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Leviathan: More sand than oil in the gears

by AGNIESZKA GEHRINGER & THOMAS MAYER

Abstract

The public sector is on the rise in many EU member states. As its productivity is lower than that of other sectors, this directly reduces productivity growth in the economy as a whole. In addition, the proliferation of bureaucracy due to increasing regulation also reduces the productivity of the private sector. Consequently, shrinking the public sector by focussing on the core of its tasks is the necessary condition for adding oil to the gears of the economy instead of sand. Only in this way can productivity growth regain momentum.

Zusammenfassung

Der öffentliche Sektor ist in vielen EU-Mitgliedsländern auf dem Vormarsch. Da seine Produktivität unter der anderer Sektoren liegt, sinkt dadurch unmittelbar das Produktivitätswachstum der gesamten Wirtschaft. Darüber hinaus verringert eine wegen zunehmender Regulierungsdichte wuchernde Bürokratie auch die Produktivität des privaten Sektors. Folglich ist die Schrumpfung des öffentlichen Sektors durch die Fokussierung auf den Kern seiner Aufgaben die notwendige Bedingung dafür, dass Öl statt Sand ins Getriebe der Wirtschaft kommt. Nur dadurch kann das Produktivitätswachstum wieder an Fahrt gewinnen.

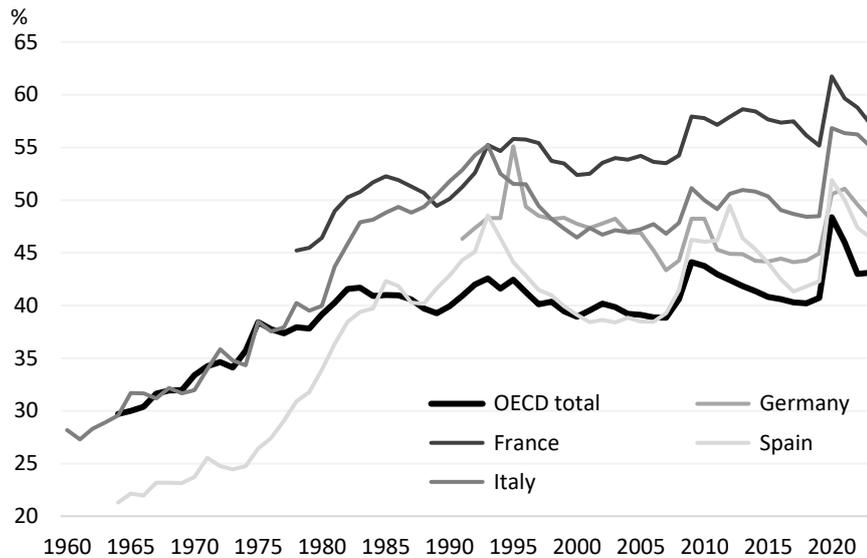


Leviathan grows

Government spending has grown faster than GDP over the years and is well above the average for all OECD countries in the EU.

In the European Union, public sector spending averages almost 50 per cent of gross domestic product (GDP) every year. The major EU countries play first fiddle: in 2023, the government spending ratio was 57 per cent in France, 55 per cent in Italy, 48 per cent in Germany and 46 per cent in Spain (Figure 1). Government spending has grown faster than GDP over the years and is well above the average for all OECD countries in the EU.

Figure 1: Government expenditure (in % of GDP)



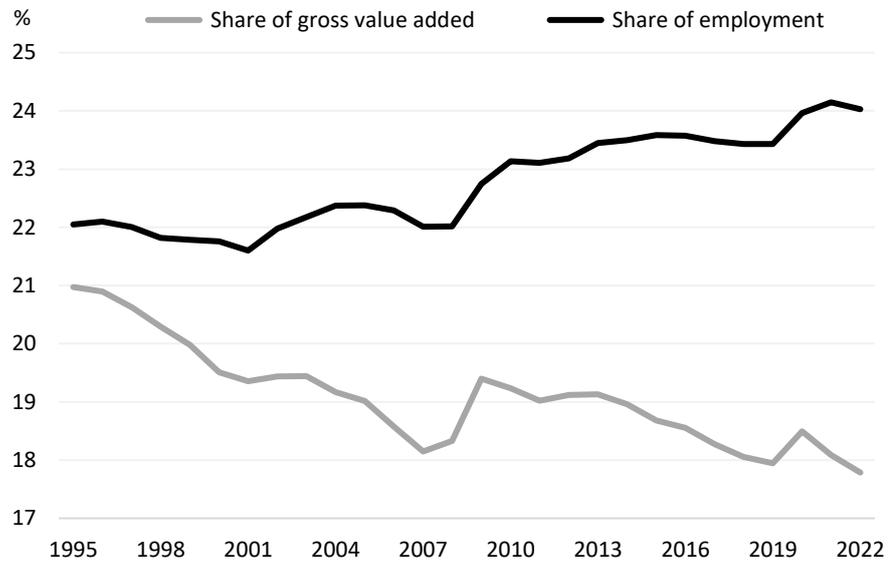
Source: Flossbach von Storch Research Institute on the basis of Macrobond

