

# DEMOCRACY, POLITICAL COMPETITION AND PUBLIC DEBT

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### Abstract

There are two major preferences shaping political choices: one, regarding who should play the leading role in running the economy (markets or politicians) and the other, concerning social spending. According to reputation, leftist parties assign the leading role to politicians (i.e. the state), whereas rightist parties entrust markets with the central role in running the economy. Right-wing parties' reputation of not favoring social spending is not backed by facts. Since both the left and the right display similar behaviors vis-à-vis social spending, it is preferable that markets play the central role in running the economy. Flexible markets help economic growth and employment, reducing the need for high social spending. The freedom of property and freedom from corruption indexes show that, in Romania, the market has never played the central role in running the economy. People's prevailing concern over their wellbeing 'now' rather than 'tomorrow' generates competition among political right and left for higher social spending, leading to high public debt. Neither left, nor right can guarantee sustainable limits for social benefits and public debt. Capping the share of public debt in GDP by means of the Constitution provides no guarantee for public debt sustainability, but is worth a try.

**Keywords:** political right, political left, reputation, political competition, time preference, markets, social spending, public debt.



Compared to non-democratic societies, authentic democracies are on average more productive, more tolerant, more transparent and freer. For these reasons, they are – as recently stated in *The Economist* (1 March 2014) – richer, more peaceful and less corrupt<sup>1</sup>. And, more fundamentally, people are free to voice their ideas. All these clearly explain man’s struggle for democracy.

However, it is less clear for people in democratic societies whether they should opt for leftist or rightist policies in their attempt to maximize their standard of living over the long term. This paper aims to suggest that certain innate or learned preferences of people may very well work against the aforementioned desideratum.

## 1. Reputation and facts

Political choices are shaped by a plethora of factors, ranging from cultural to economic ones (Kahneman and Tversky, 1984; Kahneman and Tversky, 1991; Gerber *et al.*, 2010; Healy, Malhotra and Hyunjung, 2010; Valentino *et al.*, 2008; Panagopoulos, 2010; Miller, 2011; Hersh, 2012; UShistory.org, 2015). Under their influence, people shape their preferences with regard to (i) who, among markets and politicians (the state) – the two power centers of capitalism<sup>2</sup> – should play the leading (central) role in running the economy, and (ii) the ceiling which social spending, earmarked for those lagging behind in the economic process, should not exceed.

People choose those parties whose policies they believe best satisfy these two preferences. Nevertheless, more often than not, most people do not skim through party manifestoes. They choose the parties’ reputation. Generally speaking, reputation follows facts but, once it has set in, reputation leads a life of its own and it may take a while before facts can influence it again. To the extent to which reputation becomes separated from facts, the choices no longer satisfy the preferences of the electorate.

Reputation seems to be a good guide of choices in mature democracies. In these democracies, the reputation of left-wing parties that they favor politicians and of right-wing parties that they favor the markets is still in line with facts to a great extent.

However, the reputation of right-wing parties of not favoring a larger share of social spending (i.e. the cost of unemployment benefits, public pension provisions, minimum wage and other transfers) in GDP lacks support. Quite on the contrary, in some cases, the share of public debt in GDP rose precisely as a result of higher social

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1 Drawing on a large panel data, Rock (2007) finds ‘an inverted U relationship between democracy and corruption. The turning point in corruption occurs rather early in the life of new democracies and at rather low per capita incomes.’ Recently, Kolstad and Wiig (2011) addressed endogeneity of democracy in the problem of measuring its impact on corruption and found that ‘democracy is far more effective in reducing corruption than indicated by estimates not taking the endogeneity of democracy into account.’ (p. 19). In the abstract of their paper, the authors conclude that ‘democracy is hence more important in combating corruption than previous studies would suggest’.

2 As introduced by Greider (1989).

spending promoted by right-wing parties. For instance, in the US, the share of expenses incurred with social security programs in GDP rose by almost 10 percentage points from 1965 to 2012, with Republican administrations (i.e. the American right) contributing almost 60 percent (Greenspan, 2013, p.193)<sup>3</sup>.

