

Fiscal Sociology: What For?

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Prof. Dr. Jürgen G. Backhaus

Fiscal Sociology: What For?

Abstract

In discussing the question: fiscal sociology: what for, I shall first give a short sketch of the history of thought of the field. Secondly, main issues will be identified. First in discussing the concept of the tax state, we emphasize issues in constitutional public finance. Secondly, one of the fields in which fiscal sociology has been most important is the issue of taxation, and notably income taxation. Thirdly, in citing applications and issues, an entire alphabet of fiscal sociological issues is being identified. The third paragraph deals with the future of the field in both instruction and research.

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Joseph Alois Schumpeter

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Woord vooraf

Toen ik op 1 juni 1986 mijn werkzaamheden als Hoogleraar Economie van het Overheidsgedrag en de Publieke Sector aan de Universiteit Maastricht begon¹, deed ik mijn best om de inhoud van mijn leeropdracht in begrijpelijk Nederlands uiteen te zetten. Het vak moest worden ingepast in een matrix van overlappende onderwijsactiviteiten, en het onderwijs gebeurde toen nog helemaal in het Nederlands. In de tussentijd is hier een grote verandering in gekomen. De internationalisering van de Universiteit Maastricht heeft ertoe geleid dat zeker in de economische faculteit Engels de voertaal in het onderwijs is geworden. In de algemene economie is het traditionele onderwijs vervangen door International Economic Studies en Fiscale Economie, en ik beschouw dit als een prachtige ontwikkeling. Het gevolg is wel dat ik geloof mijn toehoorders beter te bereiken door de kern van mijn betoog in het Engels uiteen te zetten.

Fiscal sociology: what for?

Introduction

In discussing the question: fiscal sociology: what for, I shall first give a short sketch of the history of thought of the field. Secondly, main issues will be identified. First, in discussing the concept of the tax state, we emphasize issues in constitutional public finance. Secondly, one of the fields in which fiscal sociology has been most important is the issue of taxation, and notably income taxation. Thirdly, in citing applications and issues, an entire alphabet of fiscal sociological issues is being identified. The third paragraph deals with the future of the field in both instruction and research.

¹ De benoeming volgde per 1 september 1986; de oratie getiteld "De financiering van de welvaartstaat: een dogmenhistorische beschouwing" werd uitgesproken op vrijdag 10 november 1989.

I. A short history of fiscal sociology

Fiscal sociology as a separate field makes sense only once economics and sociology have parted ways, leaving a void in between. Originally, when economics started as a separate field of instruction and research on the European continent, there was no need for a specialty in fiscal sociology. In repeating a perhaps familiar story, economics in an institutional sense started on the European continent when King Frederick William of Prussia, being dissatisfied with the state of the instruction of his future civil servants, founded two chairs in cameral sciences at the universities of Halle (Saale) and Frankfurt (Oder) in 1723. Cameral sciences meant, in essence, public finance. Hence, on the European continent, economics as a separate discipline started with public finance as the core subject area, since the purpose of economic thinking and teaching was to develop institutions so as to foster the wealth and happiness (*Wohlstand und Glückseligkeit*) of the states and thereby the people living in the house of the state. Hence, the wealth of a nation was seen as the result of prudent state economic policy. It would take another 99 years before at Oxford the first chair in political economy was founded in Britain. Here, the question of the nature and causes of the wealth of nations (1786) had been posed rather differently by Adam Smith. He saw the causes as lying in the division of labour as a precondition for extensive trade; the state would be reduced to taxation and upholding the public order, but was not seen as an active participator in economic activity. These two views of economics prevail to this very day, and they are often seen in different positions taken with respect to economic policy undertaken by the European Union.

While on the European continent, ever-larger numbers of students had been trained in economics, the instruction in the field was late to come in Britain and the United States. In Britain, the introduction of the tripos by Alfred Marshall brought a very small number of students indeed. In the United States, it was notably the emerging activity of Washington-based agencies in matters of social policy which required a larger number of well-trained economists and statisticians, i.e. a development of the 20th century. When from 1723 onwards, economics was taught on the European continent, it

was done in the context of cameral and policy sciences and the law. Cameral sciences were essentially economics and public finance, all this embedded in a broad social policy approach with the state and its institutions as the main source of initiative. Next to this, the student would be instructed in public administration (*Policeywissenschaften*) and law, with a strong element of technology-related issues covered as well. These might have to do with mining, agriculture, forestry or manufacturing. This entire field of related areas was called *Staatswissenschaften*, and many universities therefore had their own faculties of *Staatswissenschaften*, binding these fields of what today is law, economics, public administration, political science, sociology and contemporary history and policy together. This organization of instruction and research explains why the literature in economics and public finance all through the 19th century has a strong multi-disciplinary and interdisciplinary character, certainly as seen from today's point of view. Even in the 20th century, this is still true for the work of such authors as Werner Sombart, Joseph Alois Schumpeter or Max Weber who, while pioneering in sociology, did not consider themselves primarily sociologists. They all embody the fusion of economics and sociology: in Sombart's case, with economic history in addition, in Schumpeter's case with his strong push for economic analysis and econometrics and in Weber's case with the additional integration of law, his original field of expertise. However, with the pioneering work of Emile Durkheim, Vilfredo Pareto, Georg Simmel and Ferdinand Tönnies, the separate field of sociology had emerged.²

