

## **AN INQUIRY ON THE NATURE OF INCREASES IN TURKISH GOVERNMENT SPENDING SINCE THE BEGINNING OF WORLD WAR II**

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The paper aims to examine the nature of increases in government expenditures from the perspectives of the Wagner's Law and the Peacock-Wiseman Hypothesis using the Turkish historical data covering the period of 1936-2012 obtained from the Ministry of Development and the Revenue Administration Division of Ministry of Finance. The results partially confirm the findings of previous studies by Akbulut (1993) and Tekin and Çiftçi (2004) that focused particularly upon the effects of military coups of 1960 and 1980 and the effects of World War II, Korean War, Cyprus Peace Operation, First Gulf War and military coups, respectively. Unlike these studies, this paper scrutinizes the data of both public expenditures and tax revenues, observing that the nature of rises in government expenditures in Turkey matches Wagner's Law rather than the Peacock-Wiseman Hypothesis, except for the Special Communication Tax introduced after the Marmara Earthquake of 1999, and the Value-Added Tax rates increased following the aforementioned extraordinary events occurred after 1984.

**Keywords:** Public spending, Tax, Peacock-Wiseman Theory, Marmara earthquake, World War II.

### **Introduction**

Although over the years and even differ from country to country, public authorities have become responsible for production a number of goods and services. Public authorities make use of the public revenues at this stage. Especially, taxes are an important source of income among the public revenues.

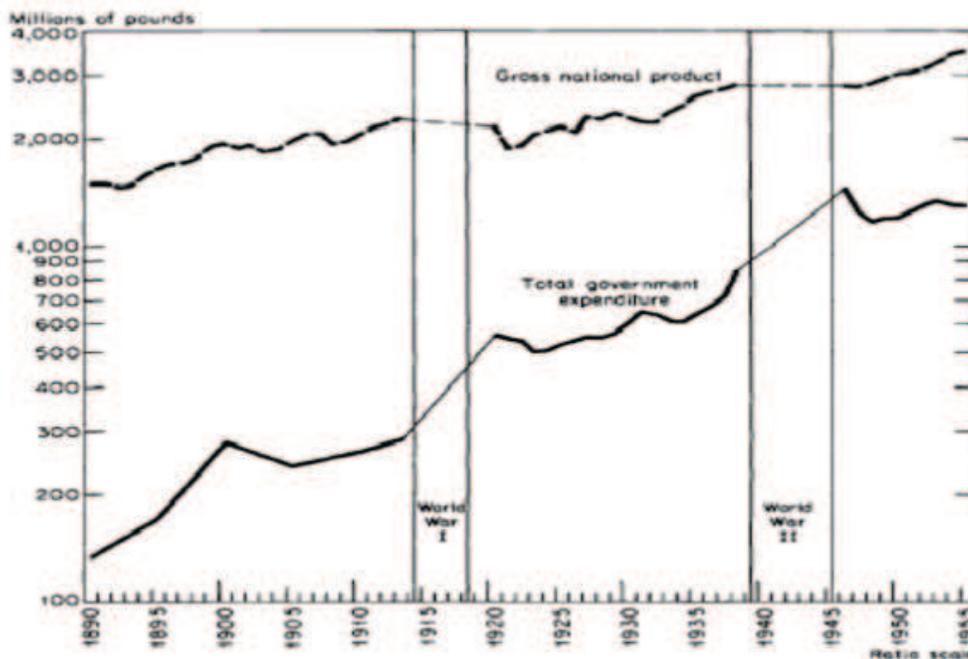
While citizens are pleased with increasing in public services in other words public spending, they are uncomfortable with reflect this rises to tax rates and amounts. Taxes are collected from the tax payers and all kind of payment will be done may be regarded as a burden by them. And this condition becomes intolerable after regarded as tolerable tax burden. After this rate, the tax increases can be acceptable only stable and parallel rate rises in the level of reel output. Deviations may occur in extraordinary period such as earthquake, war, military coup from this case that valid in normal times. Because, tolerable tax burden due to current situation caused by social upheaval increase and this situation causes an increase in public expenses. However, when effects of the social upheaval have disappeared tax rates cannot decrease previous level due to increased tax burden. This hypothesis is named as displacement effect by Peacock and Wiseman in literature.