In younger democracies, parties' reputation is less of a good guide of choices. For instance, the same as in mature democracies, in Romania as well the parties perceived as right-wing struggle with the undue reputation of being adamant to any increase in social spending or public spending in general. There are countless examples to the contrary, yet the reputation has become entrenched. For instance, social spending rose from 9.4 percent of GDP to 10.6 percent of GDP during 1997-1999, when a right-wing coalition was in power. In addition, as compared to 2004, social spending edged up 1.3 percentage points of GDP in the period from 2005 to 2008, when rightist parties were also at the helm. It only got worse in 2010, when budget sector wages and benefits were temporarily slashed by 25 percent. These cuts were the exception that proved the rule stated by Kuehnelt-Leddihn (1988), according to which 'Tighten-Your-Belt parties, if they unexpectedly gain power, generally act more wisely, but they rarely have the courage to undo the policies of the Santa parties'. The aforementioned cuts partly and temporarily undid the reckless policies of budget sector pay rises during the economic boom<sup>4</sup>. During that period, the budgetary structural deficit (the cyclically adjusted budget deficit) increased from 2.9 percent of GDP in 2004 to 8.6 percent of GDP in 2008. The wage bill increased from 8.1 percent of GDP in 2004 to 10.3 percent of GDP in 2008. The average public sector wage rose 25.3 percent per annum on average between 2005 and 2008, with the number of employees increasing by approximately 166,000. For the sake of comparison, in the same period, the average private sector wage advanced by 19.2 percent per annum. In the period from 2005 to 2008, the average public sector pension added 30 percent per annum. These increases are quite large in real terms, judging by the fact that the average annual inflation ran at a mere 7.1 percent during the said period.

The reputation of 'right-wing' parties of supporting the markets is even further away from reality (overinflated) in Romania. Although these parties ruled the country for 11 years during 1997-2000 and 2005-2011, the freedom of property (clarity of property rights) and freedom from corruption still rank among the lowest worldwide<sup>5</sup>. The low level of these economic freedoms is indicative of the fact that markets

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3 A friend suggested that the 'original sin' in this case rests on the shoulders of those who trigger this process of faster rise in social benefits compared to GDP. The 'original sin' does matter, no doubt about that, but Greenspan accounts in the book quoted in the main text how President Nixon, who parented the automatic benefit hikes pegged to inflation back in 1972, explained to him that 'if we (Republicans) don't preempt the Democrats and get the political credit, they (the Democrats) will' (Greenspan, 2013, p. 193).

4 The Romanian economy entered recession in in the fourth quarter of 2008.

5 The two freedoms define the rule of law; the higher these freedoms, the more conspicuous the rule of law.

have never played a salient role in running the Romanian economy. Judging by this criterion, which I deem essential, all parties have bestowed the leading role in running the economy upon politicians (a leftist approach), with the outcome that entrepreneurship has barely made its way through<sup>6</sup>.

In terms of demand and supply, there can be two explanations for this outcome. One is that the preference for the market playing the central role in running the economy has manifested itself, yet there was no one there to satisfy this preference. In other words, in the young Romanian democracy, most voters believe that we have parties with genuine right-wing values and policies. They believe that, by voting for these parties, they actually vote in favor of the markets playing the leading role in running the economy.

We may concede that, while the right was at the helm, markets enjoyed a higher degree of freedom, but they were certainly far from playing the central role in running the economy. Under the presumed explanation, the culprit for this outcome is the parties' overinflated reputation. Normally, a genuine demand for right-wing parties yields – sooner or later – such a political structure not only in name, but also in fact. However, where the former totalitarian regimes wreaked havoc, right-wing parties might not succeed in a short timespan to entrust markets with the central role in running the economy, owing either to the reproduction of the old elites or to politicians' educational background.

