

The Consumer Economy and Redistribution

Monica Prasad

m-prasad@northwestern.edu

Abstract

This paper identifies, but does not resolve, contradictory findings on the role of consumption on redistribution. Qualitative studies of the U.S. and Europe consistently find that savings and investment are strongest, and consumption is weakest, in precisely those countries where the welfare state is strongest. On the other hand, this paper conducts a quantitative analysis of the relationship between the proportion of GDP devoted to consumption and public welfare state spending, and finds a robust positive association that remains even after controlling for other factors that affect the size of the welfare state.

Introduction

America spends, Europe saves. This is not just a popular stereotype, but a distinction borne out by historical scholarship as well as by comparative data on spending and saving. Figure 1 shows that the countries of the advanced industrial world differ considerably in the extent to which they devote resources to household consumption, with the United States particularly marked as having a high proportion of GDP devoted to consumption since at least 1950. Figure 2 shows the inverse of this with respect to investment, with the U.S. showing much lower rates of capital formation than the countries of Europe. Figure 3 give a longer-term perspective that shows that these patterns have not always been in place: only in the 1930s and the 1940s do Europeans surpass Americans in their rates of saving, and this is not because Americans start saving less, but because Europeans start saving more.

Historians have given us a good picture into why that should be so. The historian Sheldon Garon notes: “There is nothing all that shocking about declining U.S. saving rates after 1945...Americans saved less because they could.” (Garon 2012, 318). With plentiful capital, manufacturing capacity, and monetary reserves, and not having experienced the destruction of its cities, Americans did not need to launch the savings campaigns seen in every other nation.

In Europe on the other hand “Often it felt as if the war had never ended. States throughout Europe continued to harangue citizens to save and curb spending” (Garon 2012, 211). In France after the war Jean Monnet and his group of planners decided that “capital investment was the key” to recovery, and therefore “the planners wanted to lower the output of consumer goods as much as possible without arousing opposition to the [plan]...The planners chose investment over consumption, modernization over reconstruction, or the future over the present...financial resources would be available, it was held, if consumption were controlled through such means as rationing. Then personal savings would accumulate and furnish the necessary investments” (Kuisel 1981, 222, 225, 233-234). Gunnar Trumbull (2012, 2014) has studied the use of consumer credit in the United States and France, and concludes that “France has consistently had low levels of consumer credit use...In 2010, French households still held less debt, measured as share of their disposable income, than did American households in 1950” (2012, 10).

In Germany, leaders “remained fiercely committed to encouraging saving after 1948. Economic officials steadfastly rejected Keynesian advice to stimulate domestic demand by deficit financing” (Garon 2012, 211-12)—as they continue to do until today. After the Second World War, Germany was doing everything in its power to try to restrain inflation, including restricting consumer credit (Eichengreen and Mitchener 2003), reducing lending by banks (Voth 2003), and channeling funds to investment (Overy 1996, Logemann 2007). German politicians “subordinated domestic demand to the needs of industrial capital” (Allen 1989, 263). The German growth model was: “moderate wages [which] enabled the buildup of plant and equipment to take place, ensured the stability of the new currency, and permitted Germany’s return to the world market through competitive exports” (Hardach 1980, 171). Jan Logemann (2008, 2012) notes that although West Germany was also increasing the role of consumer credit,

“the German Federal government, historically concerned about inflation and committed to asset building, was less interested than its American counterpart in bolstering mass purchasing power. This was reinforced by postwar needs for rebuilding productive assets and a longstanding focus on exports rather than domestic markets” (2008, 526).

Thrift prevailed in other countries too. “In 1955 the Swedish government regarded it as perfectly proper to subsidize saving for the explicit purpose of ‘restricting consumption’ in a heated economy. Depositors received a whopping 20 percent premium on increases in their accounts” (212). Sweden, the Netherlands, and Belgium all passed policies to encourage savings (Garon 2012, 212). In Britain, both Labour and Conservatives focused on savings, believing that recovery depended on increasing savings, and labour unions fervently promoted the savings movement (219).