The EU states need more and more resources to fulfil their growing tasks.

The EU states need more and more resources to fulfil their growing tasks. As a result, the share of public sector employees in total employment has risen from 22 per cent in 1996 to 24 per cent in 2022. At the same time, the public sector's share of total gross value added has fallen (Figure 2). This points to a significantly lower productivity of employees in the public sector.



Figure 2: Share of public administration, defence, education, health and social work in value added and employment, EU-27

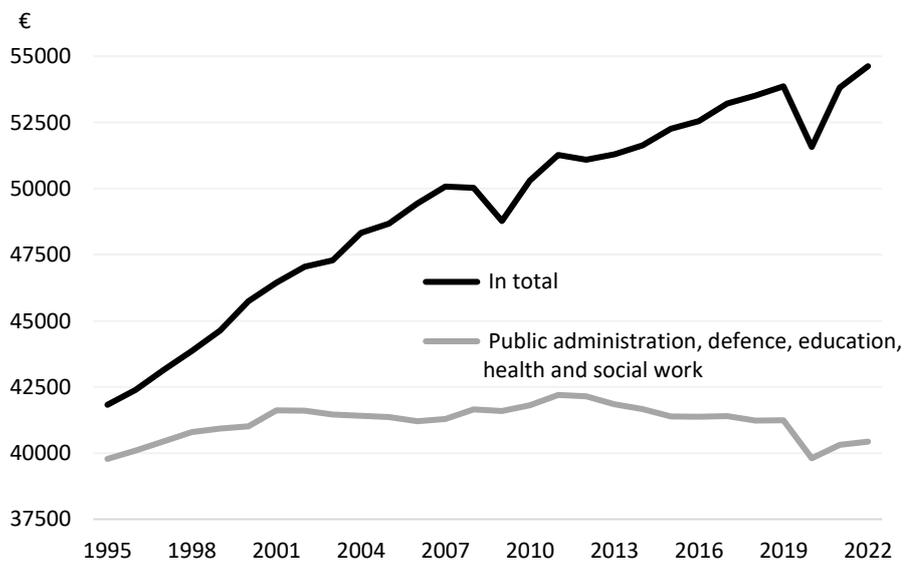


Source: Flossbach von Storch Research Institute on the basis of Macrobond

The expansion of public activities leads to a reallocation of resources from more productive to less productive areas and therefore to a dampening of overall economic productivity growth.

As figure three shows, the real gross value added per employee in the public sector is significantly lower than in the overall economy. The gap is also widening. While the productivity of the public sector in the EU (measured in this way) was still 5 per cent below overall economic productivity in 1995, the gap was already 26 per cent in 2022. As productivity in the public sector has been trending downwards since 2011, the gap is likely to widen in the future. The expansion of public activities therefore leads to a reallocation of resources from more productive to less productive areas and therefore to a dampening of overall economic productivity growth.

Figure 3: Gross value added per employee (in 2010 prices), EU-27



Source: Flossbach von Storch Research Institute on the basis of Macrobond



The sand and oil in the gears of the economy and society

Feedback effects from government activities on private activities arise because the public sector not only withdraws resources from the private sector, but also changes the efficiency of the use of resources in the private sector.

The measurement of state performance - the direct and indirect contribution of the state to overall economic productivity - remains an underdeveloped topic. To date, the World Bank with its Worldwide Governance Indicators has been the leading institution systematically dedicated to this.

In addition to the direct effects of a reallocation of resources from the private to the public sector, there are also feedback effects from public to private activities. These feedback effects arise from the fact that the public sector not only withdraws resources from the private sector, but also changes the efficiency of the use of resources in the private sector. Government activities can increase efficiency in the private sector, for example by ensuring legal certainty, the effective enforcement of property rights or the provision of public goods. The direct loss of productivity due to the transfer of resources from the private to the public sector is offset by efficiency gains in the private sector, which can be greater than the direct losses. On the other hand, government activities can reduce efficiency in the private sector when the public sector develops and enforces complex regulations for the private sector to pursue policy goals for the economy and society. In this way, instead of lubricating with oil, it throws sand in the gears of the private sector.