This study analysis social, political and economic events from Turkey concerning displacement effect and evaluate their effects on Turkish tax system after the giving information about displacement effect.

### Peacock & Wiseman Hypothesis

Public expenditures can be defined as in emerging concept of states existence and these functions and making expenditure by public entities (Nadaroğlu, 1998: 130). As in the analysis of public expenditure discussed state function and on the developments in its.

Although there are different opinions about state's existence and reason for its tasks issues, developing societies and growing needs had lead up to adoption of today's understanding of state approach which taking economic and social task by moving beyond the neutral state approach. Therefore, it is not possible to describe that the today state is the 19. century's protective state (Nadaroğlu, 1998: 130). States are in the neutral state understanding approach that can be defined as night-watchman state in order to regulate economic and social life have not to take any job while keeping limited services such as justice, defence and security; as its stands, public expenditure has been limited with these services (Nozick, 1974: 25). But states that take active role of the regulating economic and social life in the modern state understanding have increasing types of public services and their areas and this has brought about the increase in public expenditures (Özbudun, 2002: 99). Increasing in public expenditure because of the proliferation and diversification of the undertaken functions of state lead up to emergence about different approaches of developing in public expenditures and this approach has already led to the development of testing empirical studies. Subject of this study is Peacock and Wiseman Hypothesis that one of the approaches developed for the increase in public expenditures.



Graph 1

Source: Peacock, A.T. and Wiseman, J. 1961. *The Growth of Public Expenditure in the United Kingdom*. p.47, Princeton University Press, Princeton.

Peacock and Wiseman (1961) have analysed the public expenditure for United Kingdom based on the annual change in years between 1890 and 1955. In the study result, they have present that there is an increase in public expenditure like defended by Wagner but, the increasing is not form in permanent increasing over years but follow the bouncingly increasing in public spending especially wars years in

social upheaval terms (Cullis and Jones, 1998: 357). Accordingly to Peacock and Wiseman (1961), social upheavals cause to reach a new plateau public revenues and public expenditures with creating a displacement effect (Peacock and Wiseman, 1967: 34)

The relationship about UK public expenditure and Gross Domestic Product (GDP) which contain in Peacock and Wiseman analysis between 1890 and 1955 is shown in graph 1. The rebound of growth in public expenditure during the World War I and World War II (WWII) in UK is shown in the graph. As seen in it, public spending reached the highest value in the period of social crisis because of the Wars and public expenditures had maintained the its upward trend with return to previous level after the period.

Society remains unresponsive aggravated tax increase in public services provide by the public in the period of social upheaval. In order to establish the negative effects imposed by the crisis period. This situation that shown people accept the more tax burden is an expression increase in tolerable tax burden.

Wagner's Law that in the form of cornerstone of public economics literature while the long term analysis increasing in public spending, Displacement Effect by Peacock and Wiseman has revealed that can be seen sudden increase in public spending on the debate of growth of public sector (Cullis and Jones, 1998: 357).

Peacock and Wiseman had emphasis in public revenues that collected by government. As previously mentioned increasing in public expenditure leap forward in terms of extraordinary events such as war. The period has disappeared expenditures does not fall back previous level (Hockley, 1992: 30). However, Peacock and Wiseman had mentioned that as long not experienced extraordinary events tolerable tax burden and accordingly to this tax rate would be steady and only if an increase in the level of real output, public expenditure increase, too (Peacock and Wiseman, 1961: 24).

There are two aspect of the Displacement Effect as a result of occurring sudden increasing in public spending in the analysis of Peacock and Wiseman hypothesis. First one is people accept the public revenue increases that they had previously found in tolerable in the period of crisis and the second dimension is that they consent permanent tax level that achieved due to increase in the tolerable tax burden which the effect of crisis disappeared.

