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By Daniel Tarschys*

Entering a World of Footloose Tax Bases: Can the EU Generate Its Own Income?

Abstract
While the expansion of domestic trade generated many demands for provision of public services at national, regional and local levels, the growth of international exchange produces a new logic of collective action. Export-based countries require many interventions abroad, in jurisdictions other than their own. New services and new forms of protection are needed, requiring new forms of taxation. The digital economy with its long and complicated value chains is creating a new fiscal landscape. Taming multinational corporations and "business-friendly" tax havens requires political clout which only strong international authorities can provide. In the quest for future EU revenues, we should look mainly for sources beyond the control of the member states.

1 What revenue for the European Union?
Decade after decade, budget round after budget round, the same tedious script is played out again and again. Supporters of European integration present their arguments for "more Europe", economists repeat their lectures on the value of European public goods, specialised international bodies transmit their latest reports about urgent needs in response to acute crises, the European Parliament continues to lambast against the paralysis of the Council, but the member state governments remain unimpressed. With so many domestic interests competing for their attention, and large parts of their media and electorates sceptical of foreigners in general and Eurocrats in particular, they play first and foremost to their national audiences, which are understood to reward hard-nosed negotiators and reliable guardians of the public purse. As a consequence, there are few changes in the composition of the EU's financial perspectives from one period to another. The best predictor of the next long-term budget of the Union is still the present one.

The lesson from several decades of budget negotiations in the EU is that innovations on the revenue side are fiercely opposed. Even the most imaginative proposals by the most eminent teams of "wise persons" are sidelined. In the first place, member state governments do not want to cede their control over any of their presently exploited tax bases beyond the concessions already made. Secondly, they are hostile to releasing access even to potential, as yet unexplored, sources of income. The rumours of EU misspending and the anticipated reactions of those threatened with new levies suffice to galvanise the member states' opposition. Anything reeking of direct EU taxation is taboo.

Behind this firm resistance to increases in EU revenue, there seem to lurk several visceral instincts. One is the urge to defend the reserves of the domestic treasury. Another is the apprehension of impacts on the national economy. Any tax wedge is pernicious to investments and employment, and especially so if there are no immediate and direct returns.

* Professor of Political Science and associate researcher, Swedish Institute for European Policy Studies. This paper was first presented at a Robert Schuman Centre Workshop on the Own Resources of the European Union, European University Institute, Florence, on 24 April 2015.

Eventually, many funds siphoned off to the EU come back in the guise of payments from the European Union, but that is only eventually; the grumbles from those affected are in the present. And apart from the domestic protests, there are also the constant sermons about budgetary balance from the Council and the European Commission. Finally, there are the perpetual side glances towards the acquired privileges of other member states and to seemingly excessive remuneration levels in the European Union. In times of domestic austerity, the "equal pains" and "equal efforts" principles enjoy broad support. However much they agree on various European strategies at Council meetings, governments remain mesmerised by their own net balances and acquired correction gains.

The zero-sum game appears to be locked. But is it true that any new revenue for the EU is a national loss even in the first stage, before some of the money reverts? This paper explores a different tack than the transfer of fiscal competence: that of finding additional EU income in virgin pastures where national ministers of finance have not yet trod and cannot tread, or can do so only with the greatest difficulty. In a globalising world, there are potential public income sources that are not only untapped but even untappable for national governments, i.e. simply beyond their reach because several tax bases have become so footloose and etheric. This is also linked to emerging demands for public interventions that cannot be satisfied at the level of individual states. With tax havens and widening consumer markets only a few clicks away, we are facing a new logic of collective action. This makes the stagnation of the EU budget even more absurd: With two billion smart phones dispersed around the world in the last seven years, we urgently need to get smarter about the budget for the next seven years of the European Union.

2 The transformation of government, 1815-2015

As a preface to the EU household, we might first take a quick look at government revenue and government expenditures in general. Measured as a proportion of GDP, the member states' public spending stands at 50.3% and their public income at 44% (Eurostat 2010). Compared to the situation in the 19th century, this is a fourfold or fivefold increase of the fiscal quota. From 1815 to 1914, the government's share of GDP in European countries oscillated around 10 percent (Cardoso & Lains 2010).

