

What *Should* the State Do? A Political Economy of Ideas and Institutions

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Introduction

Over the past several years there has been a substantial shift in ideas amongst policy elites about the proper role of government in the society and the economy. Though it is extremely difficult, if not impossible to find a corresponding dramatic change in public attitudes, policy elites now appear to believe that government both cannot, and should not, do many of the things that it once did.²⁰ Ronald Reagan and Margaret Thatcher are no longer in office, but the ideas that were proposed by the Right, appear to now dominate the Center of the political spectrum. Indeed, there appears to be a growing consensus among elite policy makers – on all sides of the political spectrum – that the state should not do many of the things that it used to do. In other words, the argument is not simply that we *cannot do* what was once done, but now we *ought not* do what was once done.

20. See, for example, National Election Studies, historical data (now available on the WEB, www.umich.edu/~nes/).

The following paper examines the evolution of this new thinking in a particularly significant arena domestic policy making – tax policy. The focus here is not on whether ‘the state is dead’ (Korten 1995). Nor does this paper address the question of the revenue implications of internationalization (Swank and Steinmo 2002). Instead, this paper examines the evolution of policy maker’s *ideas* about taxation policy during the twentieth century. My central argument is that there is an iterative and contingent relationship between policy ideas and institutional change. Further, I believe we must see this relationship in evolutionary terms. Ideas do not come out of thin air – they are generated within a policy context. At the same time, any given policy context is the product of a previous set of ideas. Finally, neither ideas nor context can be held constant. In order to understand what the state does (or more specifically why so many states have taken a neo-liberal turn) we need to examine the evolution of both policy ideas and their subsequent institutional manifestations. This argument leans heavily on the previous works of John Campbell and Ove Pedersen – particularly their seminal book, *The Rise of Neo-Liberalism and Institutional Analysis*, which details many of the basic points I will make here. I take a somewhat longer view than *The Rise of Neo-Liberalism*, in part because I want to show the deeper history to the current intellectual ideas. But the reader will undoubtedly find a significant overlap between the arguments presented here and those offered earlier by Campbell and Pedersen (Campbell and Pedersen 2001).

In recent years, »ideas« have become the focus of a great number of works in both comparative politics and international relations.²¹ Unfortunately, as Campbell points out, the term ‘ideas’ has come to stand for a number of *different* variables (eg. norms, values, beliefs, preferences, culture, attitudes) but few of these authors have defined precisely what they specifically mean by »Ideas« (Campbell, 2001). In this analysis ‘ideas’ are defined as probabilistic arguments. Ideas are thus understood in much the same way that we use the term ‘ideas’ in everyday English. When one says: »I have an idea« what we are really saying is »I have a solution to

21. See for example, (Campbell 1998) or (Berman 2001).

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our collective problem.«²² When one says »That is a good idea!« what we are really saying is »I believe that is a good solution to the problem.« Ideas are always probabalistic solutions because in a world of enormous complexity, nested games, and some rather basic uncertainties, we cannot hope to truly predict the future. The best we can do is offer convincing arguments that this particular solution (idea) is better than some alternatives. Whether others will agree and/or can be mobilized to support a particular idea will depend on a number of other clearly related variables including their beliefs (about how the world really works), their values (about how it 'ought' to work), and, of course, their individual strategic calculations of their 'interests.'

Ideas, thus, are intimately related to both interests (even raw economic 'self-interest') and values – but are not the same as either. Too often the literature on ideas has juxtaposed ideas and interests as if they were *alternative* explanations. This distinction is false. It *may* make sense to pose 'values' and 'interests' as separate and distinct variables in a static analysis of a specific choice matrix. For example, we might try to analyze whether an actor chose A or B because of her value commitments or as a product of her calculations of her economic self-interest. (But even in a static analysis can easily see how these two variables intersect and overlap and shape one another.)²³ Ideas as used here may be the mechanism through which actors interests and values confront one another.

Ideas can change for several reasons: a) There can be new information that forces us to update our positions. b) For a variety of reasons we can be forced to confront the inconsistencies in our beliefs. c) We can be *persuaded*.

This paper argues that experiences with one era's tax regime shaped both economists and policy maker's ideas about tax reforms for the next era. This analysis has two fundamental objectives: First, it explores how and why virtually all advanced countries embarked on a series major tax

22. We use 'idea' in this sense as probabalistic solutions to collective action problems of all sorts {from 'Where shall we go to dinner?' to 'What kind of electoral system would best?'

23. See Mark Blyth (Blyth 2003) chapter 2 for a critique of the distinction between idea's and interests.

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reforms in the late 20th and early 21st century. This paper explains these current reforms in terms of an evolutionary outgrowth of the previous tax regimes dominant in the capitalist world. Secondly, the paper seeks to contribute to the growing body of literature which explored the ideational roots of policy change. I do not argue that ideas determine policy outcomes. A purely rationalist interest based explanation of policy change fails to capture substance of that change. As history moves from one equilibrium to another, policy ideas may be both the agents and the transmission belt of that change.

In a recent essay, Joel Slemrod has shown quite substantial attitudinal shifts towards tax policy professionals over the past decades (Slemrod 1995). He shows, for example, that whereas in the 1930s tax professionals were largely opposed to sales and consumption taxes and in favor of progressive income and wealth taxes, today a large percent of tax professionals are skeptical of high marginal income tax rates and quite supportive of regressive consumption taxes.

This essay demonstrates that in each major epoch of 20th century, there were specific policy ideas which 'fit' the political and economic context of the time. These ideas evolved out of policy makers and tax professionals experiences with their then extant revenue systems. The central contention here is that history is a dynamic process and thus the very policy solutions initiated in one era created new opportunities and problems that formed the foundation for new policy ideas in the next era. Policy ideas are not abstract value or ideological judgements which are simply floating around and waiting to be used by entrepreneurial policy activists. Instead, substantive historical experience with revenue policies in time 1 substantially shape policy elite's beliefs/ideas about policy options in time 2. In this sense the current epoch of tax reform is no different from the tax reform epochs of previous decades. This is an evolutionary process: The political/economic context in which policies are made also affect the political/economic context (read 'ecology') of the next era. In short, there is a dynamic and iterative relationship between tax policy ideas, tax policy outcomes and the very structure and shape of the modern capitalist welfare state.

This paper first gives a brief overview of this history of modern taxation. The emphasis here is to show how the ideas about what made for

'good' tax policy emerged in the context of both the changing structure of advancing capitalism *and* the political demands placed on policy makers. In short, new ideas became possible as the economy changed and revealed new sources of revenue which simply could not exist in a pre-modern economy. These new revenue sources, in turn, made possible new levels of government involvement in the economy which, in turn, shaped what policy makers and interest group activists understood to be possible and desirable.

