Tax Culture In The Context Of Development And Democratic Freedoms

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Abstract

This study, focusing on understanding the relationship between democracy and economic development over the concept of taxation, aims to analyze the effects of democratic freedoms on a set of economic variables such as economic development, corruption, equity of taxation and informal economic activities. From this point of view, first the concept of economic development has been defined. Then, we have tried to reveal how the relationship between tax and accountability, which restores parliamentary democracy in the West, affects the interaction between democracy and economic development. Analyses carried out taking into account the indicators such as taxation, shadow economy and corruption, showed that these variables are closely related with the concept of democracy and freedoms achieved by economic development. It was revealed that democratic freedoms were strong in countries with high level of economic development, but relatively weak in countries with low level of economic development.

Keywords: Development, Democratic Freedoms, Taxation, Shadow Economy, Corruption

Introduction

Achievement of sustainable economic growth constitutes one of the basic objectives of the concept of development, the scope of which has extended in the course of time. Achieving economic growth is of high importance for increasing the welfare of a society, i.e. providing more employment opportunities. One of the assumptions regarding how to achieve sustainable growth is that economic actors must make investments that will turn into production in the public and private sector. The primary purpose of the public sector is to finance the resources of investment with the taxes collected. However, if a state is incapable of sustaining an effective taxation system, it has to resort to borrowing to finance the investments. Preferring the borrowing option to finance the investments prevents economic growth from being sustainable.

Private sector is the locomotive of a growth that will ensure economic development. However, in order for the private sector to make investment spending, it must have confidence in the state and functioning of the markets, and must be assured that its capital is protected. However, if the state fails to give such confidence, the entrepreneurs in the private sector prefer not to make any investment or sustain their activities mostly underground. When most of the economic production in a country is run underground, state cannot impose direct taxes on the economic assets produced. Without the direct taxes failed to be collected on production, state has to collect taxes on consumption. Such indirect collection of public revenues is one of the primary reasons for unfair distribution of income in a society. Therefore, efficiency, capacity and form of taxation are of critical importance for ensuring correlation between economic development and social development within a country.

Ensuring transparency and reliability of the interaction between a government and its citizens in an effective market mechanism has been achieved through democratic judicial systems by which freedoms are protected. The first struggle for democracy in history started as a reaction to the arbitrary taxes imposed by the political power. Limiting the taxing power of the absolute power and creating the legal order for taxation is the first step toward the establishment of a constitutional democratic system (Öncel et al. 2002:7). The principle of democratic constitutional state provides legal assurance to the individuals against the state. Tax laws in the constitutional states put the government under obligation not to violate fundamental rights and freedoms. Only in such a legal structure, will the state be able to ensure efficient and effective functioning of economic actors which are classified into two groups, entrepreneurs and households.

Seeking to reveal the relationship between the concepts of development, democracy and tax equity, this study is based on the assertion that greater democratic freedoms and tax equity and less shadow economy and corruption in the societies with high level of development is not a coincidence. Economic development and tax equity emerges out of the interaction of variables such as a management mechanism in which transparency and registration of production activities in the economy is ensured. Failure of certain economically developed countries in achieving social development objectives seems to be caused by the tax inequity and their inability of implementing democratic values. Therefore, tax equity plays an important role in the relationship between the economic concept of development and social concept of democracy.

The concept of economic development

The concepts of economic development and economic growth are sometimes used interchangeably. However, they have completely different meanings. In fact, economic growth is an important subcomponent of the concept of development. It means the increase in the amount of the goods and services produced in a country. Economic development, on the other hand, aims to increase the quality of social, cultural and political lives of the individuals, as well as achieving economic growth.