Meanwhile, the United States developed a model of economic growth that Meg Jacobs (2005) calls the “purchasing power paradigm” and that Lizabeth Cohen (2003) has called the “purchaser consumer paradigm.” These terms refer to the growing belief during the Depression and the New Deal that “The prosperity of the nation is built upon spending, not saving” (quoted in Cohen 2003, 55). Such thinking was widespread, found among economists such as Robert Nathan, who argued that the nation now “must increase consumption and reduce savings” (quoted in Garon 2012, 327), as well as representatives of labor who used it to argue for higher wages for male workers: “Unless a worker’s earnings can support his family, we [will] find our whole capitalistic set-up deprived of the market for the great production of which it is capable” (quoted in Cohen 2003, 154). This thinking was found within the government, where Harold Ickes’s National Resources Committee noted that the country’s “rich abundance of natural resources and an undreamt-of capacity to convert this natural wealth into useful goods and services” required that “the consumers of the Nation are able to buy the output of goods and

services which industry can produce” (quoted in Garon 2012, 327). It even reached Roosevelt himself.

Economic historians have argued that the development of the European welfare state was inextricably involved with the post-war European economic strategy of privileging savings and investment over consumption. All over Europe, one common strategy was to extend welfare protections in return for policies of wage restraint, with the goal of making manufactured goods more competitive on export markets. In effect, European taxpayers subsidized the exporting industries through the mechanism of the welfare state: “In Belgium, the first postwar government adopted a social security scheme in return for labor’s adherence to a 1944 social pact limiting wage increases. In return for the unions’ promise of wage restraint, the Norwegian government offered legislation mandating paid vacations and limiting the length of the workweek. The Dutch government introduced unemployment insurance and old-age pensions, while extending social security coverage, as a quid pro quo for wage moderation. Starting in 1955, the Swedish government offered compulsory health insurance, an expanded system of disability insurance, and an array of retraining programs in return for labor’s acquiescence to policies of wage restraint and solidarity. The Danish government offered an expanded system of sick pay in 1956, when the agreement to link wage increases to productivity negotiated during the reconstruction phase showed signs of breaking down. The Austrian government extended tax and social insurance concessions to labor in return for wage moderation” (Eichengreen 2007, 33–34).

For these reasons, we should expect to see an *inverse* relationship between consumption and public social expenditure.

Data and Methods

This paper investigates the relationship between consumption and public social expenditure across 22 advanced industrial countries (Australia, Austria, Belgium, Canada, Denmark, Finland, France, Germany, Greece, Iceland, Ireland, Italy, Japan, Luxembourg, Netherlands, New Zealand, Norway, Portugal, Spain, Sweden, Switzerland, United Kingdom, United States) from 1980 to 2014.

The dependent variable, *Socx_pub*, is measured as total public social expenditure as percent of GDP, and is taken from the Comparative Welfare States Dataset (CWSD).

The main predictor of interest is household consumption. Because measures of household consumption as a share of GDP are not available in constant purchasing power parities, I use a measure of the ratio of household consumption to the total of household consumption plus investment (*covercplusi*). This is calculated from measures available from the CWSD ($covercplusi = csh_c / (csh_c + csh_i)$).

As control variables I have included four measures of economic performance that may be expected to influence welfare state spending (GDP per capita, unemployment, the consumer price index, and the real interest rate) and two demographic measures (female labor force participation and the population between the ages of 15 and 64) because the size of the labor force may affect the health of the welfare state. These measures are from the OECD, with the exception of the measure of real interest rates, which is from the World Bank.

I have also included controls for political variables that may be thought to influence the size of the public welfare state, including union density (*ud*, net union membership as a percentage of employed wage and salary earners), a measure of wage coordination (*wcoord*, with lower levels reflecting lower levels of wage coordination), and a measure of left voting (*leftvot*, the share of votes cast for left parties in the most recent election). These variables are from the CWSD.

Unit root tests showed that the main variables of interest were not stationary, and consequently all variables were first-differenced; to test robustness, results are also repeated with non-differenced variables.

Three different models are estimated. The first model is estimated with ordinary least squares with panel corrected standard errors, the second model repeats this estimation with a lagged dependent variable, and the third model uses country fixed effects. In the first two models panel corrected standard errors were used because the number of time points and countries suggests generalized least square methods will understate the size of standard errors and overstate significance (Beck and Katz 1995). The third model uses fixed effects to control for unobserved heterogeneity between countries.

