

Adolf Wagner's law (PUBLIC FINANCE)

Adolf Wagner a noted German political economist (1835-1917) propounded an empirical law to analyses and explains the trend in the growth of public expenditure. Wagner argued that a functional, cause and effect relationship exists between the growth of an industrializing economy and the relative growth of its public sector. According to Wagner, relative growth of the government sector is an inherent characteristic of industrializing economies. He illustrates this with the examples of Great Britain, U.S.A, France, Germany and Japan. He came to the conclusion that as per capita income and output increases in industrializing nations, the public sectors of these nations necessarily grow as a proportion of total economic activity.

Wagner hypothesized a functional relationship between industrialization and the relative importance of public sector activity. He then set out to test his hypothesis by examining the industrialization process in various European countries and Japan. His observations led to what is now called as Wagner's Law of Increasing State Activity

According to Wagner's law, the expenditure of public authorities has a continuous increasing trend due to three reasons, they are: a. Expansion of Traditional Functions: Traditional functions mainly include defence, administration of justice, maintenance of law and order and provision of social overheads. The coverage and variety of such functions have gradually increased. Defence expenditure has expanded rapidly because of a change in military arts and sciences. In modern times military activities has become sophisticated. From simple aggression, the modern warfare shifted to prevention of attack and use of sophisticated weapons. Defence outlays on men, materials and maintenance have been on a rising trend in modern times. Similar is the case with expenditure on internal protection and administration. Increasing areas of administration and spread of government machinery with expertise have become more and more expensive.

. Coverage of New Functions:

Secondly the activities of the state were increasing in their coverage. Traditionally the state activities were limited to only defence, justice, law and order, maintenance of the states over heads etc. But with the growing awareness of its responsibilities to the society, the governments started expanding its activities in the field of various welfare measures to enrich the cultural life of the society. Along with this

new welfare programmes were designed to provide social security to the people. This required increasing government expenditure on education, public health, low cost housing, subsidized provision of food, agricultural inputs, old age pension, sickness benefit etc. c. Expanding Sphere of Public Goods: Almost all modern democratic governments have increasingly recognized the need to provide and expand the sphere of public goods. The need and necessity to provide social and merit goods through budgetary allocation was increasingly recognized by the modern state. The state was trying to shift the composition of national product more in favor of public goods. As a result state activities expanded to areas like irrigation and flood control projects, construction and maintenance of public parks, provision of education and health care facilities, creation of economic overhead capital etc., Provision of these public goods and merit goods means heavy investment in public enterprises. Apart from the above mentioned factors, Wagner also examined the forces that operate on both the demand and supply side of public sector activity and explained how they interact. Changing production and marketing arrangements of public sector activity affect and are affected by social organizations in different ways. They are given:

i. Factors that affect both demand and supply of public expenditure activities:

(a) Per capital income and wealth exert a positive impact on the demand as well as cost of government services.

(b) Coupled with this rate of growth of population and density also affect the demand for public goods such as transport, communication, hospitals etc., in addition to the cost of supply of these services.

ii. Factors affecting the demand side of public expenditure activities. The major factors under this category are:

(a) Urbanization and industrialization.

(b) Structure and composition of the population which determine the demand for educational facilities, old age pension, old age homes etc.

(c) Specialization of labour and centralization of administration in both private and public activities.

iii. Factors affecting the supply side of public expenditure activities. On the supply side, the major factors affecting public sector activities are:

(a) Changing scale of production of government activities.

(b) Quality of production.

(c) Intergovernmental grants.

Obviously the functional relationships Wagner sought to trace are complex. Adolf Wagner believed that increased public expenditure was the natural result of economic growth and the continued pressure for social progress.

Graphic Presentation of the Wagner Hypothesis: The modern formulation of Wagner's law is that "as per capita income rises in industrializing nations, their public sector will grow in relative importance" (Bird, 1971, p.2). The Wagner's hypothesis of increasing state activity is illustrated in Figure No.3.1. In this graph the real per capital output of public goods (PG) is measured on the vertical axis and real per capita income (Y) is measured on the horizontal axis. Time is an important third dimension implicit in the graph, because the growth in the real per capita output of public goods and in real per capita income is realistically assumed to take place on a historical basis over an extended period of time. Line PG1 represents a circumstance in which the public sector maintains a constant proportion of the total economic production of the society over time.