CHAPTER I

Introduction

The history of state revenue production is the history of the evolution of the state. As specialization and division of labor increase, there is a greater demand on the state to provide collective goods where once there were solely private goods or no goods at all. The introduction of economies of scale in the production of state-provided goods and services augments the state's ability to provide collective goods. Improvements in state coordination of people and resources further enhance state capacity. Constituents may come to perceive gains from trade. Certainly, they become more dependent on the state. At the foundation of increases in a state's provision of goods and services is its revenue production system.

The state is a complex institution that has undergone numerous transformations in size, function, and organization over the centuries. What characterizes a state is territorially bounded and centralized regulation of important aspects of social life (Mann 1986, 26–27). The object of state regulations changes with time and place. However, all states attempt to monopolize the concentrated means of violence within a given territory.[1] All implement and enforce property rights and other formal rules,[2] including rules concerning the extraction of revenue.

This definition makes it possible to determine where a state exists or, at

[1] This statement is obviously derived from Weber's classic formulation. However, I eschew the word *legitimate,* at least until the term acquires a consensual meaning.

[2] Ostrom (1985, 465) defines rules as "prescriptions about what behaviors (or states of the world) are required, prohibited, or permitted." For an interesting discussion of rules from the constitutionalist perspective, see Brennan and Buchanan (1985). Their agenda is primarily normative, but they make some important points for positive analysis.

least, where it does not, but it sheds little light on variation in state behavior. The institution of the state is the wrong starting place for a theory of state policy in general and of revenue production policy in particular. Many of the differences among states are themselves the consequences of state policy. I propose instead to begin with rulers—actors or sets of actors who perform as the chief executives of state institutions. Monarchs, chiefs, the Senate of the Roman Republic, presidents, and prime ministers all play this role.

Rulers rule. That is, they stand at the head of the institutions that determine and implement state policies and regulations affecting a given polity and the state's provision of collective goods. They both inherit and create policies that allocate state resources. Minimally, rule connotes defense and justice; but over time rule has evolved to include a wide array of collective goods, although with considerable variation from polity to polity.

The power of rulers rests on coercion, but most operate within the rules of the political constitution. A distinction exists between the process of making the rules and the process of making decisions within the rules (Brennan and Buchanan 1985, 6). Rulers participate in both processes. However, they are also responsible for enforcing the rules. They must inhibit free riding and enforce compliance with the laws of the society, especially its laws governing property rights.

One major limitation on rule is revenue, the income of the government. The greater the revenue of the state, the more possible it is to extend rule. Revenue enhances the ability of rulers to elaborate the institutions of the state, to bring more people within the domain of those institutions, and to increase the number and variety of the collective goods provided through the state.

The major arguments in *Of Rule and Revenue* concern the constraints on a ruler's capacity to produce revenue. I hypothesize that rulers maximize the revenue accruing to the state subject to the constraints of their relative bargaining power, transaction costs, and discount rates. Relative bargaining power is defined by the degree of control over coercive, economic, and political resources. Transaction costs are the costs of negotiating an agreement on policy and the costs of implementing policy. The discount rate refers to the time horizon of a decision maker. The more an individual values the future relative to the present, the lower the discount rate.

The model I discuss and evaluate in the chapters that follow consists of two related claims: (1) the relative bargaining power, transaction costs, and discount rates of rulers will have determinant effects on their revenue production policies; and (2) changes in the relative bargaining power, transaction costs, and discount rates will lead to determinant modifications in revenue production policies. My emphasis is on the variation in the constraints that modify behavior.

My hypothesis follows from two paired assumptions. The first is that all the actors who compose the polity, including the policymakers, are rational and self-interested. By this I mean that they calculate the costs and benefits of proposed actions and choose the course of action most consistent with their fixed preferences. The second is that actors who compose the state have interests of their own, derived from and supported by institutional power. Rulers may sometimes, even often, act on behalf of others. Nonetheless, they are not simply handmaidens of the dominant economic class or other influential actors. They will act in their own interests when and if they can.

Following these assumptions and my earlier definitions, I hypothesize that rulers are predatory in that they try to extract as much revenue as they can from the population.[3] They may use the funds to line their own pockets or to promote their personal power.[4] They may use the funds to support social or personal ends. They may have ideological ends they wish to promote. They may be altruistic. Randomness of ends characterizes rational choice models in general, and rulers operate with a wide range of alternative goals. Whatever the rulers' ends, revenue is necessary to attain them. It is by means of the state and its revenues that rulers achieve their personal and social ends.