Next the paper examines the politics of tax reform in the United States up the historic Tax Reform Act of 1986 (TRA '86). The point here is both to see how the idea for this historic act grew out of the concrete and specific abuses of the tax system that had evolved up to this point (in no small part due to Reagan's own policies in his first administration) and to show that once passed, the TRA acted as an ideational rallying point (if not template) for similar tax reforms around the world. Here we see that the belief about what is possible critically shapes what is desirable. The final section offers an overview of the evolution of tax policy internationally. The paper shows both that while the specifics of tax policy changes vary to some extent, there is remarkable degree of ideational coherence in tax reforms witnessed in countries as different as Sweden and New Zealand and Argentina and Germany. While the details of course vary, the patterns are astonishingly similar. I also argue that though 'globalization' has been a useful symbolic tool in the struggle for tax reforms, it cannot in itself explain the outcomes witnessed so far and wide.

The Ability to pay and the Idea of Fair Taxes⁹⁹

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Over the last 100 years, the ways in which states have raised revenues has been transformed. At the close of the last century revenue systems were not really *systems* at all. They were instead a collection of disparate excises, charges, duties and taxes on an amazing array of items and services – everything from men's hair powder, to windows, to salted cod. These various »taxes« were highly inefficient, easy to avoid, extremely inequitably applied and did not generate very much revenue. No state collected

more than ten percent of GDP from all of the literally hundreds of revenue sources combined.

As the new century dawned, new political forces came to the fore demanding voting rights for the working classes *and* fairer distribution of tax burdens. Indeed, taxation quickly became a major battleground of both economic interests and ideology the beginnings of the twentieth century. Precisely as predicted by the great fiscal economist Knut Wicksell, the expansion of the franchise ushered in an era of new policy demands with respect to taxes. Whereas tax policy had previously been the domain of Chancellors and Finance Ministers far removed from their mass publics, the advance of democratic politics brought with it the idea that taxes should do more than simply raise revenues. Unsurprisingly, the poor bore much heavier tax burdens than the rich. But, as unions, working and middle class parties mobilized, their political representatives increasingly demanded that taxes be used as instruments to change what they believed was the maldistribution of income and wealth brought about by capitalism. Indeed, the very origins of what we now call 'modern« tax policies (that is efficient, universal and equitable taxes) were an attempt to address the growing problem of inequality in modern society

When introduced at the turn of the century these progressive income and profits taxes were in fact quite minor in revenue terms but were to be paid only by the very richest individuals. They were therefore accurately described as »class taxes«. ²⁴ Indeed, in his 1927 Presidential Address to the American Economic Association. T.S. Adams observed the following:

24. See (Brownlee 1996). In the U.S., for example, the Supreme Court ruled the first permanent progressive income tax unconstitutional in 1896. Justice Field justified this ruling in the following way: "The present assault upon capital is the beginning. It will be but the stepping stone to others, larger and more sweeping, till our political contests will become a war between the poor and the rich." Similarly, in Britain the House of Lords refused to pass Lloyd George's "Super Tax" and thus evoked a constitutional crisis. The crisis was eventually resolved when the Commons permanently stripped the House of Lords of its authority over budgetary matters (Sabine 1966). Still, tax rates were quite low by today's standards (e.g. top marginal rates were no higher than 6 percent in Sweden; 7 percent in the U.S.; 10 percent in the U.K.).

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[M]odern taxation or tax-making in its most characteristic aspect is a group contest in which powerful interests vigorously endeavor to rid themselves of present or proposed tax burdens. It is, first of all, a hard game in which he who trusts wholly to economics, reason and justice, will in the end, retire beaten and disillusioned. *Class politics is the essence of taxation* (Adams 1928: 1 my emphasis).

This truth, he went on, applies not only to the political game of tax-making. It affects vitally the economist's thinking about taxation. Economists offered theoretical justifications for progressive taxes as well. Modern capitalism resulted in enormous economic wealth *and* inequalities, they argued. The implication of this thinking, they argued, was that taxes should be levied according to the taxpayer's »ability to pay« (Elvander 1972; Stein 1969). Market forces, it was argued, produced a variety of economic 'externalities' and it was not only appropriate, but advisable that public policy be used to mitigate against these. Taxes, they increasingly believed, were an appropriate instrument in this regard (Blough and Shoup 1937).

As World War I broke out, the principle of »let the rich pay« was taken to some remarkable extremes. It is also clear that these value judgements were in many ways reinforced by the extreme fiscal needs of the nation at war. »Total War« as it was sometimes called, was extremely expensive. Thus, new »Excess Profits Taxes«, »War Preparedness Taxes« and »National Defense Levies« were implemented as 'temporary' taxes.²⁵ For most belligerents, income taxes on the very wealthy were increased to historic levels. By 1918 the top marginal income tax in the U.S., for example, reached 77 percent, in Britain the top rate reached a some-what more moderate 60 percent by 1920. In both cases, it was widely argued that it was unfair to have working class men fight this »rich man's war« while the rich stayed home and got even richer.²⁶ In many countries, these taxes quickly became the major sources of national government finance even

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25. There were several different types of excess profits taxes used in these years in these countries. They are far too complicated to explain here, but in each case an attempt was made to tax all, or nearly all, the profits made as a result of the hostilities.

26. In the U.S. the income tax was called Rich man's conscription (Waltman 1985: 45).

though they were paid only by corporations and by fewer than five percent of citizens.²⁷ But certainly the most important result was the remarkable growth in national state revenues.²⁸

During the 1920s, capital's political clout reasserted and progressive taxes were rolled back in most countries. But in no cases did fiscal policy makers attempt to abandon the principle of »Ability to Pay.« By now the idea that taxation policy had a legitimate function as an instrument of redistribution in modern society was no long seriously questioned. Clearly there was much disagreement over how progressive taxes should be, but not even the American financier Andrew Mellon who became Secretary of the Treasury in under Hoover argued that taxes should not be progressive – he simply argued that they should not be *as* progressive as they had become during the war years.

