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The Tax State: An Outdated Concept

Dirk Loehr*

Trier University of Applied Sciences, Environmental Campus Birkenfeld, Germany

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***Corresponding author:** Dirk Loehr, Trier University of Applied Sciences, Environmental Campus Birkenfeld, P.O. Box 1380, D-55761 Birkenfeld, Germany

Abstract

Taxes are compulsory levies for no consideration. Because there is no earmarking, the budget funds are often not spent effectively by the state authorities. In economic terms, the incentive effects of taxes and deadweight losses are counterproductive. The alternative would be state financing that is primarily based on performance and consideration (equivalence). A key component of this would be marginal cost-oriented charges. A second element would be the financing of provisioning costs of public infrastructure from land rents. This would largely avoid the problems of tax financing. States and public companies can be observed that are already successfully moving in this direction.

Keywords: Tax State Fees; Contributions; Henry George-Theorem; Land Value Tax; Singapore; Mass Transit Railway; Equivalence

Introduction

For the most part, taxes as a means of financing the state are accepted as having no alternative. This is particularly characteristic of the legal literature, which in various cases also assumes that the principle of the tax state is founded in the constitutions. Some political science treatises go so far as to interweave taxation with democracy [1].

Nevertheless, the financing of the state from fees and contributions is being discussed in financial economics as an alternative to tax financing [2]. Fees serve to finance the costs arising from the actual use of public services, while contributions cover the costs of providing private and public infrastructure. The so-called Henry George theorem, named after the well-known US-American land reformer, represents interesting variant for financing the provision costs of public infrastructure in particular [3]. This focuses on skimming off the land rents. However, there are many more rent-generating assets than land. Stiglitz [4] therefore extended the Henry George theorem to the "Generalized Henry George Principle", although this cannot be discussed in detail here.

The following explanations refer primarily on the legal framework of continental European states but can also be applied to many other countries.

Conventional taxes: recognition of necessity?

Only very few people like paying taxes. Why should they? There is no reciprocity. Taxes are compulsory levies for which there is no entitlement to anything in return. Reports on the waste of taxpayers' money fill libraries. Obviously, politicians are not very careful with taxpayers' money - after all, it is not their money. In addition, accountability to citizens is weakened because there is no earmarking of taxes. All revenues flow into a large pot from which they can be used for all kinds of purposes. For example, the revenue from an "environmental tax" can also be used to subsidize the exploration of gas fields.

In economic terms, taxes are seen as a necessary evil. Taxes demotivate economic activity. Taxes also cause deadweight losses, thus tempting people to take economic detours that they would not have taken without taxes. Some taxes even degenerate into "taxes for the stupid". In order to limit the loss of revenue, disproportionately high penalties are sometimes imposed on tax evaders, even in countries that otherwise consider themselves liberal and democratic. Tax law constitutes a relationship of super- and subordination between the state and its citizens, in which the fundamental rights of citizens are often given little weight.

The decision on the amount and use of tax revenue is the most important right for parliament - this is the common narrative that links taxes and democracy. In reality, however, budgets are often "petrified" due to predeterminations by previous governments and parliaments; the disponible financial resources are hardly worth mentioning.

Looking at the political camps, the left is generally open to

higher taxation. However, this applies to progressively structured direct taxes (income tax, inheritance tax, wealth tax). The more regressive indirect taxes, on the other hand, should be reduced. However, there is a trade-off here: according to the economic textbooks, progressive direct taxes tend to carry high excess burden, indirect taxes less so.

The conflict of objectives between fairness (redistribution) and efficiency (avoiding deadweight losses) is thus seen by the left as being more in favor of fairness. Taxes are also seen as a steering instrument.

The liberal-conservative side, on the other hand, tends to place greater emphasis on efficiency when balancing different taxes. Here, taxes are primarily understood as a financing instrument; steering purposes, on the other hand, should take a back seat.