Rulers are predatory in the sense that they are revenue maximizers. However, sometimes rulers are the principals—that is, the persons who primarily control and benefit from the organization of the state; and sometimes they are the agents—that is, the persons who act on behalf of

[3] I hypothesize that rulers are predatory, but this does not imply that they are necessarily exploitative. I distinguish predatory and exploitative behavior. Predatory action connotes a choice of policy based on a calculation of its pros and cons for maximizing revenue. By one definition exploitation refers to the extraction of surplus labor; the exploited individual works more hours than are necessary to produce the goods that he or she consumes (Elster 1985, 167ff.; Roemer 1982, *passim*). In another and related definition, exploitation refers to unequal access to assets (Roemer 1982, *passim*). By either definition the power of the state to enforce property rights underlies exploitation (Levi and North 1982). As heads of the state, rulers can exploit directly, can protect the ability of others to exploit, or can prevent exploitation.

[4] Rulers do not always take all that they legally or forcibly might, nor do they always engage in what Pareto labels "spoliation"—that is, personal gain at the expense of the general welfare (1966, esp. 114–20). The behaviors Pareto characterizes with that label are similar to those some public choice analysts call rent seeking, which is discussed in chapter 2. Pareto's concept is both less universal and more precise. Exploitation and spoliation are real phenomena. However, the extent to which they are undertaken varies considerably.

powerful constituents. In either case they act as the chief executives of the state.

The objection will immediately be raised (and has been raised often in seminars) that not all rulers maximize state revenue.[5] What about those few pious kings of history, or the nineteenth-century liberals, or the twentieth-century monetarists, social reformers, and other rulers whose concern is revenue reduction or a particular social end? I admit at the outset that there are rulers who cannot be characterized as revenue maximizers, but I suspect that they constitute the exception. My argument does not deny these possibilities. Revenue maximization as the source of organizational variation is a hypothesis, not a conclusion. If it is a powerful hypothesis, it will account for most, but not all, behavior.

The fact that rulers often refrain from extracting the greatest amount of revenue they could in principle extract from the population does not mean they are refraining from maximizing behavior. Rulers refrain from extraction primarily because of the constraints to which they are subject. Maximizing revenue involves reduction of the costs of extraction or a trade-off between extraction costs and gross income. This means minimizing rebellion as well as lowering the transaction costs. Revenue maximization can stimulate a desire for a higher return over time. Therefore, rulers may provide incentives to production by permitting the ruled to keep more of what they produce. What follows from my model is that proposals to lower taxes are usually reflections of constraints on rulers imposed by powerful constituents or by the desire to increase revenue over time. One can, in principle, test this claim by investigating the consequences of variations in the constraints on rulers. If the constraints do not explain the behavior, the hypothesis is disconfirmed. As usual, it is most instructive to push the hypothesis as far as possible to test its bite.

The empirical focus of my study is variation across time and place of rulers' choices of revenue production systems, particularly how revenue collection is organized and what revenues are collected from whom. My aim is to explain major policy choices. I am not concerned with incremental reforms of tax systems. Nor do I calculate the amount of revenue collected in a particular society, the amounts lost to tax collectors through pay or corruption, or the amounts personally pocketed by rulers. The records and

[5] I am well aware of the critique of maximizing and the preference, among many eminent organizational theorists, for the assumption of satisficing. Yet, on purely methodological grounds, the conventional *homo economicus* (and *femina economica*) assumption remains the most useful for comparative and testable analysis. For a recent and particularly nice defense of this assumption, see Brennan and Buchanan (1985, esp. chap. 4).

other evidence for making such calculations simply do not exist for many of the historical periods I investigate. We do not yet possess adequate tools or theory for evaluating the efficiency of any revenue production system.[6] Moreover, my aim is to account for organizational variation in revenue production systems rather than to evaluate their performance. If my hypothesis is correct, I should be able to explain the form of revenue production chosen, given the constraints of rulers' relative bargaining power, transaction costs, and discount rates.

In *Of Rule and Revenue,* I elaborate my hypothesis and draw out its theoretical implications. I provide case studies (in chapters 4–7) drawn from quite different places and periods of history. Each case presents the state at a different level of development and during a period of large-scale change. Moreover, each case is drawn from a distinct economic organization of society or, in the Marxist terminology, a distinguishable mode of production or stage in a mode of production.

