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TAX COMPETITION AND THE TRAGEDY OF THE COMMONS

James M. Buchanan, economist, winner of the 1986 Nobel Prize in Economic Science, is the advisory general director of the Center for Political Economy at George Mason University, Fairfax, Virginia. He is best known for developing the «public choice theory» of economics, which changed the way economists analyze economic and political decision making. His work opened the door for the examination of how politicians' self-interest and non-economic forces affect government economic policy. Among the many influential books he has written are «The Calculus of Consent: Logical Foundations of Constitutional Democracy» (1962) with Gordon Tullock; «Cost and Choice» (1969); «The Limits of Liberty» (1975); and «Liberty, Market and State» (1985); and his autobiography, «Better than Plowing and other Personal Essays» (1992). Most recently he published with Roger Congleton «Politics by Principle, Not Interest».

Im vergangenen Wintersemester lehrte James Buchanan, Nobelpreisträger für Ökonomie, während zwei Monaten an der Universität St. Gallen. In seinen Vorlesungen und Seminaren standen Grundsatzfragen aus dem Bereich der politischen Ökonomie im Zentrum. Anhand von neueren empirischen und theoretischen Untersuchungen befasste er sich namentlich auch mit der Funktion und Effizienz von Steuersystemen und mit der Bedeutung des «Wettbewerbs der Systeme». Sein Anknüpfungspunkt war der Umgang mit öffentlichen Gütern, bei denen – wie bei der Nutzung der Allmende – bei unterschiedlichen Akteuren verschiedene Überlegungen zur privaten und gemeinsamen Nutzenmaximierung als Dilemma in Erscheinung treten. Im folgenden Gespräch mit Jörg Baumberger, Professor für Volkswirtschaftslehre an der Universität St. Gallen und Robert Nef betonte Buchanan die Bedeutung des Wettbewerbs der Systeme und den hohen Stellenwert empirischer Studien zum Verhalten von Individuen und Kollektiven und von Individuen in Kollektiven und von Kollektiven gegenüber Individuen bei der Maximierung ihrer jeweiligen Nutzen, wobei die Besteuerung ein besonders wichtiges und besonders komplexes Phänomen darstellt.

Nef: Let me start by quoting Adam Smith: he said once that the human civilization is based on three pillars. Peace, easy taxes, and tolerable justice. Do you agree with this proposition?

Buchanan: Yes especially the easy taxes.

Nef: Perhaps we should start by explaining to our readers what you mean by «The Tragedy of the Commons».

Buchanan: The term «Tragedy of the Commons» was invented by a biologist Garrett Hardin in 1968 in the «Science» magazine. It has been common in the economics literature for a long time. It refers to a situation where there is a common resource that is being used by many people independently of each other. This resource will of course tend to be overused since people in their actions do not take into account their effect on other people. The traditional reason for the use of the word «commons» goes back to the old mediaeval notion of a commons where the sheep or cattle would graze. A situation of separate peasants adding their animals on the commons results in overgrazing of the common meadow or pasture. It has also been applied to fisheries where over-fishing occurs unless there is some control, or the

overexploitation of oil reserves if uncontrolled.

In the early history of this issue, it was the prime concern of the economics of welfare. It was proposed that this is liable to occur in any industry. This was immediately challenged by some people who showed that in the majority of cases the problem can be solved if the resource is *privatised*, if a *private* ownership right to the resource is established. To go back to the original pasture example, the private owner of the resource would have an incentive to operate the use of the resource in such a way that the rent obtainable from the particular scarce resource does not disappear. Hence, for most of the economy, the problems are solved by allowing private property, which gives the correct incentives to the owner to run the property in a proper way. After this realisation in the early debates of the 1920s, it became accepted that these problems were relatively rare.

However, later in the 1950s one begins to get discussion about fisheries, for example, which cannot really be *privatised* easily. Then, of course, there was also the whole environmental movement which

started in the 1960s, and *Garrett Hardin* wrote his piece partially in response to this.

Nef: Is there a link to the realm of taxation where excessive taxation may be a widespread phenomenon? Can we nail down the point where beneficial taxation turns into over-taxation? If there are too many sheep on the pasture, their owner may be liable to paying a tax, but should not be over-taxed himself.