Following Adolph Wagner's famous prediction of government growth as a consequence of economic development, many historians and social scientists have tried to understand the intricate causal patterns behind this evolution (an early inventory of this literature in Tarschys 1975). For the purpose of this paper, it is sufficient to consider two key preconditions: the growth of the market economy and a series of fiscal innovations.

In an agricultural society with many households surviving on their own produce, there was much less need for collective action in all of its guises: infrastructure, education, social insurance, research. Many agencies of government intervention had not yet taken shape, and even where they had started to evolve, there was much less pressure and momentum in the public sphere than today. Several states spent more on military than on civil purposes. What set many balls rolling were the incipient and interlinked processes of industrialisation, urbanisation and commercial expansion. This transformation required both new skills and new physical assets. The dependence on fickle markets produced both wealth and vulnerability, giving birth first to the "social question" and eventually to many forms of social care, social insurance and social protection.

In parallel with evolving demands for public action in the modern economy, there was also a transformation of fiscal instruments paving the way for continuous government expansion. The incomes of early states were irregular and highly inelastic: tributes during military campaigns, extraordinary levies linked to particular events such as foreign assaults or the weddings of royal descendants, tithes, a smattering of ground taxes and excise duties based on the physical control of narrow passageways such as harbours or urban *octrois*. Goods-based extraction was always clumsy, necessitating the construction and maintenance of costly storage facilities or the establishment of frequently contested, and hence, instable attribution schemes. Guarding city entrances and policing markets was a labour-intensive undertaking. Taxes in kind provided little flexibility to public spending. Non-fungible receipts were typically assigned to particular end-users serving particular public functions.

The monetarisation of the economy enabled the introduction of income taxes, but there were still considerable transaction costs for their assessment and levy. Once the two wars of the twentieth century had raised the level of taxation to permanently higher levels through Peacock-Wiseman's famous "ratchet effect" (the wheel goes only in one direction), the habit of paying taxes and the necessary control mechanisms were firmly entrenched in mid-century Europe. In the second half of the twentieth century, there followed a further dramatic expansion of government based chiefly on the two major fiscal inventions: first, employers' charges for various social transfer schemes pioneered by the Bismarck-Beveridge reforms, and second, the value-added tax which was first introduced in France in 1954 and is now, at long last, being seriously considered in the United States. The smooth payment of the employer charges and the in-built control mechanisms of the VAT have made these two forms of taxation very attractive to governments. Their elasticity as sources of public revenue is linked both to their low transaction costs and their low visibility (Tarschys 1988).

Looking at the fiscal revolution in the rear mirror, we see a steady increase in the state's capacity to extract resources from the economy. This is, in no small measure, due to recent technological breakthroughs in the sphere of payments. Monetarisation gave the decisive push, but much followed later through the gradual rationalisation of transfer streams. The introduction of compulsory cash registers and compulsory receipts made fiscal evasion more difficult. With money flows increasingly digitalised, it became much easier for the fiscal authorities to exercise control and see to it that an appropriate trickle was diverted to the state. Both the tax-payers' "rendering unto the emperor what is due to him", as spoken by Mark (12:12) and Matthew (22:21), and the authorities' supervision of such streams can now largely be managed by the appropriate computer programmes. The fiscal reach of the state has thus been significantly extended through the transformation of the economy, and extraction costs have been pushed down to minimal fractions of the various levies.

It can hardly be underscored enough that the common denominator of these two processes has been the unprecedented expansion of economic exchange. The modern state is inextricably linked to the market economy: its precondition no less than its product. Innumerable public inputs are required to keep this machine humming, but equally countless are its taxable outputs, which make modern government fundable and affordable. In the remarkable European library on the potentials and complexities of this model, from Adam Smith's *Wealth of Nations* (1776) and Wilhelm von Humboldt's *Ideen zu einem Versuch, die Grenzen der Wirksamkeit des Staates zu bestimmen* (1792) over Johann Gottlieb Fichte's *Der geschlossene Handelsstaat* (1800) and Friedrich List's *Das nationale System der politischen Ökonomie* (1840) to Émile Durkheim's *De la division du travail social* (1893), there are several different views about the desirable external boundaries of the modern trade state, but there is fundamental agreement that the expanding exchange of labour, goods and services has revolutionised the human condition and set new parameters for our economies.