Results

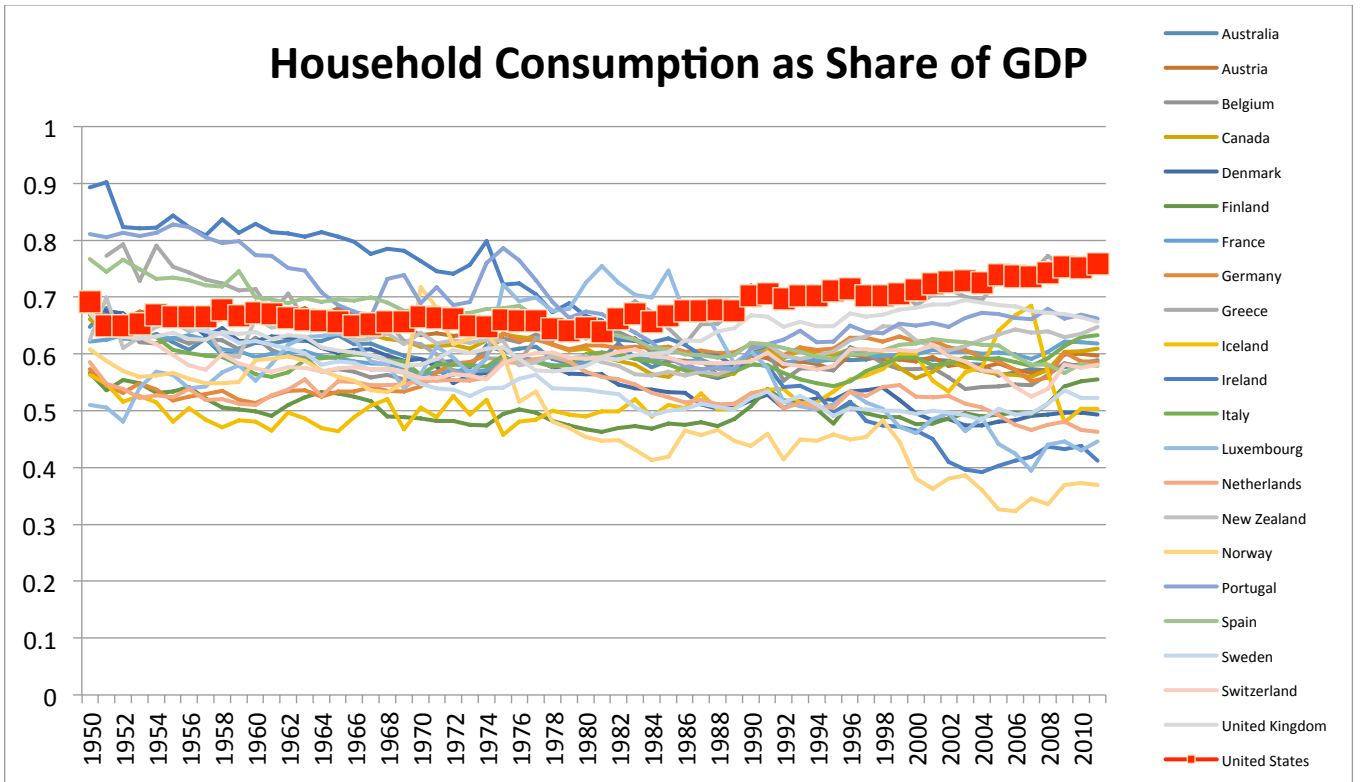
Tables 1 and 2 present the results. Table 1 presents the results with non-differenced variables, and table 2 with first-differenced variables (because the variables are not stationary, table 2 is more appropriate; table 1 is given here to show that the results are robust to differencing).

In both tables, columns 1-3 show estimations using panel-corrected standard errors, columns 4-6 show estimations using PCSE with a lagged dependent variable, and columns 7-9 show estimations using fixed effects.

All estimations show that consumption has a strong and positive association with private welfare state spending. Controlling for other factors that affect the welfare state, a one percentage point increase in consumption is associated with an 11 to 13 percentage point increase in public social welfare expenditure.

