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The evolution of policy ideas: tax policy in the 20th century

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Abstract

This analysis traces the evolution of ideas about one of the most important policies facing any state: taxation. The article will demonstrate that elite ideas about tax policy have changed dramatically over the past century and that these ideas have had enormous consequences for the development of the modern state. This article argues that there is an iterative, interdependent and dynamic relationship between policy makers' ideas, political institutions and public policy outcomes.

> The ideas of economists and political philosophers, both when they are right and when they are wrong, are more powerful than commonly understood. Indeed the world is governed by little else. Practical men, who believe themselves exempt from any intellectual influence, are usually the slaves of some defunct economist. (John Maynard Keynes)

> Academic economists discussing policy issues sometimes sound as though they are, in effect, advocating that the way the world works should be changed to fit the conditions assumed in their models. (Richard Bird)

> Economists are the most economical about ideas. They make the ones they learned in graduate school last a lifetime. (John Kenneth Galbraith)

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The purposes of this article are twofold. First, I explore the development of taxation policy in advanced democracies in the 20th century. Tax policies in a large number of advanced countries have developed in remarkably similar ways throughout the century. This article traces these developments and examines the ways in which one era's tax policies set the foundation for subsequent eras' tax policy reforms. I focus particularly on the most recent tax reform movement which has swept the globe in the past 15 years. Second, I hope to make a contribution to the development of historical institutionalist theory. This article explores the linkages between ideas, interests and policy outcomes and argues that we can view historical change in an evolutionary manner. Understanding institutions and policies in this evolutionary context allows us to get beyond the quite useless debate that aims to separate ideas and interests as *independent variables* (Goldstein and Keohane 1993; Hay 2002; John 2000). Instead, I argue that ideas and interests are interdependent variables. Indeed, as Mark Blyth compellingly argues, one cannot make sense of one without the other (Blyth 2002).

In this article I show how policy ideas (problem solutions), beliefs (interpretations), values (basic normative preferences) and interests (material self-interest) are related to one another in a dynamic and interactive process that can be described in terms of policy evolution: successful policy ideas are institutionalised and thus become the foundation upon which actors' beliefs are construed. I argue that policy ideas, beliefs and values are keys in the *selection* process between policy alternatives as well as in the process of *imitation* in which policies and institutions spread.[1] It is widely understood today that institutions shape the strategic environment in which actors fight for their interests (Hall and Taylor 1996; Thelen and Steinmo 1992). This analysis suggests that policies, once institutionalized, shape profoundly the preferences of actors in the next iteration of the policy game.

I call this an evolutionary analysis for several reasons. First, it understands historical change as 'contingent process' as Peter Kerr (2002) suggests, 'which can take multiple paths and is underpinned by a constant interplay between agents and their environment' (Kerr 2002, 1). Second, in contrast to much political science literature it explicitly understands history as non-linear (non-Newtonian) and adaptive. History evolves and changes in unpredictable ways according to the way human agents themselves adapt and change to the environment which they themselves have helped construct. Note that humans play a unique role in the physical world because they can consciously change the environment or ecology.

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They can do this most obviously by changing institutions. Third, there is more going on here than implied by a simple policy learning model[2]—though the idea of learning is key—this analysis places the evolution of this policy arena in the broader context of the evolution of modern democratic capitalism itself. Here we will see both how taxation policies constructed within a particular political/economic context have profound effects on the very structure of democratic capitalism itself *and* how changes in the political/economic context in turn affect the next round of tax policy innovation and change.

Specifically, this analysis demonstrates that, in each major epoch of the 20th century, quite different policy ideas have dominated the thinking of fiscal policy makers. The institutionalisation of these differing ideas has had enormous consequences for the development of the modern state. In each era, policy makers' ideas evolve out of policy makers' experiences with their extant revenue systems, but then become the foundation for the next generation of tax policy reforms. I understand history as a dynamic process and thus the very policy solutions initiated in one era create new opportunities and problems that form the foundation for new policy ideas in the next era. Policy ideas are not abstract value or ideological judgements which are simply floating around waiting to be used by entrepreneurial policy activists. Instead, substantive historical experience in time 1 substantially shapes policy elite's ideas about policy options in time 2. As we shall see in the concluding sections of this analysis, in this sense the current epoch of tax reform is no different from the tax reform epochs of previous decades.

This article begins with 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—even necessary—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 their turn, shaped what policy makers and interest group activists understood to be possible and desirable.