As regards the change of elites, Szelényi and Szelényi (1995) showed that changing a totalitarian regime may be associated either with the *reproduction of elites* (meaning that the technocracy was coopted by the nomenklatura or the absence of a counter-elite 'to replace the nomenklatura at the time of system breakdown') or with the *circulation of elites* (when there is an already formed counter-elite or the technocracy was not coopted by the nomenklatura). Starting from the theory of reproduction of elites and the path dependency theory, Muntean (2013) points out that the 'founding elections', i.e. the first democratic elections after the dissolution of totalitarianism, set the performance standards for several upcoming generations of members of parliament. According to Muntean, in Romania, owing to the lack of counter-elite, the founding elections enabled the reproduction of the former communist elites, which promoted their former sets of values. In my opinion, these 'old habitus', 'former mental maps' could explain why in the aforementioned periods (1997-2000 and 2005-2008) right-wing parties failed to entrust markets with the central role in running the economy.

The other underlying cause mentioned above for right-wing parties ignoring the markets when assigning the leading role in running the economy relates to the educational background. Muntean (2014) publishes several statistics indicating that the

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6 Although social spending rose at a fast pace, the inequality in terms of income and wealth has not diminished. The budget deficits prompted by the increase in social benefits have been financed via private savings. This explains why productivity and employment have been visibly outpaced by social spending.

quality of the educational background, economics included, has declined steadily in the Parliament of Romania. Based on this, we suggest that maybe the right-wing parties and their representatives in parliament either failed to grasp the importance of putting markets at the center of running the economy or they wanted to assign this leading role to markets, but did not understand which reforms had to be promoted in order to achieve this goal.

The other explanation why markets have never played a salient role in running the Romanian economy (which highlights a situation that is allegedly harder to fix), is that voters perceiving themselves as right wing did not want markets to be assigned the central role in running the Romanian economy. But, from an economic perspective, the leading role of the market lies at the core of what the concept of political right actually means. If the number of those who vote for right-wing parties and who do not embrace this meaning is large, then we do not have a relevant number of genuine right-wing voters. Preda (1994) provides explanations for why 'the Romanians declare themselves more right wing than Westerners' (p. 6) and concludes that 'left-right' is 'a not too relevant dichotomy for Romania and Eastern Europe' (p. 4).

If this was the case, right-wing parties understood the illusion their voters live with and tailored the economic components of their electoral offers and their governing programs to the voters' actual demand. Thus, the market has so far been prevented from playing the central role in running the Romanian economy.

The examples above show that the spread between parties' reputation and their actual actions (which I refer to as 'reputational spread') is a key factor that could alter the fulfillment of people's preferences for left- or right-wing policies. However, the reputational spread may also lead to the situation in which, although the simultaneous fulfillment of the aforementioned preferences (i) and (ii) is possible, the electorate might have to choose between them.

For the sake of clarity, let us assume that the public would actually want the markets to be assigned the leading role in running the economy and, at the same time, social spending to be raised. As shown above, this task could be entrusted to parties on the right. Nevertheless, their undeserved reputation of opposing social spending will render the public's decision more difficult. People will have to decide which of the two preferences is stronger. Those who believe that letting markets play the central role in running the economy is more important will vote for the right. Those who favor social spending more will vote for the left. From the point of view of the public's preference, this is a distortion in the political structure which cannot be avoided in the presence of the reputational spread.

## **2. The crises and assigning political power**

The Great Recession has ushered in changes on the political scenes of many democracies. This is a hint that the stages of the economic cycle influence people's preferences as to who exactly, between markets and politicians, should play the leading role in running the economy and to social spending. Whenever they are faced with

economic crises and lose their income or their jobs, people have the explicit or implicit tendency to identify culprits.

The changes that crises bring about on the political scenes depend on the identified culprits. The following section shows how financial markets, commercial banks in particular, have been blamed for the 2008 crisis. Here we will merely show what decisions the public takes regarding the political vote depending on who is to blame: the markets or the politicians (the state).