Peacock and Wiseman had not made any suggestion about which social crisis cause changes in the economic activity in exact terms together with they had considered WWI and WWII cause splashing in the course of public expenditure. Nevertheless they had remarked another social crisis may also cause similar effects.

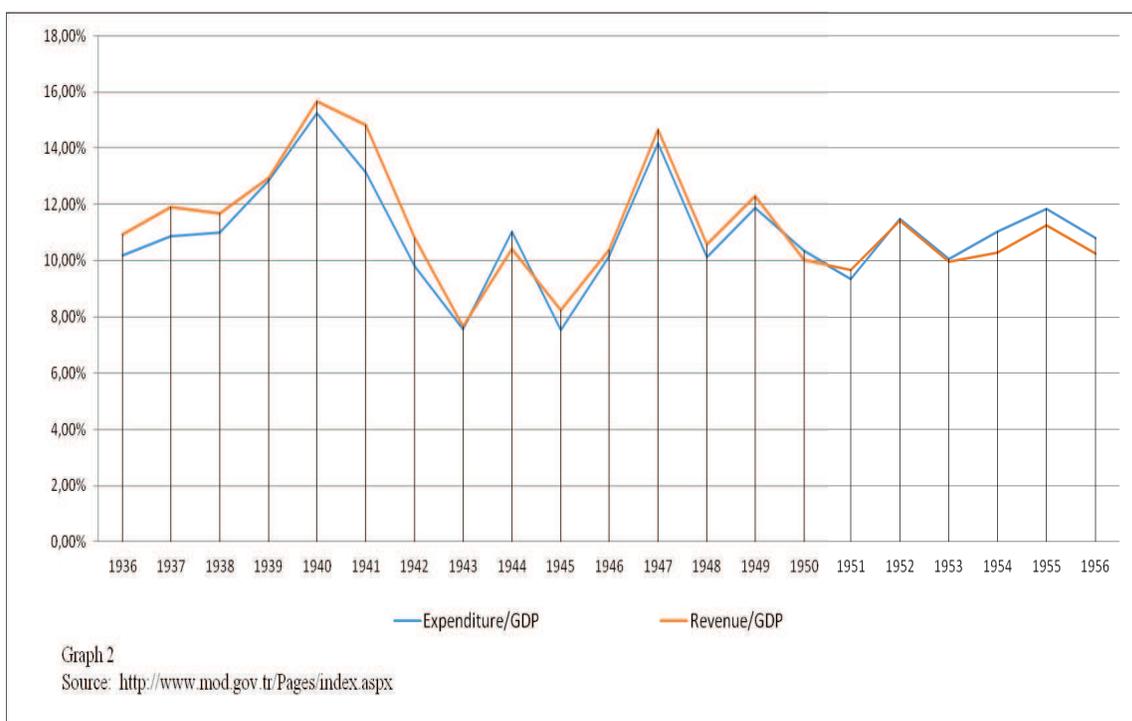
There are variety opinions regarding about what can enter into the concept of social crisis. Gupta (1969) had analysed the major economic crises of developing countries; Nagarajan (1979) had focused the non-global war between nations; Birds (1972) had evaluated cold war; Nomura have suggested could be the basis for displacement effect of the first and second oil crisis. Also some countries, France by Andre and Delorme (1978), Italy by Legrenzi (2004), Saudi Arabia by Ageli (2013) are analysed the displacement effect.

## **Social Upheavals in Turkey and Its Effects on Turkish Tax System**

### **1. Effects of WWII**

State or group of states against another state or group of states in order to their willingness by force in case of international disputes cannot be resolved by peaceful methods, the struggle by the use of military force is characterized war (Çaycı, 1995: 45). Turkey had not included WWII which one of the most striking events happened history of world. However, economic developments in terms of war had affected Turkey simultaneously. Public expenditure which can be considered as a reflection of public authorities in economic structure shows improvement with policy set out by conjuncture.

Public revenue and spending relative to GDP ratio is shown in graph 2 including before and after period WWII.