Fee-based financing of state services

Financial economists have been discussing alternatives to the tax state for many decades - especially in the form of models of a state financed by fees. When a fee is paid, there is a direct entitlement to a service in return from the state; there is direct equivalence between the fee and the service in return. In this respect, citizens only pay when they actually make use of services. This is already the case today with fees for issuing passports, marriage certificates, etc.

Fee-based financing has a number of advantages: If payment is made for the actual use according to the marginal costs incurred, evasion is impossible. Deadweight losses cannot arise either. Citizens can compare different jurisdictions according to the costs of public services, creating transparency. At the same time, citizens have an incentive not to overburden the state. Income and wealth adjustments, on the other hand, play no role, at least in the case of marginal cost-oriented charges.

Ideally, fees should best be based on marginal costs, i.e. the additional costs incurred by using the services in question. For public transport, for example, the costs of energy, the driver and wear and tear would be covered. Similarly, congestion costs can also be priced if, for example, certain roads are overloaded at certain times.

Financing the costs of providing public infrastructure

However, in many cases marginal cost-oriented charges cannot cover the costs of providing the infrastructure. In the above example of public transport, for instance, this concerns the costs of providing stations and the rail network. Nevertheless, such provision costs are in many cases the most significant part of the total infrastructure costs.

Accordingly, the financing of the fixed costs of provision must be structured differently from the actual use. One much-discussed option is financing through contributions. In contrast to fees, contributions are not paid for actual use of the infrastructure, but only for the opportunity to use it. In this respect, there is equivalence between service and consideration, but in a weakened form.

What is the best way to raise the contributions? One way would be to finance them from citizens' income. This might make sense for social insurance or the provision costs of privately constructed infrastructures, as for instance private museums. For most publicly created infrastructures, however, the Henry George theorem provides a preferable approach, which is outlined below.

The Henry George theorem

The Henry George theorem states that, on the one hand, public infrastructures "generate" land rents in the first place. In essence, land rents are differential rents that arise primarily as a result of cost advantages due to the proximity of locations to point infrastructures (e.g. metro stations, schools, public spaces). On the other hand, the costs of providing public infrastructure can, under certain conditions, be fully covered by the land rents - ideally without any taxes.

Private ownership of land, however, tears the Henry George theorem apart. Private ownership of land means that land rents are not used to finance public infrastructure but are instead privatized to a considerable extent. However, the provision of public infrastructure can then no longer be financed via land rents. Instead, conventional taxes must be levied. The tax state is thus the flip side of a rent economy that goes hand in hand with the private ownership of land: in tax states, privately created values are socialized through taxes in order to be able to privatize land rents as publicly created values.

The tax state places a burden primarily on those who can hardly avoid paying tax: These are the almost congruent groups of consumers and employees, and, to a certain extent, also the owners of physical capital. The tax burden on landowners, on the other hand, is rather homeopathic in many jurisdictions. In Germany, for example, consumers and employees account for more than 70% of total tax revenue. If social security contributions are added to taxes, the share is more than 83%. In contrast, property tax does not even account for 2% of total tax revenue [5]. When social security contributions are added, the share of property tax in total public charges is halved.

While in a market economy the benefits are borne by those who also bear the costs, the tax-based rent economy constitutes the decoupling of benefits and costs of the valorization of land. This initially has allocative effects, because where such a decoupling takes place, market failure is not far away. For example, land speculation can certainly be linked to the existence of external effects [6]. In addition, the decoupling of benefits (landowners) and costs (consumers and employees) also has distributional effects that have hardly been the subject of research to date.

The consideration of the groups particularly burdened by the tax state also underlines an argument dating back to David Ricardo [7]: he predicted that in the long term, neither the workers nor the

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capitalists, but rather the owners of the scarcely reproducible land would emerge as the winners in the distribution of income. Of course, Ricardo had an agricultural and manufacturing economy in mind here. However, his prediction also seems to apply to modern industrial and service societies: In many developed nations, interest rates have been trending downwards for decades, while workers have gained only slightly at best. In the last decade in particular, it has become clear that the low-taxed land is the big winner [8]. The distributional imbalance outlined above is exacerbated when viewed after taxes. However, the national accounts do not express this, as there is usually no differentiation between land and capital.