All the material is from Western history. Some critics will argue that my choice of cases reflects the bias of the model I have chosen to apply. However, preliminary research on revenue production in historical China and Japan, for example, suggests that the model applies to non-Western societies as well. And Robert Bates (1987, chap. 2) has successfully used a variant of this model to account for state behavior in African societies. I restricted myself to societies about which I already had sufficient knowledge, so that the research task would not become more overwhelming than it already was. Although the cases are Western, they represent a diversity of cultures, norms, and institutions. Thus, they enable me to affirm (or disconfirm) the generalizability and universality of the arguments I am positing.

Each case presents a distinct substantive problem of revenue production and highlights a distinct aspect of the theory. Together the cases form a picture of state structures evolving to capture gains from trade. Transformations in the state tend to correlate with changes in the relative prices of goods and services and with changes in the specialization and division of labor. The cases provide insights into how rulers go about establishing taxation and other state structures that enable them both to supply publicly demanded goods and services and to benefit in the process.

The first case concerns the rise and decline of tax farming in ancient

[6] Analysts continue to disagree on how one should go about untangling this thorny problem, even with the availability of a very large amount of data on contemporary tax systems. For a taste of this debate, see Posner (1975, esp. 93 in 1980 reprint) and Goetz (1978).

Rome; the second, the emergence of national tax systems in medieval and Renaissance England and France, followed by the divergence of what had been similar revenue production policies in the two countries; the third, the development and imposition of the first income tax in late-eighteenth-century Britain; and the fourth, federal imposition of a uniform income tax and subsequent problems of evasion and avoidance in Australia during and after World War II. Relative bargaining power is an important issue in all the cases, but rulers bargain with their agents in Rome; with nobles and then nobles and agents in France and England; with Commons and citizenry in Britain; and with the states and then the citizens in Australia. Transaction costs also contribute to the outcome in all the cases, but the nature of these costs changes as rulers devise more sophisticated structures for measuring and monitoring compliance and as constituents demand more goods from and permit less discretion by rulers.

It would be far fetched to claim that the cases actually "test" the model. Rather, my aim is to demonstrate that the model is consistent with the facts. By choosing a variety of examples, I also illustrate its power to illuminate diverse historical problems in quite different institutional and cultural settings.

I do not believe that such an enterprise, based in a universal theory, does violence to the diversity of the societies discussed here—although it may do violence to the vocabulary that those societies, and the academics who study them, use to describe behaviors and institutions. I persist with the use of terms such as *state, rational, ruler, contract,* and *transaction costs* even when they might be considered anachronistic (by some accounts) or no longer valid (by some accounts). Having defined them, I consider them descriptive and illuminating. Also, they enable me to make more obvious the similarities and dissimilarities among the cases I have chosen. They help make clear what is general and what is not.

My motivations for this project are both substantive and theoretical. All governments have revenue requirements. Rudolf Goldscheid, the founder of fiscal sociology, claimed that "the budget is the skeleton of the state stripped of all misleading ideologies" (quoted in Schumpeter [1918] 1954, 6). Schumpeter argued, "The fiscal history of a people is above all an essential part of its general history" ([1918] 1954, 6–7). Gabriel Ardant (1971, 1972), the author of the major contemporary work on fiscal history, justifies his study in similar terms. With few exceptions political analysts have given scanty attention to the ways in which governments go about producing and extracting revenue. The relatively small, if important, literature tends to be either empirically thin or theoretically vacuous.

Ardant's work stands out for its breadth and its insights, if not its rigor. Webber and Wildavsky (1986) provide a descriptive history of Western taxation but little explanation.

Although Brennan and Buchanan (1980), Mitchell (1983), and other public choice theorists offer some useful arguments and ideas, to which I shall return later, their work can be differentiated from mine in their singular focus on contemporary capitalist democracies and in their assumption that taxation is theft. They are therefore more concerned with possible constraints imposed on rulers by citizens than with actual constraints that exist willy-nilly in any polity. Their project is more normative than empirical. Frohlich and Oppenheimer (1974), Groves and Ledyard (1977), and, most to the point, North (1981, 1985) and Bates and Lien (1985) begin to offer theoretical guidance. They attempt to account for the mix of taxes and the nature of taxation systems given the assumption that most individuals are opportunistic but within a framework of strategic interactions and institutional arrangements. They spin out the argument in relationship to institutional change and apply it to historical evidence.