As seen from Graph 2 the condition caused by war has influenced Turkey's economy despite Turkey is not a side of WWII. Development plans have played an important role in Turkish Economy since the foundation of the Republic. However, WWII has shifting of planning perceptible. Although the war period, an increase had not occur in public spending relative to GDP as it outs forward the Peacock Wiseman hypothesis. On the other hand, rising in the trend of public spending it is equivalent to the post-war period in Turkey. Increasing in this period can be explained with the development plan for the post-war period.

## 2. Military Coup (27 May 1960)

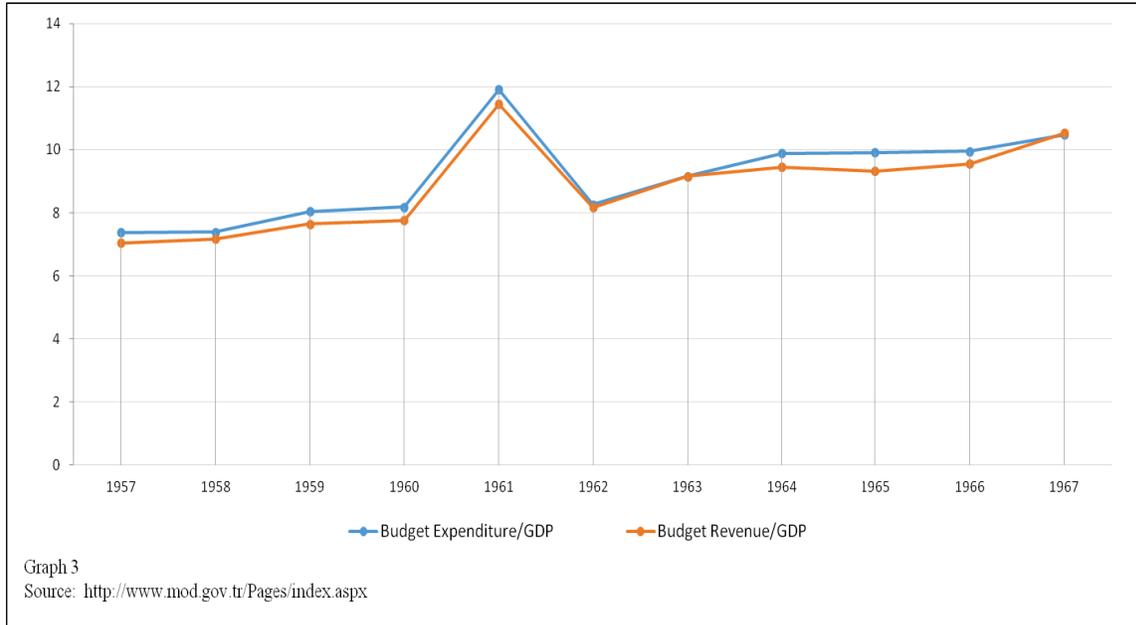
Military coup is an unconstitutional government changeover that is made by persons who belonged to government military agency, without declaring beforehand and suddenly by overthrowing the current government<sup>1</sup>. Coup government adjourned and constituted its own legislative and executive powers<sup>2</sup>. Military coup is described a social upheaval. It also effect adversely on economic and fiscal structure besides political structure. The process of budget expenditure and revenue that involved the years before and after 27 May Military Coup is seen in the Graph 3.

Before the coup broke out, Turkey negotiated with IMF about taking stabilization measures in 1958. According to the negotiation, ensuring budget balance and reducing budget spending was aimed by Turkey (Kepenek ve Yentürk, 2005: 122). But, because of the military coup the aims couldn't realise. As it is seen in the graph 3, the year when the coup broke out, budget's items deviated from their ordinary process dramatically. Even though the deviation's volume and directions was suitable for Peacock and Wiseman Theory in the coup year; in the next year, the upward trend was not continued. In fact, the items decreased. On the other hand, the condition that stemmed from the military coup formed a basis for doing

<sup>1</sup> <http://www.uzmanportal.com/darbe-nedir-askeri-darbe-tarihi-darbe-ile-basa-gecen-yoneticiler.html/>

<sup>2</sup> <http://www.gazetevatan.com/asaf-savas-akat-119530-yazar-yazisi-kisa-askeri-darbeler-tarihi/>

essential changing in Turkish Tax System. For example, Income Tax Law (21/12/1960) and Tax Procedural Law (10/01/1961) that are basic taxes law for Turkey went in effect in this period.



