**The Tax State as Creator of Perpetual Crisis**

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**Abstract**

The term “tax state” originated in a controversy between Rudolf Goldscheid and Joseph Schumpeter over the treatment of Austria’s public debt in the aftermath of World War I and the dissolution of the Austro-Hungarian Empire. Goldschied asserted that this debt represented a crisis for a state that relies on taxation, and claimed that resolution required transforming the state into an entity that operated with its own capital. In contrast, Schumpeter argued that the crisis was temporary and could be resolved by a one-time capital levy to reduce the debt, after which the state could resume its tax-based mode of operation. This essay explains that Goldscheid’s analysis was more on the mark than Schumpeter’s, and does so by exploring the logic of interaction between carriers of distinct forms of property-based action: one form is private property; the other form is common or collective property. Perpetual crisis is a systemic quality of this form of interaction, with mitigation requiring movement toward a single principle for governing human interaction across both polity and economy.

**Keywords**: fiscal crisis; tax state; conflicting rationalities; Ordnungstheorie; hotels as city states; capital accounts for states; Joseph Schumpeter; Rudolf Goldscheid

**JEL Codes**: B31, D72, E62, H11

**The Tax State as Creator of Perpetual Crisis[[1]](#footnote-1)**

The sense of crisis that arose once again in 2008 is but the latest of a continuing chain of events that have evoked claims that a crisis has surfaced that calls for extraordinary action on the part of states, presumably acting in the role of a protectorate or guardian of its citizens. For the most part, these claims reflect the presumption that any particular crisis arises from outside the state, with the state subsequently acting to alleviate that crisis. Contrary to this common way of thinking, this essay explains that tax-based states, particularly of the democratic form, contain imperatives within their *modus operandi* to create those very situations that subsequently are described as crises. This is not to say that crises are created through intentional state action, though some could well be. It is rather to treat a continuing parade of what are called crises as reflecting the logic of the operation of states that feed on taxation. Tax states attract patterns of activity that create situations that become widely regarded as critical. This heightened sense of crisis leads, in turn, to increases in power and prominence of political officials within society, further intensifying the operation of this crisis-generating logic which Higgs (1987) explores. The logic of how democratic states operate in this fashion, violating in the process a basic democratic ideology that describes states as protective or guardian agencies is the purpose of this essay. To say this is not to deny the significance of protective activities to societal flourishing. It is only to note that state activities invariably create Faustian bargains (Ostrom 1996) whereby the good that might be secured through the deployment of force to secure protection is also used to secure the numerous evils that accompany the use of force and which generate the very situations that subsequently are described as crises.

The essay starts with a brief description of the controversy between Rudolf Goldscheid and Joseph Schumpeter, for it was Goldscheid who coined the term “tax state” to express a particular mode of state operation wherein states operated by taxing market activities in contrast to operating in entrepreneurial fashion with their own capital, as Backhaus (1994) explains. This description is followed by exploring some of the parallels between cities and hotels as a means of examining alternative visions of the capital accounts of states. An understanding of the imperatives for the generation of crises through the activities of tax-states starts with recognition that that human action is subject to different substantive rationalities depending on the context of action. For purposes of this essay, the prime difference is between action that takes place within a context of private property and action that takes place within a context of common or state property. Recognition that substantive or practical rationalities can conflict leads to a different treatment of the compound noun “political economy.” In this different treatment, particular attention is given to credit markets to illustrate how the generation of situations that are commonly described as critical is an intelligible feature of democratic political economy. These alternative treatments subsequently are brought to bear on public debt in light of the distinction between tax states and capitalized states. Perpetual crises are a product of this form of interaction between differently constituted entities, as Ikeda (1997) and O’Connor (1973) each explain, with Ikeda focusing on regulation and O’Connor on budgeting. As a logical matter, elimination of perpetual crisis requires establishment of a single institutional framework for governing human action and interaction. As a historical matter, it is doubtful that this is possible because societies require some admixture of private and common property (Wagner 2007). While singularity may be impossible to attain, there are different architectures of duality which can differ in the intensities of conflict that are likely to emerge inside those architectures, as Jane Jacobs (1992) explains.

**1. Goldscheid, Schumpeter, and the Crisis of the Tax State**

The term “tax state” originated in a controversy between two Austrian economists, Rudolf Goldscheid and Joseph Schumpeter, over the treatment of Austria’s public debt in the aftermath of World War I and the dissolution of the Austro-Hungarian Empire.[[2]](#footnote-2) Goldschied asserted that this debt represented a crisis for a state that relies on taxation, and claimed that resolution of the crisis required a transformation of the state into an entity that operated with its own capital. By recapitalizing the state, Goldscheid meant a resumption of some of the aspects of feudal regimes where kings and princes used such of their assets as lands and enterprises to generate the revenues for the conduct of kingly or princely activities along the lines common to the cameralist regimes that inhabited the Germanic lands starting in the 16th century and continuing into the 19th century.