The term development was defined in the World Bank's World Development Report 1991 as "aiming to improve people's quality of life", which is one of the most comprehensive definitions of the term. The objective of improving people's quality of live includes many different variables such as higher income levels, better education opportunities, better health and nutrition conditions, less poverty, a cleaner environment, providing more equal opportunities, increasing individual freedoms and a richer cultural life. In this sense, the concept of development is a multidimensional process. Development also involves increasing the opportunities provided to the individuals and the society in the economic and social field. In this context, freedoms can be defined as the existence of various alternatives among which the individuals in a society can choose freely depending on their preferences. Sen (1996) indicates that political freedom in the form of democratic arrangements helps to safeguard economic freedom (especially freedom from extreme starvation) and the freedom to survive (against famine mortality). The instrumental roles of freedom include various interrelated components such as economic and political freedom opportunities, transparency and protective security applications. The process of development is crucially affected by these interconnections.

As specified in the study by Meier and Stiglitz (2000), the concepts trying to define underdevelopment only over low level of production were gradually replaced with structural analyses. Most of the structural analyses have focused on the effective functioning of the institutions. The institutions upon which economic activities are built are a set of formal and informal arrangements. In other words, the institutions are the rules of the game played in the society. The rules and institutions reduce the ambiguity of economic actors in the decision-making process. Corruption, bureaucracy, financial system, judicial system and property rights can be classified under the important variables involved in determining the corporate quality. An effective and fast judicial system, together with protection of property rights, is important in reducing the ambiguity faced by the economic actors. Many structural analyses focus on the effective functioning of institutions. Acemoğlu and Robinson (2012) indicate that the difference between the institutions in a country is the main reason for the differences in the levels of development between countries.

Economic Development And Democratic Freedom

When we examine the academic studies addressing the relationship between economic development and democracy, we can see that there are two different viewpoints. One of these viewpoints has been reflected in the studies by Ghali (2003) and Bardhan (2004) who suggest liberal democracy as a prerequisite for economic development. They argue that democracy must be approved as a prerequisite for economic development, since libertian values establish the institutional framework and process that guarantees property rights, i.e. the basic institution of economic improvement. The concepts such as freedom of expression and association, multipartyism and elections, the protection of human rights and separation of powers all become internalized within liberal democracy. Doğan (2005) also points out that democracies affect economic development positively, since they bring steady growth as well as investment and consumption opportunities in the short term, and they are less risky for the life. Besides, the presence of democracy makes countries to have more enduring and sound institutions against economic crises. It is also indicated that democracies affect economic growth positively, since democratically governed countries are much likely to be constitutional states and they have means to protect the property rights (Karakayalı and Yanıkkaya, 2005).

Weber argues that modern democracy can occur only in capitalist industrialization, since most of the countries which lack an enduring tradition of democracy lie in the underdeveloped sections of the world. This argument alleges that the wealthiest nations of the world are also the most democratic ones, which provides proof of the relationship between economic development and democracy (Weber: 2008). Similarly, Lipset also argues that, as the nations develop economically, societies develop skills and powers that will sustain liberal democratic governance (Lipset, 1959). Supporting these arguments, the study conducted by Adam Przeworski and Fernando Limongi in 1993 examined the experiences of all countries between 1950 and 1990, and found that the regime had a survival chance of about 8 years in democratic countries with per capita incomes under $1,500 USD. In democratic countries with per capita incomes of $1,500-3,000 USD, the expected life of the regime increased up to eighteen years. The probability that a democracy would die decreased down to 1/500 in countries with per capita incomes above $6,000 USD, and the expected life of the regime in countries with above $9,000 USD was found to be 736 years. Their study showed that 39 countries out of 69 with low levels of economic development failed to sustain democracy (Przeworski and Limongi, 1993; 1997; Zakaria, 2007).

