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RYTA DZIEMIANOWICZ

CRISIS OF TAX STATE – BORDERS OF FISCAL POLICY

1. THE THEORY OF TAX STATE CRISIS, JOSEPH ALOIS SCHUMPETER

Already at the beginning of the twentieth century, Joseph Alois Schumpeter pointed out that the excessive growth of public sector, accompanied by a steady increase in taxes, contributes to rising costs related to the conflict and continuing the ongoing struggle between public and private sectors, between the intervening country, and defending before the intervention of the private entrepreneur (Glapiński, 2003, p. 203). Therefore, he said: *"contemporary socioeconomic system tends quickly to a maximum tax burden on the sphere of private enterprise, and that leads to decay of the capitalist economic dynamism"* (Glapiński, 2003a, p. 22)

Particular attention Schumpeter pointed to the differences between the amount of state tax revenues and its expenditures, conditioned "dramatically increasing needs and demands and social expectations expressing the politically institutionalized manner" (Glapiński, 2003a, p. 25). The public expects from the state too much, not paying attention to the existing restrictions on the imposition of taxes, and that according to Schumpeter, it may lead to the collapse of capitalism.

This does not mean that Schumpeter denied the need for state institutions. On the contrary, he stressed clearly that it is necessary for the functioning of the market economy and the stability of bourgeois society and its rules. Therefore, he believed that the state taxes are a necessary complement to it (Glapiński, 2003a, p. 23). Defining the concept of state taxes he said that this is a country whose income, in contrast to the situation prevailing in previous centuries, are based primarily on taxes and which also arises with capitalism, giving it permanent existence. In his theory, we can see a clear dualism. According to Schumpeter's concept: "state taxes and the capitalist system of values are the two systems existing side by side, mutually supportive and which influence the operation of each of them, but these methods are entirely different in operation" (Glapiński, 2003, p. 206). The logic of state taxes is quite different from a purely economic logic of the system. Capitalist economic system develops through competition, while tax state realises general targets, financing its bureaucratic action by taxing the former. You can even say that it takes place at its expense, the very fact of imposition of taxes affects the shape of the capitalist economic system, which in the long term, according to Schumpeter, may even lead to its downfall. The high level of fiscal policy "strangling entrepreneurship" (Glapińki, 2003a, p. 25), contributes to lower investment, declining production and reduced consumption. It distorts economic decisions, results in costs both for the individuals, consumers and producers, as well as society, leads to an increase or reduction in demand for certain goods and services, avoidance of certain behaviors, and even evasion of tax obligations and movement to the informal economy.

Schumpeter thus rightly notes that there is a limit on the increase of the tax burden, in other words, the fiscal capacity of the state border, beyond which the public revenue, despite an increase in tax rates discontinued to rise. In his view, the reaching of fiscal policy limit, with continuous growth of social expectations and pressures for increased public expenditure means a difficult to overcome crisis of the capitalist tax state (Glapiński, 2003a, p. 28).

As you approach the limits of fiscal developments in a tax state, there appears a growing army of officials who strictly enforce tax laws. Taxes are becoming more acute, it comes to wasting energy focused on their avoidance. Then, according to Schumpeter, the tax state can no longer be equated with a state of liberal "pure capitalism". Overt and hidden struggle is growing between entrepreneurs, seeking to reduce their tax burden, and the revenue apparatus, seeking to maximize state revenues. So it turns out that the collection of taxes which were to serve the public, "serves to strengthen the state whose nature is to undermine and attack the bourgeois world" (Glapiński, 2003a, pp. 28-29) and may lead to a reduction of its development and even to its destruction.

From the perspective of more than 90 years, thoughts formulated by Schumpeter in his book *Crisis of the State taxes*, seem even more valid than in the author's lifetime. Analyzing statistical data can be noted that in the twentieth century, public expenditure in relation to GDP, which was also the result of social pressure, in most developed countries had increased several times[1], and for example in Norway, Sweden and Switzerland, more than tenfold. Public expenditure growth had generated increased demand for public funds. Since the beginning of the twentieth century, fiscal burden, which is a source of financing public expenditure, increased dramatically. But the question arises whether it has already reached its peak?