In their use of state property as a means of generating revenue for the activities of states, the cameralist regimes differed sharply from the mercantilist empires to their west. Where the mercantilist regimes were predatory on market activities and enterprises, the cameralist regimes operated within the market economy to generate revenues for the provision of services. While the cameralist era had ended early in the 19th century, a residuum of cameralist practice persisted late into the 19th century. Public finances in the Germanic lands late in the 19th century were still financed significantly more heavily by revenues derived from the operation of state enterprises, as Backhaus and Wagner (1987) discuss and as Wagner (2012b) elaborates, than were the public finances in other lands. Where agricultural enterprises in such non-cameralist lands as France, England, Italy, and Russia generated between two and four percent of state revenues, agricultural enterprises provided over 17 percent of state revenues in Bavaria and close to that share in Prussia and Württemberg. State enterprises, moreover, provided nearly 60 percent of state revenue in such formerly cameralist lands as Saxony and Prussia. Railroads, post offices, and the like were not objects that drained revenue from state treasuries but rather were significant objects for supplying revenue.

Goldscheid argued for a restoration of the cameralist form of state finance by transforming many enterprises into state ownership and subsequently operating those enterprises in revenue-generating fashion. In contrast, Schumpeter expressed doubt that under contemporary conditions state enterprises would be good sources of revenue. It was better for state revenue, he claimed, to have enterprises operated by real entrepreneurs, with states taxing those enterprises, than to try to substitute state entrepreneurship for market entrepreneurship. Instead, Schumpeter argued that Austria’s debt crisis was temporary and could be resolved by a one-time capital levy to buy bonds and then burn them, after which the state could resume its tax-based mode of operation. In short, there was nothing about the debt that jeopardized the existence of the tax state.

Significantly different conceptions of the relationship among state, economy, and society are in play in these contrasting formulations. For Schumpeter, economy and state denoted distinct and separate domains of activity within society, with each of the domains acting according to principles unique to it. Hence, entities within the economy acted according to the principles and conventions of private property whereby societal patterns arise through production and exchange among market-based entities. In contrast, entities within the polity acted in parasitical fashion by taxing the fruits of market-based interaction. To be sure, such parasitical action was accompanied by ideological support grounded in claims of public good and necessity, but the state acted parasitically upon the market economy all the same.

Contrary to Schumpeter, Goldscheid sought to locate a uniform mode of operation that would pertain to both polity and economy. In this search, he did not support a re-feudalization of society but rather sought to re-capitalize the state. In the movement from feudalism to capitalism, taxes replaced capital as the basis for the generation of state revenue. As an idealized representation, a capital-based logic impels all enterprises to act to increase their market value, which they can do only by providing service valued by others. In contrast, a discordant note is injected into society when some entities operate within a tax-based logic. In the presence of taxation, it is no longer necessary for state enterprises actively to seek mutual gain because they can live off the productive activities of market entities.

This debate is now nearly a century behind us, the parties to the debate have long been dead, and the inspiration for the debate—Austria’s public debt after World War I and the collapse of the Austro-Hungarian Empire—would seem to hold historical but not contemporary interest. Beneath the particularities of time and place concerning this debate, however, reside some enduring issues regarding relationships among what we recognize as private and public entities within a society. Both types of entity, after all, occupy the same societal space, so the governance of relationships between those different types of entity has great significance for the character of the structured living together through which societies are constituted. It is easy enough to point to particular instances of crisis. All crises contain a common thread, which is an incompatibility among the plans and anticipations of the various members of a society. The standard mode of economic theorizing treats societies as being in equilibrium until disturbed by an exogenous shock, with a new equilibrium eventually resulting. Typical discussions of crisis proceed within this mode of thought by asking how state action might help to restore a new equilibrium.

An alternative line of thought, sketched in Wagner (2010), denies that it is meaningful to speak of exogenous shocks when society is the object of analysis, even though individuals experience exogenous shocks all the time. For a society, however, what is described as an exogenous shock is a misidentified conflict among plans of various members of the society. A significant source of that conflict, moreover, arises through the different rationalities that are set in motion when discordant institutional arrangements inhabit the same societal space, as shall be explored more fully below. The present sense of crisis that has spread throughout the west since around 2008 is a readily intelligible feature of a society that contains a large set of enterprises that together comprise a tax state. At some future time the current instance of crisis may appear only in our rear view mirrors, as has happened with all such crises throughout history. Yet we may be certain that as we keep moving forward we once again find ourselves wrestling with crisis, for crisis is a natural feature of what might be called the societal genetics of the tax state.

**2. Capitalizing the State within the Economy: Cities as Hotels**

A city is a small-scale exemplification of state activity. Indeed, a city-state is an alternative to a nation-state as a form of state, as Spruynt (1994) explains in his treatment of city states and nation states. Both cities and nations organize the provision of services within some particular territory, much as did the princes of cameralist times, and as do a number of small states today, seven European ones of which are described in Eccardt (2005). So, too, do hotels. A comparison of hotels and cities provides a different analytical window for comparing tax-based states and capital-based states. A re-capitalization of the state would thus not require a restoration of feudal arrangements but would rather entail an extension of the hotel template to the organization of collective activities more generally.

There is little if any formal difference between cities and hotels, as MacCallum (1970) explains lucidly. Indeed, a continuum can be imagined running from hotels to states. What exists in any particular instance is a geographic arrangement of human interaction and governance that entails both privately- and collectively organized activity. The standard distinction between public goods and private goods is misleading because it has nothing essential to do with a distinction between the domains of collective and market activity, as Wagner (2007) explains.