The second approach addressing the relationship between economic development and democracy argues that democracy is not fundamental for ensuring economic development. Among the advocates of this approach is Chang (2003), who points out that even if economic development is achieved in the industrialized countries, the practices such as suffrage can only be realized in formal democracies very late, after lasting struggles. Chang also argues that, compared to modern-day industrialized countries in their early stages of development, the currently developing countries have much better record in terms of spread of formal democracy. In none of the modern-day industrialized countries, universal suffrage has been granted below the level of $2,000 USD per capita income. However, majority of the currently developing countries granted universal suffrage below that level of development. From this point of view, Chang suggests that democratization is not fundamental for economic development (Chang, 2003). Arguing also that democracy cannot be seen as a prerequisite for development, İnsel indicates that, in order to make economic development sustainable in a society, it is a must to ensure stability in the political data establishing the institutional framework which determines the economic activities. Existence of political stability in a society causes the entrepreneurs to predict the future, thus leading them to longer-term and more permanent economic activities, which indicates that political stability is a must for development. Thus, the positive nature of the relationship between democracy and development does not universally hold true, since democracy is not the only system of governance that ensures political stability (İnsel, 1991). Another study supporting the arguments of İnsel and Chang is the one conducted by Adejumobi. Adejumobi argues that the rate of economic development in a country is not necessarily determined by the nature of a political regime. According to his argument, what determines the economic development is not the nature of political governance, but the nature of the state. If the state is developmental, then it is a national state that prioritizes development. It is only possible through the construction of a strong bureaucracy for such a state to have relative autonomy, i.e. the capacity to manage and implement economic policies effectively. In countries with a strong bureaucracy, industrialization, and consequently the economic development speeds up (Adejumobi, 2000; Boschini 2005: 1).

The relationship between economic development, democracy and corruption

As specified previously in this study, we think that freedoms achieved by economic development are more accessible in democratic systems and they reduce the growth of shadow economy and corruption, thus ensuring effective functioning of the institutions. This study aims to reveal the relationship between development and democracy using the indices that measure the levels of development as well as perceptions of democracy and corruption. For this purpose, first, the data collected using the development index, democracy index and corruption index will be presented, and then the relationship between the data will be scrutinized.

The Human Development Index (HDI) is one of the most objective and widely used indices used in measuring the level of development and comparison of countries. The Human Development Index (HDI) has been published by the United Nations Development Program (UNDP) Human Development Report Office every year since 1990. Based on the values, the countries are classified into four groups as follows: low human development (0.0 to 0.499), medium human development (0.50 to 0.799), high human development (0.80 to 0.90) and very high human development (0.90 to 1.00).

The Democracy Index is an index prepared by the Economist Intelligence Unit to measure the state of democracy in 167 countries (166 of these countries are sovereign states, and 165 are UN member states). The index is based on 60 indicators grouped in five different categories measuring pluralism, civil liberties, and political culture. The index ranks regimes into four as follows: Authoritarian Regime (0 to 4), Hybrid Regime (4.01 to 6), Flawed Democracy (6.01 to 8) and Full Democracy (8.01 to 10).

Corruption Perceptions Index is an aggregate indicator that ranks countries in terms of the degree to which corruption is perceived to exist among public officials and politicians. The index score varies between 0 to 100. High numbers indicate less perception of corruption, whereas lower numbers indicate higher perception of corruption.

The process of development is crucially affected by various interrelated components such as economic and political freedom opportunities, transparency and protective security applications. Related to this, Table 1 shows the relationship between the development levels of countries, the democracy index and corruption. It is striking that countries with high levels of development both have improved democratic systems and low levels of perceived corruption. In addition to that, corruption index decreases with decreasing levels of democracy. When Table 1 is analyzed, a strong correlation between these two variables is revealed, strengthening the hypothesis that we proposed at the beginning. To put in clearly; the lower the democracy levels of countries, the higher the perceived levels of corruption in societies.