Next, the article examines the politics of tax reform in the United States in the 1980s focusing on 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

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administration) and to show that, once passed, the TRA '86 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. Once the US demonstrated that this kind of tax reform was possible, this idea spread across the world with remarkable force and power. Quite simply, seeing that this kind of reform was possible (even) in America, policy makers around the world have attempted to imitate these policies in their own national contexts. While the details of tax reforms actually implemented vary of course from country to country, the patterns are astonishingly similar.[3] I also argue that, though 'globalisation' 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 origins of modern taxation

Over the last 100 years, the ways in which states have raised revenues has been transformed. At the close of the 19th 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, inequitably applied and did not generate very much revenue. In 1900 no state collected more than 10 per cent of GDP from all of the literally hundreds of revenue sources combined.

As the 20th 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. In traditional tax systems the poor bore much heavier tax burdens than the rich. But, as unions, as well as working and middle class parties mobilised, their political representatives increasingly demanded that taxes be used as instruments to change 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) was seen as a partial solution to the growing problem of inequality in modern society (Pechman 1983; Weber and Wildavsky 1986; Witte 1985).

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Responding to these demands, income and profits taxes were introduced in a number of industrialising countries. In all cases, these taxes were in fact quite minor in revenue terms and were to be paid only by the very richest individuals and companies. They were therefore often referred to as 'class taxes' (Waltman 1985).

It would not be accurate, however, simply to view the introduction of progressive taxation as the product of the raw exercise of political power. In fact, progressive taxes were introduced in a number of cases *before* the right to vote had been extended to the lower classes (e.g. Japan, Germany, Sweden). Instead, this era marked a broad shift in social values in a number of industrialising countries. For many bureaucratic/fiscal elites, the idea of taxing profits and the income of the industrialists was seen as a policy solution (idea) which would both raise revenues and be 'fair' (Ishi 1993; Rodriguez 1980; Sabine 1966; Stein 1969).

In short, elite views on taxation were also evolving. Modern capitalism resulted in enormous economic wealth and inequalities, they argued, and, given this reality, taxes could be levied according to the taxpayer's 'ability to pay' (King 1983; Musgrave and Musgrave 1980; Stein 1969; Witte 1985).

As the First World War broke out, the 'ability to pay' principle was taken to some remarkable extremes. 'Total war', as it was sometimes called, was extremely expensive. In other words, the fiscal needs of the state expanded enormously just as the new tax ideas had been institutionalised. Thus, in addition to the traditional means of financing war (debt) the state now had new tools which were both financially quite lucrative and politically legitimate. Thus, new 'excess profits taxes', 'war preparedness taxes' and 'national defence levies' were implemented as 'temporary' taxes.[4] In many countries, these taxes quickly became the major sources of national government finance even though they were paid only by corporations and by fewer than 5 per cent of society's richest citizens.[5]

The institutionalisation of progressive income and corporation taxes in this era had enormous implications for subsequent developments in taxation policy—and indeed for the development of the modern welfare state as a whole. First, these new taxes produced enormous revenues. Second, the basic assumptions about how taxes could legitimately be raised had by now shifted. Taxes, it was now clear, *could and should* be used as an instrument of economic redistributive policy.

During the 1920s, the very high marginal wartime tax rates were rolled back. But in no case did fiscal policy makers attempt to abandon the principle of 'ability to pay'. By now the belief that taxation policy could be

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used as an instrument of redistribution in modern society was no longer 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 under Hoover, argued against the principle of progressivity—he simply argued that they should not be *as* progressive as they had become during the war years.[6] By now progressive taxes were an integral part of the tax system as a whole—to repeal them would violate commonly held values about social equity ... especially in view of the fact that the revenues from these taxes would necessarily have to be replaced through regressive taxation.

Once again, it was not simply politicians and demagogues who struck on the idea that progressive taxes could be expanded to help the maldistribution of wealth and income in society.[7] The following table offers insight into the tax policy elite's thinking in the mid-1930s. Unfortunately, we do not have any survey data which would reveal the attitudes of tax policy professionals in earlier eras, but all of the case studies this author has been able to find, as well as the biographies of policy makers of the era, indicate that attitudes had changed remarkably from that of previous generations (Blough and Shoup 1937; Keynes 1936; Snowden 1934; Walton 1928). We see clearly here that the majority of economists favoured progressive taxes generally and specifically favoured taxes that placed a heavier burden on 'unearned' income (see Table 1 below.) Note for example that in 1934 only 12–13 per cent felt that there should be a retail sales tax, but fully 66 per cent believed that capital income should be taxed at a higher rate than ordinary (earned) income. Moreover, fully 92 per cent believed that the federal government should impose inheritance taxes and 98 per cent believed that the federal government should tax corporate profits. Perhaps most telling, 60 per cent believed that tax rates on unearned (capital) income should be higher than tax rates on earned (wage) income. As Table 2 clearly shows, these views are dramatically at odds with the views of tax policy professionals later in the 20th century.