The standard distinction between public goods and private goods is typically thought to entail an essential distinction between collective and market activity because it is commonly presumed that public goods aren’t suitable for market production. This distinction is typically thought to render taxation the natural way to support state activity, in contrast to prices which are the means of supporting market activity. This common presumption fails to recognize the numerous instances where public goods are provided through market transactions, with hotels providing a good illustration of the supply of collectively beneficial activities through private property governance, and with Boudreaux and Holcombe (1989) exploring the broad scope for incorporating contractual principles and practices into collective activity. The standard treatment of public goods follows from the conceptualization of the tax state as a complement of the market economy. While this conceptualization is overwhelmingly accepted by economists and other social scientists, there is no necessity to accept this conceptualization because its acceptance reflects more historical convention than analytical coherence.

A large and complex hotel is an excellent illustration of how both private and public activities are organized within a particular geographical territory. A hotel is a territory within which numerous market-type activities are undertaken. Guests stay in rooms they have rented from the hotel, which is no different from the tenants who lease apartments within a city. They buy meals from restaurants located within that territory, and also visit shops located within that territory. What are recognizably market-types of activities are undertaken within the boundaries of a hotel. Within those same boundaries, however, numerous collective activities are also undertaken. Security services are provided, just as they are within cities. Hotels provide subways that run vertically, along with providing street lighting and sanitation services. Some larger hotels provide park and recreation services and sponsor art exhibits.

In short, cities illustrate how public goods can be supplied through market transactions, as against being financed by taxation. While taxation was the path taken for the supply of state activities after the demise of the feudal system, it is plausible that those activities could have been and still can be organized through the market-based institutions of private property and contractual liberty. To do this would require the Goldschied approach of re-capitalizing the state, thereby replacing the tax state with a form of entrepreneurial state. How this might be done can be adumbrated here, but this is a topic that deserves a fuller treatment, and by different people with different insights to bring to bear on the topic.

The first thing to be said about hotels is that collective activities are financed through tied sales with market purchases. People who lease rooms in a hotel are paying a charge that generates revenue to support the provision of the collective services that the hotel offers. The owners of a hotel have the problem of selecting the forms and types of public goods to offer to attract business in an environment of free and open competition. As with any commercial activity, there is neither recipe for nor guarantee of success. There is, however, freedom to try to fashion enterprises that will be successful in covering their costs, which includes convincing investors to support the enterprise.

The prime difference between cities and hotels resides in the character of their capital accounts, and with this difference leading economic calculation in different directions (Boettke 1998, 2001), as will be explored below. For a hotel, all activities are organized within a framework of private and alienable property. Hence, at one time a hotel might be owned by a single person. At some later time, the owner might divide ownership among several partners. At a yet later time, the partners might incorporate by allowing the private sale of ownership shares to replace the pervious requirement that partners could not dispose of their ownership without securing permission of the other partners. Whatever particular ownership form was in operation, the hotel would face the setting of seeking to attract customers in an environment where those customers had options regarding where to stay.

Through this openly competitive environment, we find the familiar result of hotels varying widely in the quality of the rooms they offer as well as in the quality of the public services they supply. While the residents of hotels typically stay for short periods of time, it would be easy enough to imagine their staying for extended periods. Indeed, condominiums and apartments represent long-stay versions of hotels. It would also be easy enough to imagine a hotel, condominium, or apartment complex being converted into a town or city. To accomplish this would require little more than a change in the character of the capital accounts of the members of the unit. Individual tenants would continue to have transferable ownership over their living spaces, but ownership of all common territories and properties would be transferred to a body denoting the collective entity. Initially, this might be little more than a change on paper. But as time passed, the situation would surely change. The maintenance and operation of common properties would now require collective action, which would require new organizational arrangements. The hotel would have become a city.

There is no principled reason why the reverse direction of movement couldn’t occur, with the city becoming a hotel. In either case, there is a conceptual distinction between people in their capacities as owners of assets and people in their capacities as consumers. With the hotel, people can consume services supplied by the hotel without participating in ownership of the hotel. In contrast, people are both consumers and owners when cities supply public services. Under present institutionalized practices, individual home ownership is a significant source of personal wealth. It would doubtlessly be different if cities were transformed into hotels. In this transformation, practices would come to resemble much commercial real estate where businesses are often tenants and not owners.

**3. Capitalization and the Value of Cities**

Cities contain many businesses and residences that are subject to private ownership and so have market value because those businesses and residences can be sold. Cities themselves, however, have no market value because they operate through collective or inalienable property rights. Yet they could acquire market value. All that would be necessary would be for alienable property rights to be established. If so, cities would become genuine corporations as distinct from their current status as municipal corporations, with the adjective municipal denoting that ownership of the corporation is inalienable. If the ownership rights to cities were to become alienable, the distinction between cities and hotels would dissolve, as Foldvary (1994) examines and as Wagner (2011) explores. The city as a form of tax state would be transformed into a hotel as a form of entrepreneurial state. All that would be required would be a change in the conceptualization of ownership and the associated change in the character of the capital account.