Table 1. The. Relationship Between Economic Development, Democracy and Corruption

	Democracy Index	Corruption Index	HDI (Ranking)
Norway	9.93	86	0.944 (1)
Sweden	9.73	87	0.898(12)
Iceland	9.58	79	0.895(13)
New Zealand	9.26	91	0.910(7)
Denmark	9.11	92	0.900(10)
Switzerland	9.09	86	0.917(3)
Canada	9.08	81	0.902(8)
Finland	9.03	89	0.879(24)
Australia	9.01	80	0.933(2)
Netherlands	8.92	83	0.915(4)
Luxemburg	8.88	82	0.881(21)
Ireland	8.72	74	0.899(11)
Germany	8.64	79	0.911(6)
Austria	8.54	72	0.881(21)
United Kingdom	8.31	78	0.892(14)
United States	8.11	74	0.914 (5)
Japan	8.08	76	0.890(17)
Korea	8.06	55	0.891(15)
Spain	8.05	60	0.869(27)
France	8.04	69	0.884(20)
Czech Republic	7.94	51	0.861(28)
Belgium	7.93	76	0.881(21)
Italy	7.85	43	0.872(26)
Chile	7.80	73	0.822(41)
Portugal	7.79	63	0.822(41)
Estonia	7.74	69	0.840(33)
Israel	7.63	60	0.888(19)
Slovenia	7.57	58	0.874(25)
Poland	7.47	61	0.834(35)
Greece	7.45	43	0.853(29)
Slovak Republic	7.35	50	0.830(37)
Hungary	6.90	54	0.818(43)
Mexico	6.68	35	0.756(71)
Turkey	5.12	45	0.759(69)

Source: Human Development Report (2014), Democracy Index (2014), Corruption Perception Index (2014)

Theoretically, many studies indicate that liberal democracy provides the basis for economic development. The libertarian values such as freedom of speech and association, multi-partyism, protection of human rights and separation of powers establish the institutional context and process for economic development to take place. From this perspective, democracy facilitates economic empowerment, provides a stable investment climate and speeds up the mobilization of national energies and resources for economic development/growth (Adejumobi, 2000). Studying the relationship between democratic systems of governance and long-term economic performance, Persson concludes that democratic systems of governance contributes significantly but at varying levels to the construction of a social infrastructure which encourages long-term economic performance (Persson, 2004: 4).

The Democracy Index rates countries on a 0 to 10 scale, while the Development Index rates them on a 0 to 1 scale. Chart 1 clearly shows the positive correlation between them.

Chart 1. The relationship between the Democracy Index and HDI ratings of the OECD Countries

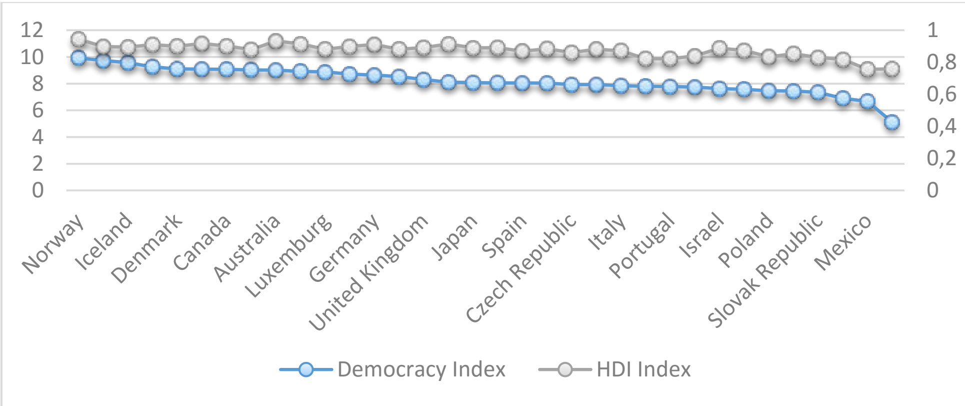
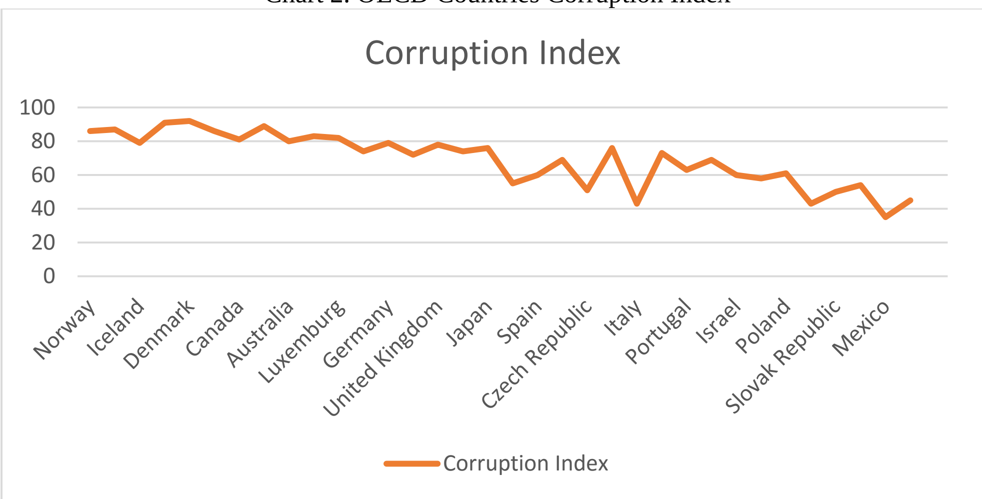