If the economy is in recession and the markets are perceived to have caused the decline, people give the central role in running the economy to politicians. To be more precise, the public opts for reducing market freedom and gives the vote to parties on the left. Conversely, during the upswing of the economic cycle, markets are perceived to be doing a good job and the public gives power to the parties perceived as best understanding the markets, namely parties on the right. Assuming the absence of the reputational spreads referred to in the first section, these preferences of the public will be satisfied. This is the basis of governments' asymmetric activism, which consists in more visible interventionism whenever there is a problem and the lack of intervention when the economy is in good shape. Asymmetric activism heightens the magnitude of the economic cycle<sup>7</sup>.

If politicians are perceived as being guilty for the crisis, conferring the power depends on the actual shape of the crisis. If expansionary policies lead to inflation, as it was the case back in the 1970s, people tend to assign the power to parties on the right or, marking a major breakthrough, to independent bureaucracies, such as the central bank.

However, if a public debt crisis emerges while an independent central bank manages (as during the Great Moderation) to keep inflation low and stable, people will not want debt-cutting measures to translate into lower social spending. From the people's perspective, it only seems logical for the debt-cutting task to be entrusted to left-wing politicians who, according to their reputation, would rather increase taxes or lower investments than diminish social spending<sup>8</sup>. As far as Romania is concerned,

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7 Intervention during downturns is expected by people and therefore governments cannot afford not stepping in, although interventions are to no avail or, even worse, they deepen the recession, for instance if governments deem it necessary to narrow budget deficits. In good times, however, macroeconomic policies cannot cool down the euphoria without generating recession. For example, assuming that the output level and the output growth rate are at their potential and that an asset price bubble is present, narrowing the budget deficit in an attempt to cool off the bubble will lead to recession, which is politically unacceptable. Thus, if the authorities cannot cool down a bubble, but can introduce regulations that stymie economic growth, asymmetric activism may increase the magnitude of the economic cycle. Of course, in response to the hypothetical reduction of the budget deficit, a central bank whose strategy consists of explicit or implicit inflation targeting will lower the policy rate in order to keep output at its potential.

8 The distinction made by Erik von Kuehnelt-Leddihn between Santa Claus parties, generous in terms of social spending, and Tighten-Your-Belt (less generous) parties must have had a strong influence on this belief.

the 25 percent wage cut in July 2010 was a decisive element in terms of the outcome of the 2012 parliamentary elections.

There are a few questions regarding this assigning of power to parties. The first question is whether entrusting politicians with the central role following a crisis, i.e. restricting market freedom, is beneficial to people. More precisely, to what extent is such a policy compatible with the objectives of social welfare? The second question is how can it be explained that both left- and right-wing governments accept to become highly indebted in order to generously finance increased public spending, especially associated with social programs? On the other hand, there has to be an answer why some governments still succeed in preserving public debt at relatively low levels. In what follows, this paper will answer all these questions.

### **3. Limiting the role played by the markets**

In the aftermath of the 2008 crisis, there was a widespread belief that conceding the central role in running the economy to the markets starting in the 1980s had been a mistake. Markets were blamed for the crisis. Consequently, in many countries hit by the crisis, the electorate voted in favor of parties which they knew would entrust politicians with the leading role in running the economy. Hence, many parties on the center-right or right worldwide lost power to left-wing parties, as it was the case in Romania as well.

Behind the opinion that markets were guilty stood the controversial idea that the roots of the crisis could be traced back to financial market deregulation initiated in the 1980s. People were given the explanation that, in the absence of regulation, the so-called 'toxic' assets emerged, which – in brief – enabled the privatization of gains and rendered the socialization of losses inevitable. There is no evidence of a connection between the loss of jobs and the somewhat liberal regulation promoted prior to the crisis. On the contrary, people have noticed that the relatively liberal regulation was associated with rising employment. For example, in the US, during 1969-1981, prior to financial liberalizations, the civilian unemployment rate trended upwards and reached 9.7 percent in 1982 from 3.5 percent in 1969. With the start of financial liberalizations after 1982, the unemployment rate trended downwards and came in at 4.6 percent in 2007. However, under the terrible impact of the massive job cuts after the onset of recession in 2008<sup>9</sup>, the outrageous explanation related to financial market deregulation seemed quite credible to a public infuriated at 'the greediness of banks' which, in some countries, had to be bailed out.