From 'class tax' to 'mass tax'

The Second World War changed the tax policy climate dramatically. Once again, the costs of fighting this war were enormous and it was clear to all concerned that no one would be able to escape massive increases in their tax burden. Between the First and Second World Wars the economy had evolved. As more and more people moved from agriculture to industry,

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Table 1: Tax professionals' opinions, 1934: responses to tax policy questions
Figures refer to percentage answering 'Yes'

Question	% Yes
In general, should there be free trade with only incidental tariffs?	61
Should there be a special tax on unearned increment of land values?	62
Should inheritance be taxed by the federal government?	92
Should there be higher income tax rates for unearned (i.e. capital) income?	66
Should all future federal, state and local government securities that are issued be fully taxable as to income?	96
Should there be a net income tax on corporations?	98
Should insurance business be taxed in a different way than general incorporated business?	73
Should railway and public utility business be taxed in a different way than general incorporated business?	55
Should there be a general retail sales tax at the federal level?	13
Should there be a general retail sales tax at the state level?	12

Source: Slemrod 1995: Table 1

more and more incomes were being paid in cash by employers in weekly pay cheques. This new political economy opened the door to new ideas about taxation.

Though clearly intended originally as taxes on the rich, treasury officials also saw the enormous revenue potential of income taxes. Specifically, revenue officials in countries as dispersed as the US, Sweden, Japan and Germany began to realise that income could be withheld by employers and paid directly to the government even before the worker collected it in his weekly cheque. Thus, the idea of a Pay as You Earn (PAYE) system was born. 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. Moreover, with this new system, massive increases in government revenues could be justified politically and morally. It was 'fair' to tax income, as long as everyone paid. Given the now common egalitarian values among elites, it was even more 'fair' if the rich paid a higher percentage of their income than the poor.[8] Consequently, marginal tax rates on the wealthy were pushed up to extraordinary levels at the same time that tax thresholds[9] were substantially lowered so that now even modest income earners would contribute to the war effort directly with each pay cheque.

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Simply put, the 'idea' was to convert what once was a 'class tax' into 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 per cent of income earners were now paying this tax. These changes increased radically 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.

Taken together the revenue reforms of the 1930–1945 era transformed the politics of taxation in all industrial democracies. By increasing tax rates steeply on companies and the very wealthy at the same time that they extended the income tax net downward, central/national governments became responsible for redistributing both wealth and income across classes and generations. 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.

Taxation as an economic tool: the carrot and the stick

At the close of the war, voters and interest groups alike expected their 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. Even where conservative parties gained majorities in parliament, tax rates were not pulled down substantially.[10] 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.[11] With these beliefs, a new policy idea emerged: instead of reducing rates across the board, the government could direct investment in socially and economically desirable ways by offering tax incentives to corporations and wealthy investors.

The logic of 'Keynesian' economic management had by now become widely accepted in most advanced capitalist nations. In other words, economists increasingly came to believe that government *could and should* effectively manage the capitalist economy. '[T]his regulation, however admirable', John Galbraith wrote, 'will work only if the magnitudes are great enough to count. Taxes must be appreciable in relation to income if they are to affect incomes and therewith demand' (Galbraith 1978, 238). It did not take major intellectual leaps, then, to conclude that the govern-

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ment might also be able to influence microeconomic outcomes. Tax policy was seen as a major instrument with which to accomplish this end. Economic policy officials quickly realised that 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 choose to ignore our incentives, you pay higher taxes.

It is important to note that the extraordinarily high marginal tax rates built up during the war were not created in order to allow public policy makers to manipulate or direct private investment. But, once these rates had been institutionalised it became easy to see how they could be used for new purposes. In short, changes in the tax structure brought on by the war became the foundation for new 'ideas' after the war. These ideas, moreover, were adopted quite easily in part because of the experience of policy makers and economists during the war when governments were actively involved in directing and shaping the private economy in order to make it more effective for fighting the enemy.[12]

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 and 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. Even before the war, economists were engaged in a debate about how, when and which taxes could be the most effective instruments of public policy (Blough and Shoup 1937). By the end of the war mainstream economists rarely doubted 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 useful (Martin 1989).

There was, moreover, a considerable amount of international sharing of ideas and specific policies over how to use the tax code most effectively to affect desired social and economic ends (Hansen 1969).[13] Tax advisers (from rich industrialised countries, at least) frequented a large number of international conferences on tax and fiscal policy. It is difficult to know exactly how effective these conferences were, of course, but there is no question that the very point was for tax policy experts to get together to

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share information on fiscal theory, policy experiences, implementation issues and politics.[14] A number of studies were produced, for example, that examined which tax expenditures worked and which others did not work in the experience of participating countries (cf. Confederation of British Industries 1965; Hansen 1969; Tanzi 1969).