² The *Deutsche Gesellschaft für Soziologie* was founded in 1909 as an expression of specific research questions and paradigms not generally pursued by economists. For instance, Durkheim and later Franz Oppenheimer explored the connections between economic conditions and people's health states; Durkheim's were the pioneering studies on suicide. Pareto, having completed the *Manual of Political Economy*, saw a need to push beyond economics proper and constructed a generalized social system in his treatise translated as "The Mind and Society" by Livingston. Simmel presented in Schmoller's seminar a socio-philosophical study of money, exploring all those aspects of money that are not economic. See also: Backhaus and Stadermann (2000a) and (2000b). Sombart was interested in the conditions which led to the development of modern capitalism and in his historical studies had to go beyond economic causes, emphasizing social,

These separate developments in sociology had the effect that the two disciplines, economics on the one hand and sociology on the other, parted ways. With the rapid development of the social sciences in the 20th century, economics including public finance, business economics, public administration, sociology, political science and policy science all came to exist side-by-side with separate research programs, and the links between all of them on the one hand and law on the other became more and more severed.³

The differentiation of separate disciplines within what formerly had been *Staatswissenschaften* left lacunae or gaps in between. While methodological eclecticism had reigned within the *Staatswissenschaften* with very few exceptions⁴, now the different disciplines within the social sciences also differentiated themselves by the methods used and, from a methodological point of view, became more homogeneous internally, but heterogeneous in distinguishing one from the other. The logical consequence was a formation of clusters linking subjects with the appropriate methods. While some subjects remain amenable to an analysis by different methods, others became neglected. As we compare, for instance, the tables of contents of two Chicago-based journals, the Journal of Political Economy and the American Journal of Sociology, we notice that many topics recur in both publications, such as issues relating to the family, issues relating to behaviour in the workplace or issues relating to the organization of firms and enterprises. Remarkably different are, of course, the questions asked and the methods of analysis used, although both journals emphasize empirical work. On the other hand, the large

political and legal preconditions for the development of capitalist institutions. Tönnies emphasized community and society, while Weber left us the gigantic attempt at *Economy and Society*.

³ The last instance of a close cooperation between economists and lawyers may have been the critique at the first draft of the German civil code mounted by Schmoller and Gierke, which had led to the second draft that was signed into law in 1896 and became effective - to this very day - from 1900 on. See also Backhaus (1999a) and (1999b).

⁴ One of them may have been the early attempt by Christian Wolff, who tried to put the entire system within his edifice of natural law. See Backhaus (1998a).

comprehensive studies leading to ambitious projects of legislation, which characterized the activities of leading social scientists towards the end of the 19th and the beginning of the 20th century by the end of 20th century, have become de-emphasized. The reason is easy to see. Such large legislative enterprises as the launching of a welfare state, the codification of the civil code, a commercial code or the formation of a system of public law or variously the construction of a workable comprehensive national system of health care all require carefully combined eclectic methods synchronized with respect to the questions asked, the empirical data generated and used, and the policy advice generated so as to be fit for legislation and implementation.

That the differentiation in the social sciences had led to a gap which needed to be filled with a fresh approach became clear towards the end of World War I, when the system of war finance had not only destroyed the state institutions of the allied powers of Germany and Austria to the core; next to the immense human and material losses, the defeated states could not continue their operation after the war in the way they had done before. This was first pointed out by Rudolf Goldscheid, who is also the father of the term fiscal sociology (*Finanzsoziologie*) and therefore one of the first classical authors in the field. His contribution has to be seen next to that of Joseph Schumpeter, since Schumpeter in his classic piece "The Crisis of the Tax State" responded to Goldscheid's analysis and thereby contributed the second classical piece to the field. To this debate, we should now turn.

II. Main issues

II a. The debate on the crisis of the tax state

The roots of contractarian or constitutional reasoning are to be found in the tradition of liberalism. The doctrines of liberalism, insofar quite different from the present Leviathan approaches centred around two related sets of civil rights for which constitutional guarantees were sought as a means of protection against the discretion of the king or sovereign: this is because as

far as the absolute ruler is concerned, property and the domain of individual liberties are substitutes; in principle, for each infringement on individual liberties imposed by a ruler to further some of his interests, there is a functional tax equivalent with which these interests can be equally served, and *vice versa*. This broader view is also taken into account by Goldscheid, who accordingly advanced an evolutionary theory of the state where, in the beginning, the state as personified by the prince could seek either revenues or services in kind.

Goldscheid's theory systematically relies on this dualism, upon which a second dichotomy is constructed. There are two classes of citizens in the population, the owners of labour and the owners of capital. While the state is able to tax the former and, beyond the point of optimal tax extraction, demand services in kind, capital, which is more flexible and powerful in his model, is only borrowed, and the state incurs the public debt. Where the first group actually contributes to the state's expenses through taxes or (mostly military) services, the second receives a claim in return, a claim which has to be satisfied later out of the general tax revenue or by services in kind.

These services, in particular the draft, play a crucial role in Goldscheid's politico-economic analysis, which is also designed to explain the extraordinary length of duration of World War I. Both Goldscheid⁵ and Schumpeter⁶ agreed that some state activities, such as the war, could never have been carried out had the enormous cost immediately and visibly been shifted to an identifiable public through expropriative taxes. While Schumpeter, however, argued more technically in terms of the maximum exhaustibility of the tax base, Goldscheid put forward his interest group perspective, where the creditors to the public (capital owners) had no interest to end the war, never expecting to be required to foot the bill, rather receiving reliable promises to be repaid.

⁵ Goldscheid (1919).

⁶ Schumpeter (1954, 1976).