The measurement of state performance - the direct and indirect contribution of the state to overall economic productivity - remains an underdeveloped topic. To date, the World Bank with its Worldwide Governance Indicators (WGI) has been the leading institution to systematically address this issue. The WGI use data from 35 sources (think tanks, international organisations, NGOs and private companies) and combine them into aggregated indicators that are intended to map a total of six dimensions of governance: 1) Administrative effectiveness, 2) Regulatory quality, 3) Voice and accountability, 4) Political stability and absence of violence/terrorism, 5) Rule of law, and 6) Control of corruption.¹

Although each indicator captures a specific aspect of governance, it is conceivable that they influence and reinforce each other. For example, an open and accountable government is likely to be generally more stable, as it responds to citizens' concerns before they degenerate into violent action. For this reason, we focus our analysis on the first three indicators - Administrative Effectiveness, Regulatory Quality, Voice and Accountability - which should provide a balanced and comprehensive picture of governance - and thus the contribution of the state to productivity in the private sector - without excessive overlap between the sub-areas.

We first take a general look at the development of the three indicators in the 27 EU member states over the entire period 1996-2023. We then use the cluster analysis method to identify groupings within the EU and recognise the underlying patterns in performance development.

¹ The data basis consists of perceptions and views of experts and survey participants. The six indicators are given either as standardised normal units, which vary between -2.5 and 2.5, or as percentile range units, which can range from 0 to 100. The sample is currently available for 214 countries for the period 1996-2023.



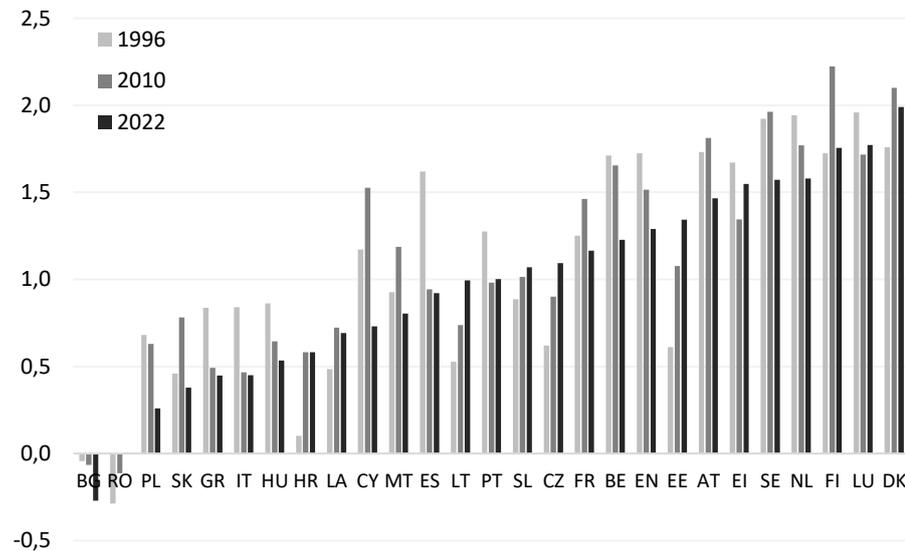
More sand than oil

Administrative effectiveness reflects perceptions and views about the quality of public services, the quality of policy formulation and implementation, the degree of independence of the public sector from political influences and the credibility of government commitment.

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Figure 4 shows the development of the indicator in the EU between 1996 and 2022. A gradual deterioration in administrative effectiveness can be observed in nine of the 27 EU member states between 1996 and 2022. In addition to Spain with the sharpest decline (ES, -0.7 index points), Belgium (BE, -0.48), Germany (DE, -0.43), Poland (PL, -0.42), Italy (IT) and Greece (GR) (-0.39 in each case) recorded the greatest losses. Positive examples are provided by some of the Eastern European countries: Estonia (EE, +0.73), Croatia (HR, +0.48), the Czech Republic (CZ) and Lithuania (LT) (+0.47 in each case).

Figure 4: Administrative effectiveness in the EU, 1996-2022



Source: Flossbach von Storch's own presentation based on Macrobond and the World Bank

In nine of the 27 EU member states, a gradual deterioration in administrative effectiveness can be observed between 1996 and 2022.