It was not deregulation that lay at the root of the crisis, but rather the inherent instability of the economy. The inherent instability of the economy was underlined

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<sup>9</sup> In the period from 2009 to 2014 (six years into the recession), the average unemployment rate in the US was 8.3 percent. During 1982-1987 (six years into the recession that had started in the fourth quarter of 1981), the average unemployment rate stood at 7.9 percent, only 0.4 percent lower.

by Minsky (1986, 1994), who also proposed to harness it by strengthening regulation. However, the profound drivers of the economic cycle are euphoria and panic, innermost traits of the human nature. As we have shown in 'The End of Regulation and the Last Regulator', regulation can influence euphoria and panic only if capital movement is under total control, but even then the control can only be temporary (Croitoru, 2013a). Although most of the adopted regulations are not intelligent, we have been wise enough so far not to reintroduce controls over capital movement.

The newly-approved regulations are, however, worryingly strict and complex, as acknowledged off the record even by politicians who have always advocated the central role of politics in running the economy. Haldane and Madouros (2012) have shown that the very large number of pages of the new regulations, if indicative of anything, are indicative of a high degree of complexity, thus generating a 'too complex to manage' problem<sup>10</sup>. Very complex regulations stifle market flexibility. The absence of financial market flexibility will delay the resumption of relatively fast economic growth and the cut in unemployment.

Such a delay is not good. In many developed countries, it renders the issue of large public debt even more complicated. Without the relatively fast-paced economic growth generated by markets not overly burdened with regulations, adjustments in public spending – social expenditures included – will necessarily be high.

In less-indebted emerging economies, surrendering the central role in running the economy to politicians prevents efforts from being focused on reducing corruption and clarifying property rights. Corruption and unclear property rights diminish market freedom markedly and delay the instituting of the rule of law.

In Romania, a country with moderate freedom (an index of economic freedom of 66.6, as reported by Heritage Foundation), this is a serious issue: the index of freedom from corruption stands at 43.0, while the index of property rights is 40, compared, for instance, with Germany (73.8), where the indices stand at 78 and 90 respectively or the Czech Republic (72.5), whose indices come in at 48 and 75 respectively<sup>11</sup>. Clearly, surrendering the central role in running the economy to left-wing politicians when financial markets are perceived as culprits for the crisis is the exclusive attribute of

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10 Basel I had 18 pages in the US and 13 in the UK. Basel III has 1,000 pages in both countries. The Glass-Steagall Act of 1933 had 27 pages, whereas its modern correspondent, the Dodd-Frank Act of 2010, boasts 848 pages, plus a further 8,842 pages in 2012, accounting for only one third of the required rules legislation. Haldane and Madouros estimate that, 'at this rate, once completed Dodd-Frank could comprise 30,000 pages of rulemaking'. They conclude that 'for example, were that rule-making to occur on a US scale, Europe's regulatory blanket would cover over 60,000 pages' (Haldane and Madouros, 2012, pp. 10-11).

11 In Romania, the property rights and freedom from corruption indices stand at similar levels to those in less-developed countries. By comparison, these indices are as follows (the overall index of economic freedom is listed in parentheses): Bulgaria (66.8) 41.0 and 30.0; Vanuatu (61.1) 33.5 and 40; Mongolia (59.2) 38.0 and 30.0; Togo (53.00) 29.0 and 30; Uganda (59.7) 26.0 and 25; Ukraine (46.9) 25.0 and 20.0 (The Heritage Foundation, 2015).



voters. But this is not the solution to step up economic growth, i.e. the ultimate source of employment and social spending.