3 The governance of export-based economies

The expansion of trade was, for a long time, essentially a domestic phenomenon. Even in the age of mercantilism and the hey-day of colonial expansion, the share of external trade remained modest. It is only in the last few decades that we have seen a major increase in exports and imports. The GDP fraction of these flows in the national economy depends very much on the size of the states. The trans-national trade of Luxembourg is explicably greater than that of Sweden, which, in turn, is greater than that of the United States. But if we look closer at subunits, the trend is clear enough. In America, it was not least the expansion of interstate commerce that increased the demand for federal intervention, a need foreseen in the Constitution, and then endlessly contested in the US Supreme Court.

If trade in general generates multiple needs for collective action, foreign trade in particular spawns demands for much more collective action abroad. An increasing economic interdependence has many facets, ranging from security to environmental concerns, health care to education, labour market rules to consumer protection. With the many expanding flows of goods and services, the residents of one country have become increasingly exposed to and dependent on the actions or inactions of other countries, controlled by governments over which they have no immediate democratic control. And foreign bureaucracies are only one part of the story. Even more powerful in the globalised economy are huge multinational corporations, which smoothly and skillfully exploit the fragmentation of political authority among states. While there have been many good reasons for deregulation in previously ossified economies, this process has also deprived modern governments of some traditional instruments of power and revealed the relative impotence of small states.

The globalisation of our economies and the many concomitant processes of internationalisation transform not only the demands for collective action, but also its supply. How can we exert influence in societies other than our own? The classical techniques of intergovernmental diplomacy do not lead very far. There are occasions when embassies and consular staffs can intervene on behalf of their compatriots, and a wealth of intergovernmental conventions lend support to such assistance. Firms in trouble in foreign markets get some assistance in similar ways. Yet there are strict limits to the logic of bilateral action. Many of the emerging challenges can be dealt with only by legal assistance abroad or through joint organisations and competence conferred on super-governmental agencies. Where regulatory intervention is required, the loopholes and opportunities for evasion are simply too large if one country after another tries to go it alone. When markets reach an advanced stage of globalisation, with producers and consumers spread over many continents, with value chains increasingly intricate and complex, with polluters, criminals, germs and other threats to the public order widely dispersed throughout the world, the option of regulatory *Alleingang* simply fades away. It is joint action, or no action at all.

All of these challenges cannot be met through the European Union, but some can be, and many others must be, *faute de mieux,* even if the prospects for success are very limited. Its shortcomings and failures notwithstanding, the Union is still the best instrument we have, and in many circumstances a necessary substitute or start engine for the global cooperation that we have not yet managed to build up. But the strong and growing demand for EU action still does not solve the crucial problem of funding. If, in some corners of their minds, the governments certainly understand the need for more collective resources, many other instincts and impulses inexorably lead them in a different direction, and so does their experience of past spending in the European Union. Just as every government cherishes some aspects of the EU record, each one has its own supply of horror stories of waste and errors in EU spending: mainly from other countries, but also sometimes from its own.

4 Reforming EU revenue: earlier proposals

A long list of options has been put forward as new income sources for the European Union. The Schreyer proposals of 2004 included a tax rate on energy consumption limited to motor fuel for road transport, a slice of the national VAT and a corporate income tax. The Lamassoure report of 2007 (A6-0066/2007 Final) presented the following as key candidates for new revenue:

- VAT
- Excise duties on motor fuel for transport and other energy taxes
- Excise duties on tobacco and alcohol
- Taxes on corporate profits.

In addition, it listed a number of other income sources that had been advanced in the European Parliament discussions:

- Taxes on dealings in securities
- Taxes on transport or telecommunications services
- Income tax
- Withholding tax on interest
- ECB profits (seigniorage)
- Ecotax
- Taxes on currency transactions
- Taxes on savings
- Taxes on financial transactions (Tobin tax).