Like cities, hotels contain territory that holds both private and collective activity. The rooms that people rent in a hotel map directly into the houses and apartments they occupy in cities. Both hotel rooms and apartments are financed through market prices. Hotels and cities differ only in how their collective activities are financed. Hotels finance collective activities through market prices that are tied to or embedded in the prices of rooms. Cities finance collective activities through taxes imposed on the value of market transactions. Those taxes might be expressed as a share of the value of real estate. They can also be expressed as a share of the value of retail transactions, as with sales and excise taxes. Collective activities will be supported in some manner, and the central questions concern what manner and to what effect. The hotel illustrates the capitalized state while the city illustrates the tax state. Before turning to the dynamical differences between the hotel and the city frameworks, it will be worth exploring a bit more fully some issues regarding the capital accounts of cities in comparison to those of hotels.

Hotels face the same problem as cities in choosing what kinds of collective activity to support and to what extent. There is, however, no problem in inducing a registration of demand for collective activities. Demand is never expressed in advance of production, contrary to all of the concerns expressed about demand revelation. Production always occurs first, with the value of those entrepreneurial choices revealed subsequently according to how eager people are to buy the services. A hotel is no different in this respect. A hotel will offer a supply of rooms along with a package of collective services. For the hotel, the supply of collective services will be tied to the rental of rooms. The economic challenge facing the hotel is to construct a package of private and collective services that will result in a successful operation, meaning that the hotel is able to generate a return on its investment that induces no desire to liquidate that investment.

The same situation is faced by cities. Cities and hotels both provide security services, and both face problems of how to organize that provision. Cities and hotels both provide forms of public transit. In cities public transit is typically in the form of busses and subways; in hotels the most common form of public transit is elevators. Cities typically provide parks, and so do hotels. The parks in smaller hotels might be small and simple, as illustrated by sitting areas in lobbies. Small cities likewise typically have small and simple parks, in contrast to large cities. But large hotels can likewise be found where elaborate parks exist and which encompass such activities as rock climbing, aquariums, aviaries, and art exhibits. There is nothing about the economic organization of hotels that does not mirror the economic organization of cities.

Nothing, that is, but the system of property rights under which that economic organization operates and takes its shape. For hotels, ownership rights are universally alienable. But for cities, alienability is incomplete. An owner of a business can sell that business in whole or in part, but ownership in city parks or busses cannot be sold. To be sure, it is possible to imagine institutional arrangements that come close to providing alienability in the ownership of cities. Suppose cities were financed by a flat tax on the value of real estate within city boundaries and that participation in collective action was the exclusive province of the owners of real estate. In this institutional setting, people acquire tied packages of real estate and city assets. In buying and selling real estate a tied package of real estate and city assets is the object of the transaction. Hence, the market value of real estate includes some implicit value for the ownership of city assets that is tied to the real estate.

**4. Owners, Customers, and Capital Accounts**

With a hotel there is a clear distinction between the capacities of being owners and being customers. While a customer can also hold ownership in the hotel, this jointness is neither necessary nor typical. With a democratically-governed city, however, those who use city services are simultaneously owners of the city and its assets. One cannot live in a tax-financed city without becoming an owner. The acquisition of ownership is a necessary condition of residing in the city, in contrast to the voluntary acquisition of ownership in hotels. With hotels, the capital account specifies the liability of individual owners: the market valuation of their ownership might fall to zero but they cannot be forced to supply additional capital. If a majority of shareholders, or even a minority of them, conclude that they would like to increase their investment in the hotel, whether by buying bonds or subscribing to new stock, they can do so. The remaining shareholders do not have to do this.

Were the hotel to be converted into a city and governed accordingly, a different setting for governance arises, due to the establishment of a different relationship between cost and choice (Buchanan 1969). There are numerous particular ways a hotel could be transformed into a city, and likewise for the transformation of a city into a hotel. A simple mental experiment for moving from a hotel to a city would be to eliminate the transferability of ownership shares and adopt some constitutional framework where governance runs through voting. The possible details by which this might be accomplished are numerous. Simple nationalization without compensation would be one option, as a type of revolutionary act. Alternatively, shareholders could be given city bonds whose face value was equal to the market value of the ownership shares. The central point of this mental experiment is to illustrate possible transformation across institutional arrangements through revisions to the capital account of the enterprise. Where the hotel is governed by private or alienable property rights and private ordering, the city is governed by collective and inalienable property rights with public ordering.

Hotel governance occurs through a network of contractually constructed relationships where all participation is voluntary. A hotel that wants to secure a vendor for one of its empty stores must attract that vendor. In contrast, a city can use partial compulsion to attract that vendor. Compulsion is partial because the city cannot conscript the vendor to locate in the city. But the city can offer inducements to potential vendors that would be unlikely to have been offered by the hotel. Those inducements would be paid for not by voluntary contributions from those residents who have special attachment to that particular vendor; they would be paid for by tax extractions paid for to a large extent by residents who lacked such special attachment. Contractual relationships reflect mutual promises (Fried 1981). In contrast, relationships organized through collective property arrangements operate with an admixture of mutuality and compulsion: where some people are willing supporters of particular collective actions, others are forced supporters through taxation. What results from this admixture is a conflict between the distinct rationalities suitable private and public ordering, and with this conflict being the source of perpetual crisis within the tax state.

