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# Political Profit: Taxing and Spending in the Hierarchical State

By ALFRED G. CUZÁN\*

**ABSTRACT.** The actions of *government* fall into two types: *taxes* (the taking of *property*) and *expenditures* (the awarding of *gifts*). Politicians profit as long as the value of *resources* raised from *taxation* exceeds the cost of expenditures. From their point of view, *fiscal efficiency* consists in maximizing the support obtained by spending and minimizing the opposition generated by taxing. This is accomplished by spending on well-organized *groups* and taxing the uninformed *public*. This results in the “iron law of political redistribution” in which *income* and *wealth* are transferred from the latter to the former. In a *hierarchical State*, it is usually profitable for those at the top to centralize control over taxing and spending, if for no other reason than to make it difficult for politicians at lower levels to compete against them. This gives rise to the “law of *hierarchical centralization*”—in a hierarchical State, power becomes centralized over time. The greater the power of government, the faster this process takes place. In order to avoid this problem, one could design *constitutions* which are non-hierarchical in nature, in which each unit of government is completely autonomous from the others, as *firms* are in a *free market*.

## I

### INTRODUCTION

In *The State*, Franz Oppenheimer views all men as purposefully acting to satisfy personal wants and desires along two fundamentally different paths: the “economic means” of production and exchange and the “political means” of coercion and expropriation (1). A market economy or “industrial city” exemplifies the economic means while the State represents the political means in their most developed form.

\*[Alfred G. Cuzán, Ph.D., is assistant professor of political science, University of West Florida, Pensacola, Fla. 32504.] An earlier draft of this paper was presented before the Public Choice Society on March 17, 1979 in Charleston, South Carolina. Between the Fall of 1978 and the present, a great number of individuals have helped me develop these ideas with their criticism and encouragement. I particularly value the aid provided me by James L. Busey, David Collier, James Buchanan, Steven Slutsky, Murray Rothbard, Philip Monypenny, Peter Bauer, Milton Friedman and Gordon Tullock. Needless to say, none of them bears any responsibility for the content of the paper. In addition, I wish to thank Paul Sagal and Cal Clark for their generous intellectual and moral support during my years at New Mexico State. Finally, I express my appreciation to my students in political economy at New Mexico State University, and in political science at the University of West Florida, who have listened and argued patiently and sympathetically as these ideas took form during lectures, seminars, and individual discussions.

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This paper analyzes the micro-economics of the "political means." It examines the logic of political action by rulers whose purpose is to maximize the real income derived from the exercise of power in a hierarchical system of government in which the ultimate or "sovereign" authority lies in a federal or national level. The analysis focuses on the strategies by which chief executives attempt to maximize political profit, or to reach what Wittfogel calls their "rationality optimum" (2). A subsequent paper will explore the constraints imposed on this behavior by democracies and dictatorships (3).

The paper follows the rules of "praxeology" or the axiomatic-deductive approach to the study of human action (4). Like much of what political economists do, the analysis employs a scientific method in which deductions are logically derived from initial premises about acting individuals with the aid of clearly specified auxiliary assumptions. The principal objective of this and the following paper is to maximize the deductive value of the theory presented; so, as many hypotheses will be generated as can be logically justified with economic theory. The most important conclusions will be examined in light of the work of such towering scholars as Franz Oppenheimer, Karl Wittfogel, Joseph Schumpeter, Herbert Spencer, and Bertrand de Jouvenel. Also, the United States and Cuba will supply data with which to evaluate key deductions empirically. Given the limits of a scientific journal article, complete empirical validation of all the hypotheses is not attempted at this time. Rather, it is hoped that the theory will receive exhaustive scrutiny by the community of social scientists in the years ahead.