Chart 2, which ranks the OECD countries along the x-axis from the one with the highest level of democracy (Norway) to the one with the lowest level of democracy (Turkey), shows that the level of perceived corruption decreases with increasing level of democracy. As specified previously, decreased index value indicates increased level of perceived corruption.

Chart 2. OECD Countries Corruption Index



Effective functioning of regulations, institutions and the judicial system in a country is important for achieving success in the process of democracy. In that, if a state does not provide services to its citizen through transparent, auditable and effectively run institutions, then the citizens may prefer conducting their business underground. Citizens do not want to give an account of their action to a state which is unable to call them to account within the framework of a judicial system. In that case, corruption, favoritism, lobbying and underground activities become widespread, starting from the level of individual to the level of whole society. As can be seen in the chart above, this situation can be represented with the very high correlation between democracy and corruption

Shadow economy emerges as a natural consequence of high rates of corruption in the economies where democracy is weak. In order to make the democracy culture widespread and to ensure effective functioning of the institutions, government revenues should mostly consist of the tax revenues collected on the manufacturing sectors. In return for the tax revenues collected from its citizens, the government is obliged to provide them with a set of social benefits such as effective services, accountability, good governance and right of democratic representation. The fact that taxpayers are spread to community at large and the share of taxes they pay in the total public revenues is high is an important driving force for making the state transparent and accountable (Polat,2010).

In Turkey, the large share of shadow economy is one of the major problems of the public revenues. Only a small portion of the population pays income taxes, making up only 4% of the working age population. Tax evasion becomes more obvious when Value Added Tax (VAT) is considered. In the year 2005 when the standard VAT rate was 18%, the effective VAT rate was 9.6%. The relatively large difference (47%) between such high official tax rates and the amount of taxes collected points at an important tax evasion problem with VAT. Unreported workers are another source of evasion which led to a loss of 1.3% of GDP in 2008 from unpaid social security premiums (Goldblatt, Lee, Sahin, Sieber: 2012). Moreover, the share of informal sector in GDP is 16% in the developed countries and 37% in the developing countries. Besides, the share of informal sector in labor force is also higher in the underdeveloped or developing countries than the developed ones, just like the informal production. The share of informal sector in labor force is 25% in the developed countries and 48% in the developing countries (IFC, 2013). In this sense, weak democracy and corruption appear to be significant barriers to economic development.

Table 2. Alternative Measures of Informal Employment and Undeclared Work

	Employees in informal jobs % of non-farm employment	Own account workers % of non-farm employment	Unpaid family workers % of non-farm employment	Undeclared Income % of workforce
Hungary	19.4	6.4	0.3	8.6
Korea	25.8	17.1	4.7	7.0
Mexico	31.5	20.6	5.1	30.9
Turkey	21.7	16.6	3.3	24.6

Source: OECD (2008)

Table 2 shows that among the OECD countries with high rates of informal economic activities, Turkey ranks after Mexico in terms of informal employment. The rates are extremely high when compared to the other OECD countries.