In either case, the war debt contributed to **fiscal illusion** in that it covered up the destruction of real resources and property and so helped carry out policies which, had their true costs been obvious to the citizens, would never have been accepted. When honouring the war debt, in Goldscheid's model, the labour class would end up with the entire bill as the creditors to the public demanded their interest and repayment out of the national dividend.

It is here where Goldscheid's peculiar approach to the notion of human capital (*Menschenökonomie*) becomes relevant. Whereas the contributions of the labour class to the expenses of the state represent real goods and services, either taxes which represent part of the national product, services in kind or other infringements on individual liberty, the capital class contributes only credits, which are to be repaid. Thus, even when real capital, human and material, is used up or destroyed, only the owners of material capital continue to present claims. These claims constitute political leverage, which, still according to Goldscheid, the creditors use to have the state governed in their own interest.

Whereas this model was obviously constructed under the impression of politico-economic interaction during the First World War in Austria and Germany, Goldscheid's proposal for fiscal reform was based more broadly on his unorthodox interpretation of the fiscal history of the state, from the middle Ages to his days. This story begins with a strong state, independent and relatively rich, relying on large property holdings. Only after the Thirty Years' War, however, the rising demands of the budget exercised by war finance and the desolation of the country give rise to a new approach to economic policy: cameralism, where the state, gradually transforming itself into the tax state, follows policies of economic development in order to strengthen the tax base, notwithstanding engagement in traditional and new forms of public entrepreneurship; both types of policies aiming at long run revenue maximization. This dual policy is constrained by the two relationships governing fiscal technology as discussed above: first, the Cameralist relationship as the interdependence between public spending and the productivity of the tax base; and second the experience of rising

marginal costs of tax extraction, which leads to the definition of a point of optimal extraction (Laffer curve).

The issue of defining a tax constitution has re-emerged on the political agenda with the European Union beginning to take shape and with elements of an emerging European constitution becoming visible. These tasks, which we face today, cannot be solved in a technical manner based on simple models. The fiscal constitution of the European Union will have to meet on the one hand the classical criteria developed in political doctrine, it has, on the other hand, to be in line with the requirements of a modern global economy, and thirdly it has to, not only accommodate member states with very different constitutions, economic and political systems, including different systems of taxation and political decision-making, but also different histories, cultures and socio-political visions. In order to meet this challenge, the different disciplines of public finance, law, public administration, political science and sociology will have to join forces as they had in the tradition of *Staatswissenschaften*. In order for such a joint venture to be successful, integrative paradigms such as those of the tax state may very well be useful in the future as they have been in the past.

II b. Income taxation

At a conference of the international Schumpeter Society in Kyoto (Japan)⁷, Richard A. Musgrave, a student of Schumpeter's surprised his audience by insisting that Schumpeter's contribution to public finance had been minimal. He only emphasized, and actually overemphasized the distortions caused by income taxation. In fact, Schumpeter's name rarely appears in current textbooks on public finance.⁸ Indeed, Schumpeter's extensive



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⁷ Shionoya and Perlman (1994).

⁸ The only exception seems to be Richard E. Wagner's public finance textbook.

contributions to public finance⁹ tend to be collected in his sociological or political writings.¹⁰

In this sense, Musgrave is perhaps correct that most of these writings do not fit within his three-winged cathedral of public finance dealing with allocation, distribution, and stabilization. Schumpeter stood firmly in the continental European tradition of public finance, from Puviani with his emphasis on fiscal illusions to Wicksell¹¹ with his emphasis on taxation and political decision-making and Da Empoli's¹² emphasis on the multiple economic and social distortions caused by all manner of taxation. In this sense, Schumpeter never severed the ties between public finance and the

⁹ He taught public finance at the University of Bonn from 1925 to 1932 and contributed fiscal analyses extensively to Wolfgang Stolper's "Der deutsche Volkswirt".

¹⁰ Schumpeter, Joseph A. (1928), Das deutsche Finanzproblem, Berlin: Der deutsche Volkswirt

Schumpeter, Joseph A. (1939), Business Cycles, New York: McGraw Hill, 1964

Schumpeter, Joseph A. (1943), Capitalism, Socialism and Democracy, London: Unwin

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Schumpeter, Joseph A. (1965), Ten Great Economists: From Marx to Keynes, New York: Oxford University Press

Schumpeter, Joseph A. (1967), Economic Doctrine and Method, New York: Oxford University Press

Schumpeter, Joseph A. (1970), Das Wesen des Geldes, Göttingen: Vandenhoeck & Ruprecht

Schumpeter, Joseph A. (1985), Aufsätze zur Wirtschaftspolitik, Chr. Seidl and W.F. Stolper (eds.), Tübingen: Mohr Siebeck

Schumpeter, Joseph A. (1992), Politische Reden, with comments by Chr. Seidl and W.F. Stolper (eds.), Tübingen: Mohr Siebeck

Schumpeter, Joseph A. (1993), Aufsätze zur Tagespolitik, with comments by Chr. Seidl and W.F. Stolper (eds.), Tübingen: Mohr Siebeck

Schumpeter, Joseph A. (2000), Briefe/Letters, U. Hetke and R. Swedberg (eds.), Tübingen: Mohr Siebeck