## II

### DEFINITIONS AND ASSUMPTIONS

POLITICS IS THE EXERCISE and influence of governmental power. Power is command or control over unowned resources. Government is the set of symbols and organizations by which politicians rule over citizens or subjects. A notion of a collectivity, such as nation, State or "revolution" universally serves as the main symbol of government. Politicians invoke these and other symbols peculiar to the history and culture of a society in order to justify their rule. All rulers claim to have the right to be obeyed by their subjects, *i.e.*, they proclaim to have authority. To the extent that those over whom power is exercised (the ruled) recognize the authority of the rulers and surrender

resources more or less voluntarily to the government, the rulers can be said to enjoy legitimacy.

Coercion is the amount of force employed by the rulers to implement their commands. It varies inversely with the legitimacy of public officials (5). The rulers of a legitimate government are able to persuade the population to obey their instructions at relatively little cost to themselves. In contrast, rulers whose authority is rejected by the people would waste their time and resources in attempting to persuade them, so they find it more economical to rely on coercion instead.

Thus, as Plato (6) long ago pointed out, persuasion and coercion constitute the two factors with which the political means are exercised. In order to control resources, a government has to persuade and coerce the population, and the more it does of either or both of these things the greater its power. The rulers will continue to acquire power by allocating resources to persuasion and coercion as long as the marginal benefits they derive from it exceed the marginal costs to themselves.

Viewed in this light, a politician is an entrepreneur who employs the political means in order to profit, or satisfy personal goals and desires. He either aspires to or holds a position of power by virtue of political support, either votes or the force of arms or both. This assumption is not only consistent with the economic axioms of self-interest and rationality—it also has formidable empirical support. According to Wittfogel, who reviewed the history of despotic government over many centuries and several continents: “Without exception . . . the masters of the agrarian apparatus State satisfied the constructional, organizational and acquisitive needs of their realm with a maximum stress on their own advantage and a minimum stress on the requirements of their subjects” (7). The paradigm of “public choice” consistently applies this maxim in its explanations of political actions and their consequences.

In this paper it is also assumed that government consists of a hierarchy of executive offices organized vertically. This is done for the purpose of analytic simplicity. The objective is to analyze the logic of entrepreneurship by which politicians seek and maintain support among subjects and followers and not among fellow politicians, as legislators necessarily have to do (8). Note, however, that the model corresponds to the hierarchical reality of all existing governments since none is exempted from the constitutional superiority of a

“national” or “federal” level whose authority over subnational units is explicitly stated or simply assumed.

### III

#### *POLITICAL PROFIT*

IN GENERAL, the actions of government fall into two types: taxes and expenditures. Taxes—including compulsory payments, other exactions and mandated costs—are the taking of property (expropriation) by government. This includes but is not limited to money. Regulations take away people’s discretion over their property; jury duty, a military draft or “volunteer labor” compel service to the government; jailings and executions take control over people’s very lives and freedom. Expenditures are the making of payments and the awarding of gifts. These include not only money but everything power can bestow: conditional rule over others, exclusive licenses and other special privileges, servants, accommodations, transport, recognition, publicity, prestige, honorific titles, “public” goods and services, etc. (9).

Taxes and expenditures divide the population into classes according to each individual’s perceived returns from government. According to Oppenheimer: “In principle, there are only two classes to be distinguished: one a ruling class, which acquires more of the total product of the labor of the people—the economic means—than it has contributed, and a subject class, which obtains less of the resultant wealth than it has contributed . . .” (10). Calhoun labeled them the tax-consumers and the taxpayers (11).

In this paper, three classes of subjects are recognized: the taxpayers, the beneficiaries, and the indifferent. The first includes all who believe that they give up to government or a specific politician more than they get back while beneficiaries perceive that the gains from government generally or specifically exceed the losses. Naturally, the personal followers, relatives and friends of a chief executive are heavily represented in the beneficiary class while his enemies, rivals and opponents make up a large proportion of the taxpayers. Note that the term “taxpayer” is not used to describe one who makes payments, renders involuntary services to or indirectly bears the cost of government, since everyone in society would fall in this category. Rather, here it means individuals who regard the actions of government net of payments and services as detrimental to their welfare, *i.e.*, they view themselves as being deprived by those in power.