**5. Conflicting Rationalities within an Entangled Political Economy**

Economic theory is centered on the presumption that people act rationally in applying means to the pursuit of ends they have chosen. In this presumption, rationality is treated in a purely formal manner, as illustrated by generic models of optimization and constrained maximization. If all economic activity took place within the framework of a pure market economy where all economic relationships were governed by private property, this might be fine because the form of rational conduct would conform to the substantive requirements of such conduct. But “political economy” denotes interactions and relationships among differently constituted entities. While economic entities are constituted according to the principles and conventions of private property, political entities are constituted according to the different principles and conventions of common or collective property. There are thus different institutional contexts within which economic interaction occurs, and these differing contexts generate differences in the substance of rational human action, as conveyed by the formulations of Bourdieu (1990), Gigerenzer (2008), and MacIntyre (1988). A single formal setting for rational conduct can map into various substantive patterns of rational conduct.

The significance of context for the substance of rational action can be illustrated by the harvesting of oysters. As Angello and Donnelley (1975) explain, oysters can be harvested on either privately-held or commonly-held grounds. Oysters are harvested by dredging the sea bed. When this is done, immature oysters are dredged up along with mature oysters. Cultch on which oysters grow is also dredged up. When oyster grounds are held privately, a farmer who takes the time to return the immature oysters and cultch before moving to another location will increase the present value of future harvests. This is not the case when oyster grounds are held in common. With common ownership, someone who stops to return immature oysters will mostly be increasing the value of the oysters that other people harvest at later times. If 100 people farm oysters on that common ground, the farmer who delays harvesting to return immature oysters and cultch will bear all of the cost of that delay while receiving on average only one percent of the increased future yield. The substantive or practical rationality of farming oysters under common property differs from the practical rationality of farming them under private property.

At first glance, this difference in contexts might seem to show simply that productivity will be higher when oyster grounds are held privately than when they are held in common. This is so, as Angello and Donnelley showed. So long as these different institutional contexts have separate domains of operation, what results is a simple difference in productivities across institutional arrangements. But what happens if the two domains intersect? This is the setting for political economy, where there is interaction among entities that operate within different institutional contexts. Market-based entities are formed according to the conventions of private property and operate according to those conventions. In contrast, polity-based entities are formed according to conventions of common or collective property and operate according to those conventions. Moreover, there is interaction between those distinct types of entity, which leads to clashes that would not normally be part of the operation of a market economy.

For instance, scholars of law and economics have long noted that commercial disputes typically are settled without the disputants going to trial (Micelli 1999). There is a simple economic explanation for this observation, and it is grounded in the logic of private property. The disputants are residual claimants to their legal expenses, so they can keep whatever expenses they can save by settling the case rather than going to trial. The situation changes if one if the disputants is a public entity. A public entity is not a residual claimant to legal expenses. Whatever legal expenses might be saved by settling a dispute will revert to the budget and will be deployed to other activities. An ambitious attorney general who is interested in seeking higher elected office can, however, convert legal expenses into an investment in seeking that higher office by selecting cases based on their ability to generate favorable publicity for the prosecutor. What results is an instance of a tectonic clash between rationalities, a clash that can be played out many times through interactions between market-based and polity-based entities, resulting in tectonically-generated turbulence within society.

Credit transactions and credit markets provide a good illustration of such internally-generated turbulence. It is conventional to refer to “credit market” in a generic fashion, just as it is conventional to speak of rationality in a purely formal manner. But just as rationality operates to differing substantive effect under different contexts for human action, so does “credit market” have widely different meanings and implications under different institutional arrangements. Credit transactions governed by private property will differ in many ways and with significant effect from credit transactions governed by common or collective property relationships. To apply the generic term credit markets across different institutional arrangements surely does more to obscure than to illuminate many credit phenomena.

Credit markets are often depicted in terms of the demand and supply of loanable funds. This depiction divides the world between those who desire to receive credit and those who are willing to supply it, and with financial institutions serving in an intermediary capacity. A credit contract is a form of rental contract where a lender gives temporary custody of an asset to a borrower. As with any rental contract, several issues arise regarding the lender’s concern with regaining the asset at the end of the contract, with receiving the asset in proper condition, and with receiving payment as agreed upon. Such issues are reflected in the various terms of credit contracts. Borrowers have to convince lenders of their reliability, with the means of trying to do so including paying higher rates of interest and accepting provisions for collateral and repossession that are sufficiently favorable to the lender to lead to an agreement between borrower and lender. The aggregate of all such transactions under wholly private property will comprise the market for credit.

Within this setting, the terms of credit transactions and the volume of those transactions is a simple aggregate of individual transactions. Whether or not a contract is made after a meeting of a borrower and lender is a matter that resides only between the parties. If the lender rejects a borrower’s proffer, the borrower is free to try a different lender; however, the borrower has no recourse to a third party to try to force the lender to extend credit. This is how it is with private property and private ordering. This situation is a purely abstract rendition of a pure market economy where all relationships are governed by private property. Probably in no place do actual credit arrangements operate in this manner because states intrude into credit markets in numerous ways. One way is through regulation of private contracting. Another way is through direct participation as borrower or lender, as illustrated by transactions in public debt and by guarantees of private loans. In all of these cases, the intrusion of public ordering into credit markets brings some qualities of common property into the operation of credit markets. This intrusion intensifies the turbulence that would naturally accompany credit transactions even under private property and private ordering, due to the conflicting rationalities that are set in motion.