Whatever the specific mechanisms used in different countries, and irrespective of whether they were always used effectively or efficiently (which they were not), there was by now widespread agreement that governments *could and should* use their tax systems as instruments of economic policy; that tax incentives could affect the timing, structure and shape of investment and other private economic decisions (cf. Hansen 1969). Under the extant fiscal regime (high marginal taxes combined with generous tax incentives and strict capital controls regulating the export of capital), the belief had now become widespread that capitalists and their money could be used to promote the ends of society as a whole. At the same time, many believed that this ‘carrot and stick’ approach helped reduce uncertainty in the market-place and contributed to the post-war economic miracle. As Christopher Howard points out, for example, because tax expenditures were seen as ‘off budget’ expenditures, advocates ‘enjoyed the luxury of accenting the programme’s benefits and ignoring its costs without fear of serious challenge’ (Howard 1997, 178; see also King 1983). This regime was a centrepiece of the post-war compromise between capital and labour in all western industrial democracies (Steinmo 1993). The now dominant definition of a ‘good’ tax system was one that promoted social equity and allowed governments to influence private economic outcomes in publicly determined ways (Bird 1980; Sandford 1993).

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. For most of the post-war period there has been simply no correlation between tax burdens and economic performance (cf. Barro 1991). There was by now, however, a widely held belief that the state could promote social equity and economic growth simultaneously.

Rethinking tax policy—the origins of tax reform

By the 1960s and 1970s, taxes were seen increasingly by political leaders as low cost (politically) solutions to virtually every problem. In country after country—under both left and right governments—policy makers

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invented a dizzying array of tax policy instruments. It would take volumes simply to 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.[15]

Ironically, the very tax incentives introduced to promote economic growth in this era tended to exacerbate the political dilemma facing virtually all advanced nations. Whether tax incentives had the general economic effects their sponsors claim or not, they clearly had the specific effect 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 multimillionaires (and even American presidents) who paid 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'.[16]

Tax policy makers also 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.

Ultimately economists and tax policy makers began to question the very propriety of the use of the tax code to accomplish government's goals. A key figure in this change in the US was Stanley Surrey, Assistant Secretary of the Treasury for Taxation from 1960–1968. Surrey argued, quite reasonably, that, if the government wished to subsidise some specific activity or industry, it ought to do it publicly—through the normal spending process—not through 'off budget' (i.e. out of sight) mechanisms like tax expenditures (see Surrey 1973). At first, Surrey's arguments against using tax incentives instead of direct government spending were taken as theoretically plausible, but politically improbable. This was not because his arguments were logically flawed, but rather because few believed politicians (in the US or elsewhere) would ever pass the kinds of reforms Surrey was advocating.

In sum, both tax policy experts in government (and many on the political left) came to believe that tax expenditures (loopholes) did not promote the economic and social goals that they had originally been intended to produce. On the contrary, their experience taught them that tax expenditures *actually institutionalised* were often simply giveaways to the rich and powerful, were

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ineffective as policy tools, cost ever larger sums to the treasury, and were outside normal public scrutiny. What was once thought to be a very 'good idea' was becoming increasingly discredited as bad after all.

The new politics of taxation

A sea change in the political climate swept the western world in the 1980s. It is clearly outside the scope of this short article to analyse all the sources and consequences of this ideological shift, but I believe its manifestation in tax policy provides important insights into the broader phenomenon. In many ways, it can be argued that tax policy was the leading edge in this new political tide.[17]

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 (Conlan, Wrightson, and Beam 1990; Pechman 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 25 June 1980, he specifically promised that, if he was elected, he would introduce an across-the-board 30 per cent cut in personal income tax rates. Few knew what this would mean in reality, but it sounded good. What happened next surprised virtually everyone. As if taking a page from Andrew Mellon's 1924 book, Reagan advanced the counter-intuitive 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.[18] The total value of this 'Economic Recovery Tax Act' was to reduce government revenues by over $750 billion over the next five years.

The immediate consequence of the 1981 tax reform was the massive increase in the public deficit. The federal government's annual deficit grew from $40 billion in 1979 to $207 billion by 1983. The second most obvious consequence was that this tax reform made the US tax system even more complicated and 'unfair'.