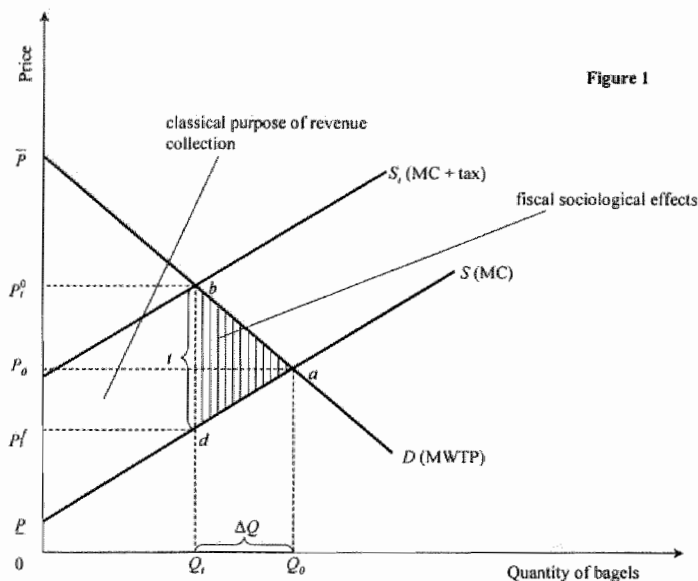
¹¹ Wicksell (1896).

¹² Da Empoli (1931).

neighbouring disciplines and can therefore be properly claimed as one of the fathers of fiscal sociology. Indeed, Musgrave's hint may service to offer a simple explanation of what fiscal sociology is about.

II c. Applications and issues

In the simplest of cases, consider a product (bagels) and an excise tax levy on this product.



The excise tax increases the demand price, it decreases the supply price and the equilibrium quantity decreases from Q_0 to Q_1 . The excess burden is the shaded triangle bad , which is equal to the excess burden of the marginal willingness to pay (for bagels) over the marginal costs (of bagels) for those bagels not produced and consumed because of the tax. Here, the textbook treatment ends. Yet the questions remain: What did the people eat who did not eat those bagels that have not been produced and consumed? What did

the baker do while not producing the bagels? What, in fact, did consumers and bakers hatch as new ideas so as to be able to avoid the tax? Shall we see new products on the markets to which the tax does not apply? Can we discern new forms of distribution to which the tax would not apply? Under what circumstances can those forms of tax avoidance arise? Where do they thrive and what further consequences do they entail? All these questions can not be asked within the traditional concept of tax burden analysis, but all these questions are indeed those we are interested in when thinking about levying, increasing or decreasing a particular tax.

This standard example of excess burden analysis in the partial and static form just presented falls far short of what Schumpeter tried to attempt in the seventh chapter of his "Theory of Economic Development", which is not contained in the English translation nor in the subsequent editions of the German text.¹³ Building on the distinction between static and dynamic analysis, partial and total (in the sense of comprehensive) modelling and introducing entrepreneurial change (defined as new compositions) which affects technology (i.e. the production function) and through this all the other factors involved, Schumpeter tries to describe (verbally) the enormous complexity that would face the economic modeller in the Lausanne tradition. For good reason, he did not try to write such models, but rather tried to use his considerable rhetorical talent to argue a case for a complex analysis, where, indeed, the argument is always on two levels, a simple and a complex one within the same language structure. Even today, with computer-supported modelling strategies we have not been able to come up with credible alternatives to Schumpeter's flowering language on various levels, akin to the suspended gardens of Semiramis. Both instruction and research in fiscal sociology will have to take heed from Schumpeter's attempt, both where he succeeded and where he obviously failed. Before addressing such strategies of instruction and research, however, let us turn to a subjective list of issues interesting in the field of fiscal sociology, and let us try to exhaust the Western alphabet.

¹³ Both the original and the translation can be found at our website: www.uni-erfurt.de. Forthcoming in Backhaus (2001).

II d. An alphabet of fiscal sociology

A The existence of alternatives or different opportunities to choose from is at the heart of the possibility of doing economics as a science.¹⁴ Only if there are alternatives to choose from can there be any reaction to an action of the government facing a taxpayer. From the point of view of public policy, the difficulty consists in a central authority's inability to know the full extent of the choices from which a citizen can choose who is intent on minimizing the impact of a governmental action on his own income or wealth. This knowledge about the alternative ways of avoiding harm, such as the burden of taxation (including both the tax itself and the excess burden) is available only in the decentralized form of knowledge and households, firms and other economic entities. It cannot be systematically collected by any central authority.¹⁵ It is for this reason that knowledge about the excess burden will be systematically underestimated by any conceivable attempt at measurement.

B The burden of taxation can be properly identified as the focus of research in fiscal sociology. The difficulty with this subject consists in its elusiveness. As citizens try to minimize the impact of the burden of taxation (and regulation), they invent ever-new forms of legal avoidance. Once this interaction is properly understood, the anticipation of such avoidance behaviour can be the cornerstone of public policy itself. By explicitly including loopholes into tax codes and regulations, citizens or firms can be made into agents of public policy.

C For instance by granting tax credits for certain favoured investments such as ecologically preferred technologies, a shift in technological development into a desired direction may be accomplished.¹⁶

D Depreciations, in particular accelerated depreciations can be used to a similar effect. Reginald Hansen¹⁷ has documented extensively how

¹⁴ Buchanan (1979).

¹⁵ Hayek (1945).

¹⁶ Backhaus (1998b).

¹⁷ Hansen (1966).

(through the exemptions introduced into the income tax code under section 7) German authorities were able to rebuild the stock of German housing after World War II, rebuild a commercial fleet and essentially rebuild Eastern Germany after reunification. Instead of enacting all these directly, use is made of the initiative of private individuals and their desire to reduce the burden of taxation. This approach has two redeeming consequences. On the one hand, the financial resources spent on, for instance, rebuilding the historical core of a destroyed city according to municipal zoning guidelines do not have to be raised through taxation, hence there is no excess burden. Secondly, opportunities for realizing these preferred investments will be found by private entrepreneurs who can use knowledge that would not be available to a government authority either in the quality or to the extent as it is available privately. Although the method looks roundabout, it is more direct than a tax-financed government programme, which would be its alternative.