2. The level of fiscal policy in the twentieth and the twenty-first century

By fiscal stringency the state policy is mostly meant aiming at maximizing revenue by imposing new taxes and parafiscal burdens. Due to large diversity of economies, setting the border between reasonable and excessive fiscal stringency is not a simple matter. According to Stanislaw Owsiak, a reasonable level of fiscal policy may be spoken of when the scale of interference by public authorities in the revenue of operators enables the former to meet their modest needs concerning public revenue and also allows economic subjects to operate and grow businesses and households to meet consumption needs at an appropriate level which, consequently, in the macro economic scale, gives a basis for sustainable economic growth (Owsiak, 2005, p. 366). Excessive fiscal stringency means an aggressive government interference in private sector income, which may lead to an economic slowdown. So formulated, however, the definition does not designate a boundary beyond which you can already speak about excessive fiscalism. Excessive fiscal stringency is considered one of the major factors inhibiting growth, reducing the competitiveness of European economies and hampering resolution of increasing in many countries socioeconomic problems and therefore its measurement, based on even indirect measures, is important. Mostly, the level of public spending and fiscal[2] burden in relation to GDP are used as an indicator for measuring the intensity of fiscal policy. The total value of all public revenue and expenditure defines indirectly the scope of interference by the public finance system in the economy[3]. The higher the level of fiscal burden and expenditure in relation to

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1 For instance, in the U.S. in 1913 amounted to 7.5% of GDP, in 1996 36.5%; in Norway adequate 3.7% of GDP and 54% of GDP.

2 By fiscal burden major public tribute is mostly meant, giving the highest income, namely: direct taxes (including first of all PIT and CIT), indirect taxes (mainly VAT and excise duties) and social insurance contributions.

3 The method of measuring fiscal policy on the basis of a statement of public expenditure in relation to GDP, although one of the easiest, it also has its limitations, which should be borne in mind. Due to the fact that in some countries (eg Sweden), social benefits are taxed, not in others (eg Hungary), individual accounts may be overstated or understated. Similarly, if you compare the tax burden. Different legal solutions applied in different jurisdictions can

GDP, the higher the state's participation in the economy and the larger and less efficient public sector. This indicator recognizes all the fiscal burden imposed on businesses, also informs how much income produced passes through the state's public finances.

In the past century, especially after World War II, the functions performed by the state changed. The state started, for different reasons, to assume responsibility for many areas which hitherto were the domain of the market. Social pressures led to a clear expansion of public spending, which began to grow after the First World War. However, a clear acceleration of growth occurred only in the years 1960-1990, mainly in European countries, where the first launched programs designed to protect society "from birth to death." As a result, in certain European countries at the end of the twentieth century the share of public expenditure to GDP approached or exceeded the limit of 50%. Expenditure growth forced tax increases, an average level relative to GDP at the end of the last century averaged about 40%.

Table 1
Taxes and other fiscal charges in selected OECD countries (% of GDP)

Country	1991	1993	1995	1996	1997	1999	2001	2003	2005	2007	2008
Australia	33.0	33.4	34.5	34.9	35.6	36.9	35.8	36.3	36.3	35.4	35.5
Belgium	46.0	47.4	47.5	48.5	49.0	49.6	49.6	51.1	49.3	48.1	48.2
France	47.6	48.5	48.9	50.4	50.8	46.7	44.7	44.4	43.6	43.9	43.4
Ireland	41.6	42.0	39.1	39.1	38.1	36.7	34.3	33.8	35.4	35.7	34.0
Japanese	33.4	32.0	31.4	31.7	31.7	31.2	32.2	30.5	31.7	33.4	35.0
Canada	43.9	43.5	43.2	43.8	44.5	44.3	42.6	41.1	40.8	40.5	39.9
N. Zealand	46.8	45.3	44.9	43.9	43.3	40.8	40.6	42.6	44.9	45.2	45.1
Germany	43.3	45.3	45.1	46.0	45.7	46.7	44.7	44.4	43.6	43.9	43.4
Norway	54.6	53.2	54.2	54.8	54.5	53.7	57.5	55.5	57.3	58.4	60.5
Switzerland	30.3	31.6	33.0	33.5	32.7	33.8	34.7	34.6	34.6	34.2	33.5
Swedish	61.0	59.8	58.0	59.6	59.0	61.4	62.9	54.8	56.1	54.9	54.0
USA	32.9	33.0	33.8	34.3	34.6	35.2	34.9	31.9	33.4	34.5	33.3
Great Britain	39.8	37.3	38.2	38.0	38.4	39.8	40.6	38.7	40.8	41.7	41.9
Italy	46.2	46.3	45.1	45.5	47.6	46.5	44.9	44.8	43.8	46.6	45.9
Poland	-	-	43.3	46.1	41.8	40.4	38.6	38.4	39.0	39.4	39.0
Euro Zone	44.7	466	45.6	46.4	46.7	46.8	45.4	45.0	44.9	45.5	44.9
OECD	37.6	37.9	38.1	38.6	38.8	39.1	38.8	37.1	38.0	38.9	38.5