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By the mid-1980s the inefficiency and inequity of the American tax system had become so obvious and pervasive that even the authors of the system were embarrassed. Public interest groups like ‘Citizens for Tax Justice’, ‘Common Cause’ and a host of others had become incensed with the increasingly common revelations that multimillionaires and mega-corporations were paying less in taxes than the people who cleaned their houses and offices (Minarik 1990, 159–179). Reflecting what was becoming an increasingly common view among tax policy experts, Henry Aaron and Harvey Galper, two widely respected fiscal economists with the Brookings Institution described the American tax code in 1986 in the following way:

> The US tax system has become a swamp of unfairness, complexity and inefficiency. The accumulation of credits, deductions and exclusions designed to help particular groups or advance special purposes conflict with one another, are poorly designed and represent no consistent policy. The tax system causes investors to waste resources on low-yield investments that carry large tax benefits while high-yield investments without such benefits go unfunded. The result is a shrunken tax base that requires needlessly high rates on wages, salaries and other taxable income. Overall the system undermines the faith of citizens that tax burdens are shared fairly. (Aaron and Galper 1986, 1)

As the gross abuses of the system became more and more commonplace in the media, the demand for ‘tax reform’ became harder and harder for even Republicans to ignore. Worried that the Democrats would use the unfairness of the tax system as a bludgeon against them in the next election (1984), several Republicans began to argue for tax reform as well. The Treasury Secretary, Don Reagan, was thus charged with the responsibility to examine a proposal for tax reform that the administration could call its own (Birnbaum and Murray 1987).

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. Conlan et al. 1990). I shall not recount these stories here.

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

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(Minarik 1990, 169). After many twists and turns, the 1986 Tax Reform Act (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', but 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. In short, the 'idea' of tax reform—meaning lowering rates and cutting many loopholes—grew on the foundation of policy elites' experience with the abuses of the old tax system. Fiscal policy experts and tax policy-makers alike now began to abandon the belief that taxes could be used effectively for redistributive policy ends, as well as instruments with which the government could direct private investment effectively. Why did they abandon this long held belief? Because their experiences with the tax system over the past several decades had taught them that, even if tax expenditures might be a good idea in principle, in reality they were too often misused and unfair.

The table above, from a recent study by Joel Slemrod, compares the opinions of tax economists in 1934 and 1994. It shows that economists over the last decade have adopted far more sceptical attitudes towards government intervention and redistributive policy than they did in the 1930s. Specifically, economists in 1994 were much more likely to favour regressive taxes (presumably because they are more economically neutral) and less likely to favour progressive taxes on capital and corporate income. These data, moreover, appear to confirm Charles McClure's conclusion in his 1984 essay 'The evolution of tax advice and the taxation of capital income in the USA':

> Over the past twenty years there has been a marked shift in the concerns of academic tax experts from equity toward efficiency. This has been manifested in a shift in professional advice on tax policy. Whereas in 1960 a comprehensive income tax levied at progressive rates was the goal of most tax economists, consumption is not pre-

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Table 2: Tax professionals' opinions, 1934 and 1994: responses to tax policy questions
Figures refer to percentage answering 'Yes'

Question	% Yes 1994 Survey	Difference between 1934 and 1994
In general, should there be free trade with only incidental tariffs?	91	0.3
Should there be a special tax on unearned increment of land values?	22	–40%
Should inheritance be taxed by the federal government?	72	–20%
Should there be higher income tax rates for unearned (i.e. capital) income?	7	–59%
Should all future federal, state and local government securities that are issued be fully taxable as to income?	61	–25%
Should there be a net income tax on corporations?	70	–28%
Should insurance business be taxed in a different way than general incorporated business?	28	–45%
Should railway and public utility business be taxed in a different way than general incorporated business?	24	–29%
Should there be a general retail sales tax at the federal level?	33	+20%
Should there be a general retail sales tax at the state level?	91	+58%
Should there be a general retail sales tax at the local level?	56	+56%

Source: (Slemrod 1995: Table 1)

> ferred by many in that profession, and graduated rates are less popular, even if the tax base is consumption, rather than income. (McLure 1984, 266)

World tax reform

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 diffusion of these ideas as follows:

> There is no question that the tax reform movement in the United States ... has sent shock waves to other countries ... [i]t provided the officials of other countries with both a challenge and an opportunity to introduce changes in their own tax systems. One does not exag-

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> gerate 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)

Cedric Sandford summarised the tax reforms passed across the globe in what he calls a 'movement ... without precedent in fiscal history'.[19] He suggests in his book, *Successful Tax Reform*, that 'even more remarkable than the widespread nature of tax reform, has been the similarity across countries. It is this similarity which justifies its description as a movement' (Sandford 1993, 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 has been broadened. (Loopholes and exemptions are reduced.)
- Reductions in income tax revenues have been financed 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)

The convergence of views has been remarkable indeed. Of course, it is not surprising that right-leaning governments should favour tax reductions for the rich. But, these views were shared increasingly by key policy makers of virtually all political persuasions throughout the democratic world (and beyond). In the last eight 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 remarkably similar beliefs. This view is best summarised 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'.[20] Former Social Democratic Chancellor of Germany Helmut Schmidt takes this basic argument even further: 'The welfare state is such a good idea, but it has been driven to extremes by Sweden, by France, by Germany, by all the European countries'. The public does not understand, he complains: 'there will be a need to reduce the burden of social services, reduce taxation and find new ways to produce goods in order to be competitive in the global economy' (quoted in Yergin and Stanislaw 1998, 329).