However, the state itself is also negatively affected by its dependence on tax revenue. This is not just about the "Laffer curve". The real problem is a structural "poverty of the state". The reason: the state and landowners compete for the land rent. Land rents can be seen as a residual that arises when the costs for the production factors of labor and capital are deducted from the income at the various locations. The US economist Mason Gaffney [9] showed that all taxes either reduce private income (consumption taxes) or increase the costs of the mobile factors of production (e.g. wage taxes) and thus reduce the residual land rent. Added to this is the deadweight loss of taxation, which is also at the expense of the land rent volume. As land values essentially represent discounted future land rents, this also makes it clear why low-tax countries regularly have comparatively higher land values than comparable countries with a high tax burden (example: Switzerland vs. Germany).

If the Gaffney is correct with his hypothesis that the land rent potential also represents the upper limit for state financing, then the land rent potential can only be partially utilized through conventional taxes. The reduction of the land rent potential through the privatization of land rents and deadweight losses is therefore an important, albeit regularly overlooked, reason why tax states are permanently plagued by public budget deficits.

Examples of the implementation of the Henry George theorem

Certain countries are moving in the direction outlined above. Take Singapore, for example: not all that glitters is gold here. However, a significant part of the public infrastructure is financed directly or indirectly from land rents. This is possible because around 90% of the land is state-owned (2002). Conventional taxes, on the other hand, are at a very low level. This financing model is likely to have contributed to the fact that Singapore has meanwhile overtaken its former colonial power Great Britain economically. Although the dominance of state-owned land, the home ownership quota is also very high by international standards at around 95%. This was achieved with constructs similar to hereditary building rights. However, Singapore is not a welfare state, but rather a meritocracy - and is also considered an entrepreneurial paradise [10].

The Henry George principle can also be applied to business management. The Mass Transit Railway in Hong Kong (MTR; www.mtr.com.hk), for example, which is largely publicly owned, has two main business areas: Rail and Development [11]. If, for example, new stations are developed, the MTR obtains the land cheaply in cooperation with the authorities. Residential and commercial buildings are planned and developed around the stations. The increased land values are captured in order to cover the costs of providing the rail infrastructure. The tickets can therefore be offered based on marginal cost prices. The MTR is therefore one of the comparatively cheapest, highest quality and most profitable railroads in the world.

Conclusion

The main topic of discussion was the replacement of taxes as the main source of state financing. The internationally dominant system of conventional taxation no longer seems appropriate in view of its many disadvantages.

Conventional taxes should at best be levied on a subsidiary basis and primarily for steering purposes, above all as direct taxes to correct remaining distributional imbalances. This also corresponds to their character as a levy without a claim to consideration. The marginal costs of using state services can be covered by fees. In contrast, the costs of providing public infrastructure can be financed primarily from the financial power of land and similar assets. Specifically, this can be done primarily through public leaseholds or a "land value tax" (LVT). The LVT is based on the principle of equivalence, which is why it is not a conventional tax. Although the absorption of land rents has an equalizing distributional effect [12], a deadweight loss is largely excluded here. Gaffney therefore spoke of a reconciliation between the goals of efficiency and fairness.

However, the consequences of a change in financing go much further, even into the relationship between citizens and the state. Above all, the relationship of subordination that is characteristic of the tax state is replaced by a relationship of coordination through the equivalence of performance and consideration.

A change in financing would also have consequences for the structure of the state: the land revenue generated locally, in the municipalities, would become the main source of finance. In the long term, this is not compatible with a centralized state, but supports a state that is built from the municipalities up and functions according to the principle of subsidiarity.

Of course, the state financing described is a vision. The existing tax and financial constitutions cannot be completely replaced overnight. However, such a vision can serve as a political model for successively reforming the existing institutions.

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