EThe elasticity of a particular activity, such as the demand for bagels in the illustration given above, determines the extent or size of the excess burden and, by implication, the realm of the fiscal sociological dimensions of a particular policy measure. Only if a particular activity, such as the demand for heating oil, is completely inelastic, will there be no excess burden, no opportunity to reduce or avoid the burden of the tax. Such cases of inelastic demand or supply functions are very rare indeed. And this implies, again, that the opportunities for avoiding the burden of taxation (or regulation) are manifold and hard to anticipate by a government agent.

FFiscal illusion is the extent to which the burden of a tax (or regulation) is underestimated by a citizenry or, conversely, the benefits of a particular government programme are overestimated. It is in the interest of a government to try to achieve fiscal illusion, and this is true both for democratic governments that are in need to win re-elections, as for non-democratic regimes that likewise need to maintain their grip on power.¹⁸ According to the canons of taxation, fiscal illusion should, of course, be avoided. However, given the incentives on the part of taxing and regulatory

¹⁸ Tullock (1987).

authorities, this rule is certainly not self-enforcing. If we do not make a special effort at discovering fiscal illusion, it will remain undetected and uncorrected, with the consequence of inefficiency in the public sector: too many projects that do not fit the demand of the citizenry, and too high a burden of taxation with the concomitant high excess burden, i.e. welfare loss. In this sense, research into fiscal illusion can be welfare enhancing in uncovering government caused inefficiencies.

Government bonds can be equivalent to taxation when the strict conditions of the Ricardian equivalence theorem holds. In that case, the anticipated future burden of taxation needed to service and redeem the bond will be factored into the decisions of current taxpayers who rationally perceive their wealth as being reduced by the future burden of taxation. However, these strict conditions only rarely hold.¹⁹ A conceivably extreme case may illustrate the point. Starting in the 80s of the last century, an extensive net of charitable foundations had been set up in Germany, many serving to finance scholarly work, even entire universities such as the University of Frankfurt (Main). These foundations had to hold their wealth in government bonds. As a consequence, after World War I these foundations had lost their wealth. Imperial government bonds could no longer be redeemed, including those issued during the war. The hyperinflation resorted to after the *coup d'état* completed the financial destruction of these foundations. In this case, the consequences, i.e. the harm done in terms of opportunities foregone for this charitable and scientific work that would otherwise have taken place through these foundations is extremely difficult to be accurately established. It can probably only be described, it may not be possible even to attempt a measurement. We thus realize that the limiting conditions of the Ricardian equivalence theorem point to a vast area of research for fiscal sociologists into the burden of government bond issue.²⁰

HHealth effects of taxation can be manifold and surprising. In an effort at harmonizing European excise taxes, Spain departed from its traditional

¹⁹ Backhaus, Holcombe and Zardkoohi (1987).

²⁰ Backhaus (1993).

tobacco monopoly which distributed tobacco products through licensed shops and introduced an excise tax along with a liberalization of tobacco sales. In particular the international producers of low-tar brands had pushed for this reform, which was also in line with European harmonization efforts. The surprising result, however, was the disappearance of the traditional local tobacco shops (*estancas*) and the appearance of contraband tobacco sales in bars and restaurants. Obviously, this resulted in heavy losses in public revenue; but it also resulted in an increase in the consumption of high-tar tobacco products, which have more adverse health effects than low-tar tobacco products. Without understanding the precise consequences, an established system of taxation (through monopolization) and containment of consumption had been displaced, with the resulting loss in public revenue and an increase in the consumption of the product for which a temperance policy had been envisaged.

Income in kind programmes can likewise have surprising consequences. The socialist Allende administration (1970-1973) in Chile had promised to deliver a litre of milk to every child. It started introducing price controls on dairy products, which, along with the heavy inflation that set in shortly after the administration had taken over, first led to a glut in meat and consequently to a disappearance of dairy products. The administration then bought milk powder in international markets, and distributed bags of milk powder to parents of children under the programme. Due to the enormous shortage of dairy products, these milk powder bags had a substantial resale value and helped the families suffering under the inflationary devaluation of their wage income to support this income through sales in the black market. The outcome, of course, was that the milk did not end up feeding the children targeted by the programme. Such a scenario is, perhaps, extreme, but it follows a strict economic logic and is clearly predictable. Whenever aid is granted in kind, one has to look at both the income and substitution effects.²¹

²¹ A classical paper is by Bruno S. Frey who showed that increases in development aid may increase weapons imports by the recipient countries. See Frey (1975).