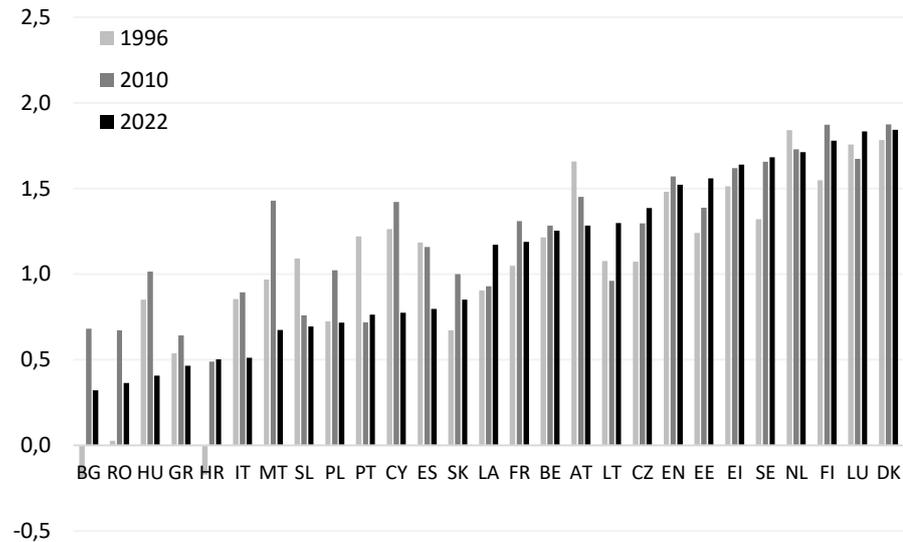
The government's ability to formulate and implement an effective and sound policy should be reflected in a high *regulatory quality*. The developments of the indicator also show a very heterogeneous picture here (Figure 5). Malta (MT, -0.75 index points), Cyprus (CY, -0.65) and Hungary (HU, -0.61) recorded the most marked deterioration between 2010 and 2022. In contrast, there was hardly any country - with the exception of Latvia (LA, +0.34) and Lithuania (LT, +0.24) - with a visibly positive development in the same period. Germany (DE) stabilised around a stable average value of 1.55 in the upper mid-field.

² See Kaufmann, D. and Kraay, A. (2024). The Worldwide Governance Indicators: Methodology and 2024 update. Policy Research Working Paper No. 10952, World Bank Group.



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Figure 5: Regulatory quality in the EU, 1996-2022

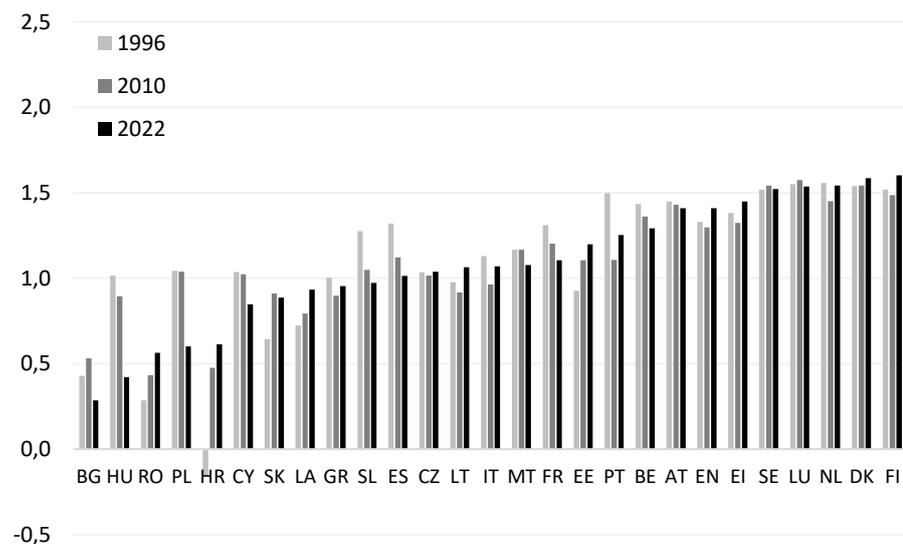


Source: Flossbach von Storch's own presentation based on Macrobond and the World Bank

Finally, *voice and accountability* measures the perception and views of citizens' involvement in the election of the government as well as their freedom of opinion and association. In principle, the indicator shows a high degree of stability in the analysed sample, albeit at a lower level than the other two indicators (Figure 6). Poland (PL, -0.44 index points), Spain (ES, -0.31) and Slovenia (SL, -0.30) recorded the sharpest declines. In contrast, Croatia improved significantly (HR, +0.77), followed by Romania (RO, +0.28), Estonia (EE, +0.27) and Slovakia (SK, +0.24).