Under private ordering, credit transactions are dyadic. Each transaction is between willing participants, and the aggregate set of transactions is what is meant by the term credit market. When public ordering intrudes, credit transactions become triadic. A credit transaction is no longer exclusively between a borrower and a lender. Public entities now participate in credit transactions. As one illustration of such participation by public entities, Freddie Mac and Fannie Mae were instructed in 1995 to provide at least 42 percent of mortgages to borrowers with incomes below the median income for that region. This requirement was increased to 52 percent in 2005, and with at least 12 percent going to borrowers whose incomes were less than 60 percent of the median income (Moyo 2011).

A different pattern of credit transactions results in the presence of public ordering than would result under purely private ordering. There is no doubt that reasons or justifications can be advanced in support of any such measure, for the supply of such derivations along the lines of Pareto (1935) is doubtlessly limited only by the quality of one’s imagination. It is equally certain, however, that the resulting set of credit transactions will be more volatile than what would have resulted under purely private ordering. The simple fact of the matter is that public ordering forces lenders to replace some transactions they would have made with transactions they would not have made. With lenders operating under private property, moreover, they bear the value consequences of non-performing loans. In contrast, collective entities bear no value consequences because those entities have no enterprise value in the first place.

It is a mistake, however, to think of market-based lenders as comprising a unified mass and public entities that are involved in credit transactions as another unified mass. Once both sets of entities are recognized to be networks of entities, analytical space is created for lenders to be differentially favored or hindered by the requirements imposed by public ordering. So we find public ordering increasing turbulence within credit markets, which in turn will elicit various offers of guarantees to cover over the increased turbulence that is created. Those guarantees, however, do not come from some sponsor’s capital account, for there is no genuine sponsor who funds the guarantee. The guarantee is left as a general charge on the fiscal commons, contributing to its tragic character (Wagner 2012a).

What results is a form of tectonic collision where the imperatives of private ordering conflict with the imperatives of public ordering, similarly to the institutional incongruity within a society that Ludwig Lachmann (1971) explores. Under private ordering, all credit transactions conform to Ricardian equivalence; for if they did not, the “transaction” could be theft or it might be charity, but most certainly it would not be commerce. With public ordering, lenders are forced to make transactions that do not conform to Ricardian equivalence. What thus results is a form of tie-in sale where lenders make some loans of their choosing while also making loans to conform to the requirements of public ordering. Regulation will thus reduce the expected gain from participating in credit markets, which by itself would shrink the supply of credit. Public ordering can also operate to offset this shrinkage, as by subsidizing those loses in a separate transaction, perhaps as illustrated by doing commercially favorable business with those lenders, and with that favorable business doubtlessly financed to some extent by tax burdens that are higher than they would otherwise have been. Beyond the particular instance of credit markets, the conflicting rationalities generate internal commotion beyond what would be generated within the ordinary ecology of plans that denotes a market economy (Wagner, forthcoming). In other words, state action cannot improve on the ecology of plans but it can disorient the operation of that ecology, in contrast to the ideology of supplying protection.

**6. Contrasting Frameworks of Political Economy**

Schumpeter’s formulation of the tax state entailed denoting states and markets as separate objects, each referring to subsets of activities that interact with one another. With the demise of the feudal system, the state became dependent on market entities for support. The state was no longer an entrepreneur or enterprise, regardless of how good or bad it might have been. Instead, it became parasitically attached to the market economy. This parasitical quality reflects recognition that the state does not have the entrepreneurial tools necessary to generate a self-supporting stream of revenue. There is no transferable ownership for public enterprises, so there can be no market valuation of those enterprises. Without such market valuation, no disinterested test is possible for claims that a particular state action has replaced a less valued with a more valued option. To be sure, state enterprises necessarily engage in economic calculation, for all choices entail appraisal by some choosing agent, but that appraisal remains the private knowledge of the chooser and is not subject to third-party examination, in contrast to the third-party appraisal that is possible when ownership shares are transferable.[[3]](#footnote-3)

Maffeo Pantaleoni (1911) conceptualized societies with a tax state as containing two systems of pricing, a market system of pricing and a political system of pricing. The market system can generate prices; the political system cannot and must instead operate parasitically upon the market system. This host-parasite relationship gives a different character to political-economic interaction in the presence of a tax state than would result in the presence of a capitalized state, and with that interaction promoting the inconsistencies among entrepreneurial plans that result in a continuing parade of situations that are commonly designated as instances of crisis.

The tax state is a form of fiscal commons (Wagner 2012a), with instances of crises reflecting interaction among common-property and private-property entities. Interaction among such entities is central to the systemic generation of crises. Should those entities operate in separate societal spaces, it would simply mean that private-property entities would tend to operate with greater technical efficiency in resource allocation than common-property entities. But those entities don’t operate in separate spheres. They are entangled in a system of political economy. It is temptingly convenient to treat the state as an independent entity, as a form of Leviathan (Brennan and Buchanan 1980)(De Jasay 1985) that maximizes its revenue or some similar objective function. In this type of formulation, the state is treated as a monocentric entity as a cousin to a private firm. Yet democratic states are characterized by having multiple sources of independent participation, resembling an order much more than an organization, as Vincent Ostrom (1997) explains with particular cogency.