CONCLUSION

Figure 1



Penn World Tables

Figure 2

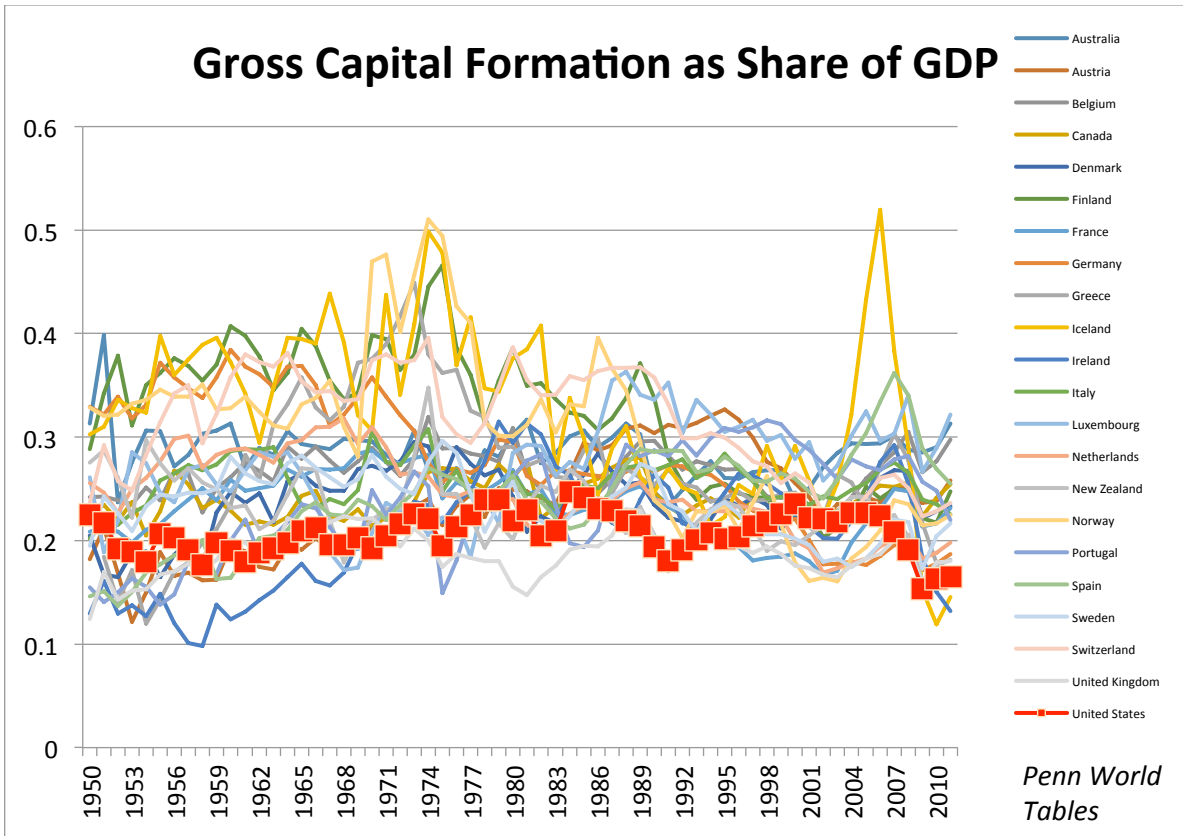


Figure 3

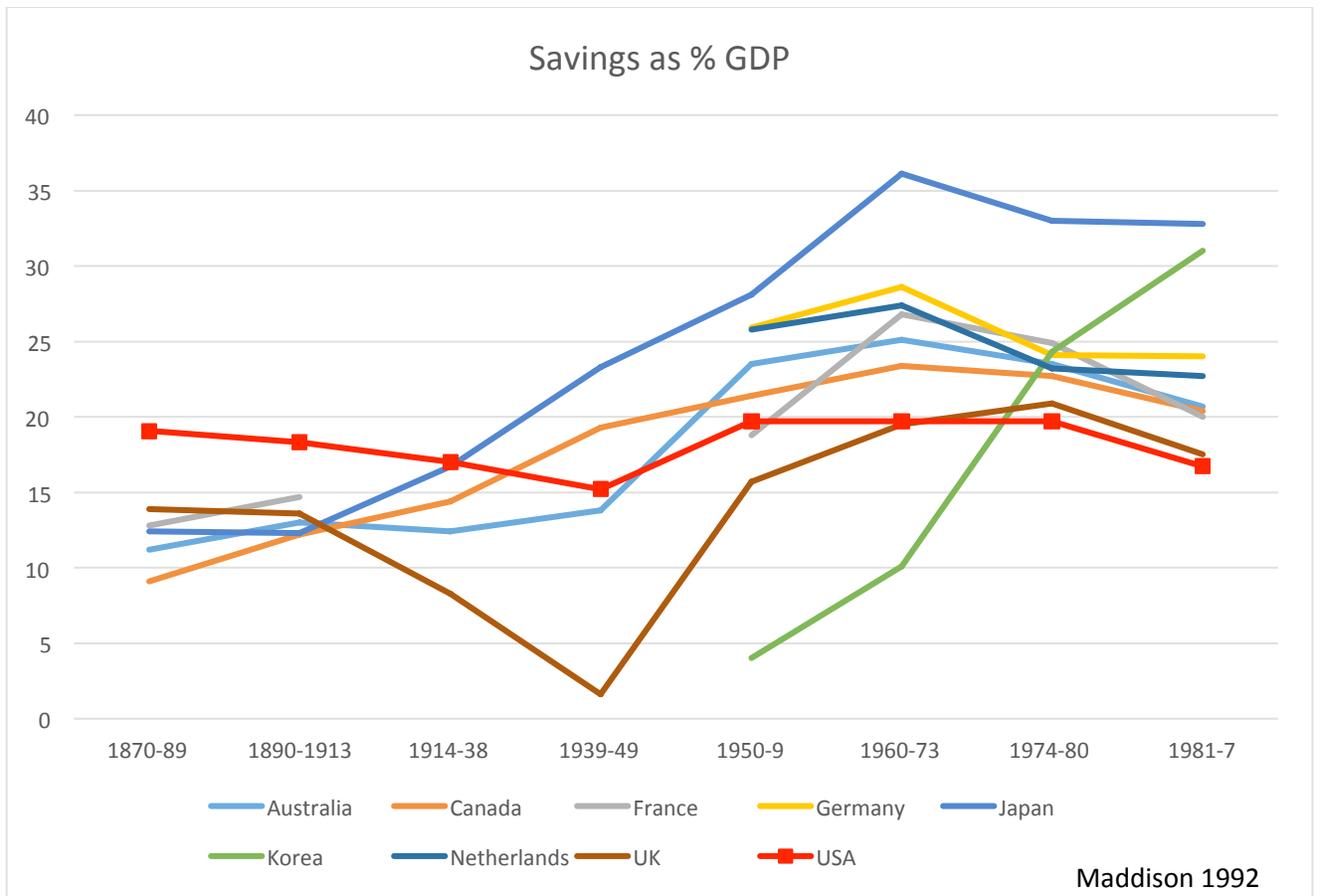


Table 1: Non-Differenced Variables

	PCSE			PCSE with LDV			Fixed Effects		
	(1) socx_pub	(2) socx_pub	(3) socx_pub	(4) socx_pub	(5) socx_pub	(6) socx_pub	(7) socx_pub	(8) socx_pub	(9) socx_pub
coverplusi	12.91*** (3.142)		39.72*** (6.396)	1.789 ⁺ (0.922)		3.266 ⁺ (1.787)	30.70*** (2.001)		12.14*** (2.462)
unemr		0.424*** (0.0328)	0.299*** (0.0297)		-0.0280* (0.0123)	-0.0327** (0.0120)		0.207*** (0.0402)	0.181*** (0.0395)
rgdpecap		0.000151*** (0.0000290)	0.0000772** (0.0000253)		-0.0000199 (0.0000133)	-0.0000243 ⁺ (0.0000122)		- 0.000350*** (0.0000479)	- 0.000294*** (0.0000475)
cpi		0.0909*** (0.00979)	0.0943*** (0.00927)		0.00517 (0.00447)	0.00651 (0.00445)		0.171*** (0.0219)	0.144*** (0.0216)
pop15to64		0.00000298 (0.00000306)	- 0.00000400 (0.00000249)		- 0.00000072 (0.000000893)	- 0.00000125 (0.000000963)		0.0000467 (0.0000494)	0.0000592 (0.0000474)
realinterstrate		0.290*** (0.0481)	0.253*** (0.0445)		0.0696*** (0.0170)	0.0689*** (0.0164)		0.0330* (0.0144)	0.0359* (0.0140)