We can sum up the damage caused by informal economic activities to the economy as follows: informal economic activities outside the formal sector imply lost tax revenue, limit the ability of the government to provide services, undermine the “fiscal social contract” between the state, business, and citizen, undermine democracy and the emergence of effective states, and limit a country’s capacity to grow. Informal firms are typically smaller and less productive compared to small formal firms, large formal firms, and formal firms which are generally run by better educated managers who are able use opportunities like advertisement and access to finance. The informal sector employs a labor force usually of low quality compared to the formal sector jobs. Informal jobs tend to be lower in quality, often paying lower wages and lacking labor safeguards. Informal workers generally receive no overtime compensation or benefits such as health insurance or retirement savings. The reason is that informal employers are not bound by labor and other standards to protect workers. Formal firms tend to provide safer working conditions than informal firms.

Economic development and tax

In order for a liberal democracy to continue its existence in a mutual relationship of rights and duties based on taxation and representation between the government and citizens, a social structure with a wealth acquired by production is needed. On the other hand, development of modern political institutions, laws and bureaucracies has always been impossible in societies having wealth not acquired by production, as easy access to money (especially countries with natural resources such as oil and mineral resources) means that a government does not need to tax its citizens. When a government taxes people it has to provide benefits in return, beginning with services, accountability, and good governance but ending with liberty and representation. This reciprocal bargain—between taxation and representation—is what gives governments legitimacy in the modern world (Zakaria, 2007, p. 74-78; Polat, 2010: 26).

We can take the Middle East countries as an example. When we look at the oil rich countries in the Middle East, we can see that wealth not earned by production is one of the biggest impediments to economic and political modernization. A government that does not have to tax its citizens is unable to develop systems such as accountability, transparency and representation. Government with a wealth acquired by natural resources does not expect anything from its citizens, nor does it provide any service to them in return. It is obvious in oil rich countries of the Middle East that economic development or enrichment does not necessarily lead to the emergence of a liberal democratic system.

Therefore, a government's capacity to effectively execute its functions increases when the added value in an economy is registered by means of taxation, because effective taxation is a must for a government to finance the public services. In their study, Ay and Talaşlı (2008) points out how social development is affected by the tax structure (i.e. direct taxes or indirect taxes) and economic development. Indirect taxes are those that are easy to be shifted. Their payers are unknown. Payment time and amount of such taxes cannot be estimated. On the other hand, it is less likely to evade these taxes. Value added tax (VAT), special consumption tax (SCT), customs duties, banking and insurance transactions tax (BITT) are all among the indirect taxes. Direct taxes are those that are not easy to be shifted. Payment time and amount of such taxes are previously determined and evasion of these taxes is possible. Among these taxes are income and corporate taxes, property tax and motor vehicles tax. In general, direct taxes are considered to be fairer than the indirect taxes. Whatever the development levels of countries are, the tax system cannot be said to be modern and fair in countries where indirect taxes occupy much more place in the tax structure. Success of a tax system cannot be measured only by high rates of taxes that are sufficient to finance public expenditures. Success of a tax system should be analyzed taking into consideration its capacity to affect investment and savings in the positive direction; whether it has a destructive effect on resource allocation in an economy; its corrective effect on income distribution, and most importantly, whether it affects economic development positively (Ağbal, 2001). Limiting the taxing power of the absolute power and creating the legal order for taxation is the first step toward the establishment of a constitutional democratic system. An effective tax system must help achieving fundamental economic and social objectives such as efficiency in resource allocation, fair distribution of income and wealth and economic stability and growth. Thus, a good tax system should first provide the resources sufficient to cover the compulsory public expenditures.