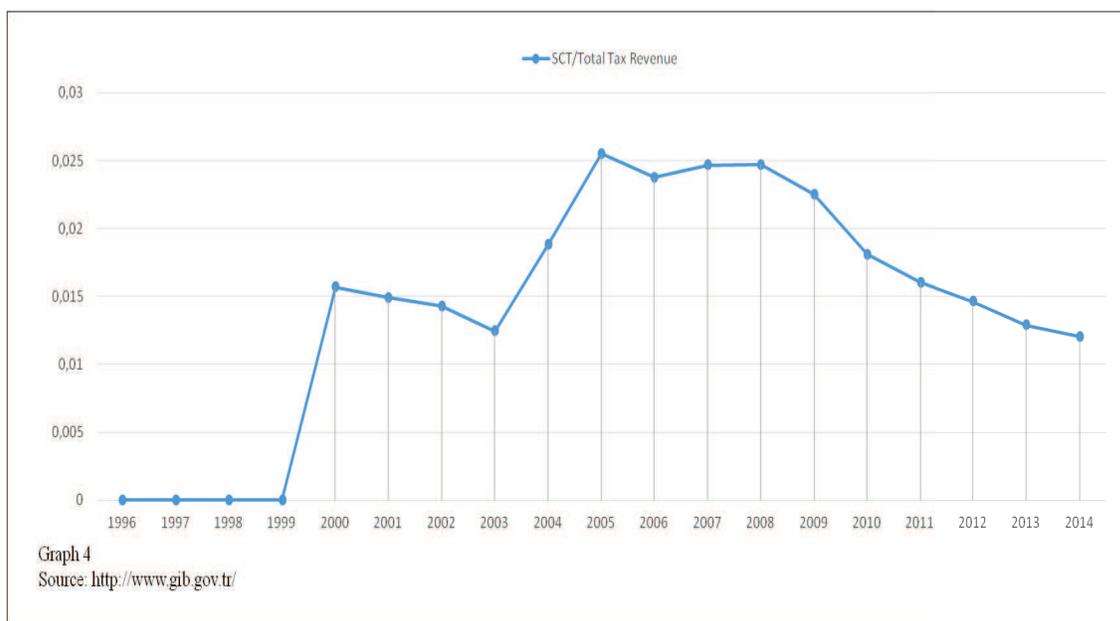
### 3. Marmara Earthquake (17 August 1999)

Earthquake is a fact of nature that caused material and moral depredation in the countries where occurred. The earthquakes cannot be precluded by hands of human. Because of it, taking measures about minimizing its probable destruction and living with earthquake awareness is necessitated for human. Even though all necessary measures have been taken or not and in fact earthquake effect on a small area for a county, a range of country-wide tax regulations applying may be needed for compensating its destructions. Thusly, the earthquake that occurred in 1999, in Marmara/Turkey caused not only many loss of lives but also loss substantial property. Besides, country-wide in-kind and in-cash aid, a tax law was implemented to apply some taxation regulations for overcoming urgently the deep trouble.

The law whose number was 4481 implemented in 26/11/1999 to have legal grounds for taxation regulation about compensating the earthquake destruction. With this law, some taxes' that have been already applied rate were increased. They were named as Extra Income Tax, Extra Cooperate Tax, Extra Property Tax, and Extra Motor Vehicle Tax. On the hand with the same law, some new taxes were created newly. They were Special Communication Tax and Special Transaction Tax. According to law preamble of both the extra taxes and the new taxes, all of them were temporary and they were going to be applied only one time (Akyazan, 2009: 19). For new taxes, Special Transaction Tax was applied one time as it was indicated in the preamble. But Special Commutation Tax gained different legal status as becoming permanent though a new law that was implemented later. (Erkekel, 2005: 6).