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Table 3: Top marginal rates of central government personal income tax: 1976, 1986, 1992, 1997, selected OECD countries

Country	1976	1986	1992	1997	reduction 1997–1976
Australia	65	57	47	47	17
France	60	65	57	57	3
Germany	56	56	53	53*	3
Ireland	77	58	52	48	29
Italy	72	62	51	51	22
Japan[1]	75	70	50	50	25
New Zealand	60	57	33	33	27
Norway[1]	48	40	23	23	35
Sweden[1]	57	50	20	25	32
United Kingdom	83	60	40	40	43
United States[1]	70	50	31	39	31
Unweighted average	**63.4**	**56.3**	**42.8**	**42.4**	**21.0**

[1] Countries with income tax at lower levels of government. Typical rates in 1992 being flat: Canada 17; Finland 16; Norway, 28; Sweden, 31; progressive: Japan 5–14; United States 2–14

* Top personal tax rate to be reduced to 42 per cent in 2005

Source: Sandford 1993: p. 12./ OECD Tax Database, 1998

Table 3 shows 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 David Williams has noted in a survey of tax reforms in the EC conducted for the accounting firm Price Waterhouse:

> ... 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 penalise 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, 24)

Unfortunately, the enormous complexity of both tax systems and the stunning number of specific tax reforms introduced over the past decade make

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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, US 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 (Björklund, Palme and Svensson 1995; Boskin and McLure Jr 1990; Gravelle 1992; Tanzi 1995). As Sandford 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).

It is also true, of course, that in recent years *the needs of capital changed as it became more internationalised*. The OECD described the effects of these new international pressures in the following way:

> The increased openness of national economies has, in practice, made it more difficult to separate out domestic and international tax issues. When changes to national tax systems are made attention has increasingly to be paid to the international implication of any proposed modifications. This, in turn, may mean that the traditional criteria used to evaluate tax reforms have to be reconsidered. Policies which may have been appropriate in economies where exchange controls and other limitations on international transactions were prevalent may be neither feasible nor desirable once these non-tax barriers are removed. (OECD 1991, 14)

In short, by the 1980s 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 affects 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 investment'. The point here is that the more internationalised firms become, the less they are likely to prefer taxes that advantage domestic suppliers and/or consumers over those beyond national frontiers (Porter 1990, 57).

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Table 4: Basic rates of corporate income tax of central government, 1986–1995

	1986	1991	1995
Australia	49	39	33
France	45	34/42	33
Germany	56	50/36	45/30
Greece	49	46	35/40
Japan	43	38	38
New Zealand	45	33	33
Sweden	52	30	28
United Kingdom	35	34	33
United States	46	34	35

Source: OECD 1997, *Taxing International Business: Emerging Trends in APEC and OECD Economies*, 63

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. Table 3 shows the changes in basic tax rates facing companies around the globe. Interestingly, as Duane Swank and Steinmo (2002) have shown, these rate reductions have not resulted in significant revenue losses to the treasuries (see also *Economist*, 2001).

How could it be that the consensus has shifted so dramatically in 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 minimises these distortions. In short, it is widely believed by the left and the right that a 'good tax system' keeps the government out of private economic decision-making.[21]

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What happened to 'the ability to pay'?

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 taxpayers 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 forced increasingly to pay too much in taxes (Svallfors 1997). What, it seems reasonable to ask, has become of this goal? The answer, bluntly put, has been that it is now down-played or forgotten. Vertical equity has virtually been taken off the agenda.[22] 'Common intellectual themes [of the tax reform movement]' report Michael Boskin and McClure 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).