Bear in mind that what determines each person’s class status is his

or her *subjective judgment* and not some “objective” indicator of gain or loss devised by an external observer. Those who support a politician, a policy or the government do so because they consider themselves beneficiaries while those who oppose any or all of these act that way because they regard themselves as taxpayers. The greater the intensity with which these judgments are held, the greater one’s efforts in support or opposition (12).

While the beneficiaries and the taxpayers constitute the two politically active classes, the indifferent make up the bulk of the population. This class is composed of everyone who believes that the net benefits or losses from government are close to zero. It includes the alienated, taxpayers who nevertheless choose not to act in opposition because they are pessimistic about the probability of changing their status for the better through political action, and the so-called “silent majority,” large numbers of people who are content with the status quo and see no need to get involved politically.

Numerically, the indifferent constitute by far the largest class. Even in a democracy, political action beyond the act of voting is limited to a small percentage of the population. In the United States, for example, less than 10 percent of citizens make time or monetary contributions to political campaigns, less than 5 percent become active party members, and less than 1 percent ever run for office (13). *Coups* and revolutions involve a tiny fraction of the subjects. Castro’s “rebel army,” for instance, amounted to a couple of thousand men just before Batista fled the country; six months earlier, he had only 300 men. Cuba’s population was then on the order of six million people (14). The reason why relatively few people become politically active lies in the relatively higher costs (especially information costs), lower probability of success and greater risks of political action compared with private, individual pursuits (15).

Every subject would like to be a beneficiary and none wants to be a taxpayer. However, securing benefits or reducing taxes involves a cost. Only if the expected value of the benefit (a tax reduction or an expenditure) exceeds the expected cost of political action by a margin large enough to be comparable to private opportunities, including black-market transactions and leisure, do individuals bother to attempt to change their fiscal status. Many taxpayers—the alienated—prefer to do little or nothing to alter their relation to government as long as they view such attempts as bound to fail or to result in an even worse loss. This is particularly true under despotism, where the

risk of incurring the despot's wrath renders the vast majority of the population hopelessly apathetic (16). But, as soon as the expected rewards exceed the cost of political action, individuals enter the arena of politics as supporters or opponents of politicians or as entrepreneurs in their own right. Sudden changes in the expected costs of political action can generate massive—if temporary—outbursts of political activity. The change from a dictatorship to a democracy or the collapse of a government are usually accompanied by increases in the rate of political participation. The alienated are particularly sensitive to the lowering of the costs of political action since it makes it economical for them to release their pent-up fury and seek redress for their complaints (17).

The class of beneficiaries lives partly or totally at the expense of the taxpaying class. This relation is one of conflict in which one set of subjects regards itself as exploited by another. However, the explosiveness of this situation is defused by two factors. The first is the size of the gain or loss relative to one's income and wealth. The other is the degree of permeability between the two classes. As long as what an individual expects to gain or lose from politics is small, political outcomes will not excite violent controversies. Also, if individuals perceive that there is a fair chance that what is lost today will be recovered tomorrow, the actions of government will be more or less acceptable to most taxpayers. Hence, when these conditions hold, the level of coercion which rulers need exercise to implement their commands will be relatively small.

However, to the extent that there exist permanent beneficiaries and permanent taxpayers, so that the classes become castes, and the greater the gains and losses, the more taxpayers come to regard government simply as an instrument of exploitation for the benefit of specific politicians and their supporters. This perception erodes the legitimacy of the regime which must then raise the level of coercion to maintain its control over the subjects.

Politicians profit from their rule. This profit is the difference between taxes and expenditures. In other words, political profit is the portion of taxes retained by the rulers for their own benefit. This profit yields real income: a salary; "kickbacks" of various kinds; official "perks" such as servants, accommodations in public and often historic buildings, and transport; the making of contacts and friends; publicity, prestige and status; the opportunity to execute pet projects with

someone else's money; leisure and entertainment; the illusion of immortality that comes from having one's name enshrined in buildings and documents; and, of course, whatever personal satisfaction is derived from "doing good."