At the request of the European Council, the Commission Budget Review of 2010 identified six areas for potential new own resources [COM(2010)700]:

- A financial transaction tax (FTT) or a financial activities tax (FAT)
- Auctioning of revenue from the EU emission trading system (ETS)
- A new VAT resource
- A charge on air transport
- An energy tax or levy
- An EU corporate income tax.

In 2011, the Commission came forward with a new proposal as part of its MFF package [COM(2011)510 final, 871 final/2]. This included a reform of the legal architecture intended to facilitate more flexible decision-making on technical aspects and implementation rules, as well as a streamlining of the various corrections. The Commission also proposed a single EU VAT rate of 1 percent on all goods and services. Among the two available alternatives for extracting resources from the financial sector it opted for the FTT, but met with strong resistance from several member states. The possibility of introducing such a tax for a limited number of countries in the form of enhanced cooperation is still being explored.

The latest contribution to this discussion is the "first assessment report" released on 17 December 2014 by the High Level Group on Own Resources (HLGOR). A key conclusion here is that it is very difficult to analyse the revenue side in isolation: "A necessary pre-condition for change is the common understanding and acknowledgement that the EU budget, and indeed the EU as a whole, is much more than a zero-sum game – financially as well as politically. This is the only positive and rallying argument that can create a concerted ambition for reform and merge national interests with a higher European interest."

This point is important. Looking at previous blueprints for revenue reform, one is struck by their timidity. The advocates of new solutions go to great lengths in underlining the "neutrality" of their proposals: The idea is not to collect more money for the EU, but simply to introduce more efficiency, transparency, solidarity and consistency into the revenue side of the budget. This argument is clearly intended not to antagonise the many governments opposed to an increase in EU expenditures, but it is far too conservative. Embedded in this cautious approach is the question, why do we then need reform in the first place? If the purpose is merely redistribution within a given quantitative framework, we might expect responses largely along the predictable lines of net balances and *juste retour*.

5 In search of greener pastures

The full drama of the events unfolding before our eyes may not yet be clear, but in the last few decades we have experienced momentous changes in the world economy requiring many more public interventions than we have as yet been able to define. If the expansion of economic exchange in domestic settings called for a large number of new collective actions at the local, regional and national levels, the same is now true in a wider trans-national setting. With export quotas ranging between 20 and 50 percent, the European countries and their social and economic actors have become much more dependent on collective action abroad, in jurisdictions other than their own. Climate change, pollution, refugee streams, tourism, contagious diseases, the flow of data and the rise of multinational corporations are just some of the related factors and processes rendering previous forms of protection woefully insufficient and inadequate. The demands for transnational regulatory interventions and other defensive measures and public services are widening into many new areas; the adjustment of supply is slowly following suit. An obvious bottleneck is the weak funding of such broader collective action.

Raising resources for the collective needs of the trade-dependent economy requires, first of all, a better understanding of our new predicament: hence the need for more and better policy analysis in general and, in particular, attention to emerging new services and payment models attuned to the digital age. The explosive growth of business on the net would not have been possible without a wide field of such innovations, but there are few signs of similar creativity in the public sector. Much of the haggling over EU resources seems to be based on the assumption that there is a pie that can be shared only this way or that way, whereas, in reality, the total pie is anything but fixed. Expanding trade provides resources that did not exist before. By the same token, there are potential sources of fiscal revenue that can be tapped only when trade patterns expand and some trans-national public authority is strong enough to secure its share of the gains.

The guiding principle, then, should be to phase out the tug-of-war between the Union and its member states over already exploited tax bases. Some sharing of such resources may still be necessary in the future, but the focus for the EU should be on fresh receipts from activities immediately linked to the process of Europeanisation and globalisation. We should seek to identify sources of public revenue that are not easily or not at all within the reach of national governments, but come about or become available only through international exchange and cooperation. A small fraction of such gains could quite reasonably and even profitably be mobilised to pay for the collective action that is its necessary concomitant and precondition. The practical difficulties linked to this approach are considerable, not least because of the many competing jurisdictions vying to offer favourable conditions to business; however, the combined strength of further investments in policy analysis, a judicious use of the legal instruments of the European Union and a mobilised public opinion should not be underrated. With enough pressure, the veto power of resistant "business-friendly" member states practising tax competition will yield.

