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POLITICAL FEATURES OF ECONOMIC POLICY AND THEIR IMPACT ON GOVERNMENT SECTOR IN THE CZECH REPUBLIC

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The size of government is in economic literature often discussed theme. There are different views on how should be government sector large, what should be the extent of its powers and even what role the government should play in the economy. The article deals with possible political features that might cause growth of the government sector, which could lead to a slowdown in economic growth of the Czech Republic. Such factors are without doubt corruption, level of democracy or political stability. However, in this paper we focus on the phenomena of political economy - interest groups and political budget cycles.

Keywords: Size of government, interest groups, political budget cycles, economic growth

The size of government is in economic literature often discussed concept. There are different views on how should be government sector large, what should be the extent of its powers and even what role the government should play in the economy. From this perspective, we can distinguish a group of economists or policy-makers with the belief that a large government sector either promotes or inhibits economic growth. The positive influence of government on the economic growth expected to Keynesianism. In this theoretical concept the government has big role. It may help the country to overcome the recession while the government borrows resources from the private sector and then return back into the economy in the form of various public programs. Increasing government consumption increases the demand and stimulates economic growth. Keynesians attach great importance to the government. However, Mitchell (2005) argues that the government sector should not be necessarily large. On the contrary, Keynesians prevent small government if it is temporarily able to start-up the sluggish economy. The consequence of failure of Keynesian theory in the 70th years was the forefront of conservative economic thinking. The role of government here is smaller. Proponents argue that if the government sector is too large, then there is a crowding out of private investment, resources are not allocated efficiently and the market is distorted.

Both of the views are still actually. At a time of high deficits and heavily indebted economies increasing demand on fiscal consolidation, the introduction of austerity measures and reforms important areas of economic policy appears. With these changes can then be restarted economic growth. The requirement of small government is appropriate.

The government sector economy is growing, as seen in Figure 1. Willingness of the politicians and policy options are very limited, and significant reductions do not occur. The question remains, however, whether there is indeed a relationship between the size and scope of government and economic growth? If so, is it negative or positive? First, it is good to clarify how it is possible to measure the government sector.

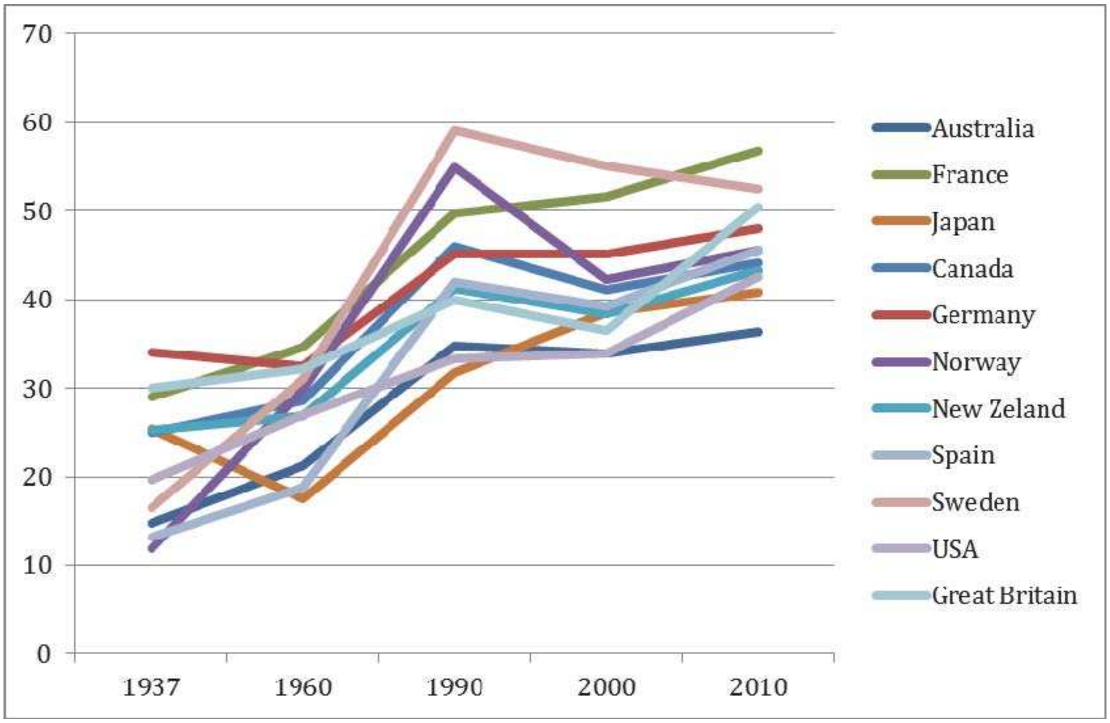

Figure 1: Size of government in the world over the years 1937 – 2010.