Jointness of investment and returns is an important principle in ensuring that a particular economic activity is seen in its entirety and taxed accordingly. This principle is often violated when income is taxed according to the source principle without consideration of the expenses it affords. Schmoller had insisted that income be measured as that amount that can be consumed without reducing wealth. Hence, if a household consumes € 100,000 and its wealth had been € 10 million in period 1 and € 10 million in period 2, this consumption is the income that has to be taxed. However, if you disjoin consumption and expenditure behaviour from income and revenue behaviour, interesting effects can occur. The case has been documented of the owner of a landed estate who lived lavishly but never realized any income whatsoever. Hence, he never paid any income tax. In a suggestive way, this can work as follows. Imagine you own a resource which is valued at € 10 million. It should increase in value at some rate, and you can therefore increase your borrowing against the asset at the same rate, discounting for interest. If the asset, for instance, is attractive land that benefits from development of bordering tracts of land, the (speculative) increase in value will be much more than the normal market return on bonds, and you can borrow against this asset accordingly. This may again support this lavish lifestyle, while no income is generated, rather further and further debt, when the asset that increases in value serves as collateral. If you insist on defining income in terms of its source instead of what it allows in supporting your lifestyle, that is, if you insist in disjoining assets and returns, you will end up with the paradoxical result that the lavishly maintained lifestyle nevertheless is not subject to income taxation. Only by studying the reality of taxpayer response to particular rules of taxation can we establish a realistic picture of the impact of taxation on the behaviour of people and the economic effects of these dual causes.

Kiddy tax is a phenomenon which penalizes households having children under the tax code. It can take many forms.²² To start with, a woman having a child necessarily has to leave the workplace for a while, and it depends on the cultural environment how long this 'while' will actually

²² Backhaus (1991).

take. It may be three months, it may be three years, there are cultures where the process takes longer. This means, however, that the mother may lose not only her proficiency in her job, but also the regular salary increments going along with normal performance. She will thus start at where she stopped, and carry the entire loss forward over the expected duration of her labour experience. From the point of view of the employer, this cannot be otherwise, since the wage has to reflect marginal productivity. From the point of view of taxation, however, it is quite possible to compensate for this necessary effect of having children while being employed. This compensation will have to be the higher, the more the mother earns - an awkward result when equity in taxation is emphasized in terms of equalizing incomes and wealth. In addition, raising children brings about lots of additional expenses, which, if they are not deductible, in fact weigh in as a kiddy tax. Some recent programmes allow mothers to establish home offices.²³ Instead of granting subsidies to some mothers for such home offices, it would be more effective to grant tax deductions for home offices actually established. That would allow for mothers who see an opportunity to combine the work with childhood at home develop entrepreneurship and establish the proper working environment. It is difficult for a state agency to identify such able home working entrepreneurial mothers and tailoring a grant to the needs that actually exist.

L Liability for false returns. No market can work without the institution of liability in contract and wrongdoing (violating property rights). Yet in taxation, very little is there in the way of liability for false returns. Tax returns may be used for all manner of ends, not only assessing the tax code, but also different social policy objectives. After all, tax returns are a goldmine of information, and this information, if it is correct, can be effectively used in order to tailor government programmes to citizens' needs. However, if rules of taxation are not self-enforcing, the information will be totally misleading and it will not be useful for any ulterior

²³ Thüringer Ministerium für Wissenschaft, Forschung und Kunst, ThüringerLandeshaushalt, Kapitel 1524 Titelgruppe 84: Förderung von Frauen in Forschung und Lehre, 2000.

government purpose. Since liability for false returns is difficult to be made actionable (without reversing burdens of proofs), the self-enforcing mechanism practiced in some Swiss cantons is instructive. Here, the method of self-declaration of income is being practiced, but the returns are made public and banks are prudent in using them for their crediting decisions, lest they be criticized in public themselves. This means that a local entrepreneur cheats on his taxes only at the expense of losing his credit line. Banks will deal only with local customers, and the system is closed.

Monitoring compliance is not only important with respect to honesty in taxation. It is particularly difficult for the tax authority when a tax is used as a policy instrument so as to achieve a particular purpose, such as the use of an ecologically preferred technology, production process or resource. The information required to monitor compliance may become very complex in such cases, and it is important to create a system of self-enforcement. Often, the necessary expertise cannot be assumed to lie with a taxing authority, certification may be required from a different agency. In such cases, the extensive use of tax credits reverses the burden of providing the information from the taxing authority to the taxpayer, who thereby has to prove compliance. This reversal of the burden of proof expedites the tax administration and offers a flexible instrument to achieve many and diverse policy objectives.²⁴

Norminal gains or losses (or even fictitious or forfeited incomes) are sometimes used for assessing taxes. In principle, only real entities will affect economic behaviour. However, when used for purposes of assessing taxes, fictitious values do indeed become real ones. In this sense, they can affect behaviour and by consequence have an influence on real wealth and welfare. Consider the case of the fictitious value of using one's own home. Under the Dutch tax code, for instance, the forfeited benefit of living in one's own home is calculated not on the basis of rents for equivalent leases, but on the basis of the value of the real estate. This figure is then added to the taxable income, adding to the progressive burden of the income tax. In

²⁴ Backhaus (1998b).

principle, from a social policy point of view, the objective is to have as much homeownership as possible. This has to do with provisions for old age or other vicissitudes of life, with the stability of neighbourhoods, with health considerations and with the general experience that privately owned housing stock is better and more efficiently maintained than publicly or institutionally owned one. Now consider a family with a modest income that has inherited a valuable house. The fictitious rental value of the house will be added to the income of that family, but the costs of maintaining the house, the opportunity costs of capital contained in the real estate and the opportunity costs of work upon the house are all not deducted from this forfeited income. Consequently, the deck is stacked against private homeownership, thereby frustrating attainment of the traditional social policy objective. It is unlikely that this result is based on a conscious decision of parliament.

Off-shore activities are a clear indication of a weak tax administration as they document opportunities of taxation forgone. The remedy lies in creating a climate in which the business can thrive on-shore and simultaneously serve as a basis for taxation.