Finally, *voice and accountability* measures citizens' perceptions and views on their involvement in electing the government and their freedom of expression and association. In principle, the indicator shows a high degree of stability in the analysed sample, albeit at a lower level than the other two indicators

Figure 6: Voice and responsibility in the EU, 1996-2022



Source: Flossbach von Storch's own presentation based on Macrobond and the World Bank



Performance clusters within the EU

Based on the three indicators, which together reflect the general performance of the state, we have identified four performance groups within the EU using cluster analysis.

Based on the three indicators, which together represent the general performance of the state, we have identified four performance groups within the EU using cluster analysis: Cluster 1 - outperformers, Cluster 2 - medium performers, Cluster 3 - medium poor performers, Cluster 4 - underperformers.³ We determined the four clusters separately for 1996 and for 2022 in order to track the main changes in the cluster composition.

Table 1 summarises the migration flows between the clusters. In 1996, Austria, Belgium, Germany, Denmark, Spain, Finland, Ireland, Luxembourg, the Netherlands and Sweden belonged to cluster 1 of the outperformers. In 2022, the composition of the cluster has changed significantly: Austria, Belgium and Germany have slipped to Cluster 2, while Spain has landed in Cluster 3. Similarly notable downgrades occurred at the other end of the classification: Greece, Italy, Poland, Romania, Slovakia and Hungary migrated from Cluster 3 to Cluster 4. Finally, only four out of 27 EU members were able to improve their cluster membership: Estonia, Latvia, Lithuania and the Czech Republic moved up from Cluster 3 to Cluster 2.

Table 1 summarises the migration flows between the clusters.

Table 1: Cluster composition in 2022 and the change compared to 1996

Cluster 1: Outperformer	Cluster 2: Average performer	Cluster 3: Mediocre performers	Cluster 4: Underperformer
~ Denmark	↓ Austria	↓ Cyprus	~ Bulgaria
~ Finland	↓ Belgium	↓↓ Spain	↓ Greece
~ Ireland	↑ Czech Republic	~ Malta	~ Croatia
~ Luxembourg	↓ Germany	↓ Portugal	↓ Hungary
~ Netherlands	↑ Estonia	~ Slovenia	↓ Italy
~ Sweden	~ France		↓ Poland
	↑ Latvia		~ Romania
	↑ Lithuania		↓ Slovakia

Note: ~ means an unchanged cluster affiliation, ↑ an ascent and ↓ a descent.

Source: Own Cluster Analysis Flossbach von Storch Research Institute

Overall, it can be said that the performance of public administration is declining in many EU member states. There may be many reasons for this. However, it is obvious that EU-wide developments have also played an important role in addition to country-specific factors. Figure 7 shows an upward trend since 2010 in the number of legal acts adopted by the various EU institutions, leading to an increase in bureaucracy in the member states. It is also noticeable that the Commission is increasingly using "delegated acts", which can be used to adopt regulations in a simplified procedure. This not only extends

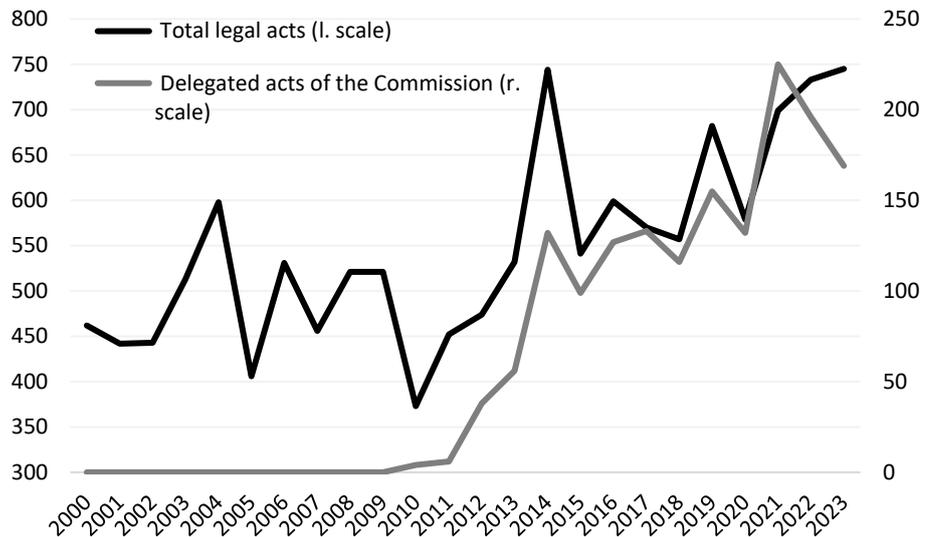
³ Cluster analysis is a statistical method for segmenting and identifying homogeneous groupings (clusters) of objects. Objects in a particular cluster should be as similar to each other as possible, but as different as possible from objects in other clusters.