Source: own study based on the OECD (2008).

often lead to a distortion of statistics. Therefore, one should be aware that international comparisons mainly determine the overall trend.

Taxation in the modern world is necessary, it provides funding for public goods, and thus the functioning of the state. Unfortunately, its amount is not indifferent to the economy. Consequently, the imposition of taxes followed by disruption of competitive conditions in the sense of Pareto equilibrium, there are private and social costs of taxation[4]. Excessive taxes can lead to the fact that the marginal costs of taxation outweigh the marginal benefits of public spending, then taxes will not only reduce revenues at the disposal of individual units, but also indirectly, by influencing, among others: the size of the investment (including human capital), motivations for making the labor market, acquiring new skills and motivations of entrepreneurs, and thus the tendency of people to work, produce and invest, may affect economic growth.

3. Fiscal stringency and the GDP growth rate

Systematic study on the impact of fiscal policy on the rate of economic growth did not begin until the end of the eighties; it can be acknowledged that pioneering research on this matter was originated by P. Romer (1986), who first introduced the so-called endogenous growth model[5]. Subsequent modifications of Romer's model provided theoretical justification for the assertion that a state policy, including fiscal, may have a permanent effect on the rate of economic growth in the long run. According to the assumptions of the endogenous models the state by appropriately targeted spending[6] increasing productivity of both physical and human capital, may affect the rate of economic growth. However, all state spending, regardless of whether they increase the growth or are negatively correlated, they are directly related to taxes which constitute the source of their funding. Taxes, having an effect on private decisions of producers and consumers can contribute to a slowdown in growth rate.

In contrast to exogenous models, according to a new theory of growth, factors that may affect economic growth, are both public expenditure, which can be adequately determined by the state, and the size and structure of government revenue (taxes).

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4 More broadly (Tarchalski, 2009, p. 54).

5 In the endogenous models (eg Romer, -1986, Lucas-1988, Barro-1990, Sala-i-Martin-1992) the basis of a sustainable growth is a departure from the assumption of declining revenue from capital. Technological progress here is a constant, endogenous rather than exogenous, growth factor. More broadly (Woźniak, 2004, pp. 186-190).

6 According to J. Siwiński, "appropriately targeted expenditure" is such which is complementary to the other input factors in the production process. Thus, it is such expenditure which either increases the productivity of capital (physical and human), or which, by correcting market imperfections affects the rate of investment. Cf. (Wilkin and Bednarski, 2003, p. 119).

This implies, therefore, that taxes can affect the rate of growth not only in the short run, but also in the long term[7].

One of the most popular models which show the mechanism of interaction of taxes and public spending on economic growth model is the Barro's model (1990), in which Robert Barro argues that, in fact, public expenditure (through the assumption that they are equal to the taxes t) will increase together with the capital, since the increase of private capital implies greater production and therefore also higher budget revenues which, in turn, contributes to increased expenditure (Markiewicz and Siwińska, 2004, p. 14). It assumes that state policy has two radically different effects. On the one hand, by increasing public spending, the state stimulates capital productivity and the growth rate but, on the other hand, an increase in public spending leads to a rise in the tax burden, which acts as a brake. The final result will be the outcome of these two opposing tendencies. Therefore, Barro shows that there is an optimal maximizing economic growth, the amount of revenue (or tax burden) and public expenditure, above which the negative consequences of tax increases are higher than the benefits resulting from spending. This means that at lower than optimal increases in expenditure, further increase in expenses will have a beneficial affect on the growth, while crossing the border of optimality and their further increase would be negatively correlated with economic growth (Markiewicz and Siwińska, 2004, p. 14).