Public works intended to overcome chronic unemployment or other forms of economic depressions are often funded from tax revenues, thereby adding to the burden of taxation and to the welfare loss of taxation. Even if the measures are effective in creating opportunities for employment, they at the same time through the method of funding chosen decrease similarly opportunities in the sector subject to taxation and dampen demand for investment and consumption. For these reasons, self-financing forms of public works are preferable such as those designed by Wilhelm Lautenbach and implemented between 1932 and 1935. In relying on the Keynesian multiplier and accelerator effects, the funds spent wisely yield a return that constitutes the original fund.²⁵

Quality of service can be tied to taxation through the benefit principle. Wicksell suggested the benefit principle, which has been a core element of

²⁵ Backhaus (1985).

the canons of taxation ever since Justi and Adam Smith in a specific institutionalised form. By insisting on consensual taxation (near unanimity rule) and simultaneity of decisions on taxation and expenditure, taxes are tied to the benefits indeed received, and institutional provisions have to be taken to ensure that tax yields decline *in tandem* with benefits and *vice versa*. This can be accomplished by tying the taxes owed to the receipt and approval of specific services, implying the expression of disapproval and opting out of the bundle of taxes and services.

RThe Ricardian equivalence theorem holding the equivalence between taxation and bond issue has to be taken as one of the typical theorems of limitation which form the basis of economic analysis. Similar theorems are those by Modigliani-Miller and Coase. In emphasizing the specific conditions under which the theorem holds, our attention is pointed to those cases where the conditions are not met. Hence, the equivalence theorem cannot be taken at face value. It serves to emphasize the distortions that occur when the future burden of the bond issue is not accurately perceived by the present generation or cannot adequately be compensated for in the present decisions of future taxpayers.²⁶

SSurprises are the focus of much work in fiscal sociology, as we try to detect and predict the unanticipated consequences of regulation and taxation. For instance, Laband²⁷ has recently shown that regulation designed to protect the habitat of endangered species in its effects is likely to endanger those very species. For instance, birds which nest in particular trees, if the habitat is being protected and such trees cannot be cut for logging purposes, logging firms will eliminate those trees from their forests before they attain the required age and will thereby eliminate the habitat intended to be protected. If an entire area is targeted for protection, logging firms will relinquish their activities in these areas, whereby forestry activity will stop and land will revert to other uses. In all these cases, the intended effect of the regulation is completely subverted, since the regulation is written

²⁶ On these limitational theorems see Backhaus (1986).

²⁷ See Laband (2000).

against the interests of the regulated instead of tying the interests of the regulated and the beneficiary of the regulation together.

TTime is an important element in determining the intended and unintended effects of taxation and regulation. The simple diagram shown above is completely static. In the long run, the effects of regulation and taxation cumulate and citizens learn to reduce the burden of taxation, thereby increasing the welfare loss, as the economy moves successively away from the production possibility frontier, and a similar effect occurs in polity and society.

Utility is distinguished by Pareto from ophelimity in order to distinguish between those effects which occur in the economy and those further repercussions which affect society in different ways. In principle, Pareto thought that ophelimity could be measured, while utility is in the eye of the beholder. Utility can be experienced in terms of oneself, other members of society as well as society's situation and development as such. About the latter very little can be done by an individual, and individuals may disagree strongly among each other. Further, an individual's ability to influence the utility he ascribes to the well-being of another is equally constrained. What can be objectively observed is how individuals try to improve their own well-being, and hence the ophelimity can, in principle, be inferred, at least in an ordinal way. As we move beyond the economic sphere into the political and social effects of regulation and taxation, we need to work with both the notion of ophelimity and the different notions of utility as Pareto had suggested.

Value and votes are closely connected, as in the polity voting is used to determine the outcome of public policy, including the welfare effects of taxation and regulation. While in their individual behaviour, voters try to reduce the burden of taxation and regulation, this may not necessarily be the case in their political behaviour as the benefits from a particular programme may be concentrated on some, while the burden can be spread over many and in such a way that it is not worth their while to mount an effort at defeating the burdensome programme. Votes are the currency of

the political process, and it takes real resources to muster the political strength as expressed in votes to launch or defeat particular programmes.

WWealth, its production, enhancement and preservation depend critically on very specific aspects of the tax system. This has already been noted in the context of the taxation of fictitious incomes. In fact, in the example chosen the tax structure affects the architectural heritage of the people. Likewise, in assessing wealth, human capital and its formation needs to be included along with all manifestations of the cultural heritage, such as libraries, musea, institutions of higher learning, architectural landscapes and the like. All these depend crucially on specific provisions in the tax code, such as education credits, deductions for charitable activities, deductions for maintaining national monuments, encouragement to endow foundations or chairs at universities and the like. We note that there are countless ramifications and interconnections between the tax structure and all aspects of society, which can be ascertained through a wide definition of wealth, as it has been chosen here so as to capture all manner of sociological effects of taxation and regulation.

XX-inefficiency is the difference between the ability of an organization to perform and its actual performance. As an organization, a firm, a household, a family and the like tries to minimize the burden it has to bear through taxation and regulation, it moves away from its efficient allocation of resources and thereby creates X-inefficiency. Hence, to the extent that we can demonstrate these effects, we can point to strategies of reducing X-inefficiency that do not lie within the organization, but are at the disposal of policy makers as they decide on issues of regulation and taxation establishing the environment in which the organizations have to operate. While organizational theory has emphasized X-inefficiency in the context of intra-organizational strategies of improving performance, a fiscal sociological approach can emphasize extra-organizational strategies to reduce X-inefficiency.