#### 4. Time preference and increasing social spending

Governments can increase spending on social programs at a faster pace than economic growth for decades. We have seen the United States embarking on this trend almost half a century ago. Many other developed European countries have had similar experiences. The propensity of governments on the left and right alike for a higher share of social spending in GDP reflects a more profound propensity of mankind that transcends ideologies. Political parties merely take this inbred inclination into account in order to gain power or stay there.

The aforementioned more profound predisposition is actually the time preference (individual 'impatience'<sup>12</sup>). It consists in the natural prevalence of man's preference 'for current goods rather than for future goods' (Mises, 2008)<sup>13</sup>. In other words, on average, people are more concerned over their wellbeing at present or in the near future than their wellbeing in the more distant future. Just like euphoria and panic, innermost traits of human nature, are the ultimate causes of the financial and business cycles, time preference fuels the uptrend in public debt.

Time preference 'shapes each choice and each action' (Mises, 2008, p. 490), including political choices. According to the time preference, voters give their votes to politicians that satisfy their need for public goods in the nearest future. If they confined themselves to tax revenues, politicians would not manage to supply the said goods as soon as the voters would like. In order to succeed, governments issue net debt at a rate that outpaces output growth. This is the mechanism whereby public debt rises. In most cases, the driver behind debt increase is social spending rather than public investment.

Social spending is financed under a pay-as-you-go system, namely from contributions paid by taxpayers. But, in most cases, these systems run a deficit and need to be financed with private funds borrowed on financial markets. For instance, the social security budget in Romania runs a deficit of lei 12.5 billion, which is covered through loans from the government budget, whose deficit is in turn financed via borrowings on private markets.

To the largest extent, social benefits are an element of consumption. This means that public borrowings for financing social spending are tantamount to a rechanneling of private savings flows from private investment to personal consumption. The excessive rechanneling of savings into private consumption may result into wider

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12 An increasing number of recent Neo-Keynesian models of the business cycle differentiate 'impatience' by economic agents. For instance, impatience is different across economic agents (some save, others borrow) in Eggertsson and Krugman (2012), Cúrdia and Woodford (2009), Iacoviello and Neri (2010) or Eggertson and Mehrotra (2014).

13 Because of this 'impatience', 100 lei today value more than 100 lei in the future.

external deficits, which – while fostering short-term economic growth – might raise growth issues over the longer term if they are not sustainable.

At the level of the society, time preference sets a ceiling on savings as a share in income, thus also acting as the fundamental driver of the real interest rate on risk-free instruments (Greenspan, 2013). Similarly, at the level of the government sector, ‘impatience’ limits public savings. When budget deficits widen, public savings drop. As far as the Romanian economy is concerned, government savings have been negative, ranging between -0.8 percent of GDP and -2.8 percent of GDP during 1997-2001. When budget deficits soared again in 2009, 2010 and 2011, public savings returned to negative territory, reaching -3.1 percent of GDP, -1.1 percent of GDP and -0.1 percent of GDP respectively.

From the perspective of time preference, saving represents the sacrifice needed at present in order to consume more goods in the future or even to have new goods. *Ceteris paribus*, the lower the time preference (‘impatience’), the higher the available saving<sup>14</sup>. However, implications on growth depend on the phase of economic cycle, the degree of development, etc.<sup>15</sup>

Given the impatience of voters and the competition that politicians engage in to satisfy it, there is not too much room left for prudent government policies either on the left or on the right. The more inflated *vis-à-vis* practice is the reputation of right-wing parties of exercising prudence in approving public spending, the more visible the deviation from prudence. Inflated reputation practically cancels out the vote of those who have a low time preference and who vote for precaution.

As long as economic growth is stable and credit is readily accessible, the mechanism of swelling public debt described above is functional, the consequence being that savings rates in the public sector remain low or become negative. It functioned smoothly for a long time prior to the financial crisis, giving birth to what we could call a ‘democracy built on debt’.