It is obvious that, in addition to country-specific factors, EU-wide developments have also played an important role. Figure 7 shows an upward trend since 2010 in the number of legal acts adopted by the various EU institutions, leading to an increase in bureaucracy in the member states.

the scope of application of laws, but also introduces substantial and burdensome new bureaucracy without the protective mechanisms of primary law (regulations, directives and decisions of the European Parliament and the Council).

Figure 7: Legal acts of the EU institutions



Note: Legislative acts include 1) ordinary legislative procedure, which includes regulations of the European Parliament and the Council, directives of the European Parliament and the Council and decisions of the European Parliament and the Council; 2) delegated acts of the Commission. All of these legal acts are binding. While regulations apply directly in each Member State, directives set out objectives, leaving it to the Member States to choose the appropriate way to achieve these objectives. Decisions are binding for the designated addressees.

Source: Flossbach von Storch Research Institute's own presentation based on data from EUR-Lex

Why Leviathan gained power

Unnoticed by most people, Carl Schmitt's understanding of the state as a decisive enforcer of what is necessary without alternative is creeping up on us.

With the "liberal renewal" of the 1980s, globalisation, and the discrediting of the state economy following the fall of the Soviet Union, prosperity grew worldwide. Against this backdrop, the widespread return of the Leviathan in the EU is puzzling at first glance. However, the threat felt by many of a return to the world of Thomas Hobbes, in which "man is the wolf of man", sheds some light on the subject. In Hobbes' world, Leviathan is the guarantor of peaceful coexistence.

"Sovereign is who decides on the state of emergency" is the famous dictum of the (controversial) constitutional lawyer Carl Schmitt. Unnoticed by most, Schmitt's understanding of the state as the decisive executor of what is necessary without alternative is creeping up on us.⁴ After the fall of the Berlin Wall and the demise of the Soviet Union, the Western liberal constitutional state triumphed. History seemed to have reached its goal, to have come to

⁴ Thomas Mayer, Überforderte Entscheider. Cicero, 12/ 2024.



its "end". But then followed three crises in which the state was able to reclaim its supremacy, its "sovereignty" over everything, to triumph over the "ossified mechanics" of law and order.

It began with the Great Financial Crisis of 2007-2008 (and the subsequent euro crisis of 2020-2012). The next major crisis came in the form of the "climate crisis". The (temporary) climax of the states of emergency was reached in the corona crisis, in which even fundamental rights were restricted or suspended.

It began with the Great Financial Crisis of 2007-2008 (and the subsequent euro crisis of 2020-2012). The crash of the US property market caused banks around the world to falter and triggered a call for help from the state. The state declared a state of emergency and - against all principles of the liberal economic order - saved the West with taxpayers' money and the money printing presses of its central banks. The next major crisis came in the form of the "climate crisis", in which apocalyptic scenarios were developed on the basis of a serious but also less than entirely certain scientific thesis, and the existence of entire branches of industry was called into question without any cost-benefit assessments for society as a whole.

The (temporary) climax of the states of emergency was reached in the coronavirus crisis, in which even basic rights were restricted or suspended. To break the chains of infection, the state ordered the wearing of face masks and lockdowns, which applied repeatedly in Germany from the beginning of 2020 until mid-2021. Anyone who did not want to be vaccinated was put under massive pressure. As only later emerged from originally secret protocols of the Robert Koch Institute, state policy interpreted the scientific findings in the sense of maximising the state of emergency and surrounded itself with scientific advisors who legitimised this interpretation. Dissenting scientific assessments were marginalised and the involvement of parliament was circumvented, in the spirit of Carl Schmitt. In an exceptional situation, the sovereign is also authorised to suspend the existing legal order and make decisions that are necessary to restore normality.

The model of the "decision-maker state" is discredited by its inevitable failures. In the meantime, these failures have triggered political earthquakes, from the USA to Germany.