Politicians make a profit through entrepreneurship. A minimum of net political support is necessary to capture every position of authority. Support is obtained by promising to spend money on various groups of subjects. This, however, is offset by the opposition of those who expect to pay the taxes with which the politician plans to reward his supporters (18). They in turn support rival politicians who promise either to spend money on them while taxing still others, or to reduce their taxes. The politician who receives the greatest net support wins. In order to measure support, one needs to do more than simply count the number of supporters, since this says nothing about the intensity of their feelings. Intensity could be measured by adding the amount of money or monetary equivalent of the manpower contributed to the campaign of a politician per supporter, *i.e.*, by estimating the economic value of their support.

Since support is obtained with expenditures, the less a politician need spend to secure a given level of support, the greater his profit. Similarly, the more he can tax without generating opposition, the greater his profit. From the politician's standpoint, then, fiscal efficiency consists in raising the level of support from any amount spent and/or reducing the level of opposition from any amount taxed.

The ratio of support to expenditures can be raised by organizing and informing groups of subjects who clearly stand to benefit from government expenditures. Thus, if interest groups did not form independently, politicians would have the incentive to organize them.

On the other hand, politicians have a vested interest in raising taxes inconspicuously and thus generally promote fiscal illusions among the subjects. They avoid informing the targets of taxation of the real cost or magnitude of revenue-sharing measures while at the same time they exaggerate the value of expenditures to the beneficiaries. Ironically, it is the poorer sectors of society who know the least about government finances and the real impact of public policies. Hence, they are most likely to suffer fiscal illusions about their relations with government and to consider themselves beneficiaries or at worst indifferent whereas if they had better knowledge or information they might conclude otherwise.



## IV

*THE POLITICIAN AS ENTREPRENEUR*

IN SUM, political profit is made by taxing the uninformed and the unorganized and spending on the informed and the organized. This results in what might be called the "iron law of political redistribution" in which income and wealth are transferred from the former to the latter. Virtually every public policy can be explained as the result of the efforts of organized interests to gain an economic advantage at the expense of the mass of the public (19).

Note that politicians have no incentive to redistribute income and wealth from "the rich" to "the poor." A politician gains nothing by taxing well-organized, well-informed, high-income groups and spending the money among a large number of unorganized low-income people who might not even realize the benefits of the action. On the contrary, the organized, high-income groups will oppose him while the unorganized poor will do nothing. Thus, whatever improvements in the lot of "the poor" are brought about by fiscal action are incidental to the goal of securing political support from interest groups who will benefit by administering or selling services to the "anti-poverty" programs.

This conclusion is supported empirically by Reynolds and Smolensky, who measured the post-fiscal distribution of income at three points in time between 1950 and 1970 in the United States. They "could find no major changes in final income distribution despite rapid growth of government, sizable changes in the composition of taxes and expenditures, and increasing concern about the distributive effects among intellectuals and bureaucrats. . . ." They explain their findings as follows: "Most government benefits are distributed independently of income and depend upon characteristics, such as being a farmer, or aged, or a veteran, driving an automobile or going to a public college. Thus, much redistribution is back and forth within the middle income groups, and only a portion of the large and growing share of income controlled by government is directed toward modifying the size distribution of final income . . ." (20). Indeed, one might find that welfare payments to the poor fail to compensate them for the loss in income which results from diverting resources from productive private investment to inefficient government programs which subsidize the non-poor.

The greater the property transfer between taxpayers and beneficiaries, the greater the margin of profit for the politician. It should

be obvious that if a politician reallocates \$100 among 100 people so that 51 end up with an average of approximately \$1.05 each and 49 with an average of \$.95 each, the margin of profit is much less than if the redistribution left 10 people with an average of approximately \$5.00 and the rest with an average of \$.55 each. But, if the profit is greater the greater the transfer, so is the risk. The greater the exploitation of the taxpayers, the greater the likelihood of violent retaliation and hence the greater the level of coercion that must be imposed on at least a few of the subjects.