This recognition that states are polycentric entities leads to an alternative orientation toward the internal generation of crises. Economists typically treat entities as scalable, with the difference between small and large being a simple matter of multiplication. There is good reason to think that the conventions of private property promote scalability. Should a firm that doubles in size encounter organizational difficulties that reduce its ability to compete with smaller entities, we may feel confident that competitive processes will reduce the size of that firm. There is thus good reason to think that the difference between small and large firms is mainly quantitative, with large firms just doing more business than small firms—and with firms of all sizes engaged in the same types of activity all the same.

Extended to governments, the principle of scalability would similarly say that there is no significant difference between a town of 10,000 people, a city of 1,000,000 people, and a nation of 100,000,000 people. Each larger unit is 100 times larger than the preceding unit, but governance is scalable and proceeds in the same manner regardless of size. This common presumption, however, is erroneous. Suppose the town is governed by a council of ten members. Each member of the council will represent 1,000 residents. At this scale it is reasonable to presume that each member of the council has personal knowledge of residents he represents. It’s also reasonable to presume that members of the town council have deep knowledge of one another, allow great scope for tacit knowledge to come into play, and conduct much town business in a relatively informal manner even if regularly scheduled meetings are also held.

Governance within a city with 1,000,000 is not simply a matter of multiplying town governance by 100. Governance relationships are not scalable.[[4]](#footnote-4) The city council could remain at ten members. If so, each member would now represent 100,000 residents. At this scale it is impossible for council members to have personal knowledge of more than the proverbial handful of those they represent. To the extent residents are known to council members it typically will be as a member of some such aggregated status as a campaign contributor or member of some prominent association. The political patterns associated with interest-group processes will come more fully into play. Alternatively, the town council could be enlarged to 1,000 members, thus maintaining the scale of representation at 1,000 residents per council member. An assembly with 1,000 members cannot, however, conduct any business in an open manner, and will instead revert to various oligarchic devices that limit significant participation to a handful of members of the council, as Robert Michels (1962) and Bertrand De Jouvenal (1961) explain.

For a nation of 100,000,000 people, the oligarchic tendency of democratic polities intensifies further. Nations will thus undertake activities that would never be undertaken in towns, due to changes in the scale of governance in conjunction with the specialized and divided quality of knowledge. The business of a town council might be conducted under conditions that conform reasonably well to notions of complete knowledge that economists use so often to close their models. But as the scale of government increases, the activities of government become more fragmented and specialized, as is knowledge about the activities of government. Within a town, for instance, business regulation is likely to be general in its application. For a large nation, regulation will be highly discriminatory, extending even to some firms in the same industry being treated differently from other firms in the same industry. Public debt provides a promising avenue into the analysis of democratic oligarchy within the tax state.

**7. Promise, Contract, and Public Debt: Who Owes What to Whom?**

The tax state does not finance its activities from the revenues it generates through commercial activities by the enterprises it sponsors. Rather it generates its revenues from the taxes it imposes on the activities and enterprises of private citizens who act within the market. Rather than imposing taxes to finance an activity, the tax state can issue debt by selling bonds. Doing this is to substitute future taxation for present taxation. It is a linguistic convention to speak of states as being indebted, as illustrated by references to the effect that the public debt of the American federal government is now roughly equal to annual GDP, which in turn can be expressed as being on the order of $50,000 per resident. This convention is misleading because it treats the state as an acting entity that acquires debt just as a monarch might acquire debt. A monarch can become indebted, and it would be reasonable for a monarch’s creditors to be concerned about being repaid. If we ask who it is that becomes indebted when a democratic state borrows, the question is not easy to answer in any substantive manner. As a purely formal matter, the question can be answered by saying that the people become indebted. But this answer isn’t quite right because it reduces “the people” to a representative agent, in which case borrowing is impossible.

For a democratic polity, public debt is incurred by a parliamentary assembly. Creditors of the state have agreed to buy government debt. But who has agreed to accept liability to amortize the debt? It is certainly not the members of parliament who approved the debt, for they bear no liability to repay that debt. Liability to service the debt becomes a future charge upon the fiscal commons. But what kind of liability is this, or whom might it obligate? With personal debt established under private ordering, the pattern of obligation for amortization is clear. But it is not similarly clear for public debt. Much in this respect surely depends on the appropriate characterization of the political process through which public debt is created. In this respect, Antonio De Viti de Marco (1936) distinguished between two forms of democratic states, which he called cooperative and monopolistic. The cooperative state was similar to Knut Wicksell’s (1896) call for unanimity within parliament as a suitable benchmark for beneficial collective action. If collective choices were made under a rule of unanimity, collective activity would expand so long as everyone in the society thought they gained from such activity. This statement could not be made under other voting arrangements, for unanimity brings scalability in its train while other arrangements do not.