The model of the "decision-maker state" emerging from the crises is behind the concept of the "entrepreneurial state" propagated by fashionable economist Marianna Mazzucato, the "build-back-better plan" of the Biden administration in the US, or the "Green Deal" of EU Commission President Ursula von der Leyen. However, this "decision-maker state" is being discredited by its inevitable failures. In the meantime, these failures have triggered political earthquakes, from the USA to Germany.

Conclusion

Leviathan is on the rise in many EU member states. The advance was driven by the crises of the last two decades, which brought the decider state onto the scene by declaring a state of emergency. However, the decider state cannot deliver what it promises. As the productivity of the public sector is below that of the private sector, the productivity growth of the entire economy is directly reduced. In addition, the proliferation of bureaucracy due to increasing regulation reduces the productivity of the private sector. Consequently,

The shrinking of the public sector is a necessary condition for increasing productivity growth.



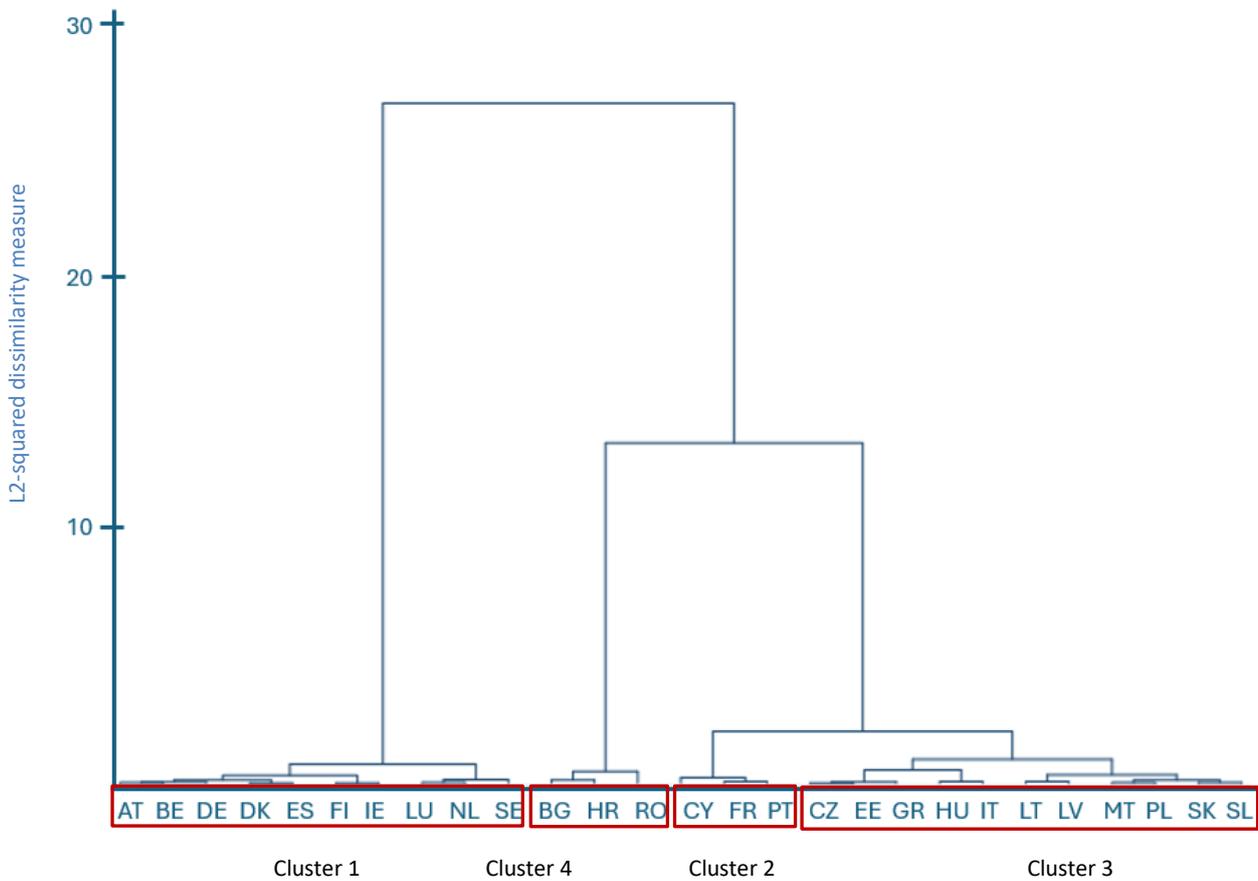
the shrinking of the public sector is a necessary condition for increasing productivity growth. At the end of this process must be the return of the liberal rule of law and the liberal economic order, if prosperity, democracy and freedom are to be preserved.