As indicated before, according to Peacock- Wiseman Theory, the citizens who cannot tolerate high tax increasing in ordinary times, showed more tolerance when the situation that caused social upheaval like war, natural disaster, economic crisis comes to. In other words, in the times when social sensibility raised, tolerable tax burden increased (Peacock and Wiseman, 1961: 27). Forasmuch as the all taxes were applied with the law whose number was 4481 was too heavy to taxpayers in Turkey. None the less, it didn't cause response against the tax. Because the earthquake's causing loss of lives disturbed the conscience extremely. But, as far as Peacock-Wiseman Theory, it is alleged that because of the tragic

situation, the society's tolerable tax burden raised and this raising isn't decrease previous level when effect of the situation end. (Peacock and Wiseman, 1961: 27). In this situation, even though the taxes that applied after the law whose number was 4482 raised the public revenue and expenditure, all of them repealed after compensating the earthquake's destruction except from special communication tax. And consequently, even if Special Communication Tax had been carried into effect as temporary like the others for compensating the earthquake effect, it can be seen in graph 4, although its share in total tax has shown decreasing for last years, it has been applied since Marmara Earthquake. And the tax revenue that is collected from it has been getting bigger years by years. As a result, it is thought that Special Communication Tax can be an example for Peacock-Wiseman Theory.

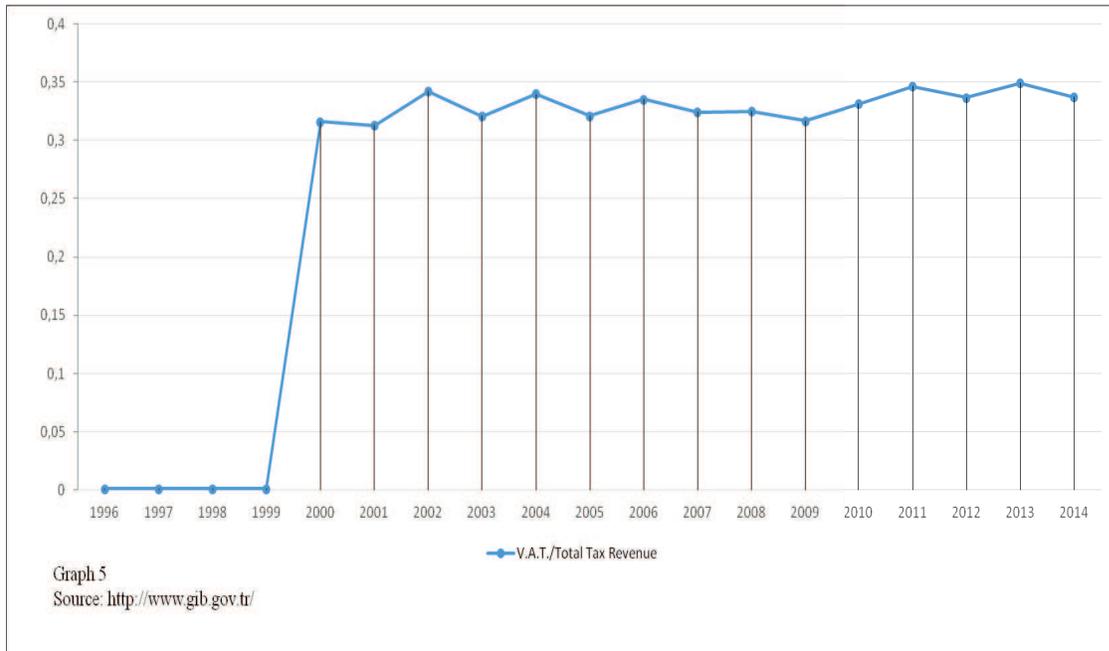


In Turkey, council of minister has limited authorization about changing on some tax rates. After Marmara Earthquake, for compensating the earthquake's effects, the council of minister made a decision<sup>3</sup> about rising withholding rate for income from immobile and mobile capital. According to the decision; the rates were raised from 15 % to 20 % (Öz, 2006: 139). And today, 20 % is current rate. Therefore, the rate changing can be considered as sample for Peacock-Wiseman Theory. Besides this, council minister made another decision<sup>4</sup> for the same purpose. According to the decision, Value Added Tax rate was raised from 15 % to 17 % (Öz, 2006: 139). Now, its current rate is 18 %. Like the rates changing that was above-mentioned, the changing of Value added tax rates can be set an example for Peacock-Wiseman Theory.