Tax competition has also allowed some potential objects of taxation to pass under the radar. As fiscal systems undergo all kinds of "greening", a spectacular exception is that of aviation fuel. One reason for this is no doubt the lobbying strength of the airlines, but this industry also predicted doom and gloom in its earlier battle for tax-free sales without being hit too hard by the measures eventually taken. When it comes to fuel, the industry threatens to re-source purchases to evade taxation, but transport costs reduce the possible harm of that option.

Many of the more promising footloose tax bases are connected to the activities of multinational corporations. It is important not to demonise these actors. The multinationals have played and continue playing a preeminent role in technology transfer and economic development in all corners of the globe. The historic breakthrough in poverty reduction in recent decades would have been impossible without their thrust and momentum. Both multinational companies and their national counterparts are tightly dependent on public action, and their expansion is intertwined with that of state expansion. In small open European economies, the GDP share of government and the GDP share of foreign trade have both quadrupled over the last century. While national and multinational companies are both dependent on domestic public investments, transfers and services, the latter are in a much better position to be free riders. Many of the countermeasures required to set the record straight call for more resolute trans-frontier cooperation.

Corporate taxes in Europe have come down from around 35 percent in the mid-nineties to around 23 percent now, as an average. The span is very wide, however, with Bulgaria and Ireland at the bottom and mainly larger states at the top.

Country size seems to put a brake on the race to the bottom. If that is true, a jurisdiction of 500 million would probably be more resilient to competitive pressure than smaller states.

6 The early steps of BEPS

Important initiatives against fiscal competition have been taken within the OECD, especially in the programme on Base Erosion and Profit Shifting (BEPS). A first set of recommendations was endorsed in 2014 by the Finance Ministers of the G20. The 15 actions included the promotion of greater fiscal transparency between states, measures against the abuse of transfer pricing and action against "hybrid mismatches". These are cross-border arrangements that take advantage of differences in the tax treatment of financial instruments, asset transfers and entities to achieve "double non-taxation" or long-term deferral outcomes which may not have been intended by either country. BEPS is in an early stage, but has the potential of paving the way for important advances in the next few years.

The major business consultancy firms offer advice on "value chain management" and tax optimisation. The European Commission has long had corporate tax avoidance on its agenda and is now an active participant in the BEPS process. The revision of the Parent-Subsidiary Directive in 2014 was intended to prevent companies from using mismatches in national tax regimes to avoid taxes. The Commission's competition investigations into tax rulings and scrutiny of Patent Boxes under the Code of Conduct on Harmful Business Taxation are also aimed at countering unfair tax regimes in member states. In March of 2015, it presented a tax transparency package intended to increase the flow of automatic information between member states. In a comment, Pierre Moskovici said: "Tolerance has reached rock-bottom for companies that avoid paying their fair share of taxes, and for the regimes that enable them to do this. We have to rebuild the link between where companies really make their profits and where they are taxed. To do this, Member States need to open up and work together. That is what today's Tax Transparency Package aims to achieve."

Meanwhile, the European Parliament has also stepped up its activity in this field. Following the Lux Leak scandal, it created a temporary committee on tax rulings led by Alain Lamassoure. Although the mandate is only for six months, there is every reason to believe that the legislators' interest will persist, as will the cooperation between the OECD and the European Commission. The impact of recent years' efforts among taxation professionals is already sizable

7 Standing up to monopolies and oligopolies

Another area in which sovereign states experience limitations in their reach and clout is that of consumer protection. Apart from banks "too big to fail", the modern world also has actors that are "too big to jail", or too distant. Software giants such as Google are difficult to come to grips with, both on competition matters and on issues of data protection and personal integrity. "The right to be forgotten" has been proclaimed by the company, but whether this promise is being kept is hard to insure with as yet non-existent instruments of international monitoring and supervision.

Recent EU measures have aimed at capping roaming charges on mobile telephones and charges on credit card transactions. The nominal gains for EU consumers are impressive, but the final results remain to be established after a further analysis of the subsequent incidence. Major companies are unlikely to absorb such shocks without strenuous efforts to shift the burden forwards, backwards or sideways. Nevertheless, interventions in monopolistic and oligopolistic markets seem promising and can no doubt confer important benefits on the taxpayers.

