Political Management between Ethical Grounds and Electoral Purposes. The Case of Taxation

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Abstract

Many empirical studies illustrate the natural correlation between freedom and economic prosperity. Therefore, the quality of economic and political institutions that prevail in a country must be assessed considering their capacity to promote a lower level of government intervention in all aspects of social life. This paper offers both theoretical and empirical arguments to support "more market and less *government" framework as the best way to promote economic prosperity and political stability within our society. In their way to gain political power, politicians and political parties have to adapt their political management and electoral agenda according to the population preferences and expectations.*

It has been proved in the past elections that Romanians are favourable to a low level of taxation, even if part of them demands in the same time more financial support from the government. This state of facts represents a real challenge for politicians to shape their political management and strategies in order to gain more votes on the one hand, and to not affect budgetary equilibrium on the other. In some extent, the conclusions of the paper provide some possible solutions for the electorate to rationally discern between different electoral offers, to understand their short run and long run economic and social effects.

Keywords*:* *political management, electoral strategies, economic freedom, fiscal policies, institutional reform, economic development*

JEL classification: **B13, D63, H10, O17, O43.**

Introduction

"Everything has to be done not to achieve the maximum of social utility, a vague principle and a source of undesirable legislation, but to an absolute exercise of natural rights"... is emphasized by Nicholas de Condorcet, in one of his famous writings, in the second half of 18th century. Although the principle of utility and happiness has constantly concern the world's philosophers, the welknown phrase "the happiness of people has to be the ultimate purpose of the rulers" has became a simple stereotipe.

For those economists and philosophers who embraced liberal ideas, such issue has a more simple solution. In the first place, there is no human being called Society. Moreover, because only human beings could have feelings and emotions, we cannot speak about sentiments, satisfactions or happiness at a holistic level such society. Secondly, it is impossible to sum individual happiness in order to

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determine the global happiness. In the third place, hypothetically speaking, even if this phenomenon could be measured, the general happiness political provider would be constraint by limits of quantitative analysis. These individual feelings are constantly influenced by various factors such as social interactions, subjective gains and losses that result from human action or cognitive process. Therefore, the hypothetical aggregate level of well-being and happiness is a dynamic and unpredictable figure.

Liberalism doctrine suggest to abandon the utility principle and to replace it with a basic ethical criteria: justice. From this perspective, justice is the most acceptable standard to analyze the quality of laws or other institutional arrangements (e.g. fiscal, monetary etc.). It is indubitable that everyone is capable to refer to a specific human action as being right or wrong. In addition, "if this spontaneous feeling of justice were organic correlated with a logical reality, the result would be a judicial code, an *a priori* right; in short, a natural right" (Vergara, 1998). Once assimilated as a milestone for their further theoretical developments, the liberal philosophers refer to private property rights as a natural right because respects *ad validitatem* conditions.

This is the theoretical perspective that we consider in this article on taxation and political management. The state, as a political organization with the monopoly power to regulate and tax, has a fundamental constitutional obligation to protect life and freedom of individuals. In more applied terms, according to the protective dimension, state has to protect legitimate property rights. Nevertheless, this aim cannot logically be achieved because an absolute protection of private property rights means a zero level of taxation. Because taxation is not a voluntary exchange between two parties, private property rights would be fully preserved only in the absence of taxation. On the other hand, without financial support, state's agencies are no longer able to protect the citizens.

The escape from this vicious circle was the step back of classical liberals with regard the acceptance of a low level of taxation in exchange for a small state intervention. However, as we will present further, governments have expanded continuously their powers and threatening economic freedom and other personal liberties.

1. Competing perspectives in economic literature

After 1950, mainstream economists' way of thinking was relied on the following philosophy: in order to reduce unemployment rate, to stimulate growth and to equitable distribute national income, governments should increase public expenditures and expand market regulations. Unavoidable, these prescriptions implied a proportional increase in taxation level to avoid possible unbalanced public budgets.

In Keynesian school full glory, the 1962 famous book of Milton Friedman entitled Capitalism and Freedom is dedicated to contradict most part of that time widespread economic ideas. Two decades after, at the Mont Pelerin Society meeting held in Cambridge, participants have agreed to develop some empirical research to illustrate the positive correlation between economic freedom and prosperity. In 1986, a small group met in California to shape the foundations of this idea. The Canadian Fraser Institute had organized a conference and invited Milton and Rose Friedman, Armen Alchian, Arnold Harberger and Assar Lindbeck to participate. Starting from this year, economic literature has been enriched with empirical findings showing the economic freedom plays a substantial role in development equation. For example, Bauer emphasize that economic development is strictly dependent by private property and voluntary exchange. Thus, the maximization of liberty correlated with minimization of coercion is the essential condition for maximizing economic development. The state power should therefore be limited by Constitution to protect individuals and property. “In the development process, both rich and poor will benefit. Whenever law protects private property, market exchange flourishes and voluntary trade makes every participant better off". Peter Bauer (1984)