Table 3 showing the tax distribution in OECD countries reveals that Consumption Taxes account for 44.3% of Total Taxation in Turkey, which is much higher than the OECD average of 30.7%. Besides, Taxes on Specific Goods account for 22% of total taxation which is again much higher than the OECD average of 10.5%.

Table 3. Distribution of Taxes in OECD Countries, 2013

Countries	Consumption Taxes %Total Taxation (2013)	Taxes on Property% Total Taxation (2013)	Social Security Contributions % of Total Taxation (2013)	Taxes on Specific Goods and Services % Total Taxation (2013)
Norway	25.9	3.0	23.5	6.9
Sweden	27.5	2.5	23.3	6.4
Iceland	31.8	6.9	10.3	9.7
New Zealand	35.9	6.1	0.0	5.8
Denmark	29.7	3.9	0.2	9.6
Switzerland	19.5	6.7	25.1	6.4
Canada	22.5	10.4	15.8	8.3
Finland	32.1	2.9	28.9	10.8
Australia	23.8	9.4	0.0	10.8
Netherlands	26.4	3.4	40.8	8.6
Luxemburg	28	7.3	28.8	8.7
Ireland	30.6	7.1	17.8	10.2
Germany	26.9	2.5	38.1	7.8
Austria	25.8	1.7	34.3	7.6
United Kingdom	31.7	12.3	18.8	10.7
United States	14.6	11.3	24.2	6.8
Japan	15.9	8.8	40.9	6.7
Korea	28.8	10.3	26.4	11.8
Spain	26.4	6.7	34.5	8.6
France	23.4	8.4	37.2	7.7
Czech Republic	32.5	1.4	43.2	10.7
Belgium	22.8	7.8	31.7	7.2
Italy	23	6.2	29.8	9.7
Chile	50.7	4.1	7.2	9.9
Portugal	35.2	3.3	25.9	11.7
Estonia	39.9	1.0	34.8	13.8
Israel	36.3	8.8	16.6	5.9
Slovenia	37.5	1.7	40.1	14.6
Poland	35.1	4.4	38.6	13.1
Greece	34.7	7.6	31.1	12.7
Slovak Republic	31.6	1.5	43.8	10.6
Hungary	42.9	3.4	32.6	13.1
Mexico	49.2	1.5	15.5	31.6
Turkey	44.3	4.6	27.4	22.4
OECD unweighted average	30.7	5.6	26.1	10.5

Source: OECD Revenue Statistics, 2014

Both Table 3 and Table 4 show that the high share of indirect taxes in the tax revenues is one of the biggest problems that negatively affect the fair distribution of income in Turkey. Because, tax revenues that could not be directly collected from income and activities as well as the taxes levied on consumption without distinction of the rich and poor show that there is no transparent interaction between the government and taxpayers, and the share of informal activities in the economy is high.

Table 4 Indirect Tax and Informal Economic Activities Paradox.

Countries	Direct Tax (%)	Indirect Tax (%)	Informal Activities (%)
United States	76.3	23.7	8.6
Germany	50.7	48.9	16.8
Austria	55.2	44.1	13.8
Belgium	62.2	36.1	21.5
Denmark	65.6	34.2	17.5
France	53.7	46	14.8
Holland	50.3	48.5	12.8
England	60	39.4	12.3
Spain	55.2	44.2	22.3
Sweden	61.6	38	18.7
Switzerland	69.6	30.4	9.5
Canada	68.4	31.6	15.4
Norway	59.4	40.6	18.7
Turkey	34.4	65.6	30-60

Source: Ay,H.M., Talaşlı,,E. Ülkelerin Ekonomik Gelişmişlik Seviyeleri ve Vergi Yapıları Arasındaki İlişki [The Relationship between Economic Development Levels of Countries and Tax Structures], *Maliye Dergisi, Volume 154, 2008*