In real economies, in addition to income and budget accounts, their structure and character are important. Therefore, in subsequent models Barro analysis was extended by introducing in the model a division of fiscal instruments into distortionary taxation, non-distortionary taxation, productive public expenditure, unproductive public expenditure[8].

An increase in productive spending, financed by taxes which do not distort investment incentives of taxpayers (non-distortionary taxation), can lead to increased growth. The effect is reversed if they are financed by increasing taxes distorting investment incentives of taxpayers (distortionary taxation). Thus, the use of non-distortionary taxation is rather neutral for growth, and vice versa, the use of distortionary taxation has a negative impact. It should be noted, however, that even the ex-

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7 The implications of endogenous growth models of fiscal policy have been studied by: R. Barro (1990), R. King 's and S. Rebelo (1990), LE Jones and coauthors (1993), Stokey N.'s and S. Rebelo (1995), EG Mendoza and co-authors (1997). More broadly (Dziemianowicz, 2007, pp. 54-69).

8 In productive spending M. Bleaney and N. Gemmel, R. Kneller include, expenditure on: research and development, infrastructure, education, healthcare, national security. Non-productive in their view are: social spending on recreation and leisure, business services. Distortionary taxation includes, among other things: income taxes (including income from business), property taxes, fuel taxes, while the non-distortionary taxation – for example, taxes on goods and services. More broadly (Bleaney, Gemmel, Kneller, 2001, pp. 36-57).

penses which are neutral from the point of view of their impact on the growth rate and which do not affect either productivity or the amount of physical and human capital, but in fact act as a brake. Expenditure is always linked to the need to impose taxes that reduce economic activity of the private sector, so even the neutral ones by contributing to an increase in the tax burden, may inhibit the development[9].

With low-income share of public expenditure effects of expenditure, the profitable effects of the incurred costs are likely to outweigh the social costs resulting from the imposition of taxes, allowing their financing. If, however, the share of public expenditure in GDP and, therefore, also the taxes needed to finance them exceeds a certain level, you can usually see a clear decline in the effectiveness of the outlays, which can significantly contribute to a decline in the economic growth. These negative effects are even more pronounced when the increase in expenditure is financed by an increase of direct taxes (eg income), which is definitely easier to change, depending on the observed phenomena in the economy of the country. The high level of tax burdens and rates of direct taxes, clearly affects the amount of output per capita, bringing it down. In addition, the obtained results are materially affected by the structure and nature of public spending, which decide whether forced high taxes can contribute to economic development or vice versa. If the structure of government expenditure is dominated by expenditures and transfers included to the so-called unproductive group, it is difficult to expect that an increase in the tax burden will positively influence the economy.

In the last decade of the twentieth century many empirical studies[10] were conducted in which theoretical models were verified and the impact of different types of taxes and spending as well as the size of the public sector on the economic growth were analyzed. Although theoretical models concerning these issues seem to be quite clear, it appears that empirical studies, whose task is to verify the theory, do not provide conclusive answers in this respect. This relates primarily to a detailed study, taking into account the mechanism of interaction of individual taxes. More explicit are macroeconomic studies passing over many specific detailed dependencies. In this case, most researchers agree with the conclusions reached in the Fabian Commission report on Taxation[11] in which the authors conclude, indeed, that the experience of European

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9 More broadly (Dziemianowicz, 2007, pp. 54-69).

10 A detailed review of these works represent, among other things: W. Leibfritz, J. Thornton and A. Bibbee, who are trying to determine the relationship between taxes and economic growth, and P. Gerson focused primarily on the relationship between fiscal policy and rate of growth. More broadly (Dziemianowicz, 2007, pp. 54-69).