A monopolistic state dominated by interest-group processes, for instance, would be encased in relationships of domination and subordination. Some would gain and some would lose through state activity, which might lead to a distinction between willing debtors and forced debtors with respect to public debt. In this instance, the creation of public debt to finance added expenditure would reflect a coalition among bondholders and citizen advocates of added public spending, and with that coalition dominating citizen opponents of added public spending. So long as the dominant coalition remains dominant, rolling over of the debt is likely to continue. A shift in the pattern of coalitional dominance, however, could bring a reversal in support for public debt.

Actual polities are doubtlessly admixtures of cooperative and monopolistic modes of operation, and with the monopolistic mode increasing with increases in the size of units of government. In the US, for instance, nearly half of the adult population is exempt from the federal income tax. For people in this position, there is no personal cost of supporting governmental activities financed through the income tax. On the other side of the matter, something like 50 percent of income tax revenues are collected from about 10 percent of the population. This situation can easily map into a distinction between tax-providers and tax-eaters, which in turn is a form of domination-and-subordination and not a form of cooperative state. If a population comes increasingly to sense the existence of some such cleavage, questions concerning the legitimacy of a particular regime seem increasingly likely to come into play as a consequence of conflicting rationalities.

**8. Some Final Observations**

The tax state represents a particular historical appearance of a particular manner of societal organization to provide for various collective activities. Prior to the tax state there was the feudal state. Human nature is constituted so as to provide space in society both for activities directed at private accomplishment and activities directed at providing for collective wants within the relevant territory. With the demise of the feudal state, states in the persons of princes and kings gave way to parliamentary assemblies, and with formerly royal lands largely transformed into private ownership. The tax state arose as a parasitical attachment to the market economy. Where the feudal state generated revenue through its activities, the tax state generates revenue through parasitical attachment to market enterprises and activities.

This parasitical attachment generates forms of societal tectonics through the clash of rationalities that accompanies the division of the economic organization of the society into collective and market activity, and with collective activity conforming to the imperatives of common property while market activity conforms to the imperatives of private property. What results is a continuing sequence of societal earthquakes that often are described as instances of crisis, recognizing that crisis is a description that can be used as a tool for generating support for a regime.

Whether the continuing parade of crises can be weathered is for the future to determine. It can be asserted, however, that those crises are a product of conflicts and incongruences among the institutional arrangements that operate within the same society, with some of those incongruities noted with especial clarity by Ludwig Lachmann’s (1971) examination of Max Weber. As presently organized, the democratic state operates with a feudal-proletarian orientation which conflicts with the bourgeois orientation that characterizes the market economy. There are, however, institutional means of going beyond that conflict be expanding on the notion of hotels as cities, which would lead in the direction of an entrepreneurial state to replace the tax state.

Knut Wicksell’s (1896) treatment of unanimity and not majority rule as a benchmark for beneficial collective action is one particular institutional suggesting for dissolving the incongruity private ordering and public ordering. While Wicksell is mostly cited as an exponent of unanimous consent, his adventure into institutional based public finance had several elements that he thought would work together to bridge the gap between private and public ordering, as Wagner (1988) explains. For one thing, Wicksell presumed that a system of proportional representation could be instituted that would make it reasonable to claim that unanimity within a parliamentary assembly would correspond to unanimity within the society. Under unanimity, moreover, parliamentary activity would resemble commercial transactions. In Wicksell’s formulation, the tax state would have been replaced by a form of entrepreneurial or commercial state.

A formulation similar in spirit was set forth by Walter Eucken (1952) in articulating the requirement that state actions should not violate the central operating principles of a market economy, namely private property, freedom of contract, and liability for the value consequences of one’s actions.[[5]](#footnote-5) State actions would thus be restricted to conformability with the operating principles of a market economy. To be sure, one might reasonably wonder how this restriction might be implemented. After all, David Primo (2007: 109) notes that Congress enacted legislation in 1978, known as Bryd-Grassley, which abolished deficits after 1981! Simply to articulate a principle is not by itself to bring that principle to life. There are, however, several strands of thought that come together in illuminating how perpetual crises are a natural operating feature of a tax state, and with the supporters of state action typically seeking to use the crisis of the day to strengthen state power still more. The capitalized state is an ideal type that stands in sharp contrast to the tax state. Cities are municipal corporations that could be transformed into genuine corporations, dissolving in the process the institutional incongruity that brings about a continuing parade of crises as a natural product of a tax state inside an otherwise liberal society.

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1. I am grateful to Peter Boettke for offering valuable comments and suggestions on an earlier version of this essay. [↑](#footnote-ref-1)
2. This began with publication of Goldscheid (1917) and continued with Schumpeter (1918). These items, along with additional pieces by Goldscheid, are collected by Rudolf Hickel (1976), and accompanied by Hickel’s introductory essay. Schumpeter’s piece was made available in English in 1954. Goldschied is not available in English, save for a 1958 excerpt. [↑](#footnote-ref-2)
3. Closely held firms don’t have an active market in ownership shares, but ownership is transferable all the same and so such firms have latent market value that is revealed when such firms are sold or otherwise reorganized. [↑](#footnote-ref-3)
4. See Barabási (2002) for an extended examination of networks that are scalable in comparison with those that are scale free. [↑](#footnote-ref-4)
5. For some significant extensions of these ideas, see Vanberg (1988), Streit (1992), and the essays collected in Leipold and Pies (2000). [↑](#footnote-ref-5)