Chapter 16
The Effects of Globalization on Public Expenditures, Tax Revenues, and Public Debt:
An Empirical Evidence From the European Countries

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ABSTRACT

Globalization is a process that transcends national borders, integrates national economies, cultures, technologies, governance and generates complex affairs with interdependence. Considering the emergence of globalization, the way it spreads and its impact areas, economic, financial, political, cultural, technological, geographical, sociological, and ecological aspects are mentioned. In this study, the effect of globalization on public expenditures, tax revenues and public debt in 1995-2017 period for EU countries was investigated within the framework of compensation and efficiency hypotheses. Analysis results indicate that globalization has a negative effect on public expenditures, but a positive effect on tax revenues. Study results analyzing the effects of globalization in EU countries favour the efficiency hypothesis in terms of public expenditures and the compensation hypothesis in terms of tax revenues. In addition, although panel cointegration tests indicate a long-term relationship between globalization and public debt in EU countries, long-term coefficients are not statistically significant.

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INTRODUCTION

Globalization is a process which includes economic, technological, social, cultural, political, and commercial integration around the world and generates international affairs depending on interdependence. Labor mobility, capital mobility and dissemination in information and communication are among the outstanding features of globalization. Globalization is not only an effective process on domestic economic units and economic structure, but it also has an effect on public sector activities as well. Globalization leads to an increase in public debts due to the development in global public goods produced by the public (Global Public Goods: Health, Environment, Peace and Safety, Financial Stability etc.), the increase in public expenditures as a result of the fight against global problems, the global tax problems concerning taxation (tax competition, transfer pricing, taxation of e-trade) and the capital liberalization.

Two main theoretical approaches explaining the relationship between globalization and public finance are efficiency hypothesis and compensation hypothesis. Efficiency (Productivity) hypothesis favours the view that as the level of globalization (expand trade) in economies increases, the size of the public sector decreases and also supports limiting the size of the state, the shrinkage of welfare state, the reduction in tax rate and tax competition. Compensation hypothesis is an approach that creates an effect on increase in public expenditures and taxes and argues that the state should play a compensatory role by increasing public expenditures in order to reduce the external risks of globalization.

The number of studies analyzing the relationship between globalization and public finance indicators is highly limited in literature. Trade openness and financial openness were commonly used in literature as the indicators of globalization. In literature there are a few studies in which an index value is used as an indicator of globalization. This study is expected to use all of the public finance indicators (public expenditures, tax revenues and public debt) in the same study, to use KOF globalization index, a multi-layered (economic, social and political) index as a globalization indicator and contribute to the literature in terms of methodology. In addition, through this study it is aimed to make certain domestic policy inferences in order to reduce the risks due to the globalization and maximize its benefits.

The relationship between globalization and public finance indicators for 28 EU countries and 1995-2017 period is econometrically investigated in this study by using panel data analysis. Following the introduction part, the information about globalization and globalization index is given and the theoretical framework about public finance and the studies analyzed in the literature on the subject are included in the study. Afterwards, the obtained findings are interpreted after the data set and method concerning the empirical analysis are explained. The study is concluded with the conclusion part.

Globalization and Globalization Index

Globalization defines the process of establishing connection networks between actors at different distances mediated through various flows, including people, information and ideas, capital, and goods. Globalization is a process that transcends national borders, integrates national economies, cultures, technologies, and governance, and generates complex affairs with interdependence (Savina et al., 2018: 5). Determinants and effectors of the globalization process are multinational companies, international companies, nation states and non-governmental organizations. Considering the emergence of globalization, the way it spreads and its impact areas, its eight different dimensions as economic, financial, political, cultural, technological, geographical, sociological, and ecological are mentioned (Çaşkurlu, 2017: 17-18).

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