The Great Depression quickly reinvigorated the tax policy debate. The voice of those who wished to use tax policy as a punitive instrument with which to »soak the rich« grew louder and louder. Unsurprisingly, given the huge political dissatisfaction with capitalism and capitalists at the time, taxes on the rich were increased. Tax rates – even on the very rich – would not, however, be pushed back up to the levels they had seen during the Great War. In many countries, tax authorities began to seriously evaluate the various revenue options available to them for funding expanded social and economic programs. In the U.S. Roosevelt was personally devoted to both a balanced budget *and* redistributitional taxation he »favored 'soak the rich' taxation – shifting the tax burden to the wealthiest individuals and corporations according to 'ability to pay'« (Brownlee 1996: 74). Tax policy, in other words, increasingly became proactive.

27. In 1918, income and profits taxes contributed 44.8 percent of total state and local government revenue in Sweden. In the same year, the income and profits taxes contributed 63.1 percent the federal government's ordinary receipts in the U.S. In Britain these taxes contributed 64.9 percent of total tax revenue in 1920.

28. To take but one example, US Federal government receipts grew from \$761 million in 1916 to \$5,130 million by 1920. Federal outlays grew from \$713 million to \$8,493 million in the same period. (Source: Budget of the United States, 2000, Historical Tables, Table 1.1.)

Economists too were apparently persuaded by the idea that taxes should be used as instruments of redistributive policy. According to the data provided by Slemrod in his essay comparing tax professional's opinion in 1934 and 1994, the earlier generation of tax economists were more likely to favor progressive taxes and oppose regressive taxes than economists today. For example only 12-13 percent felt that there should be a retail sales tax but fully 66 percent believed that capital income should be taxed at a higher rate than ordinary (earned) income (Slemrod, 1995).

A Time of Sacrifice

World War II changed the tax policy climate dramatically. The costs of fighting this war were enormous, and it was clear to virtually all concerned that no one would be able to escape massive increases in their tax burden. The fiscal problem was that traditional revenue sources were clearly incapable of financing the new kind of 'mass war.' Fortunately (?) the new income tax systems which were by now in place could be adapted. The brilliant idea which occurred to policy makers across the globe, was that if the average worker could be brought into the income tax net, huge revenues would come to the state each month. Once again, the income tax was originally intended as a tax on the rich, but the new idea was to bring everyone into this tax net. The political problem, however, was how could policy makers persuade average citizens that this was 'fair?' The answer? To massively increase the tax rates on companies and the very rich.

Very high taxes on capital and capital income were re-introduced everywhere. There was a firm political commitment in all democratic nations to the principle that capitalists should not get rich supplying the instruments of war. In many cases the various profits taxes introduced in these years, reached close to 100 percent of net earnings. Wealthy individuals were also subjected to very steep increases in their tax burdens. In Britain, for example, the top marginal tax bracket was pushed up to 97.5 percent in 1941. In the U.S. the top bracket peaked at 94 percent in 1944.

Though clearly intended originally as taxes on the rich, Ministers of Finance or Treasury, officials also saw the enormous revenue potential of

income taxes. The 'idea' soon developed that income could be withheld by employers and paid directly to the government even before the worker collected it in his weekly check. Two factors are critical to understanding how these 'ideas' came to the fore: First, as capitalism advanced a larger and larger share of the workforce moved from agriculture to wage employment. Wages are far easier to assess and tax than agricultural income – especially small farmer income. Thus, quite simply modern capitalism made a 'modern' mass income tax possible. Secondly, the revenue needs required to finance modern warfare were tremendous. Income taxes, financial policy officials quickly realized, could be collected with each worker's paycheck via the PAYE (Pay As You Earn) system. Such a system had enormous financial advantages to the state. With this system employers could effectively act as revenue collectors for the state and the state would not have to wait for the monies until the end of the fiscal year. Finally, massive increases in government revenues could be politically and morally justified. It was 'fair' to tax income, as long as everyone paid. Moreover, given the now common egalitarian beliefs among elites it was even more 'fair' if the rich paid a higher percentage of their income than the poor. The eventual result, though not without considerable controversy in some cases, was the lowering of tax thresholds such that even modest income earners would now have taxes deducted from their weekly check. In short, during WWII that the income tax ceased being a »class tax« and became a »mass tax« Whereas until the end of the 1930s income taxes were still paid by only the very richest in society, by the end of the war at least 60 percent of income earners were now paying this tax. These changes massively increased the revenue raising capacity of central governments in Europe and America. Tax revenues as a share of GDP nearly doubled in most countries between 1930 and 1945 (Mitchell 1998).

The implementation of these new policy ideas fundamentally transformed the future of the modern state. No one could have predicted the long term consequences of this new revenue system, but at this point, it is virtually impossible to under-estimate its long-term impact. Taken together the revenue reforms of the 1930-1945 era transformed the politics of taxation in all industrial democracies. By steeply increasing tax rates on companies and the very wealthy at the same time that they extended the income tax net downward, central/national governments became re-

sponsible for both redistributing wealth and income across classes and generations and, as we shall see, managing both the macro and micro economic outcomes. As we shall see below, the structural fact of high tax revenues and high tax rates now provided a new foundation upon which new policy ideas could evolve.

After the War – now what?

At the close of the war, voters and interest groups alike expected governments to roll back taxes to somewhere near pre-war levels. This, of course, did not happen. Instead, all western democratic governments, held on to the high levels of taxation that the war had made politically possible (Peacock and Weisman 1961). Even where conservative parties gained majorities in Parliament, tax rates were not pulled down substantially.²⁹ Why were taxes not rolled back when the war was over? The key is that by the end of the 1940s there was a widespread consensus (belief) among policy elites that the state now had a meaningful and appropriate role in managing the capitalist economy. Moreover, now, given the high levels of taxation brought in during the war, these elites had a new mechanism to aid in this management.

The experience of wartime planning and economic management opened the door to a new set of ideas about the proper role of the state in society. The well known economist John Maynard Keynes then, offer a new set of ideas which could help states translate their experience into a positive program of state intervention. Whereas the dominant idea before the war was that the state should not manipulate the economy, Keynes' ideas was that if the state actively managed demand it could produce higher long term growth and lower unemployment in the short run. How could any politician resist such and idea?

»Keynsian« economic management quickly became widely accepted in most advanced capitalist nations. The basic tenet of this economic idea was that governments had both the right and the ability to influence the

29. In most cases the wartime "Excess Profits" duties and taxes were scaled back and/or folded into more permanent corporate profit tax systems.

macro economy (Hall 1986; Hall 1989). It did not take major intellectual leaps, then, to conclude that the government might also be able to influence more micro economic outcomes. Tax policy was seen as a major instrument with which to accomplish this end. Modern governments discovered that, given the high marginal rates of taxation, the tax structure could be manipulated to provide incentives for a wide range of economic activities. In effect, governments now were in a position to impose a deal on capital: if you invest in places, times, or activities that we determine, you will pay lower taxes. If you chose to ignore our incentives, you pay higher taxes.