The changing of Value Added Tax rate may be looking minor as only two points. But in Turkey, because, share of indirect tax in total tax is about 70 % and most of indirect tax is constituted from expenditure, naturally, the changing look like minor can be too important to budget. The graph 5 brings effect of the rate's changing to light. It is seen in the graph, two points changing cause dramatic increase. It can be said that, this changing and its effect is completely suitable for Peacock and Wiseman Theory but in its own right only.

<sup>3</sup> Date: 27.11.1999 Decision No: 99/13646

<sup>4</sup> Date: 2.12.1999 Decision No: 99/13648



## Conclusion

Peacock-Wiseman Theory locates at the focal point of the theories that discuss increasing of public spending as supply-side. Peacock and Wiseman improved their theory whose name is displacement effect by bringing criticism against Wagner's Law. They alleged that in their theory that involved in progression of public spending in United Kingdom between the years of 1989 and 1950 public spending didn't increase as fixed rate; it increased gradually. According to them, sudden increase in the public spending process was stemmed from big social upheaval like wars. They said that there was discrimination between tax and public finance that was desired by citizens. But, when social upheaval comes to, the effect of the discrimination reduced. And when the social upheaval end reached new tax and spending levels was accepted by society.

When date of Turkey is examined as aspects of social, political and economic, it is reveal that there are many events that can be became example for Peacock and Wiseman theory. Although Turkey was not side of the World War II, it was effected negatively by economic circumstance was caused by the war. Because, for Turkey, development plans had important roles since foundation of Turkish republic (1923). And the war shifted of the planning perfective. Before the war, budget items had increasing trend. But as long as the war period any increase was not occurred in budget items relative to GDP as it was asserted in Peacock and Wiseman Theory. But, on the other hand, in the post war period the trend of the budget items caught increasing trend again. This increasing can be explained with new development plans for post war period.

The military coup can be evaluated as another social upheaval. It especially effects on political structure. But, besides this, its effect is also felt economic and financial structure. In Turkey, the year when the military coup broke out, 1960, both budget expenditure and budget revenue increased considerably as the process of budget items deviating from their ordinary process. As it seen in the graph 3, it can be said that the increasing was evaluated as bouncingly. And this situation corroborates the first part of the Peacock and Wiseman Theory. Thusly, according to Peacock-Wiseman Theory, increasing must be sustained, but, after the coup year the uptrend of the items was not continue or remain. In fact the

items decreased. In addition, the coup condition formed a basis for radical changing in Turkish Tax System. Income Tax Law<sup>5</sup> and Tax Procedural Law<sup>6</sup> went into effect in 1961.

It is known that earthquake cannot prevent by hands of human and many countries have not remarkable success about minimizing its destructions. It is also true for Turkey. In this study, the effect of Marmara Earthquake that was evaluated as the other sample of social upheaval was evaluated for Peacock-Wiseman Theory. In this way, Special Communication Tax that is known Earthquake Tax in Turkey is suitable for the theory. Because, it was not abolish after compensating the earthquake destruction and it can be seen in the graph 5 the tax become important item in budget revenue items. In addition, the increasing in Value Added Tax rate and withholding rate for immobile and mobile capital can be also sample for the theory. Because the rates did not come back previous level after ending of the earthquake effect. As a result, creating new taxes and increasing in tax some rates are evaluated as a sample for increasing of tolerable tax burden that is alleged in the Peacock – Wiseman Theory.

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<sup>5</sup> Law number : 193

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