My theoretical motivation is twofold. The first is to explain state behavior. The second is to make the point that both individuals and institutions matter. My aim is to account for the effects of institutional change on policy, especially tax policy. Such an objective, I believe, requires a microtheory of individual behavior that links one macro-state of policy to the next. I want to emphasize the importance of structures and institutions while bringing people back into the state.[7]

Explanation would be incomplete without an account of the ways in which macro-level variables affect the micro-level ones, and vice versa. However, theorists have tended to do one or the other. The structuralists have linked one macro-state to another, with little regard to the mechanisms that affect the correlations they perceive. Most neoclassical economists and other methodological individualists have generally ignored the state, organizations, and other events and institutions that affect the decisions of individual consumers.[8]

The form of political economy often called rational choice—that is, the

[7] I am playing here on the title of the famous 1964 presidential address to the American Sociological Association by George Homans, "Bringing Men Back In," and on Skocpol's "Bringing the State Back In" (which serves as the set piece and title of Evans, Rueschemeyer, and Skocpol, 1985a). Homans was arguing against and offering an alternative to functional-structuralism. Skocpol is arguing for a historically grounded structuralism. Thus, I find myself reiterating some of Homans's pleas and some of Skocpol's, although with the following difference: I advocate a micro-macro theory that includes both individuals and structures. See the appendix for an elaboration of these themes.

[8] For a review of the relevant literatures, refer to the appendix.

theory of individual strategic decision making—begins to resolve some of the theoretical and methodological dilemmas inherent in attempts to provide causal explanations of policy choices and changes.[9] Of particular influence on me are those writers who attempt to provide the microfoundations of macro-historical and comparative phenomena (Barry 1970; Bates 1981, 1987; Bates and Lien 1985; Boudon 1979; Brenner 1983; Elster 1978, 1979, 1983a, 1983b, 1985; Emerson 1983; Hardin 1982; Hechter 1983, 1987; North 1981, 1985; Popkin 1979; Przeworski 1985a, 1985b; Riker 1982, 1984; Roemer 1982; Schott 1984; Taylor [1976] 1987, 1982). All use rational choice, and all are concerned with the collective action problem as defined by Mancur Olson (1965). Some draw on game theory. Others emphasize the tools of micro-economics. Most call on Marx at some point in their arguments. By applying their findings to significant political problems, I hope to be able to evaluate the power of the rational choice approach. And that is at least part of my purpose.

Rational choice is committed to methodological individualism but does not reduce actors to antisocial or asocial creatures lacking regard for or influence on one another. It searches for behavioral regularities but does not practice a simple determinism in which the constraints make choices absolutely predictable. There is always a range of alternatives within the structured set.

The rational choice approach recognizes that institutions and structures are the consequences of human actions. It is individuals who act, individuals who think. Individuals create institutions—although, of course, institutions, structures, and other macro-states also influence individual preferences and behaviors. These influences can be modeled as the rules of the game. Given a new set of rules, will people rebel, how will institutions be transformed, what policy changes will occur? Although the current power of rational choice lies in accounting for the ways in which individuals interact with and influence one another within a particular framework, the ultimate goal, the explanation of long-term secular change, may be in sight.

To achieve my ends, I start with a simple and, I believe, acceptable assumption about human behavior—namely, that individuals calculate the costs and benefits to themselves of various actions they are considering and then choose the alternative most consistent with their fixed preferences. I

[9] The concluding essay in Bates (1987) is a compelling statement of the advantages of rational choice as I have described it. Bates also clarifies the consistencies and inconsistencies of rational choice with both Marxism and neoclassical economics, an enterprise in which I am also engaged. Also see Przeworski (1985b) on "Marxism and Rational Choice."

then posit that rulers maximize revenue to the state subject to determinant constraints on their behavior. It is these constraints that motivate my hypothesis. It is the effects of the variations in these constraints that I am investigating. Finally, I attempt to construct more fine-tuned arguments about the mechanisms by which the institutions of the state are created and maintained. Ultimately, I hope to demonstrate the process by which state structures evolve in response to changes in bargaining power, transaction costs, and discount rates.