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 have meant a downward redistribution of tax burdens in several countries.[23]

Redefining the role of government

> What's the single most important thing to learn from an economics course today? What I tried to leave my students with is the view that the invisible hand is more powerful than the [un] hidden hand. Things will happen in well-organised efforts without direction, controls, plans. That's the consensus among economists. That's the Hayek legacy. (Lawrence Summers, quoted in Yergin and Stanislaw 1998, 150–151)

We are currently witnessing the evolution of a new logic upon which democratic states raise revenue. No matter who holds the reins of power, all

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modern governments appear to have concluded that a 'good' tax system must cut taxes for both the wealthy and for internationally mobile capital and retreat from using tax policy as an active instrument of economic management. The now common belief is 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 (see also Blyth 2002). As Richard Musgrave, author of the most widely used fiscal economics text in the world noted: 'The major factor [behind the reforms] has been a change in political climate towards a less egalitarian view of distributive justice' (Musgrave 1990, 317).

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 1980s and 1990s 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 is 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, original emphasis). Similarly Richard Musgrave, one of the world's most respected fiscal economists wrote in 1982:

> While my generation of tax economists has placed much emphasis on equity, the younger generation is now stressing efficiency. The change ... may reflect the fact that efficiency considerations are more amenable to the exercise of technical tools, a practice that brings rewards to the young professional but may not be most helpful to a balanced view of reform. This shift in emphasis reflects, as well, changes in social values. (Quoted in McLure 1984, 258)

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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 article 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—i.e. 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 sceptical 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.

Economic realities have clearly played a role in the specific character of the reforms witnessed in recent years. As I have tried to show, the realities of economic internationalisation contributed substantially 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

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when they further the economic interest of powerful groups' (Adams 1928, 4).

Ideas about policy are formed in political, economic and institutional contexts. As we have seen, experiences with poorly designed and implemented tax policies helped shape the attitudes and beliefs of politicians, economists and tax officials 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 globalisation have ultimately shaped what policy elites now believe can be done *and what ought to be done*.[24] Whereas in the middle 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. This new consensus is not simply the product of a shift in political power from the left to the right. Instead, it comes about through the evolution of ideas about tax policy; economists and tax policy-makers no longer believe that they can effectively manage the economy through tax manipulations. They have instead moved to the belief that if government gets involved, the politicians' incentives will drive them to create tax policies that are fundamentally destructive to an efficient capitalist economy.

Conclusion

Is this simply a story of policy learning? I suggest not. Certainly, learning is going on in this story, but this evolutionary model also takes into account: first, that what governments do affects the ecology (both normatively and substantively) in which subsequent policy choices are made; and second, the co-evolution (Futuyma and Slatkin 1983; John 1999) of modern capitalism itself. Policy ideas and/or institutions that may have

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'fitted' in the 1940s may no longer fit at the beginning of the 21st century because of both the evolution of policy ideas and the political/economic context in which they evolve.

The very size of the modern welfare state today is a direct product of tax policy choices that were made in earlier eras by policy-makers whose attention was clearly focused elsewhere. This is not to suggest that the size of the modern welfare state is either an 'accident' or the product of a conspiracy (Buchanan 1987; Levi 1988). Rather, policy choices operate in an evolutionary manner; those made in one era clearly shape the context (ecology) in which future tax policy choices are made. Political leaders anticipate—they are the agents who carry or bring forward new policy ideas. These ideas may be new policy solutions which have become available due to previous policy choices, or they may be older ideas which have been more or less dormant for a period. In either case, policy ideas are 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, enabling those that are advantaged by certain policy ideas to push their agenda over others.

I understand this process much like Hugh Ward (1997) as one in which evolution is contingent and open ended. However, the analysis here emphasises that agents do not 'grope blindly' for new policy solutions in times of crisis. Instead, the policy solutions they conceive of are framed fundamentally by the substantive, as well as the normative, context in which they find themselves (see also Rothstein and Steinmo 2002). This context, once again, is at least partly a product of the institutions that policy-makers themselves have constructed in earlier eras. As this analysis has demonstrated, this does not suggest that policy-makers are 'locked in' in a functionalist sense. But, it does help us understand exactly how the 'history of play' affects the current choices on offer (Young 1998).

Of course, 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 trend towards lower marginal tax rates for capital and high income earners witnessed around the world is a direct result of 'globalisation'. But, as this analysis of the evolution of this policy arena has shown, these tax changes are also the product of the negative experience economists and policy-

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makers had with high marginal tax rates in the 1970s to 1990s, and of the growing belief that policy-makers could not be 'trusted' to implement tax policies either fairly or efficiently. To be sure, the bogey-man of 'globalisation' and the threat of capital exit in the late 1980s and 1990s provided a powerful justification for tax policies which tax economists and tax policy advisers had long wanted to make—but when one looks more closely at the timing of the reforms and the arguments laid out on their behalf, it is difficult to argue that it was international competition that 'made us do it'.