Although the gross national income per capita increases in some countries, their neither human development level nor democratic freedoms increase as much as the other countries with similar index values in the West. The most important reason for such countries to fall behind in terms of human development and democratic freedoms despite the increasing economic growth is the unfair distribution of income. The government comes into play in cases of income equality, and by means of collecting taxes, takes some steps that will support the low income groups. Trying to achieve the welfare equality among different social classes to a certain extent by means of social transfer expenditures. The government resorts to increasing taxes to carry out this mission. Unable to finance the public expenditures through taxes collected from registered economic activities, the government tries to increase its revenues through indirect taxes. The correlation between the indirect taxes and informal economic activities shown in Table 4 confirms this relationship. However, as specified previously, informal production is inefficient for the economy, as it cannot be controlled. Since many companies that cannot be engaged in any production activities if they effectively pay their taxes still run their business underground, they can produce products with low costs, but force other uncorrupt companies to unfair competition. This causes a problems called "moral hazard" in the literature.

As analyzed by Işık (2009) in detail, there is a significant correlation between the democracy culture and tax moral. The studies show that direct democracy has a significant impact on tax moral in Sweden. It was detected that democracy and attitudes of the taxpayers have a positive impact on tax moral not only in Sweden, but also in Belgium and Spain. Constitutional confidence (confidence in legal system) and the existing political-economic confidence are important for a society that pays its taxes. Therefore, for the governments and tax administrations, running a strategy aiming to build confidence in themselves and their competencies may result in higher tax moral (Nerre, 2001).

Conclusion

Establishment of a regular tax system that can finance the public services is one of the conditions required for a democratic regime to function properly (Çağan, 1980). Taxation is of critical importance not only for economic relations of production to be grounded in a sound and legal framework, but also for the functionality of the democratic political system. Nowadays, most of the developed Western democracies are derived from the relationship between taxation and representation. An individual paying his/her taxes to the government develops an ability to question the quality of public services provided to him/her in return. In the Western type parliamentary democracies, this led to the emergence of state-citizen relationship based on the mutual rights and responsibilities of the state and citizens. Individuals should be able to foresee the government interventions to the rights and freedoms through taxation, and should make their future plans accordingly. In this way, arbitrary taxation can be prevented to a considerable extent. Therefore, a sound taxation system also indicates a sound legal order in that country. Constitutional state is a must for effective taxation. Lack the confidence in the state and legal order increases corruption and informal activities. Increase in the informal activities affects the total tax revenue to be collected by the government negatively, thus causing the government either to be involved in making investment through borrowing, or not to be involved in investments at all. The high share of informal economic activities in the total production also affects the ability to run effective and productive business activities adversely. The manufacturers reluctant to pay their taxes to the government prefer manufacturing with low labor costs, as they are not subject to any governmental supervision. This prevents the welfare and wealth from extending to the poorer parts of the society, i.e. the fair distribution of income. Poor quality products produced with low costs and unskilled labor must be cheap, which creates a cycle of low-cost production. Entering into competition with low-priced products at the international markets is one of the biggest impediments to the economic growth of a country.

For a political system with democratic freedoms, it is important to consider how economic development is distributed among the individuals. If economic development is achieved through effective taxation on production, then the size of the shadow economy will be reduced, leading to a fairer distribution of income. Integration of taxation into a system that takes into account the income distribution is closely related with the principle of a constitutional state and can only be achieved with a strong legal arrangement. Countries with a strong legal structure have low level of perceived corruption, just like the low size of shadow economy. In countries where income distribution is relatively fair and taxes are imposed on income, the citizens have confidence in the government for the economic and political matters, which leads to increased tax moral and awareness of citizenship. In countries where such an environment is created, the relations between the citizens and the government are based on mutual rights and duties. Therefore, the representation system which is the most widely used mechanism for the functioning of democratic regimes is mainly based on the rights and duties.

We conclude that the relationship between democracy and development is defined by the nature of the instruments that bring forth economic development. In this respect, existence and continuity of a democratic regime depends on economic development; however, the development must be based on effective taxation and a strong legal order required by such a tax structure.

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