2. Methodological aspects of measuring economic freedom

In 1996, one decade later, James Gwartney, Robert Larson and Walter Block published the first volume of Economic Freedom of the World. The economic Freedom index includes 115 countries and presents the degree in which government restraints economic freedom through inflationary monetary policy, taxation, regulations and trade barriers. The construction of this index is based on four basic aspects: (a) personal choice rather than collective choice; (b) voluntary exchange and market allocation of resources rather than discretionary political allocation; (c) freedom to enter the market and to compete; and (d) law protection of individuals and property. (Gwartney, 2005)

These ingredients of economic freedom strongly influence the government role in society. Government could act in favor of economic freedom by consolidating judicial system and protecting private property and contractual liberty. However, it could act in detriment of economic freedom whenever increases taxes and public expenditures or when personal choices are substituted by regulations (e.g. labor market).

The structure of Economic Freedom Index (EFI) indicates five major areas: (a) size of government: expenditures, taxes, and enterprises; (b) legal structure and security of property rights; (c) access to sound money; (d) freedom to trade internationally; (e) regulation of credit, labor, and business. The empirical findings confirm our hypothesis according to a higher degree of government intervention tends to lower economic freedom and, consequently, to compromise the development process.

3. Empirical findings from EU countries

In this article, we analyze the evolution of economic freedom between 1990 and 2009 for the first area of EFI because it illustrates the dimension of fiscal burden of population and business environment. The four components of this area address to government expenditures as a share of total consumption, transfers and subsidies, public enterprises and the top marginal income tax rate.

Taken together, these dimensions reveal the degree in which the economic activity is based on consumer preferences, personal choice and market rather than political decisions to allocate resources and produce goods and services. In conclusion, a high level of economic freedom for this area is associated with countries with reduced public consumption, low number of public enterprises and low marginal income tax rate. The countries selected for comparative analysis are old and new members of European Union: UK, France, Czech Republic, Poland, Romania and Bulgaria (table no.1).

Tabel no. 1: Economic freedom – public sector dimension

	1990	1995	2000	2005	2008	2009
UK	5.65	5.42	6.13	6.29	6.02	5.68
France	3.53	3.22	2.56	4.11	5.43	4.72
Czech Republic	-	2.81	3.13	3.30	3.72	3.62
Poland	1.85	2.62	4.25	5.40	5.59	5.63
Romania	**3.09**	**3.37**	**5.02**	**6.86**	**6.14**	**6.27**
Bulgaria	2.34	4.03	4.51	6.30	7.46	7.29

Source: Gwartney et al. (2011)

The following figure better illustrates economic freedom evolution in selected countries according to the size of government criteria. We draw some important conclusions regarding the European perspective on economic prosperity and the different strategies adopted by post-communist countries in transition period.

The first conclusion worthly to mention is that the public sector in EU 27 countinue to have a large share of GDP as long as for most selected countries the indicator level is situated between 4 and 6. Even if UK registered the high levels for the first period, the following statistical evolution shows a descent below the upper limit of this range down to 4.11 levels. Since 2005, Bulgaria has leaved the emerging economies group, becoming the country with the highest value in this area. Consistent privatization measures have contributed to reduction of state's role in producing goods and services. Furthermore, the significant reduction of fiscal burden, correlated with lower bureaucracy, has favored fiscal consolidation in our neighbor country. Borrowing metaphorical terminology of the National Bank of Romania governor, we could affirm there is not an accident to conclude Bulgaria registered "a soft landing" in recession period of business cycle. Meanwhile, Romania seems so far to be condemned to experience "hard landing".