Tax policy thus quickly became a major instrument of social and economic management. Tax incentives could be (and were) used to affect decisions about where to invest, when to invest, and what to invest in (Howard 1997). There were far too many complicated incentive mechanisms developed in various nations to discuss here: They ranged from general investment tax credits, to inventory, to reserve funds, to special depreciation allowances, to tax deductions for investments in particular regions, products, and companies). But it is important to note that all countries engaged in these micro-manipulations of the economy via the tax code irrespective of party, ideology, and level of economic wealth. Economists did not doubt that taxes could be used as instruments of what they called »Social Control« the real questions were which instruments were best and which were less so.

Certainly there were those who continued to argue that high taxes damaged economic performance. But, as a number of empirical studies have indicated, there was very little empirical evidence that could be used to support this proposition (Barro 1991; Ferleger and Mandle 1993; Lindert 2004). For most of the post-war period there has simply been no correlation between tax burdens and economic performance.

Taxation and Inflation: Taxes as a free Lunch

As early as the 1930s economists and tax advisors became concerned about the complex relationships between taxes and inflation. On the one hand, taxation contributed to inflation by raising the price of goods. This

was particularly clear for taxes on goods and services. But even income taxes might encourage employees to demand higher wages to, in effect, compensate for the taxes that they would inevitably pay. At the same time, inflation increased the costs of government programs and the government needed sources of revenue that would grow along with the costs of providing services. Progressive income taxes helped governments with this revenue problem (Brownlee 1996: 98). The very idea of a progressive income tax is that those who earn larger incomes should pay a higher percentage of that income in taxes. But what happens when it is inflation that drives people's incomes up? The answer is that income earners not only pay more in taxes, but also they pay a larger share of their income in taxes... even if their real incomes have not gone up. This was known as »bracket creep.« From a revenue point of view, this is excellent news. From a public relations point of view, this is potentially explosive.

The way policy makers solved (or at least assuaged) this dilemma in the 1950s, 60s and 70s was to cut taxes periodically. As before, no one thought of this possibility when these taxes were introduced, but experience led them to new understandings, new possibilities and new ideas. In this way politicians could have their cake and eat it too. In other words, inflation and economic growth would drive up revenues and politicians could then take credit for lowering taxes. In this way public revenues would be held largely constant (as in the US or could be allowed to grow (as in most European countries) all the while, politicians could take credit for helping their supporters by passing tax cuts. These cuts tended, naturally, to go to the politically powerful more often than to those who most 'deserved' them in an economic/inflationary sense.

By the late 1970s, however, the problems with this revenue strategy became came to a head.

Low economic growth combined with high inflation created a political one-two punch. Inflation pushed individuals into higher and higher tax brackets – and thus increased taxes as a share of their real income – while low economic growth made it more difficult to increase real gross income. Unsurprisingly, resentment for taxes increased. Beginning with the »Proposition 13« tax revolt in California, taxpayers around the US, and eventually across the globe began to rise up against the »unfairness« of the tax systems that their governments were creating with their inflation

finance tax cuts for the special interest. Whereas tax systems were justified 'fair' because of their adherence to the principle of 'ability to pay', it became increasingly obvious that this principle was being pushed aside by the revenue needs of the state on the one hand, and the desire of political leaders to buy off their most important constituents on the other. Thus once again, the basic structure into which modern tax systems had evolved provided the foundation for new ideas about what a good tax system should and could do.

Rethinking Tax Policy – the Origins of Tax Reform

By the 1960s and 70s, taxes were increasingly seen by political leaders as low cost (politically) solutions to virtually every problem. In country after country – under both left and right governments – policy makers invented a dizzying array of tax policy instruments. It would take volumes to simply catalogue the astonishing number of tax instruments enacted in the 1960s through to the early 1980s that were designed to promote or support different types of economic activity within the OECD (Reese 1980; Witte 1983). The truth was that tax expenditures became far more than social and economic instruments in the pursuit of commonly held public goals – it was increasingly obvious that they were more and more likely to be political plums whose intent was to satisfy particular constituencies.

Ironically, the very tax incentives introduced to promote economic growth in this era tended to exacerbate the political dilemma facing virtually all OECD nations. Whether tax incentives had the general economic effects their sponsors claim or not, they clearly had the specific effects of complicating tax codes, making it easier for sophisticated taxpayers to avoid paying taxes and, finally, radically reducing taxes for *some* taxpayers. Consequently, reports of huge corporations and multi-millionaires (and even American Presidents) who payed little or no taxes became virtually commonplace throughout the OECD. In short, tax policies justified with reference to the goal of promoting economic growth, had the direct effect of undermining another widely accepted goal for tax policy – equity. Taxes were increasingly felt to be »unfair».

The second reason the Left came to question tax expenditures was that they grew increasingly skeptical about how well they actually worked. As the numbers of tax expenditures grew, the argument that they in fact effectively directed investment, for example, became increasingly doubtful.

Tax policy makers grew increasingly concerned with the revenue consequences of expanding tax expenditures. The American case was perhaps the most dramatic, by the 1980s the total revenue loss from tax expenditures to the Treasury *exceeded* the total revenues brought in by the Federal Income Tax (Witte 1983). In other words, other taxes had to be raised in order to pay for tax expenditures. The most obvious consequence of this fact was directly political. To stabilize revenues in the face of increasing spending demands *and* increasing tax leakage (especially at the top end of the income scale) effective tax rates borne by the middle classes were allowed to creep up.

Ultimately economists began to question the very propriety of the use of the tax code to accomplish government's goals. If the government wished to subsidize this activity, or that industry, it ought to do it publicly – through the normal spending process – not through 'off budget' (ie. out of sight) mechanisms like tax expenditures (Howard 1997).

In sum, both tax policy experts in government and many on the political Left became increasingly skeptical of tax expenditures (loopholes) because they were seen as giveaways to the rich, that were ineffective as policy tools, they cost ever larger sums to the Treasury, and they were outside normal public scrutiny.

The political Right Takes the Agenda

A sea change in the political climate swept the western world in the 1980s. It is clearly outside the scope of this short paper to analyze all the sources and consequences of this ideological shift – but I believe its manifestation in tax policy provides us important insights into the broader phenomenon. In many ways, it can be argued that tax policy was the leading edge in these new political tides. In short, old policies created new problems. New ideas were introduced to help solve these new problems.