ud		0.109*** (0.00712)	0.113*** (0.00856)		-0.000834 (0.00242)	0.000551 (0.00234)		0.0180 (0.0306)	0.0157 (0.0294)
wcoord		0.214* (0.0982)	0.876*** (0.198)		0.0156 (0.0318)	0.0714 (0.0503)		0.0636 (0.0676)	0.0332 (0.0662)
leftvot		0.128*** (0.0133)	0.107*** (0.0117)		-0.000491 (0.00428)	-0.00101 (0.00419)		-0.0283 ⁺ (0.0148)	-0.0297 ⁺ (0.0144)
L.socx_pub				0.979*** (0.00970)	0.973*** (0.0100)	0.963*** (0.0132)			
_cons	12.10*** (2.240)	-4.442*** (1.346)	-30.61*** (5.304)	-0.557 (0.638)	0.694 (0.492)	-1.531 (1.410)	3.098*** (0.0937)	13.24*** (0.255)	5.635*** (0.299)
N	620	442	442	595	428	428	599	422	422
adj. R ²							0.264	0.350	0.387

Table 2: First Differences

	PCSE			PCSE with LDV			Fixed Effects		
	(1) dsocx_pub	(2) dsocx_pub	(3) dsocx_pub	(4) dsocx_pub	(5) dsocx_pub	(6) dsocx_pub	(7) dsocx_pub	(8) dsocx_pub	(9) dsocx_pub
dcoverplus i	29.72*** (3.751)		11.35*** (3.057)	28.90*** (3.543)		13.42*** (3.114)	29.72*** (1.968)		11.32*** (2.389)
dunemr		0.187*** (0.0496)	0.162*** (0.0491)		0.143** (0.0512)	0.0994+ (0.0514)		0.176*** (0.0394)	0.156*** (0.0386)