Buchanan: This is an interesting juxtaposition. I started dealing with this issue about five years ago, although it has always been close to my direct interest. Suppose you have a situation where you recognise that although private property might provide a solution, for historic reasons and for the sake of tradition, you do not want to privatise the resource. This unwillingness is relatively understandable in some areas since, with privatisation, somebody will get all the rents. If you are not that particular person, you personally don't care about whether the resource is used properly or not, and the whole question becomes to a close approximation a distributional one: a competition over who gets the rents.

Thus if, because of the generally held values, you are not willing to privatise to a particular individual, but still want to manage the resource «properly» by a majority rule («let the government do it»), the question arises whether this majority-based solution would be different from that which was based on individual private ownership?

By posing the problem in this way one runs into the following problems: How large must the majority be? Does it matter who is in the majority? What if there are overlapping majorities on smaller partial issues? All these problems are interesting analytically, especially when one includes the fiscal question: What is the power to tax here? A large subsequent literature has been developed around these questions, trying to relate the fiscal instruments to various models of majorities.

Baumberger: I was going to ask the following question: surely, there is a difference between the commons on the one hand and the tax-base on the other. The latter category, after all, consists of consciously acting people. The analogy with the commons therefore is imperfect since

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grass, unlike people, cannot move and cannot take counter-measures. The taxpayers, on the other hand, do have a freedom of movement. Does that alter the implicit game of the commons in any significant way?

Buchanan: Obviously the two are not the same thing. The optimal «use» of the tax-base is not to tax at all. That way you maximise income (subject to some minimal requirements for maintaining law and order). In the case of the commons, on the other hand, the optimum for the private owner is to actually charge people for the use of the commons and thus put the right amount of sheep on the commons. The tax models would actually be an example of what we have called in another context an «anti-commons»: although you are always dissipating value. The reason why value is dissipated with the increase of any tax is exactly the one you mentioned: people are going to behave differently and less income will be produced with a higher tax rate. You can think of the standard demand curve for generating taxable income. If people behaved the same way, no matter what the tax was, then of course all the different spending causes could be financed. The fact is, though, that the tax payers will react. The higher the taxes, the less income will be produced. You will be wasting resources, people will be entering the shadow economy, and the total value produced would be reduced.

Baumberger: In your theory of the Leviathan state you suggest, if I am correct, that loopholes are a sort of a subtle device in the tax system and therefore you would advocate consciously keeping them in place. Do you have some sort of ordering in your mind as to what loopholes are «better than others» or would you instead say that any loophole is as good as any other, as long as it is there? Would you attach any distributional and/or fairness criteria to the design of a «proper» system of loopholes?

Buchanan: You quote me quite correctly. I did come out in favour of loopholes explicitly at one time, although later when a whole book was produced on the subject, the word or the concept of a loophole became more implicit than explicit.

Tax-loopholes are generally a protection against the over-exploitative reach of the

government. If we know that the taxpayers will react, we will not tax as much but if I were to «design a tax structure» today, I would subscribe to there being not a single Franc of «exempted» for some reason.

Baumberger: I can make the observation that the evolution of the taxing system goes the opposite way of fragmenting the tax base and splitting off labour-income taxation from capital-income taxation. Even such countries as Sweden have done this. Capital income is taxed at a flat rate and the labour-income is subject to a steeply progressive tax. This may be caused by some tax-competition considerations. Do you think that this evolution should be welcomed or would you not be that supportive?

Buchanan: I think you have to be careful when identifying what the evolutionary path of tax-structures is, leaving aside the tax-competition question for a minute if I may. I think you are right in saying that there is a great pressure towards shredding the tax system into little parts. I look at it even more cynically and see the legislators responding to continuous pressure from lobbyists, industries, labour unions etc. where extreme amounts of resources are spent in trying to get special treatment or special loopholes. Over time, you are getting more and more targeted tax-cuts. That may indeed be the picture of the present situation. However, things can get built up to a level where there are so many special and targeted provisions that people can get fed up with it. In the U.S. we have had that very experience, which surprised everybody, right, left or centre of the political spectrum. In 1986 this critical level of complications was reached and the Congress, with the support of President *Reagan*, passed the 1986 Tax Reform Act which did reverse the evolution which you have described. We reduced the number of tax brackets, many of which were exactly these special provisions etc. In one of my pieces, I made the prediction that from a Public Choice perspective, this «truce» won't last. The

politicians will start selling the rents again – which is indeed what they did. However, at least one has the swings and the relationship is not always so direct and going only in one direction.

Tax competition generally means that your less mobile resources will be subjected to a more differentiated tax system.