Annex

Figures A.1 and A.2 show the clusters 1-4 created in 1996 and 2022 using the dendrograms. In a dendrogram, the height of the horizontal lines shows the distance (measured using the so-called L2 squared dissimilarity measure) at which the objects were grouped together. The higher the horizontal line, the more dissimilar the groupings are to each other. In Figure A.1, Cluster 1 is the furthest away from all other clusters. Cluster 4 is also very different from clusters 2 and 3. Finally, the distance between clusters 2 and 3 is the smallest. To determine the number of clusters, the distance is reduced until the dissimilarity measure between the members of the clusters becomes negligible. This is the case with four clusters in our analysis.

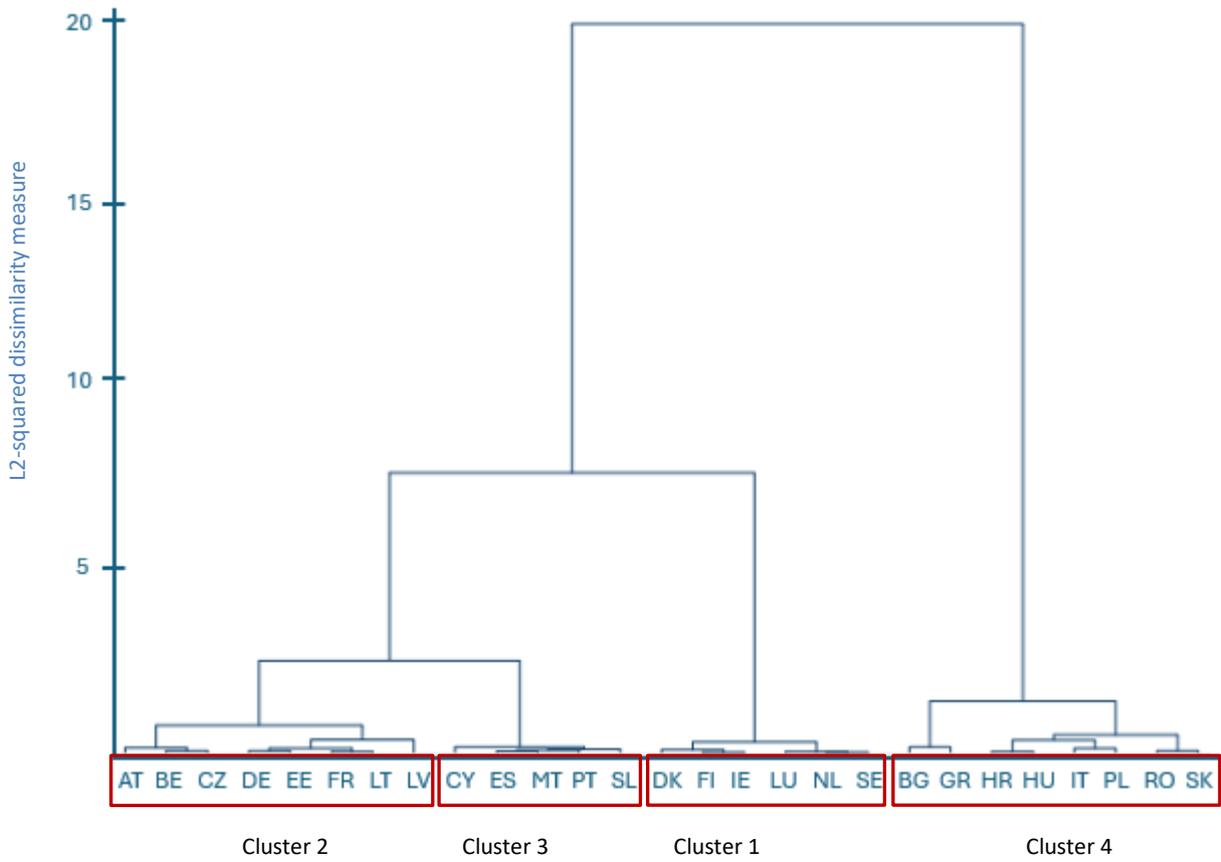
Figure A.1. dendrogram of the cluster analysis for the year 1996



Source: Based on Stata



Figure A.2. dendrogram of the cluster analysis for the year 2022



Source: Based on Stata



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