YThe yield of taxation tends to be entirely overestimated, as the cost of taxation can never be completely established, since tax payers and agents under regulation have no desire to cheaply provide information about their

avoidance behaviour. From this point of view, it is advisable to use forms of revenue generation which strictly follow the benefit principle, as the *quid pro quo* between taxes and services provided tends to leave no excess burden and creates incentives to generate information about the transactions between the government and the private sector.

ZZero-based budgeting has often been suggested as a strategy to make budgets manageable and contain the growth of government. However, as citizens learn to deal with taxation and regulation just as well as expenditure programmes, they are able to decrease distortions over time. When entire programmes or tax systems are questioned abruptly, the learning done by individuals and organizations is being undone and additional costs of transactions are being imposed on economy and society. What is required instead are budgetary procedures that incorporate as much decentralized information as possible. In using the insights from Hayek's piece on the use of knowledge in society, this can be a plea to organize as much governmental activity as possible in a market context so as to make an optimal use of knowledge in society by both public and private market participants.

III. Fiscal sociology as a field of instruction and research

III a. Instruction

In emphasizing opportunities for research and instruction in fiscal sociology, a good start is Humboldt's principle²⁸ of a unity of research and teaching at the university level. Although this principle seems to fly in the face of the economic principle of the division of labour, a closer look shows that it actually reinforces this principle. Universities as institutions for basic research and high-level instruction have to maintain, increase and

²⁸ Incidentally, this forceful reformer of cultural institutions closed the old (1392) University of Erfurt for not being willing to go with the time.

communicate that type of knowledge which is not readily canonized into mass education. It is necessarily the role of a research university to be small in the sense of having many small centres of learning where scholars and students can interact directly. In this sense, teaching and research opportunities can very well overlap.

As a field of teaching, fiscal sociology offers fascinating opportunities at all levels of instruction.

At the bachelor's level, elements of fiscal practice can be integrated into the course of study. Consider the bargaining situation between a regulator and a regulated activity, such as the process of applying for a building permit; or alternatively, consider negotiations after filing a tax return. These cases can be realistically simulated in the curriculum and students can be introduced into the breezing climate of adversary negotiations. Through such a method, the technical concepts such as the rectangles and the triangles shown above can be imbued with life and may be readily grasped by students who favour rather non-technical disciplines otherwise and therefore might shy away from taking an economics course.

At the master level, this experience can be built upon. Now, the expertise would have to be raised to the professional level, since fiscal sociology includes a study of the unintended impact of taxation as well as regulation, it has implications for almost every activity of government that somehow affects the private sector. And with this, there is a wide field of professional activities in both government and the respective governmental counterpart *where a proper understanding of these effects is of great use*. Hence, the supply of interesting topics for master theses is inexhaustible.

Under current conditions of widespread underfunding of universities and the iron cartel of public universities with few private initiatives that can have a chance under such circumstances, it is difficult to encourage PhD students to pursue an academic career. Fiscal sociology, however, is to such an extent an under-researched field that a wealth of research opportunities exists with tangible benefits to both governmental and private agents. And this should, if sufficient effort at convincing sponsors of the

use of this work is undertaken, provide for research opportunities that are appealing, even to the most frugal budget administrator.

III b. Research

As we noted previously, before the dissolution of the unity of *Staatswissenschaften*, scholarly activity was able to centre on legislative projects, such as the civil code, the welfare state and the like. These concerted efforts can, with difficulty, be accomplished again in the context of focused niche subdisciplines. We have recently seen the emergence of health economics, which is such a niche subdiscipline in combining every conceivable economic method to analyse health related issues and institutions. Another such instance is the recent emergence of the subdiscipline of law & economics. Fiscal sociology can be positioned in a similar way. These niche subdisciplines which bridge otherwise separate scholarly pursuits can play a pivotal role in facilitating focused research on major legislative endeavours.²⁹

Example 1: With the further integration of the European Union, a repetition of the large legislative project of the civil code will now have to be made for Europe. A framework legislation for a common civil code in the European Union, including harmonization and union access will have to be forthcoming and it will have to address issues of taxation and regulation while helping to integrate diverse legal institutions and cultures. Research into unintended side effects of regulation and taxation will be of immense importance for facilitating such a project.

Example 2: The key concept of public finance is Wicksell's principle of just taxation, which entails a simultaneous process of deciding on taxes and expenditures. With the further integration of the European Union, a framework legislation will have to be forthcoming which satisfies this

²⁹ The leading journal in economics in the German language area during the time of these large legislative endeavours was notably called Annals of Legislation, Administration and Economics (*Jahrbücher für Gesetzgebung, Verwaltung und Volkswirtschaft*).

principle and also allows for popular decisions to be efficiently and effectively made by acknowledging, at the same time, the different histories, cultures and institutions of the different member states. Frey's³⁰ suggestion of functionally overlapping competing jurisdictions is one such attempt. Research into unintended consequences of such decision-making will have to be a necessary companion of launching such initiatives.

Example 3: With further integration of the European Union, some framework legislation for customs and excise taxes will have to be forthcoming that allows for the different member states and their subdivisions to remain sovereign and democratically constituted while at the same time allowing for harmonization and a minimization of the burden of those custom duties and excise taxes. Again, research into the side effects of legislation on excise taxes and customs duties will have to be necessary in order to help design efficient legislative proposals.

III c. Conclusion

In conclusion, fiscal sociology offers ample opportunities for research and instruction that can be said to be truly helpful in reducing the adverse effects of government activity and thereby enhancing the welfare and wealth of nations.

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Ik heb gezegd.

³⁰ Frey and Eichenberger (1999).

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