It would be wrong to suggest that Ronald Reagan came to power in 1981 with a clear mandate from the people. Many factors contributed to his electoral victory including the Iranian hostage crisis, disaffection with the previous administration, and the continuing economic crisis facing the United States. It is clear, however, that Ronald Reagan came to power with an agenda – he wanted to cut taxes and balance the Federal budget (Birnbaum and Murray 1987). What it meant to ‘cut taxes’ was still somewhat unspecified: Whose taxes should be cut, and by how much, were still issues to be decided. How he would reduce the deficit, it turned out, was even less clearly worked out.

During his electoral campaign, Reagan campaigned vociferously on behalf of the ‘overtaxed middle class.’ On June 25, 1980, he specifically promised that if he was elected, he would introduce an across the board 30 percent cut in personal income tax rates. Few knew what this would mean in reality, but it sounded good: Even fewer thought that Congress would ever agree to a tax cut of this magnitude – even if Reagan were to follow through with his promise and introduce it once he was elected. What happened next surprised virtually everyone. As if taking a page from Andrew Mellon’s 1924 book, Reagan advanced the counterintuitive argument that cutting taxes would actually stimulate growth and therefore increase revenues taken in by the state. Following this logic, Reagan thus introduced the most sweeping tax cut in modern American history. The process by which the »Economic Recovery Tax Act« (ERTA) was passed tells us a great deal about the nature of the tax policy that had developed up to this point (at least in America). Promising to cut taxes is like singing to the choir. How could any politician be expected to resist such a brilliant idea?

The logic was simple. In order to pass a huge tax rate cut, the administration offered to add literally hundreds of tax expenditures to the tax bill to »sweeten« the package (Stockman, 1986: 44). What started out as a side deal here and a side deal there, however, ended up becoming an avalanche. By the time they were through, Congress passed and Reagan signed a 25 percent across the board tax rate cut and hundreds upon hundreds of special tax expenditures (appropriately called ‘loopholes’ in this context) to particular clients. The total value of this »Economic Re-

covery Tax Act« was to reduce government revenues by over \$750 billion dollars over the next five years.

Along with this massive tax giveaway (and maybe because of it) Congress was also persuaded by the Treasury officials and the Republican advisors to introduce what turned out to be one of the most significant tax innovations passed in a generation: They indexed the personal income tax rate schedules. When first proposed, this idea was dismissed as politically unthinkable. (What good politician would give away his cake?) But in the massive frenzy of passing ERTA this little noticed provision was passed with remarkably little discussion or debate. The Reagan administration wanted to reduce government spending through any means possible. So why not stop government from collecting new revenue simply through bracket creep?

As it turned out, the Reagan administration proved remarkably unable to actually cut government spending directly... but with this measure they were able to strangle government over the longer run. »The enactment of indexation provides a striking example of how radical change sometimes hangs on precarious events,« Paul Pierson tells us. »Indexation enjoyed only a brief window of political opportunity; by 1982 the mounting budget deficits would have made the change impossible. Once enacted, however, it had truly revolutionary effects« (Pierson 1994: 153).

The immediate consequence of the 1981 tax reform was the massive increase in the public deficit. Though Reagan clearly wanted to cut many government programs, Congress was far less accommodating in this regard. Cutting people's taxes was a far easier thing to do than take away programs that they had become used to. The Federal government's annual deficit grew from \$40 billion in 1979 to \$207 billion by 1983.

Increasing the public debt to this extent, fundamentally, framed and constrained all policy making in the United States for at least the next decade and a half. From this point forward, the central questions facing proponents of welfare state programs in American became: 1) How can we cut spending to help balance the budget and 2) If we want to introduce new spending, how will we pay for it? Some »revenue enhancing« measures were introduced in 1983 and 1984, by Senate Finance chairman Bob Dole, in an explicit attempt to take back some of the grossest cases of fiscal giveaway that occurred in 1981. But, certainly as long as Ronald

Reagan was President, it was very clear that any future initiatives could not contribute to the growth of the welfare state.

The new political economy of welfare state spending can be understood as a direct consequence of the massive tax giveaway introduced by Ronald Reagan in the first forty days of his first term in office.

The ideas of indexing income taxes and cutting tax rates fundamentally altered the fiscal future of the modern state. Never again would political leaders be able to cut taxes year after year and have revenues grow none-the-less. From here on out, maintaining a welfare state would be a far more difficult political proposition (Campbell and Pedersen 2001).

The detailed twists and turns that tax reform politics took over the next year have been the grist of many excellent books on American politics and policy making (cf. Birnbaum and Murray 1987; Conlan, Wrightson et al. 1990). I shall not recount these stories here. The bottom line, for our purposes, was that the Reagan administration took on what had been a Democratic policy agenda and manipulated it for their own purposes. There were, however, two critical differences between the Bradley-Gephardt tax reform proposals and the proposals eventually put forward by the administration: First, while the Democratic proposal was intended to *restore progressivity* to the tax system by eliminating loopholes and reducing rates on the middle and lower income earners, the administration's proposal eliminated many loopholes and proposed across the board rate reductions. (It was widely reported that Reagan's central personal goal was to cut the top marginal rate to 35 percent, which would mean he had cut the rate by 50 percent since he came to office.) Secondly, the Bradley-Gephardt tax reform was intended to raise revenue and restore fiscal balance to the Federal budget. Reagan specifically prohibited the administration from considering any tax reform proposals that would raise revenues... Apparently the increasing deficit (which now stood at \$212 billion in 1986) was serving its purpose. A balanced budget (despite Reagan's earlier claims) was no longer a priority issue.

Democratic reformers and policy experts alike were now in a remarkably awkward position. They had been arguing for decades that the Federal Tax system needed to be reformed and simplified... that loopholes undermined its legitimacy and its fairness. Now the Republicans were proposing a tax reform that promised to make the tax code more

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simple and, by some measures at least, more fair. Though many pundits predicted at the time that tax reform of this magnitude would surely fail, the particular combination of forces came together in a way not unlike the »Nixon visits China« phenomenon (Minarik 1990:169). After many, many twists and turns, the TRA eventually made it through Congress and was signed by the President. Truly, what eventually passed was remarkable. Tax rates were lowered for most individuals and corporations and this was financed largely by the elimination of hundreds of tax expenditures/loopholes. Though marginally regressive, the distribution of these cuts was mostly proportional to income. It could scarcely be argued that the new American tax system was »fair« it almost certainly was more fair than the one it replaced.

It is important to remember, however, that the American tax system was improved *in comparison to the tax system since 1981*. When we remember that the tax code had become radically more inefficient, complex and unfair than it had been only five years earlier, the marvel of the 1986 tax reform loses some of its sheen.