11 The authors conclude that taxes, especially income, may restrict economic activity. They believe that in the absence of individual taxes would be higher production. Therefore, the impact of taxes on the economy should be taken into consideration when designing fiscal policy. More broadly (Paying for..., 2000).

countries did not indicate a strong correlation between a high share of taxes in GDP and low economic growth and vice versa, but due to the fact that the effect of low / high taxes is usually delayed, and the effects of discretionary fiscal policy, high charges, are visible only in the higher stages of economic development, the relationship is likely to occur and manifest itself at a later date.

4. Fiscal stringency and social welfare

In addition, in literature on the subject there is an ongoing discussion about whether the increase in public spending contributes to a real improvement of life of most citizens, or perhaps they would be better-off if the level of public expenditure, and therefore also the tax was lower, and more funds remained at their disposal? Assuming that higher public spending contributes significantly to higher levels of social development[12] measured by e.g. HDI[13] index, which is often treated as a synthetic measure of prosperity, the countries with the highest level of expenditure should be included at the head of the ranking list. In reality, however, the increased expenditure does not always solve all the problems of socioeconomic and compensate for the losses incurred in the private sector and, consequently, their high level does not automatically mean higher level of growth and social welfare.

This is confirmed by research conducted by Vito Tanzi[14], according to which the relationship between changes in share of public expenditure in GDP and the relationship between the desired change in quality of life of citizens is minimal. The research shows that in countries where public expenditure grew faster, there was a better indicator of quality of life than in countries with smaller public sector.

Table 2 presents the data concerning the 19 most developed countries, which indicate a lack of positive correlation between the aforementioned index. Based on their analysis, it is noted that the countries in which the level of public expenditure is the highest, did not rank the highest in the ranking in terms of social development (as measured by HDI index). In four countries with the highest HDI, namely Norway, Australia, Canada and Ireland, the average level of public expenditure is 37.6% of GDP, while four countries with the highest level of expenditure such as Sweden, France, Denmark and Finland took appropriate 5, 9, 13 and 10 place in the HDI ranking. Their average level of expenditure in 2005 amounted to 53.5% of GDP (Tanzi, 2008, pp. 23-24).

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12 The level of social development is evidenced, by life expectancy, infant mortality, illiteracy, level of education, income growth per person.

13 HDI – Human Development Index, a synthetic measure used by the United Nations for international comparisons of socioeconomic development of each country.

14 More broadly (Tanzi, 2008).

Table 2
Public spending and the rate of HDI in selected developed countries in 2005

Country	Public expenditure % GDP	Classification	HDI (Classification)
Swedish	56.6	1	5
France	54.0	2	9
Denmark	52.8	3	13
Finland	50.4	4	10
Austria	49.9	5	14
Belgium	48.8	6	16
Italy	48.3	7	18
Germany	46.9	8	19
Holland	45.5	9	8
Great Britain	44.7	10	15
Norway	42.3	11	1
Canada	39.3	12	3
New Zealand	38.3	13	17
Japanese	38.2	14	7
Spain	38.2	15	12
USA	36.6	16	11
Switzerland	35.8	17	6
Australia	34.6	18	2
Ireland	34.4	19	4

Source: own study based on the Tanzi (2008).

It can therefore be concluded that the “smart” state policy achieves its objectives, at the same time, the lower level of public expenditure, and hence also at the lower tax burden on society. Thanks to this, there are more financial resources at the disposal of the citizens, which are properly used to increase social welfare. Some of the social needs need not be satisfied by the state, they may as well be delivered cheaply by the private sector.

In Tanzi's opinion, reduction of public expenditure, and thus fiscal policy, does not mean less social welfare, but it is rather a political problem. In his opinion, the level of public spending in a given country is “the result of current and past political processes, with particular emphasis on the role of the past” (Tanzi, 2006, p. 12). During the period 1992-2007, many countries with first-place rankings in terms of HDI factor clearly reduced their public expenditure (Table 3). It appears that the reduction in public expenditure will not result in a significant decrease in social welfare in those countries. If, therefore, reduction of the expenditure does not significantly affect the well-being, while high taxes reduce the net income which is available to citizens and, therefore, probably in the long run adversely affect the productivity of the economy and economic growth, the question arises about the possible reduction in public expenditure and determining a limit on fiscal policy which would not affect negatively on the economy.

