Understanding fiscal politics in times of austerity: tax linkages in Britain and France

Why do national fiscal pathways diverge in times of austerity? Since the late 1970s, most of the OECD countries have either responded to such episodes by cutting spending and keeping taxes low, or by increasing taxes to match growing public spending. The UK and France are two striking examples of this divergence. ***Zbigniew Truchlewski*** *explains how tax linkages can account for these opposing approaches.*

Since the onset of the age of fiscal austerity in the mid-1970s, national fiscal pathways – the proportion of taxation and public spending to GDP – have diverged among OECD countries. Some have increased both their spending and tax levels, while others sought to limit their increase.

The United Kingdom and France are epitomes of these divergent fiscal pathways. British governments have increased taxes only marginally in the past four decades, thus remaining in the OECD average, but have changed the distribution of their burden in significant ways. In the UK, Labour could only win elections when it promised not to increase taxes, and converged with the Conservatives in terms of economic policies in the mid-1990s. French governments, on the other hand, gradually increased the tax burden to one of the highest in the world. In France, the Right converged with the Left in terms of tax policies, mostly increasing social security contributions or seeking alternatives to this option.

In my research, I argue that this puzzling divergence is due to domestic "tax linkages", i.e. how dominant forms of taxation shape state-society relationships and partisan competition. Tax linkages have three main characteristics: their nature, their governance structure, and the dilemmas they create. Using these three characteristics I propose a new typology of fiscal politics during austerity.

First, the nature of tax linkages creates expectations depending on whether they are earmarked (like social contributions) or not (often time the case of income taxes). Earmarked taxes generate expectations on return on investment and thus constrain governments regarding spending cuts, making tax increases more likely. By contrast, if taxes are not earmarked, they generate uncertainty: voters resist tax increases and thus governments find it easier to cut spending.

Second, tax linkages are embedded in different governance structures which imply different distributions of power. They can be governed either centrally – tax revenues are gathered into one fund over which the Treasury has power – or they can be governed in a decentralized manner – for instance, trade unions have veto power over taxes paid in special funds.

Third, tax linkages create dilemmas in the long run. Increasing strong tax linkages like social contributions leads to high labour costs that undermine national competitiveness and produce unemployment. In this French scenario, the Left is trapped in a serious fiscal dilemma, exacerbated by issues of fairness: workers bear the brunt of taxation, while pensioners benefit from higher social expenditure. Conversely, governments can also be trapped in weak tax linkages. These constrain redistribution in times where fighting inequality is paramount to preclude the rise of populism. As a result, governments find new ways to redistribute income by resorting to tax credits (as in the UK).

The concept of tax linkages yields a new typology of austerity politics with at least two ideal types epitomized by Britain and France.

The British case

In Britain, OECD data suggests that between 1963 and 2015, levels of taxation hovered around 33% of GDP with a standard deviation of 1.65% of GDP. British revenues are structured in a way that suggests weak tax linkages. Income tax dominates heavily, representing 40% of revenue, indirect taxation of goods at 35%, and social contributions averaging 17% between 1965 and 2015. Additionally, the UK governance of tax linkages has been increasingly centralised in the Treasury. British tax linkages were strong after WWII, with National Insurance Contributions introduced in 1911, and these were supposed to be strengthened according to the Beveridge Report (1942).

However, in 1948, additional means-tested benefits were established and in the 1950s the Treasury cut contributions to the National Insurance Fund – thus replacing the actuarial logic of the system with pay-as-you-go. Since then, NIC and income tax have converged in terms of rates, while the Treasury took over the management of both in the 2000s. The reason for this centralization and marginalization of strong tax linkages is that the Treasury prefers to manage public expenditure flexibly by avoiding strong tax linkages. Additionally, since the late 1970s, a coalition of experts, business organisations, and academics is pushing for a merger of the National Insurance Contributions and income tax, further weakening the tax linkage. If this has not happened so far, it is mainly because the Treasury estimates that the administrative costs of such a complex reform outweigh its benefits.

Finally, the alternation of short majorities after 1945 resulted not only in weak but also inconsistent tax linkages that rendered the tax system incoherent, inflexible, and unstable, compounding its weak revenue-generating capacity. As a result, weak tax linkages governed by a strong Treasury implies that the Right has an advantage in cutting spending and keeping the tax burden constant as a proportion of GDP. Therefore, weak tax linkages advantage the Right, while the Left has an incentive to carry out “pre-emptive” strikes to appear credible and capture the median voter.

The French case

Contrast this with the French fiscal profile where the tax burden is among the three highest in the OECD (53% of GDP) and public spending tops the club (over 50% of GDP). French tax linkages are dominated by social security contributions (varying between 35 and 45% of tax revenues since 1963), with a small share of income tax (between 15 and 20% before the early 1990s and then between 20% and 25%). French tax linkages also rely on indirect taxation on consumption. In countries like France strong tax linkages that are co-governed with social partners means that the left has an advantage in protecting social spending and that the right will have a hard time cutting such spending unless it strikes a bargain with veto players.

Given that austerity happens in times of recession and high unemployment, this country responds with tax and spending increases. Again, this type of responsiveness may be prone to a self-reinforcing logic. But here, left-wing parties have a strategic advantage over right-wing parties: it is more difficult for the latter to cut spending and the right converges on the left in matters of austerity.

The dynamics of French tax linkages suggest that while contributory taxes increased substantially from 1978 to 1991, they negatively impacted French competitiveness and unemployment. This resulted in a three-decade-long battle on “social charges” between trade-unions, business organisations, and the government, which leads to the question of the governance of tax linkages: while income and indirect taxes are governed by the State, social contributions are co-governed with trade unions with the involvement of parliament since 1995. Although the State pilots social security finances, the governance architecture of the French welfare state means there is a different structure of political competition during austerity than in the UK.

This new taxonomy of austerity politics based on tax linkages offers a simple way to grasp the complex politics of fiscal adjustment over long periods of time, and offers important insights into how partisan competition is shaped by underlying tax linkages in hard times.

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Note: the above draws on the author’s published work in *Party Politics*.

About the Author

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