Apart from price-related interventions in the interests of consumers, there are many needs for health protection in mass markets. End users may have more confidence in controls exercised near the point of sales, but other factors may favour shifting the point of gravity further up the value chain, to the locus of production. If governments can arrange for the funding of such operations, there may be considerable efficiency gains in store. Other control demands are more altruistic, such as the desire to ensure safe and fair labour conditions in distant supplier countries.

8 Taxation in a digital economy

A major social transformation under way is the marriage of the World Wide Web with new models of production, distribution and consumption. Its impact on taxation has already been dramatic, in that the governments' extractive capacity has gone up while their extraction costs have gone down. But a menace threatening at the horizon is the loss of territorial control. If money can move around at a click, so can legal instruments and immaterial assets of all kinds. A new era of fiscal mobility seems to be dawning. There is every reason to predict that private actors wishing to exploit these new opportunities will prove more agile and inventive than the heavy-footed fiscal authorities following in their trail.

The new European Commission has recognised this development and placed the digital economy at the top of its political agenda. VAT coordination goes a long way back in the Union, with the Sixth VAT Directive in 1977 and the 2006 Council Directive on VAT as important milestones, but new issues crop up all the time. In its BEPS action plan, the OECD also gives a great deal of attention to this field. In the last year, the ECJ has been wrestling with the taxation of business in bitcoins. A special report (OECD 2014) addresses "the tax challenges of the digital economy". A recent seminar organised by one of the leading consultancy firms dealt with "tax governance and tax risk management in a post-BEPS world".

The full consequences of this development are not yet discernible, but there is little doubt that new threats to the sovereign state will emerge even in the short-to-medium term, and that larger political jurisdictions, such as the European Union, are in a much better position to tackle these matters than smaller ones. An interesting precedent is provided by the United States, where the global reach of the tax authorities has increased substantially in recent years through the Foreign Account Tax Compliance Act (FATCA), with concomitant risks both for its own innocents abroad and for its trading partners. The ongoing negotiations on TTIP and various related trade flows offer additional evidence that size matters in the formation of regulatory frameworks for global business relations.

9 Conclusion: freeware, payware, taxware

The World Wide Web started less than 25 years ago. Apps began appearing less than 5 years ago. Bliss is it in this dawn to be alive: Never have we seen a greater supply of free lunches. Yet for how long? To survive in the digital age, content producers must find reliable paths from freeware or shareware to payware. This task is now being tackled in many ingenious ways, with a steady stream of new payment models appearing in different branches of the economy. There are already millions of apps available in the major app stores, with purchases often taking place once the fly has come into the spider's parlour ("apps in apps"). Offering "premium services" to customers tired of the ads and the slow pace of the free versions is a standard device. Online newspapers publish blurbs for free, but request payment for the full texts.

Governments have much to learn from this huge wave of innovations. They face a similar dilemma: The provision of collective action is difficult to fund while there are so many opportunities to enjoy substantial benefits without footing the bill. Free riders abound. The governments' long struggle with this problem is written into our fiscal history. Gateways have often been erected to facilitate the collection of fees or taxes. When indivisibility appears at the international level, we must explore very carefully the potential direct links between the particular services (including regulations) and the added value they provide. In some cases, trickles may be diverted from massive payment streams with relative ease; in others, the technical obstacles are substantial and not yet superseded.

To sum up, the most promising sources for EU funding are not in further fractions of the already exploited tax bases that may be wrenched from recalcitrant member state governments in future negotiations. A much better strategy is to aim for tax bases that are, more or less, beyond the reach of individual states and accessible only by joint action. Some of these sources are tappable only if the Union is strong enough to confront the states that are its fiscal competitors and the non-state actors that have become such experienced masters of fiscal evasion. Many of these tax bases are linked to the emerging digital economy. While much remains to be done to explore these reserves, design appropriate interventions and refine the technology of extraction, there is promise of ample rewards if a greater proportion of the traded volumes can be converted into taxware. Pushing in this direction would make the European Union far more sustainable than it is today and could finally provide it with "own resources" that are truly its own.

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