Table 3
The level of public expenditure in selected developed countries during the period 1992-2007 (as% of GDP)

Country	HDI (Classification)	Public expenditure		Difference 2007-1992
		1992	2007	
Norway	1	55.7	41.0	-14.7
Australia	2	38.6	34.0	-4.6
Canada	3	53.3	39.1	-14.2
Ireland	4	45.1	34.4	-10.7
Swedish	5	71.1	54.1	-16.7

Source: own study based on the Tanzi (2008).

5. Boundaries of fiscal policy

Estimate of the threshold of economic efficiency of public spending in the twentieth century was dealt with by many authors. In 1983, Philip Grosman specified the optimal level of public spending in the U.S. for 20% of GDP, while Gerard Scully in 1994 to 23%, by 14 percentage points below the actual expenditure in the year of publication. Significantly lower optimal share of public spending in the United States was estimated in 1998, Richard Vedder and Lowell Gallaway, ie 17.45% of GDP (Tarchalski, 2009, pp. 66-67). In 1992, James Gwartney et al. (1998) [15] based on the classical theory of government, identified the cost of implementing the necessary traditional functions, such as external defense, internal security, education at primary level, environmental protection, infrastructure provision, at an average of 13.8% GDP (Table 4).

Tanzi's studies show that for developed countries such an optimal point is a 40% share of public expenditure in relation to GDP, beyond which social welfare is not likely to increase any longer. Tanzi argues that public spending amounting to 30-35%

[15] More broadly (Gwartney, Holcombe, Lawson, 1998).

GDP1 should be sufficient to enable the implementation of all state functions. The basic condition is their effectiveness.

Table 4
The functions of government in selected countries
as% of public expenditure in GDP

Country	Year	Basis functions (A)	All functions (B)	Related A/B
USA	1992	13.8	38.5	2.8
Canada	1995	10.9	48.5	4.4
Great Britain	1992	13.4	45.6	3.4
Australia	1989	10.8	35.7	3.3
Germany	1991	9.1	46.1	5.1
Swedish	1992	13.2	69.3	5.3

Source: Tarchalski (2009).

The situation is somewhat different in developing countries where, according to the above-cited researcher, due to widespread poverty, social inequality, the need to improve institutions, but also lower the efficiency of the public sector, the share of public spending relative to GDP should be higher (Tanzi, 2008, pp. 25-27).

In conclusion, both the poor state's role in the economy and its excessive role can be detrimental to development and social welfare. As a consequence, too low taxes (public revenue), and public expenditure can be just as detrimental to the economy as too high. Remaining to be solved, unfortunately, is to find the optimum level. A limit of the optimal fiscal policy in different countries, characterized by different levels of socioeconomic development and at different times, can run on an uneven level. Its determination is therefore not a simple matter. It does not change the fact that the estimate of the fiscal policy limit, i.e. the fiscal capacity of the state is important. It must be remembered that excessive fiscal stringency may contribute to a decline in growth rates, which cannot be compensated by increased public spending which, as studies suggest, have a limited impact on an improvement of social welfare.

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Schumpeter, quoted at the outset, paid particular attention to the moderate level of taxation and public spending. Although the word did not mean a moderately uniform level of value for all countries which, after all were at different stages of development and changed over time. Nevertheless, Schumpeter set a limit of 25% level of taxation on income which, if exceeded, according to him would mean "the distortion of incentive mechanism of *homo economicus*, and the permanent deformation and disorganization of organizational structures of capitalism" (Glapiński, 2003a, p. 35). Although the rapid computerization and globalization of the economy probably moved that limit of fiscal capacity of the state and postponed in time the "crisis of taxes state", but is this postponing of possible "collapse of the capitalist state" financed primarily with current and future taxes sustainable? Finding answers to this question is of particular important, especially during the global crisis, when most governments treat the public expenditure growth as an important instrument to combat the crisis and the recipe for stimulating the economy.

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