A politician may choose to consume, save or invest his profit, depending on personal preferences and circumstances. Profit is consumed in high salaries, luxurious offices, travel, leisure, the organizing of parades, military displays, speeches, banquets, celebrations, parties, status games, hobbies and personal entertainment. Profit is saved by converting it into private wealth. While this is easy to accomplish by means of "kickbacks" ingeniously built into public expenditures, it invariably incurs the wrath of taxpayers, and this is exploited by rival politicians as an issue with which to attract support. Finally, profit is invested by allocating it to the pursuit of more powerful offices. This is done by allocating resources toward attracting the attention of broader constituencies, criticizing those who occupy the desired positions, and building up a cadre of loyal followers who will proselytize for him.

Most politicians seek profit as doggedly as any businessman. Those who don't are driven out by those who do, if only because the latter use their profit as a source of political investments. Only truly benevolent rulers take a lower rate of profit than the power of the office allows. However, as it has already been noted, such rulers are rare; benevolence seldom extends beyond one's immediate family and circle of close friends, a human characteristic which may have a genetic base (21). What often passes for self-denial on the part of a ruler is actually only an appearance, a carefully manufactured image designed to attract support. In any case, even in the unusual case of a benevolent ruler, his less noble aides end up capturing the profit which he had intended to return to the subjects. The only effective way of reducing the profit from an office is to limit its power, *i.e.*, its ability to redistribute income and wealth with the "political means."

This, however, is very difficult to do with respect to the highest office of a hierarchical State. A constitution which vests ultimate authority in the highest level of government provides the legal means for centralizing the political means. The national executive can find

it profitable to centralize the State if for no other reason than to make it difficult for rivals at lower levels to challenge him. As Wittfogel explains, the greater the scope of the power of the State, the more economical it becomes to centralize it. Over time, a succession of chief executives, each aiming only at a temporary advantage over competitors, will tend to centralize State power. If no checks are imposed on the growth of government, the process inexorably continues until society comes to be ruled by some form of despotism. Wittfogel calls this phenomenon the "cumulative tendency of unchecked power" which, as he observes, does not become fully manifest until the scope of the "political means" reaches a critical threshold of size (22). Another name for it might be "the law of hierarchical centralization." As the succeeding paper will show, democracies are more resistant to it than dictatorships.

There are two possible ways to deal with this problem. One is to divide power among the levels of government precisely, forbidding the higher offices from undermining the authority of the lower offices. But, since it would still be up to the highest office to enforce the Constitution, such stipulations are unlikely to be effective. In response, the people may wish to organize constitutional conventions periodically for the explicit purpose of decentralizing the government and designing ever more ingenious methods of preventing the chief executive from accumulating undue power. However, there is no assurance that the President would not use his power and influence to persuade the convention to adopt centralizing "reforms" instead.

An alternative constitutional strategy would be to adopt forms of government which are non-hierarchical in nature, so that each level of government would be completely autonomous from the others, as business firms are in a free market. Such constitutional designs would lack a "superior" or "ultimate" center of authority and thus would be inherently anarchical. They would produce confederations of states, not federations or unitary governments. Before attempting to draft such documents, more must be known about the theory of anarchy and horizontal coordination among governments.

1. Franz Oppenheimer, *The State* (Indianapolis: The Bobbs-Merrill Company Publishers, 1914).

2. Karl A. Wittfogel, *Oriental Despotism* (New Haven: Yale Univ. Press, 1957) pp. 128-36.

3. Alfred G. Cuzán, "Political Profit: Taxing and Spending in Democracies and Dictatorships," forthcoming in the *American Journal of Economics and Sociology*.

4. "Praxeology" is a term used by the late economist Ludwig von Mises and his followers to mean the study of "the formal implications of the fact that men use means

to attain various chosen ends" (i.e., that they act economically) as Murray Rothbard puts it in *Man, Economy and State* (Los Angeles: Nash Publishing, 1962) p. 64. See also Ludwig von Mises, *Human Action* (New Haven: Yale Univ. Press, 1949) pp. 64–69; Mario J. Rizzo, "Praxeology and Econometrics: A Critique of Positivist Economics" in Louis M. Spadaro (ed.) *New Directions in Austrian Economics* (Kansas City: Sheed Andrews and McMeel, Inc., 1978); Murray Rothbard, "Praxeology as the Method of the Social Sciences," in *Individualism and the Philosophy of the Social Sciences* (San Francisco: The Cato Institute, 1979.) For a deductive "systems analysis" of society, see Alfred Kuhn, *The Logic of Social Systems* (San Francisco: Jossey-Bass Publishers, 1974).