Source: *1937–1990: TANZI V., SCHUKNECHT L. Reconsidering the Fiscal Role of Government: The International Perspective, 1997. 2000–2010: OECD. Economic Outlook No. 91*

Measuring the Size of the Government

There are plenty of indicators that can be used to assess the size of government. The most common way of measuring the size of the government sector is the volume of government expenditures. They record government purchases of goods, services and transfer payments and provide a comprehensive picture of government operations. Government spending as a share of GDP also allows international comparison (Vlková, 2012). Another government size is the government revenue to GDP or share of government revenues of total revenues of the state budget, the share of employment in the government sector to total employment, the share of government assets to total national assets or the share of government investment in total national investment. Data for these indicators are not available, to an extent, as is the first indicator, plus do not give a comprehensive picture of the government, but characterizes only certain segments of the economy (Vlková, 2012). We will deal with the share of government spending in GDP in this article.

Size of the Government and Economic Growth

In this article we focus on the relationship between government size and economic growth. It displays the various theoretical concepts largely inverted U-shaped curve. The best-known concepts are Armey curve (Gwartney, Lawson, Holcombe, 1998) BARS curve (Magazzino, Forte, 2010), Scully curve (Scully, 1995), or Rahn Curve (Mitchell, 2005). All are based on the assumption that a certain size of government and its further growth slows down economic growth. By the "turning point" we understand the optimal size of government. It is difficult to measure the optimal size, because there is no uniform methodology of calculation. This is also the reason why authors vary in the estimates of the optimal size of government.

Relationship between the size of government and economic growth of the Czech Republic is negative since the late 20th century (Vlková, 2012). Coasting transformation probably influenced earlier development. But what should be the optimal size? Friedman (1997) estimated optimum size of the government between 15-50%. This is a great variance. Magazzino and Forte (2010) are more specific. They state that the optimal size of government for the Czech Republic was estimated at 40% of GDP. Government spending in the Czech Republic in 2011 was equal to 43% of GDP. This means that excessive expenditure cause slowing growth. Rising costs, however, are by Chobodanov and Mladenova (2009) and Tanzi (2011) aimed to less productive areas, the crowding out effects appears, and government intervention is increasing, and also the tax burden increases. High tax burden can lead to loss of motivation of people to invest and do business. All these effects lead to a slowdown in GDP growth.

Political Features of Economic Policy and Their Impact on Government Sector in the Czech Republic

We are interested in possible political features that might cause growth of the government sector, which could lead to a slowdown in economic growth in the Czech Republic. Such factors are without doubt, for corruption, level of democracy or political stability. However, in this paper we focus on the phenomena of political economy - interest groups and political budget cycles.

First of them are interest groups. They are one of the key players in both the political and economic process. Economics considers that interest groups are able to provide for their members significant benefits with minimum costs. In addition, these benefits are divided among agents who are not members of theses groups. One of the first authors, who outlined the principle of theoretical Influencing the economy through interest groups, was Olson (1974, 2002). And he is popular mainly because of his theory of institutional sclerosis. Interest groups, according to this theory, forms in a stable environment, and their involvement in the redistributive process leads to divert scarce economic resources from technological progress and other growth-enhancing activities towards redistribution. The existence and activities of theses groups has thus a negative impact on economic growth. Empirical testing of this theory is difficult. However, the results of studies indicate that it reflects reality to some extent. The way to again growth again is only possible according to Heckelman (2007) with great social change such as coups, revolutions or wars when interest groups or their ways of influencing policy are destroyed.

The most important interest groups in each country are trade unions. This can be seen in the following figure 2. Their position is different in each country. Most union members we can observe in the Nordic countries. There is however the duty of every employee to join a union and not necessarily related with the slowdown in economic growth in these countries. But the values above the OECD average are alarming and could lead to slowing economic growth.