The Spread of new Ideas

Once the Americans had reformed their tax system, other countries were remarkably quick to follow suit. One of the most respected economists in the international tax policy community, Vito Tanzi, describes the process as follows:

There is no question that the tax reform movement in the United States that started in 1981 and culminated in the U.S. Tax Reform Act of 1986 has sent shock waves to other countries. Because that movement represented in part the political expression of a powerful Government, and, perhaps equally important, because it appeared to be built on a foundation of discontent with various aspects of existing tax systems, it provided the officials of other countries with both a challenge and an opportunity to introduce changes in their own tax systems. One does not exaggerate in stating that very rarely has the world seen so much interest in tax reform as in the past couple of years, and very rarely has there been such a convergence of views on at least some aspects of the tax systems that need to be modified (Tanzi 1987:5).

For the most part, the studies that examine each of these reforms are single case studies which explain their country's tax reform in domestic terms. But the more interesting story is found in the fact that after having pursued remarkably similar policy goals in taxation policy for over fifty years, virtually every country in the world effectively changes strategy and begins to emphasize different set of policy objectives from those that had dominated the agenda previously.

It would not be accurate to say that totally new goals suddenly rose to the forefront of the tax policy agenda. Rather the emphasis given to various competing goals shifted quite dramatically. Whereas (after raising revenue) tax policy had been principally driven by the goals of social 'equity' and the desire to use taxes as instruments of economic policy; by the 1990s economic 'efficiency' was now the dominant concern. To be sure, equity is still *part* of the agenda, but now 'horizontal equity' dominates the minds of tax policy makers as opposed to their previous concern with 'vertical equity'.³⁰

Cedric Sandford summarized the tax reforms passed across the globe in what he calls a »movement...without precedent in fiscal history«. He suggests in his book, *Successful Tax Reform*, that »even more remarkable than the widespread nature of tax reform, has been the similarity which justify its description as a movement« (Sandford 1993:9,10). He lists the main features of this tax movement as follows:

- Rates of personal income tax have been scaled back (particularly at the top end).
- The number of steps in the income tax scale has been reduced.
- The income tax base as been broadened. (Loopholes and exemptions are reduced.)
- Reductions in income tax revenues have been finance by increases in other taxes (VAT, Social Security, etc.)
- Corporate tax rates have been lowered and tax incentives for corporations have been correspondingly cut back. (Sandford 1993: 10-20)

30. Vertical equity implies progressivity (that "fair" taxes should tax those with greater ability to pay *more* than those with lesser abilities to pay). Horizontal equity, in contrast, refers to treating those with equal incomes equally {often irrespective of their ability to pay. | -

The convergence of views was indeed remarkable. It is, of course, not surprising that Right-leaning governments, such as those in power in the U.S. and the UK at the time should favor tax reductions for the rich. But, these views were increasingly shared by key policy makers throughout the democratic world (and beyond) of virtually all political persuasions. In the last five years, this author interviewed Ministry of Finance officials in seven OECD countries from Australia and Japan to Sweden and Denmark. *In every single case*, I have heard a remarkably similar argument. This view is best summarized in the following statement made by former Swedish Minister of Finance, Kjell Olof Feldt: »The very high level of progressive taxation just doesn't work.«³¹

One of the consequences of this tax reform process: Tax rates on upper income individuals and corporations have been drastically slashed. It is possible, however, that the cuts in tax rates are being distributed progressively in some countries. I have found no evidence, however, to suggest that this has happened. It appears instead, as Williams has noted in a survey of tax reforms in the EC conducted for the accounting firm Price Waterhouse:

At the same time as some disillusion was spreading about the efficacy of our main taxes, other pressures were building up. Our objective now is to be neutrality [sic], with taxes that do not penalize one person rather than another. They give [priority to] equality of opportunity rather than equality of result. A 'fair' tax is one which presents us with a 'level playing field' and does not concern itself with the quality of the teams (Williams 1991:14).

Unfortunately, the enormous complexity of both tax systems and the stunning number of specific tax reforms introduced over the past decade, make it impossible to provide a full accounting of all tax changes introduced. Still, while there are some who may focus on a particular major piece of legislation (say, U.S. 1986, Sweden 1991, Germany 2000) and argue that this specific reform was »neutral« between income classes, virtually all analysts agree that the *cumulative* effects of the many tax policy changes introduced in OECD nations over the past decade and a half have made these tax systems less progressive (Boskin 1990). As Sandford

31. Interview with author, May 1988.

admits, the first »main blot« on the tax reform movement has been »its tendency to increase inequalities in income and in wealth« (Sandford 1993:222).

The result was that tax policy makers across the world began to think more carefully both about the changing nature of capital's interests in the new global economy and to better understand the effects of capital taxes on both those with mobile and immobile capital assets. We saw above that corporate taxes had become major instruments of domestic economic policy in all industrial states. What this effectively meant was that there were some types of firms and some types of investments that were tax advantaged. Obviously, there was considerable variation across countries and even over time as to who actually benefitted the most. But the general pattern was to yield tax incentives for domestic investment (particularly during economic slowdowns) in plants, equipment, and machinery. Due to these various tax programs, domestic manufacturing, construction, and retailing (not coincidentally – those industries which tended to have large well organized union presence) were generally tax advantaged. In short, domestic investment was advantaged over foreign investment.

By the 1980s, however, the very structure of capital's interest had begun to change. Not only are modern corporations bigger in the global economy, they are also more interconnected and more interdependent. This also effects their tax policy interests. Firms that formerly would have been quite content with tax incentive policies that released them from paying taxes as long as they invested in domestic plants and equipment, no longer find these kinds of incentives appealing. In a largely insulated economy, manufacturing firms would be quite happy with accelerated depreciation for capital investment, for example. But a global manufacturing firm, in contrast, prefers a lower tax rate with fewer incentives which »lock in investments.« The point here is that the more internationalized firms become, the less they are likely to prefer taxes that advantage domestic suppliers and/or consumers over those beyond national frontiers.

As we saw above, the tax policies of the 1970s and 1980s discredited the increased use of specific tax incentives. They appeared not to work *and* they substantially added to these political problems facing modern governments. Policy makers throughout the OECD thus were under dual, and in many ways contradictory, pressures with respect to tax policy. On

the one hand, there was growing disenchantment with specific tax incentives from the Left. On the other hand, it was becoming equally obvious that both technological and policy changes were making it possible for capital and capitalists to place their money and investment in areas where they received the highest possible *after tax* return. As a result, policy makers began to see the multiple advantages of abandoning or severely restricting their use of taxation policy as an instrument of economic management. Tax incentives were cut in a move to »let the market (and not the government) decide« where, when, and what economic actors should do. In other words, the carrot and stick of tax policy has been increasingly being abandoned by modern governments.