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14 Time preference is specific to each individual. Time preference stands above average in case of individuals concerned with their standing in the immediate future and below average among individuals concerned with their standing in the more distant future. Time preference of individuals is stable and reflects a certain degree of intelligence. Experiments have shown that the temptation of eating a cake runs extremely high among four- to six-year olds. Only some of the children can postpone the eating of the cake for a relatively short period if, at the expiry of such period, they may eat two cakes. The same children that managed to delay the eating of the cake scored better at the high school graduation exams, which proves that a lower time preference is associated with higher intelligence, a correlation that is stable over time (the example is taken from Greenspan, 2013). More on time preference can be found in Shane, Loewenstein and O’Donoghue (2002).

15 For example, if the economy is at steady state and a shock arises in the time preference rate, economic growth will be stimulated if the shock is positive and slowed if the shock is negative. Furthermore, given the law of diminishing returns, one can expect that the larger the capital per capita stock, the lower the positive effects of the increase in the time preference rate on economic growth.

The unease about low or negative saving in the public sector is not new. *The Economist* reminds us that Plato used to say, referring to democracy, that the citizen ‘lives from day to day to the end, in the gratification of the casual appetite’<sup>16</sup> (Plato, 1997, p. 281). The problem with a democracy built on debt is that it becomes vulnerable to the business cycle and to the financial cycle, whose profound causes – euphoria and panic – cannot be influenced by public policies.

Keynes has shown that democratic governments need to widen fiscal deficits when, unavoidably, private demand collapses. This means that, in times of stable economic growth and easy access to credit, budget deficits and hence public debt should remain low, so as to have room for expansion in times of crisis. The implicit idea is that governments should take on the thorny task of saving more and borrowing less during good times.

However, voters’ time preference (‘impatience’) is at odds with this desideratum. Given this impatience among voters, it is virtually impossible for democratic governments to engage in primary fiscal surpluses during upturns in order to diminish public debt. On the contrary, voters’ inbred ‘impatience’ keeps the competition among parties alive, irrespective of ideology, in order to meet the public’s demands in the nearest future.

The unabated demand for social programs, which neither left-wing governments, nor right-wing ones can ignore, has serious implications. The larger share of social benefits in GDP leads to a slower growth rate of investment and, eventually, of output. In order not to impair the capacity to finance future social programs, the pace of increase of social benefits should equal that of GDP. Granted, such a strategy would slow down the achievement of social welfare objectives, but it would allow for smaller public debt and would speed up economic growth, the ultimate source of social benefits.

Prior to the crisis, politicians thought that, via regulations, they had abolished the cyclical nature of the economy and thus mitigated risks, including those associated with high levels of public debt. The crisis shattered this illusion. One cannot raise public debt by betting on the fact that regulations abolish the economic cycle, since euphoria and panic are its ultimate causes. In the aftermath of the crisis, financial regulation was strengthened yet again but, just like it has not managed to cool off euphoria and panic in the past, the measure is doomed to fail in the future as well<sup>17</sup>. New fiscal rules were also adopted. They will have a positive effect until history repeats itself and political competition to offer voters what they want in the present or in the near future leads to the abolishment or the tacit violation of such rules.

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16 This is, in my opinion, one of the first references of a philosopher to the contents of the ‘time preference’ concept, which Carl Menger introduced in economics through his *Principles of Economics*. Plato suggests the contents of this concept by referring to moderation, while the notion of precaution is implicit.

17 A demonstration is provided in Croitoru (2013a, pp. 33-55).

## 5. In lieu of a conclusion

The public's preference on who should play the central role in running the economy (the markets or politicians, i.e. the state) influences political choices. If parties' reputation in this respect becomes separated from facts, discrepancies emerge between people's preferences and the political structure of parliament.

Economic crises can bring about abrupt changes in people's educated preferences on who should play the leading role in running the economy. If markets are found guilty for the crisis, the central role in running the economy will stay with/will be entrusted to politicians. This does not always work the other way round.

Euphoria, panic and the herd behavior cannot be annihilated via regulations and will forever act as the ultimate causes of the economic cycle. For this reason, financial markets will often find themselves in the position of 'culprits' for the crises. At least on those occasions, they will lose for a while the central role in running the economy.

