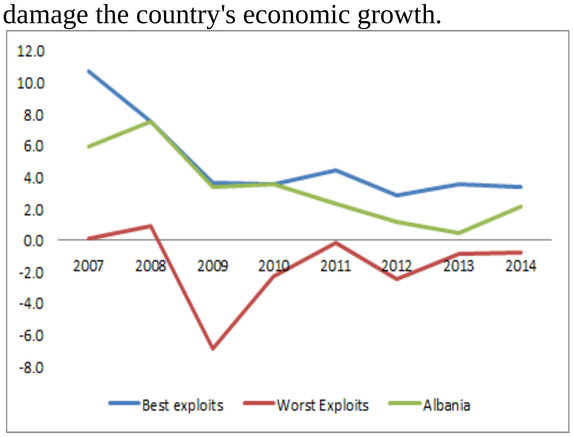

Figure 2 Albanian GDP Growth compared with the maximal and minimal GDP growth in the region.

Till now economists believed that during periods of economic crisis, following the Keynesian policies, governments should increase their expenditures by resorting to deficit spending and consecutive increases of the public debt.

All this would be justifiable if governments would increase spending to support aggregate demand and consumption. That would increase the GDP and improve the relationship between public debt and GDP. This theory, however, was elaborated only in emergencies, such as economic crises.

Usually governments should be of small size relative to GDP. What we did not expect by the results of analysis of Southeastern Europe is that during the economic crisis too it's better to follow the Neoliberal doctrines, intending with that a state with little income and contained expenditure. During the economic crisis too, the Neoliberal countries grew more than the Keynesians and welfare countries.

With Neoliberals countries we mean: Albania, Kosovo, Macedonia, Bulgaria and Romania. With Keynesians countries we mean: Bosnia, Croatia, Hungary, Montenegro and Serbia.

During the period 2007-2014, when the crisis hit Europe, the Neoliberals Balkans countries have increased their public debt to GDP by 2.8% per year.

Countries with a large government increased their public debt to GDP by 4.4% per year.

Total investment on GDP in countries with a large government were 22% on average, while countries with a small government had on average 26.8% of GDP per year on investments. The purchasing power of citizens in the Neoliberal countries is arising by an average of 32.1% cumulatively from 2007 to 2014, while in the same period in Keynesians countries purchasing power per person is arising by only 14.2%.

Finally, GDP at constant prices in countries with small Governments is ascending by an average of 2.7% per year over the time period analyzed, while in countries with a Government of large scale, economic growth has barely reached 0.9% per year.

4. Conclusions

Is evident that, the Neoliberal Governments works better than the Keynesian ones, whom intervene in the economy not only during periods of economic growth but also during economic crises. This does not happen only in developed countries but also for developing countries as the Southeastern European countries are. Governments need to recognize that citizens know how to administer their money better than the Government Institutions. The Governments must reduce taxes and public spending. Big Governments, in this case, were not able to support the economy, consumption and investment, but have only been able to squander taxpayers' money.

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