It has long been argued that tax incentives do not create new activity, but simply give some economic actors rewards for doing what they might have done anyway. In previous decades, fiscal economists and policy-makers alike responded to these criticisms by arguing that the entire point of tax incentives was to produce distortions and to give tax advantages to those who are doing what society determined should be encouraged or compensated for. But in the past several years this view has been scarcely heard. How could it be that the consensus has shifted so dramatically such a short time? The answer is clearly that governments believe they can no longer effectively manage or control private economic decision makers through the tax system. A »good tax system« has moved from being one that explicitly introduced distortions into the capitalist market place to one that minimizes these distortions. In short, a »good tax system«ⁿ it is widely believed by the left and the right, keeps the government out of private economic decision making.³²

32. Vito Tanzi surveys the recent literature and suggests that changes in the international economy are so profound that there are serious doubts about whether capital taxation can continue to exist at all. For example, Roger H. Gordon has asked, "Can capital income taxes survive in open economies?" In the same spirit, Jack M. Mintz asked, "Is there a future for capital income taxation?" For Guttorm Schjelderup, "the fear is that capital mobility may lead to capital flight from high to low tax countries in such large amounts that it deprives a nation of its tax base and, as a consequence, its welfare system" (Tanzi 1995). Tanzi goes on to argue that it is especially small open countries that are the most vulnerable: Similar fears have been expressed by other authors, inclu-

Where did the »old« Ideas go?

The reader will remember that the original justification for 'reforming' the tax system (in America as elsewhere) was that it had become so littered with tax expenditures/incentives/ loopholes, that it was widely perceived as unfair by tax policy makers and tax payers alike. Also remember that by fairness citizens at least meant that the rich were not paying their fair share and the poor and middle classes had been increasingly been forced to pay too much in taxes (Hadenius 1986; Roper 1988; Taylor-Gooby 1994); Lewis, 1978). What, it seems reasonable to ask, has become of this goal? The answer, bluntly put, has been that it is often downplayed or forgotten. Vertical equity has virtually been taken off the agenda.³³ »Common intellectual themes [of the tax reform movement]« report Boskin and McLure in their book, *World Tax Reform*, »included concern about the adverse incentive effects of high marginal tax rates and about distortions caused by differential tax treatment of economically similar activities, and a downplaying of vertical equity as a central objective of tax policy« (Boskin 1990: 3, my emphasis). As the OECD argued in 1989:

The pursuit of greater neutrality has been based on the growing acceptance of the fact that a proportional tax system is more likely to be optimal from an efficiency point of view than one which is graduated and selective. Also, the idea of minimizing the impact of the tax structure on economic behavior has been a distinctly unfamiliar idea to many OECD governments until recently.

ding Frenkel, Razin, and Sadka. These fears are related to the taxation of capital in all countries but acquire special urgency in small countries. Small countries may find it particularly difficult to maintain high tax rates on capital income, and some of them may be tempted to become "tax havens" for foreign capital, thus making it more difficult other countries to maintain their tax rates. As Razin and Sadka have put it, "No capital income tax, whatsoever, can be efficiently imposed by a small open economy if capital flight to the rest of the world cannot be stopped." Of course, for capital to move out of a given country the net-of-tax rate of return in the rest of the world must be lower than that in the country. The idea that especially small countries will be exposed to the effects of deep integration on capital taxation is a recurrent theme in the literature on international taxation (Tanzi 1995).

33. Vertical equity usually implies that those with greater incomes should pay a larger share of their income in taxes.

Governments have often used the tax system deliberately to alter consumption or investment patterns (OECD 1989).

It was certainly true that there were so many 'loopholes' in modern tax systems (especially the American and British) that tax reforms *could have* cut out the inefficiencies *and* increased the progressivity of the tax systems, but in no case that I am aware of did this actually occur. Indeed, most often exactly the opposite came about. To be sure, rate cuts were partially financed with reductions in tax expenditures, but in most cases they were also replaced with increases in consumption taxes or social insurance fees. Taken together these moves has meant a downward redistribution of tax burdens for most countries.

In a recent conference Richard Musgrave, author of the most widely used fiscal economics text in the world comment on the current tax reform movement in the following way: »The major factor [behind the reforms] has been a change in political climate towards a less egalitarian view of distributive justice« (Musgrave 1990:317).

What *should* the State do?

We are currently witnessing the evolution of a new logic upon which democratic states raise revenue. No matter who holds the reigns of power all modern governments appear to have concluded that a »good« tax system must both cut taxes for the wealthy and for internationally mobile capital and retreat from using tax policy as an active instrument of economic management. They have apparently decided that the market should be ever more responsible for economic outcomes. Governments, even Social Democratic governments, are moving to get out of the way. In short, tax reform means changing the character of the relationship between the state and the private economy: public authority is being yielded to private interests.

It is clearly the case that pro-market and state-interventionist ideas are now dominant, but it is not true that these ideas are new. Capital and the ideological Right have made these same arguments since the turn of the century. But up until recently, those who called for more socially and economically »neutral« tax systems have been overwhelmed by those who saw

it as the legitimate responsibility of the state to try to shape both the distribution of income/wealth in society and to encourage certain kinds of economic activity over others. Reading the current economic literature on tax policy one might conclude that these new/old principles driving tax policy in the 1980's and 1990's have won because they are superior ideas: that the idea that taxes should be based on the principles of »ability to pay« and state management of the economy are simply intellectually bankrupt. Sandford puts it thus: »Above all, however, tax reform reflected a change in economic philosophy. In most countries, certainly amongst the leaders, tax reform was part of a programme of pushing back the boundaries of the state... Disillusionment with the results of state intervention had led to a decline in belief in the efficacy of state intervention and a revival of belief in the efficacy of markets« (Sandford 1993:20, emphasis in original).

It is not true that the tax policy changes that have occurred around the world over the past twenty years or so are purely the product of a new attack on the part of capital and/or the rich against the middle and lower classes. Instead, as this paper has attempted to demonstrate, it was equally the increased disaffection with extant tax systems and what they had become that opened the door to new thinking about taxation and tax policy. It was the horrible mess that many countries had made of their tax systems in the 1970s and early 1980s that created the disillusionment with taxes than some new systematic attack by forces on the Right. Both the Left and the Right, after all, contributed to building the increasingly complex, inefficient and inequitable systems that these countries had developed.