Notes

1. The process is indeed intentional, but outcomes are rarely those that were initially intended. Indeed, this analysis will demonstrate that often the most important effects of particular policies may be those never considered by the original actors. In short, the functions that they may end up serving (see discussion of PAYE below) may be 'undesigned or a byproduct' of other decisions (Dowding 2000, 74). See also response to Dowding in John (2000).
2. For excellent discussions of policy learning see Baumgartner and Jones (1993); Hall (1993); Pierson (1993).
3. This analysis does not attempt to predict particular policy outcomes. Instead, the point here is to demonstrate the ways in which broad changes in taxation policy can be explained as adaptations to the evolving political and economic climate in which they are developed while fully recognising that these policies must necessarily be adapted to the particular national circumstances in which they are implemented. Just as global warming may result in similar adaptations among similar mammals in different parts of the world in the long run, it would be a mistake to assume that an adaptation in one place would or could be replicated exactly in another, (see Dowding 2000, 73). Moreover, the process of adaptation and imitation amongst humans is quite different from that of non-sentient beings precisely because we can and do behave intentionally (see note 1).
4. 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.
5. In 1918, income and profits taxes contributed 44.8 per cent of total state and local government revenue in Sweden. In the same year, the income and profits taxes contributed 63.1 per cent of the federal government's ordinary receipts in the US. In Britain these taxes contributed 64.9 per cent of total tax revenue in 1920.
6. In what would several decades later be called 'supply side' economics, Mellon argued that cutting taxes on the rich would leave them with more money to invest. This in turn would stimulate the economy, put more people to work and, in the end, generate even more revenues for the state (Mellon 1924). Needless to say, others were sceptical, but Congress was anxious to pass out tax cuts and quickly moved to accommodate Mellon's plan (Adams 1928; Walton 1928).

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7. See, for example, Benham (1942); Blough and Shoup (1937); Eberstein (1929); Genberg (1942); Haas (1937); Keynes (1933); Shirras and Rostas (1942); SOU (1936a and 1936b); Strachey (1933).
8. In the American case the government employed a public relations firm to help propagandise these ideas. A very popular slogan, for example, was 'Taxes to beat the Axis' (see Jones 1996).
9. The income at which the individual begins to pay income tax.
10. In most cases the wartime 'Excess Profits' duties and taxes were scaled back and/or folded into more permanent corporate profit tax systems.
11. Assar Lindbeck, undoubtedly one of Sweden's most influential and powerful economists in Sweden since Gunnar Myrdal wrote in 1970, for example, 'One can look in any elementary economics textbook today and see that we have the possibility through monetary and fiscal policy to maintain total demand in the economy exactly at any point that we wish' (Lindbeck 1970, 20). Professor Lindbeck was the chair of the Nobel Prize in Economics Committee for 14 years and is an ardent neo-classical economist.
12. Tax expenditures have had a long history, of course, and were not invented during these years. What was different here was the growing belief that tax expenditures could be effective instruments of public management rather than simply political prizes offered to the powerful.
13. Of course, the character and structure of these tax expenditures could differ quite dramatically between nations. I have argued elsewhere that the variation in tax expenditure policies is best explained as a product of variations in state institutional structures (Steinmo 1986). The US, for example, tended to write very specific tax incentives designed to benefit specific (politically powerful) industries, firms and individuals. Other countries designed broader (and less complicated) incentive mechanisms which could be used by anyone who invested in the ways determined by the government. Two of the countries which perfected these incentive mechanisms the most were Germany and Sweden.
14. See, for example, the publications of the International Fiscal Association, Cahiers De Droit Fiscal International, from 1939 forward (on the WEB at http://www.vuw.ac.nz/~holmesk/cahiers.html), or international conference publication put out by the Brookings Institution.
15. For an attempt at such a catalogue see McDaniel and Surrey (1985).
16. See Pechman and Okner (1974, 7) in praise of the Carter Commission report on the Canadian Tax System.
17. For a broader and more comprehensive analysis of these changes see Blyth (2002).
18. 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.
19. 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.
20. Interview with author, May 1988.
21. 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

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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, including 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 for 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).

22. Vertical equity usually implies that those with greater incomes should pay a larger share of their income in taxes.
23. Comparative data on effective tax rates by income class is extraordinarily difficult to attain or even compile. This author has examined the shift in tax burdens in five countries (Britain, Sweden, Germany, the US and Japan) and found that tax rates among 'middle-class' families have not changed dramatically over the past 10 years, but taxes paid by the very poor have gone up as a percentage of their income and taxes paid by the very rich have gone down as a percentage of their income in each case.
24. 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 internationalising incentives by calling taxes and/or redistributing the tax burden. Apparently, however, elite policy makers have not read these analyses (cf. Garrett 1995; Garrett and Lange 1995).

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