drgdpecap		- 0.000474*** (0.0000628)	- 0.000412*** (0.0000636)		- 0.000465*** (0.0000650)	- 0.000391*** (0.0000648)		- 0.000501*** (0.0000555)	- 0.000434*** (0.0000558)
dcpi		0.0430 (0.0289)	0.0412 (0.0278)		0.0466 (0.0297)	0.0454 (0.0278)		0.0432 (0.0301)	0.0315 (0.0294)
dpop15to64		0.0000249 (0.0000332)	0.0000307 (0.0000324)		0.0000438 (0.0000327)	0.0000536+ (0.0000313)		0.0000341 (0.0000576)	0.0000475 (0.0000562)
drealinterest rate		0.0302* (0.0142)	0.0342* (0.0140)		0.0441** (0.0167)	0.0494** (0.0162)		0.0278* (0.0135)	0.0323* (0.0132)
dud		0.0449 (0.0340)	0.0438 (0.0324)		0.0346 (0.0379)	0.0307 (0.0361)		0.0649* (0.0318)	0.0657* (0.0310)
dwcoord		0.0793 (0.0803)	0.0497 (0.0782)		0.0988 (0.0792)	0.0724 (0.0765)		0.0820 (0.0642)	0.0529 (0.0628)
dleftvot		-0.0289+ (0.0152)	-0.0291* (0.0148)		-0.0235 (0.0151)	-0.0223 (0.0146)		-0.0251+ (0.0146)	-0.0259+ (0.0142)
L.dsocx_pu b				0.302*** (0.0700)	0.139* (0.0651)	0.185** (0.0624)			
_cons	0.206* (0.0813)	0.391*** (0.0931)	0.341*** (0.0921)	0.142+ (0.0754)	0.346*** (0.0957)	0.276** (0.0918)	0.206*** (0.0324)	0.415*** (0.0893)	0.385*** (0.0871)
N	595	419	419	574	407	407	595	419	419
adj. R ²								0.386	0.418