Returning to the point about tax competition, I think you are absolutely right. You will get mobility of capital in the age of globalisation, therefore it will be difficult to sustain special deals, preferential differential tax-rates on different kinds of capital and so on. Tax competition generally means that your less mobile resources will be subjected to a more differentiated tax system.

Nef: Tax competition is just one of the pressures towards lower taxes. However, when the system is spoilt by inter-governmental redistribution, it ceases to work. On the one hand, there is the beneficial operation of tax competition, but at the same time the system is spoilt by redistribution on the regional level. That is exactly what happens in Switzerland, where we have healthy tax-competition, but we keep spoiling it with the system of financial equalisation ...



Das Ende eines Lebens als Paar. Mann und Frau starren ratlos vor sich hin. Der Ehebruch hat unwiderruflich einen Keil zwischen die beiden getrieben. Unerbittlich limitiert die Zugehörigkeit des Titels zum Bild in der linken unteren Ecke einerseits die Interpretationsmöglichkeiten durch den Betrachter, andererseits bleibt unausgesprochen, wer von beiden für die Untreue die Verantwortung trägt. (Michael Wirth)

Félix Vallotton, «L'Irréparable», gravure sur bois, 17,6 x 22,2 cm. Lausanne, Musée cantonal des Beaux-Arts (s. auch S. 31).

Buchanan: It is a question of finding the right balance. With pure tax competition, one achieves the desired efficient allocation of resources in the system. On the other hand, some of these inter-governmental adjustments could be seen as desirable in maintaining a fiscal balance amongst the different regions.

Nef: And we are probably also back to one of *Adam Smith's* pillars – to the question of peace ...

Buchanan: Indeed. If we rely purely on tax competition, it is migration that bears the burden of being the adjusting force. Yet there may be other inefficiencies resulting from this, such as the likelihood that the population will start to concentrate too greatly in population centres etc. ...

Nef: What do you think about the argument that tax competition will lead to a «race to the bottom» – that at the end there will be too low taxes, none in the extreme, and they would be incapable of providing even the minimal supply of collective goods?

Buchanan: I don't buy that argument at all. It seems to me that is not what would happen. In effective fiscal competition, both sides of the equation matter, the giving and the taking. It may be true that those localities with the lowest tax rates will attract more investment and inflow of people, but this will not be the case unless they do provide some services in return. People as well as capital owners evaluate both the tax rate and the level of services when they make a decision whether or not to migrate. Fiscal competition will ensure that you have efficient level of services, which does not mean lowest-tax public sectors or the highest-spending public sectors. What it does mean, however, is that in these efficient public sectors there will not be much of wasteful redistribution spending.

Nef: That is exactly our experience in Switzerland. People do not like paying taxes, but they will pay them if they can see «their money's worth» in terms of services provided. They may not like it, but they do pay taxes.

Baumberger: At the same time, should we not distinguish between services which are actual products and those services which take the form pure benefits, e.g. social-security benefits or benefits for the

poor? In the first category, equilibrium will obviously easily establish itself. However, among the unrequited benefits, will there also be an equilibrium or is there a reason for fearing that the race to the bottom will play out quite badly for the socially less powerful?

Buchanan: There is no doubt that the poor will see this story differently. We said that we were going to get the efficient level of services, and giving aid to the poor is not necessarily economically efficient. If aid is your primary objective, you will not get it through this kind of competition.

Baumberger: Will we agree that as far as giving aid to the poor is concerned, it should be uniform, devoid of any competition and not delegated to the lower levels of government as it is done in the U.S.?

Buchanan: You have to be careful here of another aspect, though: You seem to look at it from a narrow point of view economic efficiency, probably neglecting somewhat the way in which governments actually behave. One may say that the central government ought to do the fiscal redistribution because it can and the more local levels find it harder. However, if we look at the behaviour of governments from the point of view of moral legitimacy, we see that at least in the big countries (Switzerland may or may not be different from this), central redistribution programs will probably run out of popular support of the, say, 250 million people of the whole nation. People do not much care about the poor when it is not somehow within their immediate capacity as a moral being to associate with the plights of those particular people. The person in Virginia might well be interested in supporting the poor in Virginia, but (s)he will not be interested in supporting the poor in California. If you get your units too big, you lose this moral capacity. After all, the support for a redistribution scheme has to come from the sphere of morals and morality.

Nef: That will become a problem especially in the EU.