Public dissatisfaction with taxes in the early 1980s was rooted in the belief that the poor and the middle classes were paying too much and the rich and corporations were paying too little – ie. vertical equity. But *elite* dissatisfaction with taxes was more rooted in distrust of the efficacy of the tax expenditures that now littered the tax codes and the economic inefficiencies they created. In a fundamental sense, fiscal economists and Treasury/Finance officials grew increasingly skeptical of their political masters. It is not clear that tax policy experts believed tax incentives were by definition bad. But they clearly believed that they were wrongly used and misused by the political leadership. It would be better, they came to

believe to have no (or very few) tax expenditures than to have a tax system littered with tax loopholes designed for the politically powerful.

It would be equally wrong to suggest that economic realities did not play a role in the specific character of the reforms that were eventually passed. As I have tried to show, the realities of economic internationalization substantially contributed to the change in what tax policy makers thought was desirable. As Vito Tanzi puts it, »[t]ax competition from other countries may force some countries into choosing tax structures (and, perhaps, tax levels) that their policy-makers might consider less desirable than the ones they would have chosen if their economies had remained closed« (Tanzi 1995: 134).

Rarely, however, do policy makers think in terms of »if we only could have ...« Instead their thinking is fundamentally framed within the economic/intellectual climate in which they work. Just as in the 1930s when it seemed self-evident to economists that taxes should contribute to social justice, today it is self-evident to them that the state should 'level the playing field.' The President of the American Economic Association T.S. Adams, put this point quite well in his address to his association in 1928: »The dominating factor of economic interest in taxation determines to a large extent the role or place of idealism in taxation. Ideals are effective when they further the economic interest of powerful groups« (Adams 1928: 4).

Ideas about policy are formed in a political and institutional context. As we have seen, experiences with poorly designed and implemented tax policies helped shape politicians', economists' and tax officials' attitudes and beliefs about what reforms were necessary and desirable. This is because beliefs about what is desirable are constructed within the context of historical experience. What we want is fundamentally framed by what we can imagine achieving – and what we can imagine achieving is informed by what we have done before. At the same time, policies are also framed in an economic context. In the present era, the context in which tax reform is constructed is one of increased international economic mobility. The result has been the growing conviction among policy makers that markets will outrun political boundaries no matter how well policies are designed.

In short, both the apparent failure of the political structure to make efficient and fair use of tax policy and the realities of globalization have ultimately shaped what policy elites now believe can be done *and what*

*ought to be done.*³⁴ Whereas in the first seven decades of this century, there was a widespread consensus that taxes *should* be used as a social policy instrument that had an essential function in redistributing income and wealth in capitalist democracies, today there appears to be a growing consensus (among elites, at least) that taxes *should* not be used for these purposes.

One Path or many?

One should not misinterpret the argument in these pages to suggest either that modern states have no option but to follow the logic of neo-liberal tax policy, nor that all modern states have followed exactly the same path. To draw either of these conclusions would be a significant misinterpretation of the arguments presented here. First, in this essay I have tried to explore *why* certain tax policy ideas have grown and prospered across the advanced capitalist world. While it is quite clear that these ideas have been broadly similar in places as different as the USA and Sweden, it is equally clear that the *interpretation* and *implementation* of these ideas has often been significantly different in different countries. For example, in an essay I published in 2003 titled »Bucking The Trend: Swedish Social Democracy in the Global Economy« I argued that Sweden was *not* following the neo-liberal logic of rolling back the welfare state in the face of globalization (Steinmo 2003). But clearly neo-liberal ideas have had significant influence in Swedish political economy. Indeed, my evidence supports Kjær and Pedersen when they say, »neo-liberalism should not be conceived as a universally meaningful totality of ideas that diffused across nations and through time, but as a more loosely connected set of concepts, distinctions, and ideas that gained meaning as they were selected, articulated, and then stabilized in unique ways« (Kjær and Pedersen 2001: 221).

34. It is interesting to note that there has been a recent flurry of academic writing among political scientists that appears to argue that tax policy makers do not have to respond to internationalizing incentives by calling taxes and/or redistributing the tax burden. Apparently, however, elite policy makers have not read these analyses.

Secondly, I have argued here that ideas, institutions and policy choices must be understood in an evolutionary manner. A keystone of the evolutionary perspective is *contingency* (Lewis and Steinmo 2007). By this I mean to suggest not only that specific outcomes are not predictable, but also that the local ecology can be equally important to explaining an evolutionary event as the broader global ecology in which it develops. While we know that 'global warming,' for example, will raise average temperatures around the world, we cannot know for certain whether global warming will raise average temperatures in a place on the globe. The same can be said for 'globalization.' Clearly the increasing mobility of capital and labor will continue to have enormous consequences for the entire world, but this does not mean that we can specifically predict the particular outcomes of 'globalization' in a specific place in the world.

My aim here has not been to predict what will occur. My goals have been far more humble: I have argued that the political/economic context in which tax policies are made affect the environment (ecology) in which future tax policy choices are made. Political leaders problem-solve and bring forward policy ideas as potential solutions to new problems. These ideas may be new policy solutions that have become available due to previous policy choices, or they may be older ideas that have been more or less dormant for a period. In either case, policy ideas should be seen as »problem solutions« – a kind of rational probabilistic calculation linking problems with potential solutions. New ideas come to the fore because a) older ideas are discredited by experience, b) a new political/economic context opens up new opportunities for innovation or c) the political balance of power shifts, thus those that are advantaged by certain policy ideas are able to push their agenda over others.

Finally, we also must remember that ideas and the policies they imply are not neutral: They advantage some interests over others. One cannot disaggregate ideas from interests as if they were separate and *independent* variables (as one might in a simple regression model) because ideas and interests are both interactive and interdependent. It is tempting to argue, for example, that the recent trends towards lower marginal tax rates for capital and high income earners witnessed around the world is a direct result of 'globalization.' But to do so would be to ignore the way that the negative experience policy makers have had with high marginal tax rates

in the 1970-1990s in terms of growing belief that high tax rates led to new inequalities and to the growing belief that policy makers could not be 'trusted' to implement tax policies either fairly or efficiently. These beliefs intersected with one another at a time when the world was in fact become more 'global', thus policy makers and advisors did not believe that it would be possible to close every loophole. Thus the fact of globalization in many ways became a justification for policies which tax professionals and tax policy advisors had long wanted to make. In this view then, the 'ideas' are not derivative of the interests, instead interests may be constructed in a particular way to justify specific ideas.

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