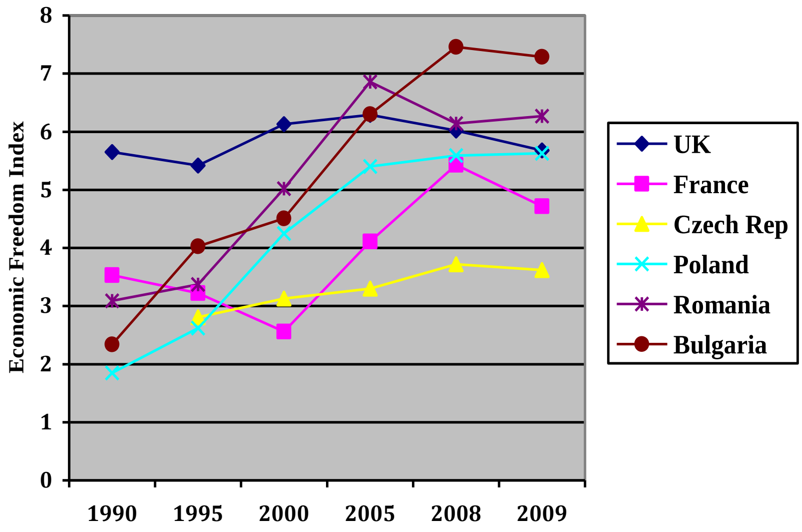

Figure 1 Economic freedom – public sector dimension
Source: author

Looking at other countries analyzed in the sample, France is indicated to have among the lowest levels of freedom corresponding to area 1, confirming the interventionist institutional framework. The French government is also a significant owner of the means of production and economic resources, spending about 50% of GDP.

The above data can easily be explained as long as the EU (especially France and Germany) voted for a social market economy, which became increasingly suffocated by the social dimension. The European welfare state is designed, on the one hand, to provide extensive social programs, transfer payments and generous subsidies, and, on the other hand, to impose a high level of taxation aimed to support massive national and European spending. What we can logically deduce is that Eurocrats are more interested in wealth redistribution rather than sustaining wealth accumulation. Another reason for the relatively low level of economic freedom registeredby old European members is the particular fiscal attitude predominance. Most western European countries have a high level of taxation and are no longer fiscal competitive, while new eastern members offer a friendlier fiscal regime. In the near future, there are only two major possibilities concerning this matter: the complete harmonization of fiscal regimes across Europe or the old members' acceptance of fiscal competition within European boundaries. The first solution, as a way of combating "unfair and harmful" competition is supported by countries with high level of taxation such as Germany, France or Sweden.

In order to maintain the welfare state societies' functionality, there is necessary to maintain high-level tax rates, and this is incompatible with fiscal competition because business tend to locate (and pay taxes) in those tax friendly countries. Edmund Phelps considers “almost all the European countries have increased the unemployment figures due to excessive labor tax and higher personal income tax levels”. (Phelps, 1994)

Although we consider a social justice model, in reality, the European welfare state model tends to affect in a negative way the social goal itself. After decades, it becomes a system in which low-income population pay high taxes. Thereafter, this population needs further governmental social assistance in order to maintain a decent standard of living.

Regarding the post-communist countries, recently integrated in European construction, there are some significant aspects to mention. In the first place, after the fall of communism, the economic freedom increases in the transition period to the market economy system. On the one hand, the dimension of public sector considerably declines especially for two components of this area of research due to privatization process and structural adjustments. The now private companies have contributed to global economic efficiency increase in the business sector. On the other, fiscal relaxation reforms initiated in the last decade by the majority of ex-communist countries (e.g. Hungary, Czech Republic, Bulgaria, Romania etc.) stimulated consumption and investments and oriented public policies for further pro-market reforms. This evolution explains positive trend of economic freedom illustrated above.

In the second place, shaping the institutional arrangements of the new EU members in accordance with the EU criteria (*acquis communautaire*) has proved to be unfavorable to economic freedom. The figure illustrates a slowdown in the economic freedom positive evolution. It suggests that European model confront with serious limits in promoting economic freedom and stimulating entrepreneurial activities. The different political perspectives explain the freedom deficit of European continent in comparison with other regions and OECD countries.

While the EU - driven by France and Germany – is taking into account more sophisticated ways to resuscitate welfare state institutional arrangement, countries like Chile, Canada or Hong Kong have consolidated their economic policies around concepts as private property rights, voluntary exchange, market prices and free trade.

4. Political management, society welfare and political offers

Nowadays, most of liberal scholars agree that political power must protect individuals against internal and external aggression e.g. internal security and national defense. However, if we look back, history shows a continuous weakening of natural property rights to the detriment of the common good promoted by public policies. In addition, state functions have been increasingly numerous, considering now not only protective function, but also the production attribute (of goods and services of common interest) or the redistributive function.

Hazlitt, in his famous book “Economics in one lesson” describes this as follows: “Of course, taxation is indispensable for the fulfillment of basic governmental functions. But higher percentage of national income confiscated by taxation, the greater will be the degree in discouraging production and employment in the private sector. When the total tax burden exceeds a tolerable level, the problem of setting a neutral tax level becomes impossible to achieve.”

In the Romanian case, from our point of view, we are far beyond the taxation level that Smith, Mill, Mises or Hezlitt thought of. Even Keynes considered to be unsupportable a tax burden that exceeds 25% of GDP. According to the Eurostat, in 2010, public spending in Romania represents 40.8% of GDP. This figure means that individuals have to work 149 days per year for the government. And the situation is similar in many other (social oriented, but still democratic!) European countries.