5. The empirical evidence is summarized in Ted Robert Gurr, *Why Men Rebel* (Princeton: Princeton Univ. Press, 1971), pp. 185–92. For a systematic analysis of the relationships between legitimacy, persuasion, coercion, and the scope of political control of society see Alfred G. Cuzán, "Authority, Scope and Force: An Analysis of Five Central American Countries," forthcoming in a special issue of *Public Choice*, 1980; Alfred G. Cuzán and Richard J. Heggen, "A Micro-Political Explanation of the Nicaraguan Revolution," forthcoming in the *Latin American Research Review*; and Richard J. Heggen and Alfred G. Cuzán, "Legitimacy, Coercion and Scope: An Expansion-Path Analysis Applied to Five Central American Countries and Cuba," paper presented before the Public Choice Society meeting in San Francisco, March 14, 1980.

6. "... And yet legislators never appear to have considered that they have two instruments which they might use in legislation—persuasion and force; for in dealing with the rude and uneducated multitude, they use the one only as far as they can; they do not mingle persuasion with coercion, but employ force pure and simple. . . ." Plato, "The Laws," in B. Jowett, *The Dialogues of Plato* (New York: Random House, 1937), p. 493.

7. Wittfogel, *Oriental Despotism*, p. 128.

8. Gordon Tullock, *The Vote Motive* (London: Institute of Economic Affairs, 1976), p. 16.

9. A very similar approach to the study of regulation is developed by Sam Peltzman, "Toward a More General Theory of Regulation," *Journal of Law and Economics*, August, 1976, pp. 211–40.

10. Oppenheimer, *The State*, p. 258.

11. John C. Calhoun, *A Disquisition on Government* (New York: Political Science Classics, 1947).

12. von Mises, in *Human Action*, discusses the subjectivity of value and its revelation through action (pp. 94–96).

13. James McGregor Burns et al., *Government by the People* (Englewood Cliffs, N.J.: Prentice Hall, 1978), p. 204.

14. Hugh Thomas, *The Cuban Revolution* (New York: Harper & Row, 1977), pp. 260 and 311.

15. In fact, Downs concludes that the expected benefits from political action are so low for most individuals, that it is a wonder so many people even show up at the polls on election day. See Anthony Downs, *An Economic Theory of Democracy* (New York: Harper & Row, 1957). See also Randall Bartlett, *Economic Foundations of Political Power* (New York: The Free Press, 1973).

16. Wittfogel, *Oriental Despotism*, Ch. 5.

17. Very similar logic is employed by Thomas Ireland, "The Rationale of Revolt," *Papers on Non-Market Decision Making* (Charlottesville, Va.: Thomas Jefferson Center for Political Economy, Vol. 3, Fall, 1967); and Morris Silver, "Political Revolution and Repression: An Economic Approach," *Public Choice*, Spring, 1974, pp. 63–71.

18. A similar line of argument is pursued by Philip Monypenny, "Federal Grants-in-Aid to State Governments: A Political Analysis," *National Tax Journal*, Vol. 13, 1960, pp. 12–16.

19. John C. Goodman and Edwin G. Dolan, *Economics of Public Policy: The Micro View* (St. Paul: West Publishing Company, 1979).

20. Morgan Reynolds and Eugene Smolensky, "Post-Fisc Distributions of Income in 1950, 1961 and 1970," *Public Finance Quarterly*, October, 1977, p. 435.

21. Richard Dawkins, *The Selfish Gene* (New York: Oxford Univ. Press, 1976).

22. Wittfogel, *Oriental Despotism*, p. 106.