If they want politicians (the state) to play the central role in running the economy, people will give their votes to parties on the left. Pushing markets into the back-seat will slow economic growth, which is the ultimate source of social spending. The economic advance required for generating new jobs will stall, stifled by unwise (unintelligent) regulations. Experience shows that introducing unwise regulations takes several years but unwinding them is becoming possible only decades later. Goodhard (2010) refers to several rules and regulations initially introduced during the 1930s-1960s and repealed during 1980-2007.

If people choose markets to play the central role in running the economy, their vote will go to right-wing parties. The flexible markets will contribute to economic growth by stimulating competition, innovation and productivity growth, which will lead to higher employment and diminish the need for increased social spending. The experience of the UK under Margaret Thatcher and John Major is well known. The consistent enforcement of right-wing policies took the UK, over a 19-year period, from the 19th place to the second place among OECD countries in terms of standard of living (Blundell, 2008).

When Margaret Thatcher died, I wrote an article (Croitoru, 2013b), which concluded that 'Basically, what counted was a correct philosophy (that of freedom) on who plays the central role in running the economy (the market or the government), along with political will and the courage to put it into practice. The rest comes easy'. It is the main conclusion of this paper as well.

In Romania, starting with the 1940s, markets have never played the central role in running the economy. The chance for markets to hold the leading role in running the economy can only be offered by a genuine political right. When this happens, the freedom of property and freedom from corruption will increase, unleashing the entrepreneurial spirit and stimulating productivity and the standard of living.

Time preference, namely people's inbred tendency to be concerned with their wellbeing at present or in the near future than with their wellbeing in the more dis-

tant future, is a major driver of the competition among parties for increasing social benefits, irrespective of ideology.

Since parties on the left and right alike compete for higher social spending, the public's preference for a certain ceiling on social spending as a percent in GDP should not have a bearing on the vote. However, right-wing parties' reputation of being less favorable to social spending compared to left-wing parties makes it so that the social spending preference does influence the vote.

Given the time preference, neither right-wing governments, nor left-wing ones can provide any guarantee that, over long periods of time, the growth in social benefits and public debt will not outpace GDP dynamics, thereby reducing the available resources for private and public investment. In other words, neither the left, nor the right can oppose financing democracy on debt.

The time preference, which leads to swelling public debt, calls for adopting fiscal rules meant to cap its increase as a share in GDP. In order for them to be as resilient as possible to political competition fuelled by the time preference, rules need to be enshrined in the Constitution, which would render them difficult to abolish.

Some EU Member States, such as Estonia, Romania, Norway, Denmark or Bulgaria have succeeded in containing public debt as a share of GDP to relatively low levels, without applying such a rule. The same thing happens, however, in some poor African countries, or in some developed economies in Asia, hinting at the presence of other factors that, in some cases, may suppress public debt as a share of GDP. Take Bulgaria for example: the fixed exchange rate set by the currency board causes the current account to worsen in times of large capital inflows, so that narrowing the fiscal deficit and thus containing the public debt remain the main tools to fix the external imbalance. In the case of Norway, the oil reserves ensure strong budget revenues, stemming the need for public borrowings. For the poor countries, putting a cap on debt is most likely ensured by foreign investors' low tolerance for large public debt figures. Ultimately, in some countries, cultural factors play a role, as is the case of the economies in the euro area's North versus the South.

In view of the said factors – culture, investors' tolerance (development level), hydrocarbon resources and the currency regime –, to establish a rule for containing public debt as a share of GDP may prove more beneficial if we consider that it openly expresses the objective to cap public debt. Nonetheless, this rule too has its weak points (Croitoru, 2013c). First, it cannot operate in a currency area that is not backed by a fiscal union. Second, it cannot ensure the government's good fiscal behavior towards too-big-to-fail entities. When such entities fail, the government will have to step in, no matter how high public debt rises after such an intervention. Apart from these instances, one may hope that the rule will be able to put a cap on public debt, which is also the limit to which political competition between rightist and leftist governments may go in boosting spending.

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