Considering ideas mentioned above, there are some implications that deserve our attention. Firstly, state agencies apparently follow a golden rule: once created, a particular public authority is transformed, renamed but never abolished. Secondly, such evolution has uncountable negative effects for human behavior. Each person will try to solve their particular problems as cheaply as possible, often resorting to bribery, personal relationships etc. Moreover, many people will find it more efficient to become public servants to be able to set the "price" for their favoritism. Eventually, the bureaucrats’ numbers tend to increase and their activity demands more taxation and/or market regulations. In his book Bureaucracy, Mises stated "because of (so-called) progressive policies, new offices and public agencies thrive and spread like mushrooms” (Mises, 2006).

What happens in Romania for more than 20 years, with people waiting for all sorts of authorizations, does not mean anything but real impediments for a better living or for doing business. Apparently and misleading, the public sector invoke all these barriers to economic freedom in order to achieve (or, eventually, maintain) the social order and aggregate happiness.

Finally, states have gradually replaced, as Mises said, the economic and social philosophy that prevails before. The one in which all citizens shared a single political ideal, the common welfare, and state had its obligation to not interfere in economic life. In the present days, it seems that states’ duties are gradually oriented to financialy support, subsidize of favor a social categoryor another, a specific industry etc. "What is presented on the political scene today, virtually without exception in the democratic countries, there are no political parties in the old classical sense, but only special interest groups” (Mises, 1998:100).

But once reached the extreme limit of social supportability, the sense of self-preservation of political parties (being or not in place to rule) forces them to weaken somehow the bureaucratic and fiscal burden that population and business environment confront with. Suddenly, before elections, we assist to various reform proposals from all corners of political scene. Each political party develops macroeconomic strategies to improve living standards of citizens on the one hand, and to reduce structural budget deficits aggravated by economic downturn on the other. All political voices promote, without exception, national interest and common wellbeing. Surely, everybody wants to rule, but above all, political parties are interested to avoid state dissolution. The reason might be that the interest groups behind the political scene are very satisfied to manage taxpayers' money, and politicians are satisfied with financial confort and other political privilegies.

Mass media is overwhelmed by election slogans that defend economic freedom and wellbeing of citizens, which invoke political and electoral sacrifice on the altar of the people happiness etc. More and more doctrinaire disputes claim for paternity or legitimacy of a specific electoral offer. The most recent example is the tax regime (flat tax vs. progressive tax). The debates unfold artificially around the regime corresponding to the left wing or right political spectrum, without knowing the fact that there is no scientific reasoning in this taxonomy. Not the way you tax is doctrinary relevant, but the level of taxation! As long as there is no scientific ground to determine the optimum fiscal level, we must admit that mostly everything is set arbitrarly, based on political reasons rather than economical ones.

Therefore, we consider that all political offers should be analyzed following these truths, very simple but difficult to be recognized by politicians, and unfortunately difficult to accept by the voting taxpayers.

5. Past lessons for the future

For an individual who understand and embrace liberal ideas, the option for one or the other electoral offer is based on the criteria of economic freedom and natural rights. The political program which protect economic freedom, which imply a lower tax burden, for example, becomes more desirable. Even more encouraging might be the fact that the medium voter tends to manifest a natural inclination to vote in favor of those who promise a lower taxation level. In the past, many succession to power around the world were also influenced by differences in fiscal elctoral proposals. This might be the reason why politicians consider fiscally aspects a way to convince voters.

However, capturing the attention of people and businesses only on certain taxes (considered extremely important), such as corporation tax or income tax, can be a costly trap for electorate. Because, as recent experience demonstrates, the government might easily pretend flat tax defender and tax increase opponent, but on the other hand, could increase indirect taxes (such as VAT, excise duties on tobacco, gasoline, etc.). More recently, some of the laws passed by the Government or Parliament implicitly lead to an increase of fiscal burden, such as mandatory insurance for homes or winter tires. Therefore, businesses in such areas are the direct beneficiaries of such discretionary legislation. Their additional revenues are the result of satisfying consumers’ demand, not their real needs. In the end, we could assist to a substantial increase in fiscal burden (as a percent of GDP), although the corporation and personal income tax remain unchanged.

For this reason, relatively recent scientific research reflected in Economic Freedom Index or Tax Freedom Day prove to be extremely useful tools in measuring the real cost of government.

Conclusions

The present article offered both theoretical arguments and empirical evidence to support "more market and less government" framework as the best way to allocate resources in society and to promote economic prosperity. In their way to gain political power, politicians and political parties have to adapt their political management and electoral agenda according to the population needs and expectations. The paper also provides some possible solutions for the electorate to rationally discern between different electoral offers, to understand their short and long run economic and social effects. Although we focused here only on taxation, the research could be further extended to other areas.

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