Buchanan: And even more because of the different backgrounds. Why should somebody in Germany care directly about somebody in Portugal, for example ...

Nef: We even have the same thing in Switzerland with the cultural divide ...

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which does
not mean
lowest-tax
public sectors
or the highest-
spending
public sectors.

Baumberger: This in fact fits naturally with our previous discussion of the tax competition and indeed of the loopholes. On the spending side you would therefore advocate uniform social security benefits (in line with the uniform taxation proposition), but these benefits ought not be constructed uniform across too large a jurisdiction and there ought to be a possibility of differentiation across regions.

Let us progress somewhat in our theme without actually completely changing it. Can you conceive of a situation where there could be excessive competition, or at least excessive tax-competition? Is there some sort of an internal stable optimum within reach or do you think that benefits of competition continue increasing as long as competition increases? Perhaps it could be a mere theoretical possibility, one

which does not actually empirically occur in any country.

Buchanan: Well, my prejudices tell me that I should say I could *not* conceive of a situation of excessive competition. However, let me mention at least one of the objections against competition that always comes up in this context. In the U.S., many local levels of the government (be it state or country) will forgive taxes to businesses if only they would locate there and guarantee that they would stay there for quite some time). So firms follow these tax breaks and often stay only as long as the break lasts. Now if the individual states or localities competed only at the level of rates, there would be no problems. But because of the heavy use of targeting of particular cases, there are indeed large inefficiencies and a rather counter-productive climate. ♦

TITELBILD

SIEGER UND BESIEGTE

Félix Vallottons Holzschnitt «L'Argent» und seine Holzschnitt-Reihe «Intimités». Titelbild und Illustrationen des Dossiers



Félix Vallotton (1865-1925), *L'Argent*, 1897-1898, Gravure sur bois, 17,9 x 22,5 cm, Villa Flora, Sammlung Hahnloser, Winterthur.

(Vallotton). Ende 1894 hatte der Künstler im Théâtre de l'Euvre in Paris Strindbergs Trauerspiel «Der Vater» gesehen. Das Stück berührte ihn tief. In seiner beeindruckenden Vallotton-Monographie (NZZ-Verlag 1998), äussert Werner Weber, ein Wortwechsel aus dem Stück könnte «nachwirkend, als Motto über den *Intimités* stehen»: «Rittmeister: Noch ein Wort zur Wirklichkeit: Hasst du mich? Laura: Ja manchmal. Denn du bist ein Mann. (...) Rittmeister: Ich fühle, dass in diesem Kampf einer von uns untergehen muss.»

Bemerkenswert in der Reihe «Intimités» ist in der Tat, dass Mann und Frau sich mit ungleichen Waffen gegenüberstehen und es Sieger und Besiegte gibt.

Doch wer ist gestärkt, wer ist geschwächt, ja vielleicht zerstört aus der Auseinandersetzung hervorgegangen? Die Frage lässt Vallotton bewusst unbeantwortet. Diese Zweideutigkeit macht den Reiz der Drucke aus. Das Titelblatt «L'Argent» zeigt einen Mann, dessen Silhouette gleichsam den Körper der Frau zeichnet. Oder ist es umgekehrt? Der Mann erscheint übermächtig in dem Masse, wie die grosse schwarze Fläche ein Teil von ihm zu sein scheint. Zudem redet er auf die Frau ein. Sie jedoch blickt verloren in eine andere Richtung. Rechts unten prangt wie ein mysteriöser Hinweis auf den Inhalt der Worte, die gesprochen werden, der Titel des Holzschnitts: «L'Argent». Vallotton bezieht sich hier auf ein Theaterstück von Emil Fabre: Die Frau eines Chocolatiers wird von einem Bankier verführt, den sie an Stelle ihres mutlosen Mannes aufsucht, um ihm, der kurz vor dem Konkurs steht, einen Kredit zu besorgen. Der Mann erfährt von der Untreue seiner Frau und bricht mit ihr. Darauf rächt sie sich grausam.

Vier Holzschnitte der Reihe «Intimités» sind im Dossier dieser Ausgabe der «Schweizer Monatshefte» zu finden: «La Raison probante», «Le Triomphe», «Le grand Moyen» und «L'Irréparable» geben über ihre Mehrdeutigkeit hinaus auch den sozialen Abstieg der Frau als Folge des Geschlechterkampfes zu bedenken.

Michael Wirth