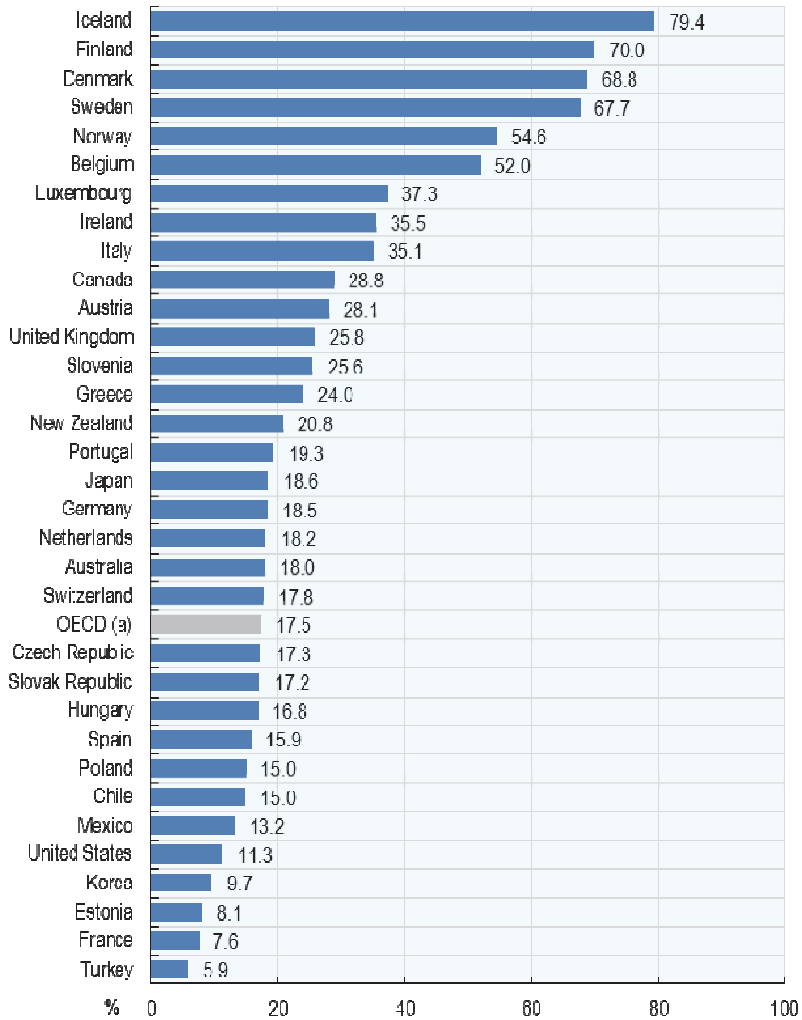

Figure 2: Union members density, 2011.

Source: *OECD, Employment policies and data, available: http://www.oecd.org/els/emp/onlineoecdemploymentdatabase.htm#union*

The second political feature that might have impact on the size of the government and consequently on the economic growth is political budget cycle. Which is a tendency of a government to abuse the fiscal policy to the re-election. In another words politicians use expansionary fiscal policy (lower taxes and higher expenditures) before the elections and fiscal restraint (higher taxes and lower expenditures) after elections to gain rent or to buy votes. Economic theory distinguishes between new democracies and established democracies. Fiscal manipulation is used more broadly in new democracies, where it may work because of lack of experience with electoral politics or lack of information is available in the established democracies and used by experienced voters (Brender, Drazen, 2004). Czech Republic is regarded as a new democracy. In the Czech Republic we can only observe the first part of the cycle - fiscal expansion. The political budget cycle before the elections occurred in all the periods from 1995 till 2006. A significant increase especially in the social benefits during election years was observed. The fiscal restraint after the elections did not appear. There was no will of weak coalition government or rent-seeking politicians to do the restriction (Vlková, 2011).

The above-mentioned factors undoubtedly distort allocative efficiency. Part of the resources that could be used productively in the economy is lost in the form of rent of politicians or interest groups. Both of these factors, in my opinion, lead to undesirable increases in the government sector and the subsequent economic slowdown. It will be interesting to empirically verify these prerequisites in the future research.

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